Bangladesh Economy in FY2007-08

An Interim Review of Macroeconomic Performance

Centre for Policy Dialogue (CPD)

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A report prepared by the CPD under the Programme
Independent Review of Bangladesh's Development (IRBD)

Centre for Policy Dialogue (CPD)

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Centre for Policy Dialogue (CPD)
House No. 40/C, Road No. 11 (new)
Dhaka 1209, Bangladesh
Telephone (8802) 8124770, 9141703, 9141734
Fax: (8802) 8130951
E-mail info@cpd.org.bd
Website www.cpd.org.bd

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

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Avra Bhattacharjee

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Shaiful Hassan

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CPD IRBD TEAM

Professor Mustafizur Rahman, Executive Director, CPD was in overall charge of preparing this report as the team leader.

Lead contributions were obtained from *Dr Uttam Kumar Deb*, Head, Research Division; *Dr Fahmida Khatun*, Senior Research Fellow; *Dr Khondaker Golam Moazzem*, Research Fellow; *Kazi Mahmudur Rahman*, Senior Research Associate and *Ashiq Iqbal*, Research Associate.

Competent research assistance was received from *Asif Anwar*, Research Associate; *Nafisa Khaled*, Research Associate; *Hasanuzzaman*, Research Associate; *Subir Kanti Bairagi*, Research Associate; *Tariqur Rahman*, Research Associate; *Muhammad Alamin*, Research Associate; *Abu Naim Muhammad Nazmul Bari*, Research Associate; *Tapas Kumar Paul*, Programme Associate; *Abdullah Al Mahmood Mosfeq*, Programme Associate; *Abdus Sobhan*, Programme Associate; *Nusrat Jahan,* Programme Associate; *Ashiqun Nabi*, Programme Associate; *Uday Tauheed Islam*, Intern.

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ADP	Annual Development Programme
AfT	Aid for Trade
BB	Bangladesh Bank
BBF	Better Business Forum
BCIC	Bangladesh Chemical Industries Corporation
BEPZA	Bangladesh Export Processing Zones Authority
BGTB	Bangladesh Government Treasury Bond
BMET	Bureau of Manpower, Employment and Training
BPC	Bangladesh Petroleum Corporation
BPDB	Bangladesh Power Development Board
BRAC	Bangladesh Rural Advancement Committee
CPI	Consumer Price Index
CSE	Chittagong Stock Exchange
CTG	Caretaker Government
DAE	Department of Agricultural Extension
DAP	Di-Ammonium Phosphate
DF-QF	Duty Free-Quota Free
DSE	Dhaka Stock Exchange
EP	Essential Priority
EPZs	Export Processing Zones
EU	European Union
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investment
FFE	Food for Education
FFW	Food for Works
FPC	Fair Price Card
FY	Fiscal Year
GDP	Gross Domestic Product
GNI	Gross National Income
IDB	Islamic Development Bank
IDCOL	Infrastructure Development Company Limited
IFIs	International Financial Institutions
IMF	International Monetary Fund
IMO	International Maritime Organization
IPOs	Initial Public Offerings
KAFCO	Karnaphuli Fertilizer Co.
LCs	Letter of Credits
LDC	Least Developed Countries
LEI	Large Employee Industries
MoA	Ministry of Agriculture

MoP	Muriate of Potash
MPS	Monetary Policy Statement
NCBs	Nationalised Commercial Banks
NPDA	New Partnership for Development Act
NSD	National Savings Directorate
OMS	Open Market Sale
OP	Other Priority
PDB	Power Development Board
PFDS	Public Foodgrain Distribution System
PKSF	Palli Karma-Sahayak Foundation
PSTN	Public Switched Telephone Network
RMG	Readymade Garments
RRC	Regulatory Reforms Commission
RRI	Real Rate of Interest
TR	Test Relief
TSP	Triple Super Phosphate
US	United States
US$	United States Dollar
VGD	Vulnerable Group Development
VGF	Vulnerable Group Feeding
WTO	World Trade Organization

1

INTRODUCTION

Both FY2007 and the ongoing FY2008 will go down as exceptional years in the history of Bangladesh. Fiscal year 2008 started its journey in the backdrop of the moderately high growth rate of 6.51 per cent achieved in FY2007. Experience of FY2007 was unique in the sense that it saw three consecutive governments and declaration of a state of emergency. The new caretaker governments (CTG's) first six months coincided with the second half of FY2007. Despite the challenging scenario, political turmoil and disruption in the economy in the early months of FY2007 (particularly in November-December, 2006) and the uncertainties afflicting the economy during the period following the takeover by the current CTG in January 2007, FY2007 saw a number of positive developments. These included moderately high growth of manufacturing industries (10.01 per cent), robust performance of the export sector (15.69 per cent growth), revitalized capital market (121 per cent growth in DSE market-capitalisation) and high growth of remittance flow (24.5 per cent). However, some disturbing signs were already discernible as FY2007 was drawing to a close: a deteriorating trade balance, weak implementation of public investment programmes, stagnating food grains production and a fall in agricultural credit disbursement. Creeping inflation throughout the year, particularly, rising prices of cereals and fuel originating from increasing world prices of cereals and oil, was already emerging as causes for concern. The wide ranging anti-corruption drive gave rise to confusion and uncertainties which affected investment and business environment with consequent negative implications for domestic and foreign investment.

One distinctive feature of FY2008 is that the CTG has been in charge of macroeconomic management for the duration of the full fiscal year. However, this was not the only departure from a normal year. Firstly, three consecutive natural disasters, two floods and cyclone *Sidr*, inflicted severe burden on the macroeconomic management in FY2008. The damage to the economy was estimated to be of $1.8 billion and a lot of attention had to be paid for rehabilitation and reconstruction related activities. Secondly, the creeping inflation observed in FY2007 gathered momentum as the year proceeded, driven by rising food and fuel prices in the international market and also domestic supply-side constraints. Thirdly, global economic slowdown, particularly the downturn in the US economy, generated negative consequences for the increasingly globally integrated economy of Bangladesh. Exports particularly to the US and terms of trade suffered as a result.

In his budget speech of FY2008 the Finance Adviser had mentioned about seven objectives in the area of macroeconomic management. These were: maintain macroeconomic stability, accelerate economic growth, keep inflation within tolerable limits, remove constraints to private-sector led growth, reduction of poverty, ensure regional income equity and ensure food security. As FY2008 proceeded, all these seven objectives came under severe strain weakening the macroeconomic framework anticipated in the FY2008 budget. This emerging fragility of the macro-framework undermined some of the dynamics observed at the micro level and made macroeconomic governance even more challenging in FY2008.

Macroeconomic performance during FY2008 was marked by acceleration of the inflationary momentum, lower level of ADP implementation underpinned by cost escalation of project and weak implementation capacity of the government machinery, higher public expenditure owing to the flood and cyclone rehabilitation related efforts, rising demand for subsidy in the wake of higher import prices, and pressure on balance of payment arising from higher trade deficit driven by higher import expenditure particularly for food and fuel imports and relatively low pace of export growth. Frequent power shortages, high cost of construction raw materials and inputs, uncertainties afflicting investment in both industry and real estate in the context of the ongoing anti-graft drive, had adverse impact on investment environment. FY2008 also saw larger than anticipated budget deficit on account of high levels of subsidy arising from higher import prices of food, fuel and fertiliser and wider coverage under safety-net programmes.

Towards the end of the first half of the fiscal year, the economy had started to show signs of rebound as business confidence was gradually restored. Investment scenario changed for the better, with export oriented industries gearing up the pace, higher demand for investment credit, high import of raw materials and intermediate inputs and robust capital market performance. It is hoped that institutional reforms particularly formation of *Regulatory Reform Commission* (RRC) and the *Better Business Forum* (BBF) will impact positively on the performance of the economy, on revenue earnings, and improve business climate. The economy also experienced a number of positive developments driven by phenomenal growth in earnings from income tax, substantial growth of export earnings and remittance flow, and growing foreign exchange reserves.

Notwithstanding the upturn seen in the recent past, the cumulative impact of the global and domestic challenges facing the economy resulted in a downward revision of the growth projection of about 1 per cent, to about 6 per cent, from the earlier envisaged 7 per cent GDP growth target set for FY2008.

The cumulative impact of high inflation and significant income erosion is being most severely felt particularly by low income groups of people in the country. According to CPD estimates, even when the increase in cumulative GNI is considered (between 2005 and 2008), given the price hike (particularly taking into consideration the weighted inflationary impact of price of rice), an additional 8.5 per cent households have fallen below the *poverty line* in recent times because of high inflation (taking Household Income and Expenditure Survey data for 2005 as reference point). This would mean that an additional 2.5 million household could have fallen below the poverty line in terms of real income. However, it needs to be kept in mind that a large proportion of these households have received support from government's various safety net programmes, coverage of which was substantially increased in the recent past. This support would have enabled such households to address their immediate nutritional needs, to some extent. Notwithstanding this, the fact of the matter is that the prevailing high rate of inflation is having severe negative consequences for life and livelihoods of a large segment of the population in Bangladesh, particularly those belonging to low and fixed income groups.

As FY2008 draws to an end, and the CTG prepares to present the budget for FY2008-09 the challenge will be to contain the inflation, ensure food security, mobilise resources for the rising budget deficit and create a supportive environment for investment through appropriate policy support and energy security.

This report presents an analysis of the performance of major macroeconomic indicators of Bangladesh during the first three quarters of FY2007-8 (and in some cases beyond) in relation to some of the key emerging challenges which characterised this particular period.

2

GLOBAL TRENDS AND THEIR IMPLICATIONS

Global economic developments in 2008 had important implications for macroeconomic performance of Bangladesh in FY2008. The increasingly globally integrated economy of Bangladesh suffered the consequences of some of the negative trends experienced by the global economy in 2008. As is known, about 56 per cent of Bangladesh economy is at present connected with the global economy through export and import of goods and services, and aid and investment. Slower growth projections for major export destinations of Bangladesh, particularly the stagflation in the US (following the sub-prime mortgage market crisis) and also the Eurozone countries, and the high global inflationary trends, have had an adverse impact on the performance of Bangladesh economy in FY2008. As is evidenced by information in Table 1, growth projections for the US economy for 2008 was a low 0.5 per cent (down from 2.2 per cent in 2007); for the EU the corresponding figure was 1.8 per cent (3.1 per cent in 2007) and for Japan this was 1.4 per cent (2.1 per cent in 2007). Growth rates were also revised downward for China and India, two major import sources of Bangladesh. Indeed IMF has reduced its 2008 global growth projections from 4.1 per cent to 3.7 per cent; world trade growth is expected to come down to 4.5 per cent in 2008. High commodity prices, particularly of critically important import items of Bangladesh including food, fuel and fertiliser, raised the import burden significantly. Prices of these increased in the range of 100-200 per cent in the span of one year between April 2007 and April 2008.

Table 1: Projections of Real GDP Growth of Selected Countries

(in percentage)

	2007	2008	2009
World	4.9	3.7	3.8
United States	2.2	0.5	0.6
Japan	2.1	1.4	1.5
European Union	3.1	1.8	1.7
China	11.4	9.3	9.5
India	9.2	7.9	8.0
Singapore	7.7	4.0	4.5
Hong Kong	6.3	4.3	4.8
Bangladesh	6.5	5.5	6.5

Source: *World Economic Outlook, April 2008*

Sluggish growth in developed countries is also likely to have dampening effect on FDI and portfolio investment flow to Bangladesh and adverse implications for flow of foreign aid. Sluggish US growth, and consequently lower consumer demand, led to a deceleration in demand for Bangladeshi exports – in the first nine months of FY2008 export to US had come down by 10 per cent; however, export to EU registered quite robust growth. One effect of the sluggish global demand had been increasing price squeeze in the international market for Bangladesh's major exports, including apparels. Higher commodity prices in global market, and declining export prices of Bangladeshi commodities has led to deteriorating terms of trade and higher trade deficit in the first three quarters of FY2008. A weakened dollar also had negative impact for Bangladesh's forex reserves (denominated, to a significant extent, in dollar terms), and for import from Eurozone and other countries. Slower growth of major economies could also dampen initiatives such as *aid for trade*, and also undermine the prospects of LDC-friendly initiatives in the WTO in the form of *DF-QF market access*, and the *NPDA2007* initiative in US (providing zero-tariff access to LDC products). On the other hand, rising fuel prices have significantly enhanced export earnings of oil-exporting economies which are attracting increasing number of migrant workers, leading to higher remittance flow to countries such as Bangladesh.

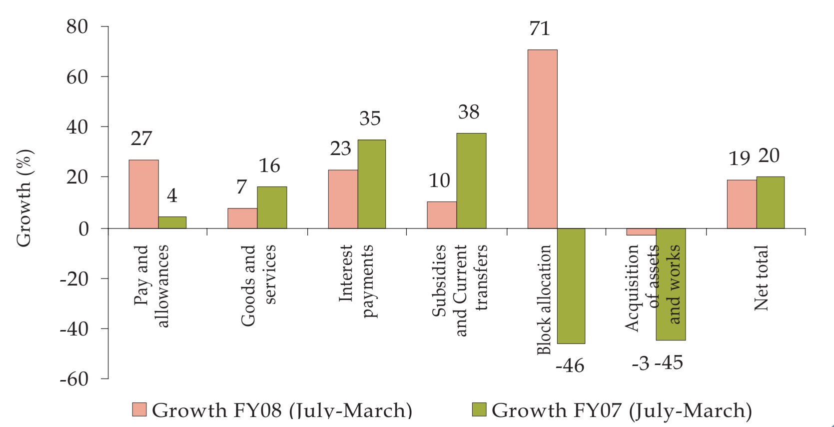
The experience of FY2008 indicates the need for a close monitoring of the developments in the global economy and the necessity of pursuing appropriate strategies in view of both the emerging challenges and the attendant opportunities for Bangladesh.

3

MANAGING THE FISCAL DEFICIT IN A YEAR OF HIGH SPENDING

Growing Deficit: Despite the impressive growth in revenue collection (amounting to Tk. 41,557.0 crore in first nine months), budget deficit in FY2008 is likely to exceed the target set in the national budget by quite a significant margin. The government was under serious expenditure pressure during the first three quarters of FY2008, due to two consecutive floods, cyclone *Sidr*, and increased import payments and high levels of subsidy at a time of high global inflation. Total revenue expenditure in first nine months was Tk. 32,860 crore and ADP expenditure in first ten months was Taka 12,367 crore. In the backdrop of substantial rise in food, fertiliser and fuel prices in the international market, demand for subsidy for the year is estimated to surpass the initial allocation of Tk. 6,000 crore by about Tk. 10,000 crore. With increased expenditure on subsidy, together with flood/cyclone rehabilitation cost, the first nine months experienced a 20.3 per cent rise in revenue expenditure (Figure 1). Higher interest payment requirement (by 36.2 per cent, compared to the payment made during July-March period of FY2007) on domestic and foreign borrowing also contributed to the high growth of revenue expenditure.

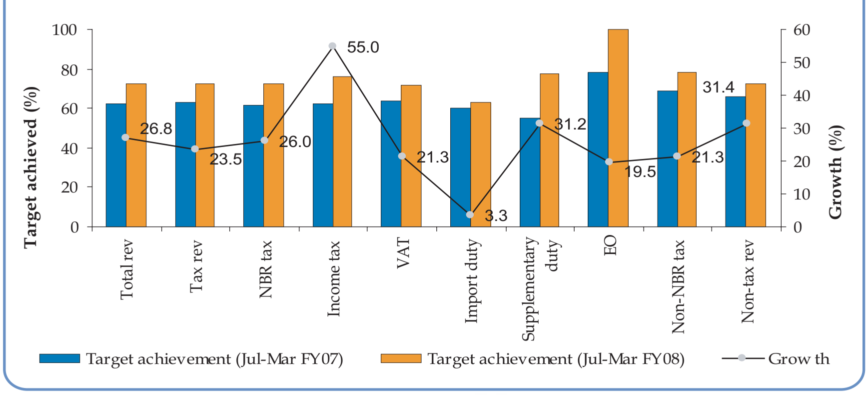
Figure 1: Growth of Revenue Expenditure by Economic Classification FY2007 & FY2008 (Jul-Mar)



Source: *CPD IRBD Database.*

Such high levels of expenditure demand has led to a deficit of Tk. 16,678 crore in the first eight months of the current fiscal, more than twice the amount of deficit (123 per cent growth) incurred during the same period of the previous year. It is to be noted in this connection that such phenomenal rise in deficit has emerged in the backdrop of a substantial rise in revenue mobilisation (26.8 per cent) during July-March period (driven by high growth of income tax collection of about 55.0 per cent), which was higher than the targeted growth of 22.3 per cent (Figure 2), and a frustrating ADP implementation of only 46.7 per cent (Figure 3) of the

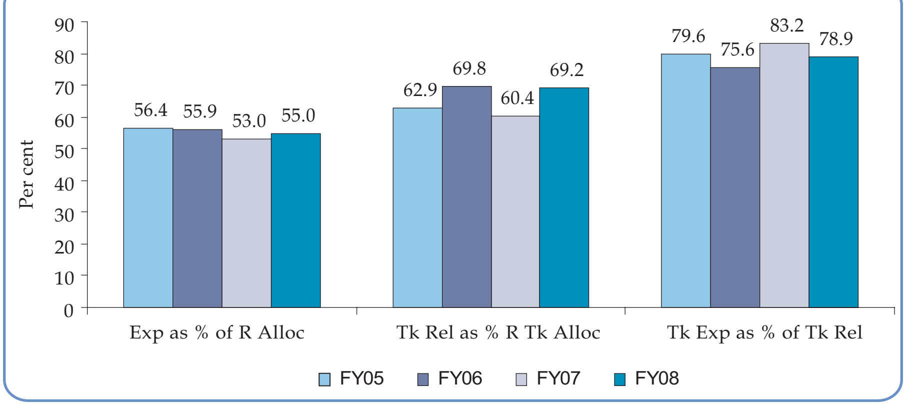
Figure 2: Revenue Collection Scenario During July-March 0f FY2007 & FY2008



Source: *CPD IRBD Database.*

original target (or 55.0 per cent of the revised target in the first ten months). The deficit would have been much higher had the pace of ADP implementation been faster. It is also to be noted that revenue generation in this particular year also included an additional income of Tk 802 crore from tax on undisclosed income (the total amount disclosed was of Tk 5,213 crore by 42,459 persons).

Figure 3: Performance of ADP During July-March (FY2005 to FY2008)



Source: *CPD IRBD Database.*

Financing the Deficit: Mobilising both domestic and foreign resources to finance this very high deficit will be a major challenge confronting the caretaker government. The government had to lean heavily on the banking sources for deficit financing which experienced a high growth of 133.8 per cent during July-February period; non-bank financing was low probably owing to the anticorruption drive that resulted in a significant fall in the sale of NSD certificates. About 88.5 per cent of the entire domestic financing during this period was raised from the banking sector (Table 2).

Table 2: Growth in Deficit and Sources of Financing During July-February of FY2007 and FY2008

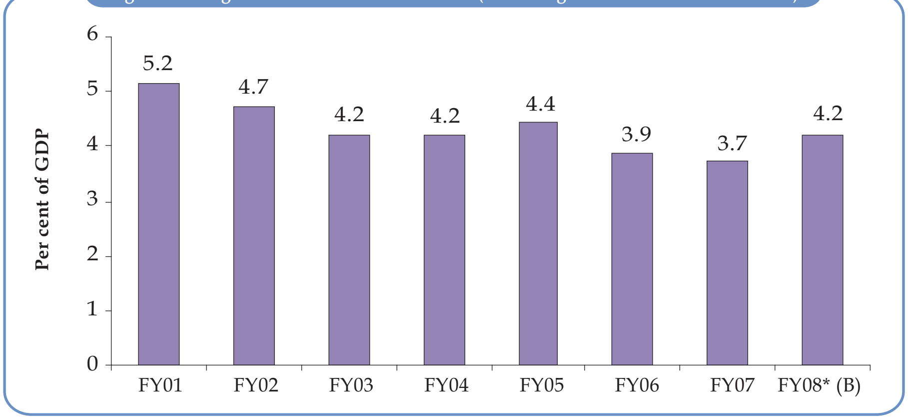
(in crore taka)

	FY2007		FY2008		Growth FY2008 (Jul-Feb)
	Budget	Actual (July-Feb)	Budget	Actual (July-Feb)	
Net Foreign financing	8364.4	-326.8	10560.2	2780.6	--
Grant	2508.0	247.2	4255.0	418.1	69.1
Loan	9618.0	1927.5	10403.0	5094.1	164.3
Amortisation	3761.6	2501.5	4097.8	2731.6	9.2
Domestic Financing	8896.8	7806.3	11808.8	13898.0	78.0
Non-Bank Borrowing	3400.0	2509.0	4500.0	1582.2	-36.9
Bank Borrowing	5434.0	5262.9	7253.0	12305.7	133.8
Sale of Assets	62.8	34.4	55.8	10.1	-70.6
Deficit as % of GDP (excluding grants and BPC liabilities)	3.7		4.2		

Source: *CPD IRBD Database.*

Higher foreign aid inflow in FY2008 provided a cushion to the public exchequer in view of the aforesaid increasing deficit. Aid disbursement during the first eight months was 122 per cent higher (in net terms, if debt servicing is included the growth would be 322 per cent). However, a significant part of this was related to financial aid for disaster management. The apprehension is that the government will fall short of achieving the target of mobilising the anticipated US$ 1.5 bln (net) foreign funding envisaged in the budget to finance the projected deficit of 4.2 per cent of GDP (Figure 4), excluding BPC liabilities (not accounting for the aid specific to disasters).

Figure 4: Budget Deficit as Per cent of GDP (Excluding Grants and BPC Liabilities)

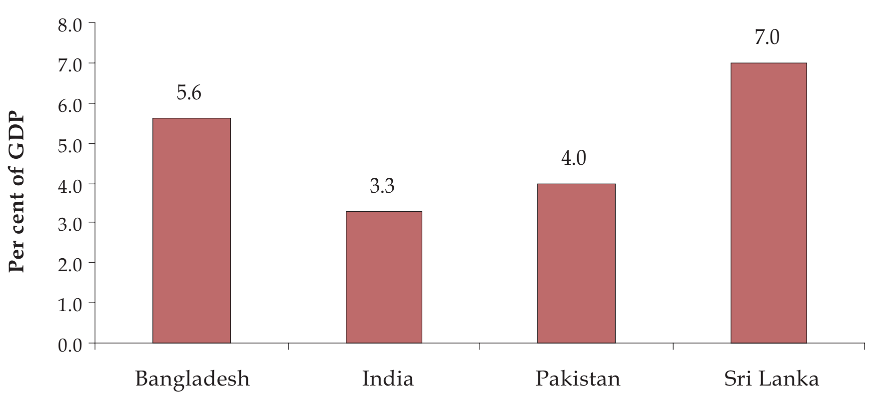


Source: *CPD IRBD Database*
* Budget figure for FY2008 (excluding BPC liabilities)

The actual deficit is likely to reach (if not exceed) 5 per cent of the GDP towards the end of FY2008. Significant expenditure is still to be incurred by the end of June, 2008 including the Tk. 4,200 crore required for procurement of the planned 1.5 million tonnes of rice following the harvest of the Boro crop.

Policy Options: Given the emerging domestic and global scenario, it appears that the government may have to go for a higher deficit budget in the next fiscal year. It will also perhaps need to carry some of the liabilities forward to the next fiscal. In view of the growing subsidy for fuel in the context of rising global fuel prices, the government may be compelled to take additional loans from the IFIs. There are already indications of this (a possible $2.9 billion loan from IDB). The government may also be compelled to consider readjustment of the fuel prices, to varying degrees, for various types of fuel. However, any fuel price adjustment will need to be crafted very carefully. The subsidy for diesel, kerosene, octane and petrol will need to be adjusted keeping in view (a) international market price movements, (b) needs of crop and productive sectors, (c) relative purchasing power of different strata of the population and (d) equity consideration. For example, diesel, used for irrigation in agriculture, will need to enjoy continued subsidisation to a significant level, for reasons of food security. A mechanism for transfer of the subsidy (a variety of which was put in practice this year) will need to be designed if the general price level of diesel is adjusted to reflect market prices. It may be mentioned here that petrol and diesel are selling in Kolkata (May 2008) at prices which are higher by about 28 per cent and 50 per cent respectively compared to the prevailing prices in Bangladesh.

Figure 5: Budget Deficit as Per cent of GDP in South Asian Countries (Budgetary Targets of FY2008)



Source: *CPD IRBD Database*

A sustained high deficit for a long period may create a vicious circle of borrowing and revenue expenditure through increasing debt servicing liabilities, as has been the case in recent years in some of the developing countries such as India. India now spends over 25 per cent of the total budgetary allocations for interest payments. This has been due to the cumulative impact of high and sustained deficit of over 6 per cent of India's GDP throughout the 90's and early years of the current decade. Although Bangladesh spends around 13 per cent of the budget expenditure on interest payments, the share has been on the rise in recent years and could become a major cause of concern in the coming years. It is to be noted that Bangladesh's budget deficit, as a share of GDP, was higher than India and Pakistan (Figure 5).

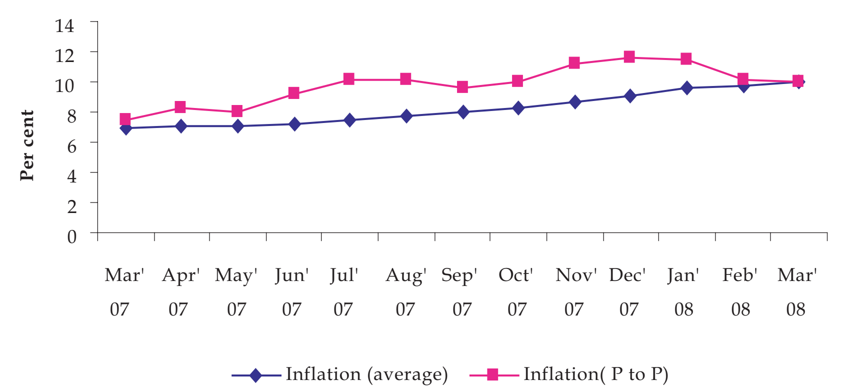
4

HIGH INFLATIONARY TREND CONTINUES TO BE A MAJOR CONCERN

Recent Inflation Rate: High inflation continues to be a major concern for the Bangladesh economy. Higher general price level experienced in FY2007-08 originated from both domestic and global factors. In the domestic arena *increase in food inflation* has been due to lower food production as a result of two consequent floods, one severe cyclone in 2008 and low stock of food. Internationally too, prices of food items such as rice, wheat and soybean oil increased at a fast pace breaking all past records. Parallel to this, *prices of non-food* items including fuel oil and construction material soared in the global market.

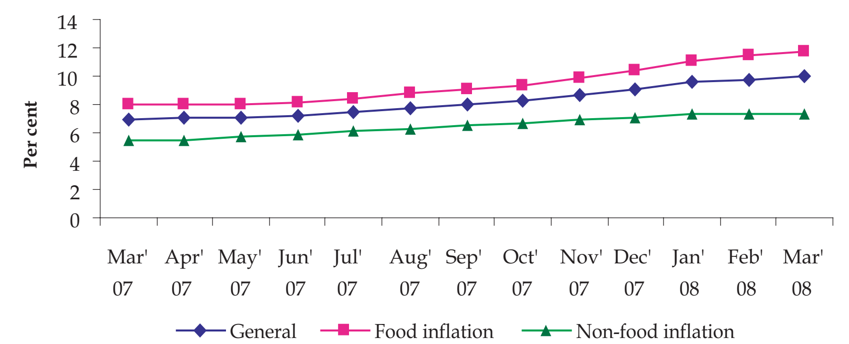
The 12-month annual average inflation rate increased to 10.00 per cent in March 2008 from 6.94 per cent in March 2007 (Figure 6). This high inflation was on account of increased food and non-food inflation, both in urban and rural areas (Figure 7). At the end of March 2008, point to point urban inflation reached 10.02 per cent while rural inflation was 10.08 per cent. As food comprises 59 per cent of the Consumer Price Index (CPI) of Bangladesh and food prices rose at higher rates than non-food prices, food inflation was higher than non-food inflation. In recent period, point to point food and non-food inflation in Bangladesh has registered a slight declining trend – these rates were 12.92 per cent and 5.63 per cent respectively in March 2008 compared to 14.46 per cent for food and 7.27 per cent for non-food inflation in December 2007. Whilst this may give reasons for optimism, prices are not likely to come down sharply any time, particularly in view of the fact that the *bumper boro production is yet to have any tangible impact on retail prices of rice*. Global projections with regard to cereal output in 2008 and 2009 are higher than 2007, although according

Figure 6: CPI Inflation



Source: *Bangladesh Bureau of Statistics.*

Figure 7: General, Food and Non-food Inflation (12 Month Average)



Source: *Bangladesh Bureau of Statistics.*

to some projections global fuel prices could go up further (Table 3). The government is expecting the inflation rate to come down to 9 per cent in the next fiscal year, a possibility but not a certainty.

Table 3: Global Price of Selected Commodities

Period	Rice US$/metric tonne	
	Thailand 5 % Broken Parboiled	Vietnam 5 % Broken
April 2007	324	303
April 2008	855	725
	Crude oil US$/barrel	
18 May 2007	63.92	
29 May 2008	131	
	Wheat US$/ metric tonne	
March 2007	199.1	
February 2008	425.0	
	Soybean oil US$/ metric tonne	
March 2007	679.5	
February 2008	1307.7	

Source: *Bangladesh Bank; www.eia.doe.gov; www.ers.usda.gov, www.bbc.com.*

Income Erosion due to Inflationary Pressure: Recent inflationary pressure has had an adverse impact on the consumers through reduction of their purchasing power and income erosion. High inflation, particularly high food inflation, has affected the poor and people in the fixed income group more than others. *A CPD estimate shows that those below the poverty level of income experienced an income erosion of 36.7 per cent during January 2007 to March 2008.* This section of the population spends 45.6 per cent of their income on rice alone. Given the increase of rice price by 66.9 per cent during January 2007 and March 2008 income erosion due only to price hike of rice was about 30.5 per cent. For the remaining 54.4 per cent expenditure, income erosion would be to the tune of 6.2 per cent if only the overall inflation rate is considered.

Indeed, most of the workers in the manufacturing and other sectors whose income level is very low are experiencing considerable income erosion. If wages of the lower income groups are adjusted against this inflationary trend, real wage would be much lower. For example, monthly wages of the workers in grades 5, 6 and 7 in the readymade garments (RMG) sector have been fixed at Tk 2046, Tk 1851 and Tk 1662.5 respectively at the time of the last minimum wage review. Taking into account an average income erosion of 36.7 percent the real wages of these workers come down to Tk 1295, Tk 1172 and Tk 1052 for workers belonging to the respective grades per month.

The CPD estimate also shows that even when the increase in cumulative Gross National Income (GNI) is considered (between 2005 and 2008), given the price hike (particularly taking into consideration of the weighted inflationary impact of price of rice), *an additional 8.5 per cent people have fallen below the poverty line in recent times because of high inflation* (taking Household Income and Expenditure Survey data for 2005 as reference point). This would mean that as high as an additional 2.5 million households could have fallen below the poverty line in terms of real income. Government's Public Food Distribution System (PFDS) and other safety net programes, covering about 10 million people have helped to mitigate the food deprivation of people below the hard core poverty line.

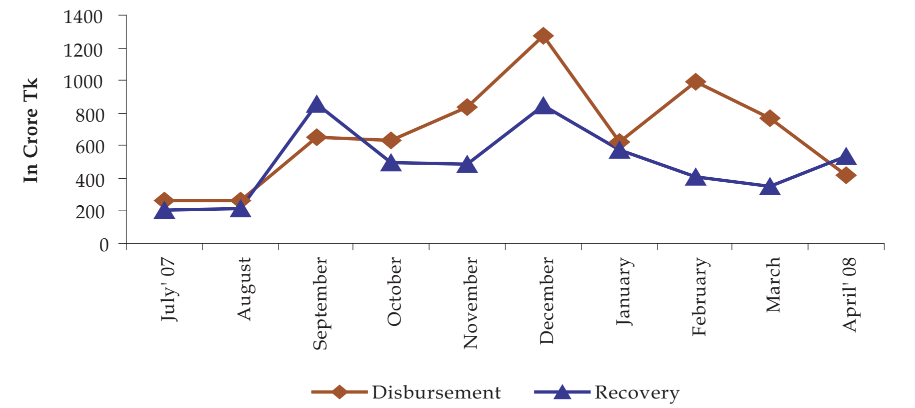
Fiscal Measures to Curb Inflation: The government has undertaken several *fiscal and monetary measures* to tackle the price hike and contain inflation. Sales of essential food items through the open market system (OMS) and expansion of social safety net programmes such as vulnerable group development (VGD) were some of the fiscal measures. The government has withdrawn import duty from a number of essential commodities in order to keep the prices low. The government has also pursued a proactive policy for distribution of fertiliser and agricultural inputs to increase food production. A procurement strategy has been devised by fixing the procurement price of paddy and rice. Though a bumper boro production was expected to ease the situation to some extent, it is yet to be reflected on retail level prices. Higher rice storage, government's market intervention and wider safety net programmes appear to be the key to addressing the situation.

It should be kept in mind that the present price situation is not a short-term problem, a structural one. Given the fact that in the context of the present global economic scenario commodity prices will not decline dramatically in the immediate future, Bangladesh, as many other developing countries, may not be able to get back to a comfortable situation with a tolerable level of inflation any time soon.

In view of the above, a two pronged strategy needs to be followed. In the *short term*, procurement of food has to be increased to a comfortable level. At the same time social safety net programmes such as vulnerable group feeding VGD), VGD, test relief (TR), food for works (FFW), open market sale (OMS) at subsidized price and allowances for the destitute will have to be broadened, and the entitlement under those programmes need to be increased. In the *medium term*, the purchasing power of the poor has to be enhanced through opportunities for employment and income. A guaranteed employment scheme for the poor will be an important initiative in this context. The agriculture sector will need to be given more attention and see more investment through introduction of modern and high yielding varieties and by providing technological, marketing, extension, research and price support.

In a bid to increase agricultural production a lot of emphasis was given on agricultural credit during FY2007 which was reflected in *increased disbursement of agricultural credit* (Figure 8). Agricultural credit disbursement was 56.73 per cent higher in FY2008 than FY2007 for the period July-April. The increased disbursement was mainly due to the directive of the Bangladesh Bank (BB) to the private commercial banks to increase disbursement of agricultural credit in view of the production loss due to flood and cyclone in 2008.

Figure 8: Agricultural Credit Position FY2007 & FY2008 (July to April)



Source: Bangladesh Bank Agricultural Credit & Special Programme Department.

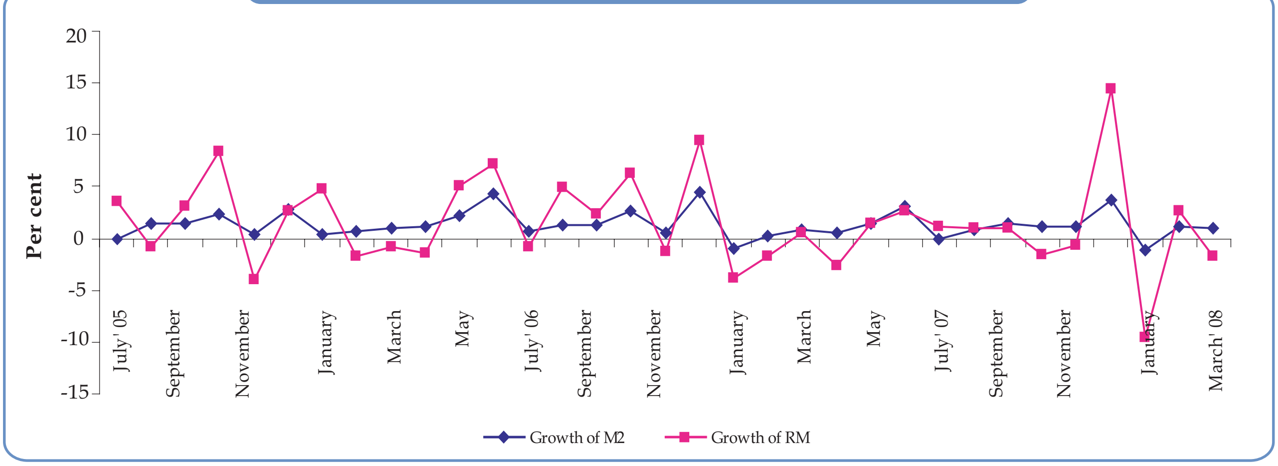
Private banks are lending to the agriculture sector in two ways. *First,* following the model of the Indian ICICI Bank's *Para Banking* (which has in fact been developed on the basis of the Grameen Bank model blended with the Indian reality), a number of private banks have come to an agreement with some large non-government organisations (NGOs) such as BRAC, ASA and TMSS to disburse agri-loan through them. They are now finding out that agriculture credit can also be profitable. Such arrangements have been made in view of the fact that these NGOs have infrastructural and institutional set up in the rural areas, and it is not always financially viable for the banks to establish a new set up in the remote areas. *Second,* under a tripartite arrangement among the government, private banks and NGOs credits are being disbursed for the agriculture sector. Currently, a pilot project is being implemented through two private banks – Eastern Bank Ltd and BASIC Bank. The Asian Development Bank (ADB) has provided a fund to the Ministry of Finance (MoF) for this. The government has disbursed US$ 36 million to these two private banks at 3.5 percent interest rate. The private banks are lending these funds to the aforesaid three NGOs at 7 percent interest rate.

The tackling of *non-food inflationary pressure* will require simultaneous efforts towards efficient resource management and increasing purchasing power by the government. The global fuel price has experienced an unprecedented increase during the last year. Data shows that on 29 May 2008 the price of crude oil reached US$ 131.0 per barrel compared to US$ 63.92 per barrel on 18 May 2007. Oil price in Bangladesh is an administered one, with huge subsidies being provided by the government. Inflation on account of high fuel prices was somewhat contained thanks to this which, otherwise, would have been much higher. The burden of such subsidies is borne by the Bangladesh Petroleum Corporation (BPC) whose liabilities worth Tk. 7523 crore, equivalent to about 1.4 per cent of the Gross Domestic Product (GDP), was absorbed by the government in the budget for FY2007-08 (in effect through sale of bonds to the nationalised commercial banks (NCBs)). In view of the rising fuel prices, and unchanged domestic administered price, the liabilities of BPC are likely to increase further this year.

Any adjustment should be carried out in phases and should be implemented carefully so that the consequent increased costs do not affect agricultural production which may lead to increased production cost, and thus increased food prices. This could also adversely affect production. A cross-subsidisation policy should be pursued in case of energy pricing in order to avoid price incidence on the poorer section of the society.

Monetary Measures to Curb Inflation: According to its Monetary Policy Statement (MPS) of January-June 2008 the Bangladesh Bank (BB) aims to 'support the highest sustainable output growth along with maintaining price stability' (Monetary Policy Statement, Bangladesh Bank, January 2008). To this end the BB has resisted the suggestion of the International Monetary Fund (IMF) to raise interest rate and follow a contractionary monetary policy. As a matter of fact, the BB has been pursuing an 'accommodative monetary policy' in view of domestic and global price developments. As evidence shows, *money supply went up* between July-March period by 11.1 per cent in FY 2006, 10.6 per cent in FY 2007 and 9.9 per cent this year. However, there is no denying that the BB will need to perform a very careful balancing act in view of the need to control inflation and the need to stimulate investment at a time of sluggish growth. *It is important that the BB continues to follow an independent monetary policy keeping in view of the larger interest of the economy.* Figure 9 shows the monthly trend of money supply during July 2005 and March 2008.

Figure 9 : Monthly Trend of Money Supply and Reserve Money



Source: *Bangladesh Bank.*

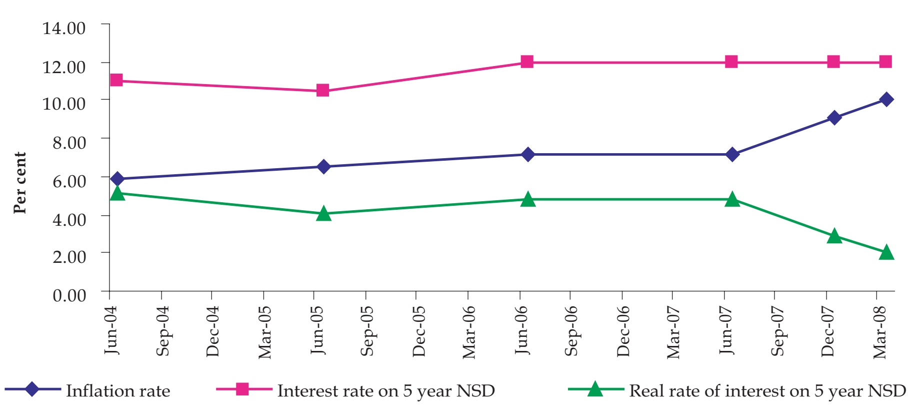
The challenge before Bangladesh Bank's monetary policy is *how to strike a balance between high inflation and interest rate*. The long term interest rates have either declined or remained the same in Bangladesh over the years. For example, interest rates on 5 year and 10 year Bangladesh Government Treasury Bond (BGTB) have declined while the interest rate on National Savings Directorate (NSD) certificates remained same in March 2008 compared to December 2007 (Table 4). As a result, the real rate of interest (RRI) in March 2008 was only 0.60 per cent on 5 year BGTB, 1.72 per cent on 10 year BGTB, 1.50 per cent on 3 year NSD certificate and 2.0 per cent on 5 year NSD certificate (Figure 10). This has been a disincentive to the depositors who are

Table 4: Weighted Average Interest Rate of Government Long Term T-Bill/Bonds and Inflation

BGTB	BGTB		NSD		Inflation Rate (12 month average)	Real Rate of Interest on			
	5-Year	10-Year	3-Year	5-Year		5-Year BGTB	10-Year BGTB	3-Year NSD	5-Year NSD
June 2004	8.00	10.00	10.50	11.00	5.83	2.17	4.17	4.67	5.17
June 2005	8.75	9.93	10.00	10.50	6.49	2.26	3.44	3.51	4.01
June 2006	10.60	12.09	10.00	12.00	7.16	3.44	4.93	2.84	4.84
June 2007		12.14	11.50	12.00	7.20		4.94	4.30	4.80
December 2007	10.65	11.73	11.50	12.00	9.11	1.54	2.62	2.39	2.89
March 2008	10.60	11.72	11.50	12.00	10.00	0.60	1.72	1.50	2.00

Source: *Monetary Policy Department, Bangladesh Bank.*

Figure 10 : Real Rate of Interest



Source: Bangladesh Bank.

currently shifting towards the capital market instead of saving in NSD certificates. As a matter of fact, net sale of NSD certificates during July-February 2008 was 40.23 per cent lower compared to July-February 2007 while total sale was 6.97 per cent less during the same period (Table 5).

This has also contributed to the *liquidity crisis observed* in the banking sector in recent times. Excess liquidity of the scheduled banks was lower at Tk.13488.51 crore as of end February 2008, against Tk.14279.42 crore as of end June 2007. This is reflected in the deposit collection drive by some commercial banks in recent months through offering competitive interests rates on long term deposits. Banks are also borrowing from the call money market at a high interest rate for their day to day operations.

Table 5 : Sale and Repayment of NSDS

(in crore Tk.)

Period	Sale	Repayment	Net Sale	Outstanding at the End Period
July -Feb 2006-07	9932.29	7369.88	2562.41	42026.67
July -Feb 2007-08	9240.01	7709.65	1530.36	45169.54

Source: Bangladesh Bank.

In order to ease the liquidity crisis the government has also started to inject money in the economy. The government had earlier withdrawn an amount of Tk. 5000 crore in FY2008 from the banking sector through primary dealers (by way of sale of treasury bills to nationalized banks and a few commercial banks) for government's use and to control inflation by reducing money supply in the market. However, this has raised the call money rate, which sometimes reaches as high a level as 20 per cent. The government is now trying to keep the call money rate around 8 to 8.5 per cent and has recently injected Tk. 1000 crore to this end.

However, the liability to be carried out by the state owned banks as against the loss of Tk 7523 by the BPC has had an impact on the excess liquidity situation. Though the government took the liability, it did not provide banks with cash. Instead, they were given bonds, which the banks cannot use for statutory liquidity ratio (SLR) requirement. As a result, although the balance sheets of the banks show the liabilities, actually there is no cash flow against them. *Hence the excess liquidity figure may be overstated.*

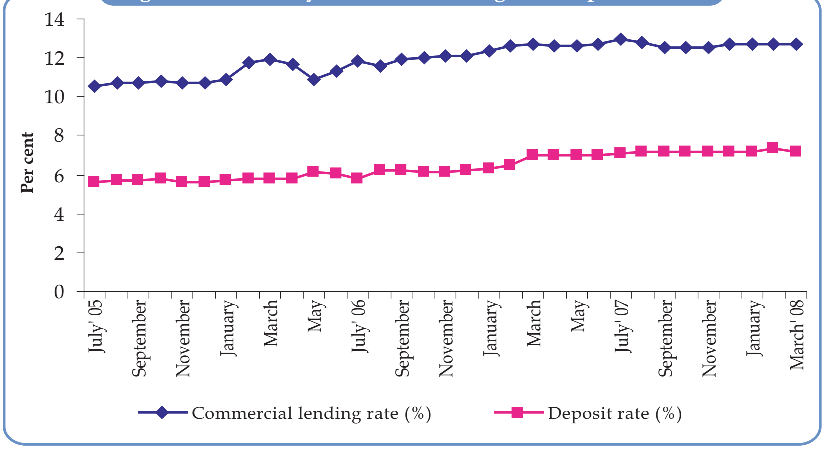
Table 6 : Weighted Average of Interest Rates

Period	Lending Rate	Deposit Rate	Call Money Rate
December 2004	10.83	5.56	7.62
December 2005	11.25	5.90	8.40
December 2006	12.60	6.99	7.16
December 2007	12.75	6.77	9.37
April 2008			18.85
May 2008			20.00

Source: Bangladesh Bank and Communication with Private Banks.

Ensuring better returns on deposits would be one way to address the liquidity crisis and improve the situation. The lending rate (calculated on a quarterly basis) of scheduled banks was 12.75 per cent in December 2007 as compared to 12.60 per cent in December 2006 (Table 6). Their deposit rate (calculated on a quarterly basis) also stood lower at 6.77 per cent in December

Figure 11: Monthly Trend of Lending and Deposit Rates



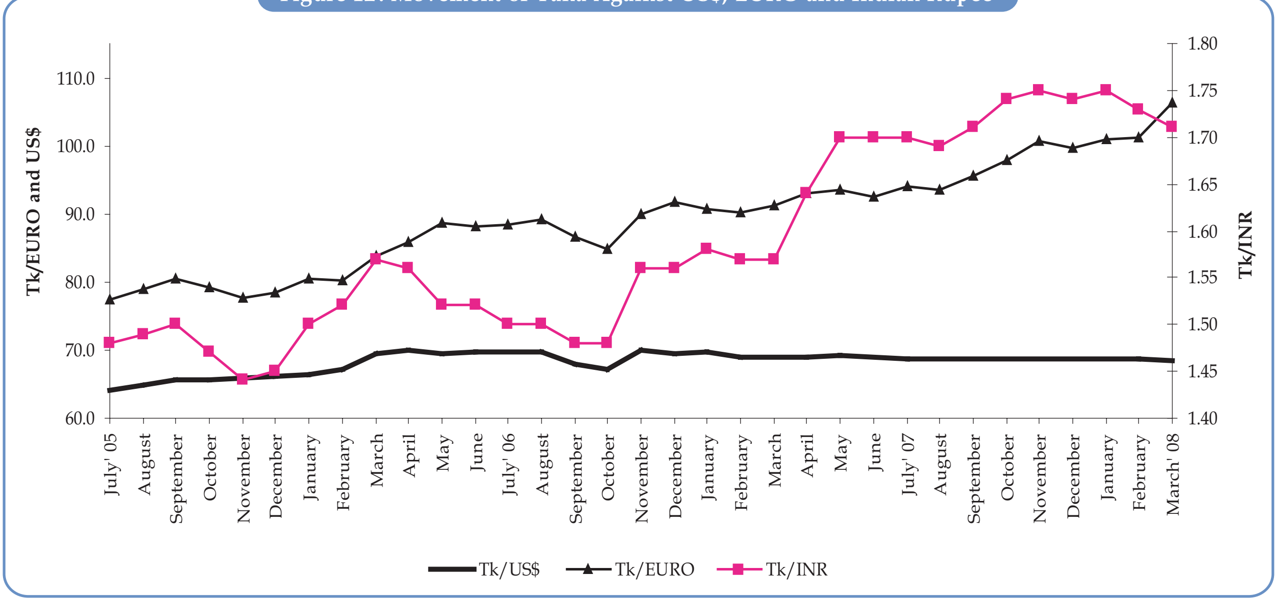
Source: *Bangladesh Bank.*

2007 as compared to 6.99 per cent in December 2006. The monthly trend in lending and deposit rates over the years is shown in Figure 11.

In recent times the spread between banks' *lending and deposit rates* in Bangladesh has come under scrutiny. A study by the BB pointed out that the spread is relatively high in Bangladesh because of inefficiencies, market segmentation and lack of competition (Bangladesh Bank, Policy Analysis Unit, May 2008). The BB has recently directed the major commercial banks to reduce the interest rate spread and reduce the lending rates. There has been an agreement recently to fix the highest lending rate at 14.0 per cent. However, the business community is still pursuing for a higher cut in the lending rate. On the other hand, private banks feel that given the high cost of funds and high risks of lending in Bangladesh any further reduction in the lending rate is not feasible. Moreover, a lower lending rate could consequently lead to a lower deposit rate which could discourage depositors from keeping their savings with the banking system and which could lead to liquidity shortage in the banking sector. If the BB pushes banks to lower their lending rates devoid of any self-clearing market mechanism this could have damaging consequences. *If the real rate of interest continues to decrease people might become more aggressive to hedge inflation by investing in real estate or capital market which could create bubble in the respective markets.*

Notwithstanding high inflation rate, *Bangladesh Taka (BDT) has remained strong against the US Dollar (US$) in view of the relatively high levels of forex reserves underpinned by unprecedented growth in remittance flows*. At the end of March 2008 BDT per US$ declined to Tk.68.58 from Tk.68.81 at the end of March 2007. The weakening of the US$ at the global level is also likely to keep BDT/US$ exchange rate stable. In FY2008 the BB has injected about US$ 500 million in the foreign exchange market to keep BDT from depreciating further. A stable exchange rate against the US$ has been helpful in not allowing import prices to rise further. In Bangladesh there is no

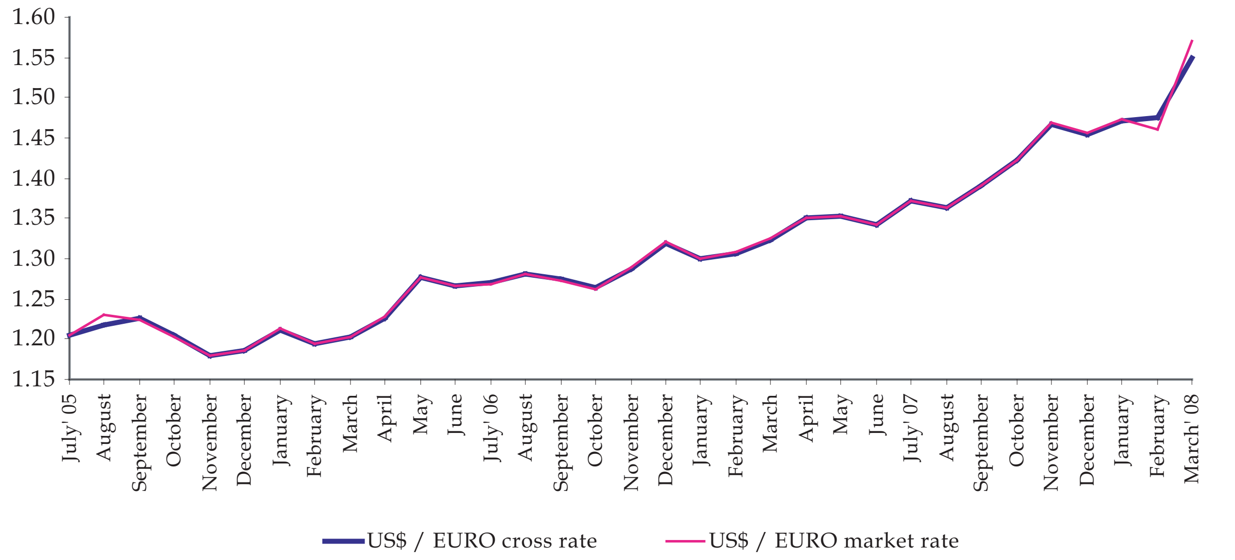
Figure 12: Movement of Taka Against US$, EURO and Indian Rupee



Source: *Bangladesh Bank.*

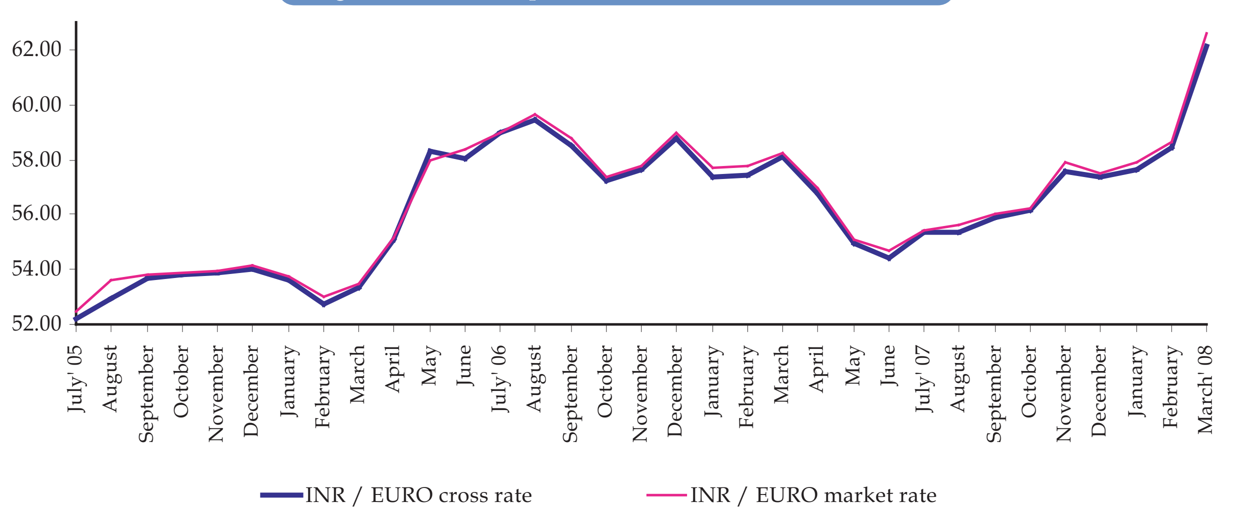
EURO/BDT market and EURO/BDT rate is calculated from the traded rates of US$/BDT. Against EURO, BDT depreciated is being as EURO appreciated significantly against US$ over time, and US$ remained stable against BDT. Given the increase in volume of trade between Bangladesh and India the exchange rate of BDT with Indian Rupee (INR) is becoming important too. Depreciation of BDT against INR in recent years has helped Bangladeshi exporters. Figures 12, 13 and 14 present monthly movements of BDT against US$, EURO and INR during July 2005 and March 2008.

Figure 13: US$/Euro Cross Rate and Market Rate



Source: Bangladesh Bank.

Figure 14: Indian Rupee/Euro Cross Rate and Market Rate



Source: Bangladesh Bank.

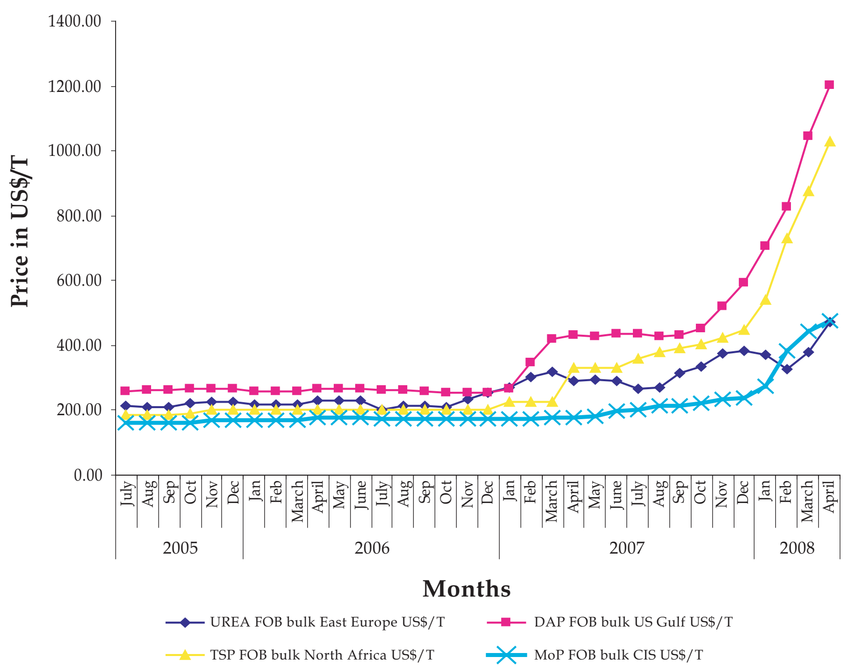
5

ABSORBING THE INCREASING SUBSIDY BURDEN

Subsidy has become a major issue in Bangladesh from the vantage point of macroeconomic management in FY2008. International price of fertiliser, fuel and food have increased quite significantly during the last one year, undermining many of the original budgetary estimations and assumptions. As is known, Government agencies in Bangladesh play a major role in import of foodgrains (rice and wheat) whilst they enjoy monopoly in import of petroleum products and fertiliser (urea). These items are then distributed to consumers and farmers at *administered prices*. High price increase of these commodities in the international market has resulted in additional requirement of subsidy in the budget in view of the rising gap between global price and the subsidised administered price.

Subsidy on Fertiliser and Other Agricultural Activities: National Budget FY2008 allocated Tk. 1500 crore as subsidy for fertiliser and Tk. 750 crore as subsidy for diesel. Fertilisers used by farmers in Bangladesh are obtained from two sources: domestic and international. The Ministry of Agriculture (MoA) estimated demand for urea fertiliser in FY2008 as 28.18 lakh metric tonnes, TSP 4.76 lakh metric tonnes, DAP 2.50 lakh metric tonnes and MoP 4.00 lakh metric tonnes. The MoA planned that total demand for urea would be met through 15.00 lakh metric tonnes from production of BCIC factories, 4.50 lakh metric tonnes from KAFCO and 9.00 lakh metric tonnes from international import. According to the MoA report (October 2007), per kg production cost of urea in Bangladesh was Tk. 7.20 which was sold at Tk. 4.80 and subsidy for per kg urea from domestic sources was thus equivalent to Tk. 2.40. On the other hand, import cost of per kg urea was estimated to be Tk. 31.00 which was sold at Tk. 5.30; thus the government had to subsidise Tk. 25.70 for each kg fertiliser imported from abroad. According to the aforesaid report amount of *total subsidy* for fertiliser was estimated at Tk. 3606 crore (urea: Tk. 3120 crore and TSP, DAP and MoP: Tk. 486 crore). As it happens, price of fertiliser in the international market has continued to rise and, consequently, amount of subsidy on account of fertiliser had to be substantially increased.

Figure 15: International Price of Fertiliser (Urea, DAP, TSP & MoP): July 2005 to April 2008



Between June 2007 (Budget announcement) and April 2008, price of all types of fertiliser has consistently increased in the international market (Figure 15). Price of urea increased from US$ 289.00 per metric tonne in June'07 to US$ 471.30 in April 2008. During this period, per metric tonne price of TSP has increased from US$ 331.00 to US$ 1029.00, and that of DAP increased from US$ 434.50 to US$ 1201.00; price of MoP has increased from US$ 196.90 to US$ 477.60.

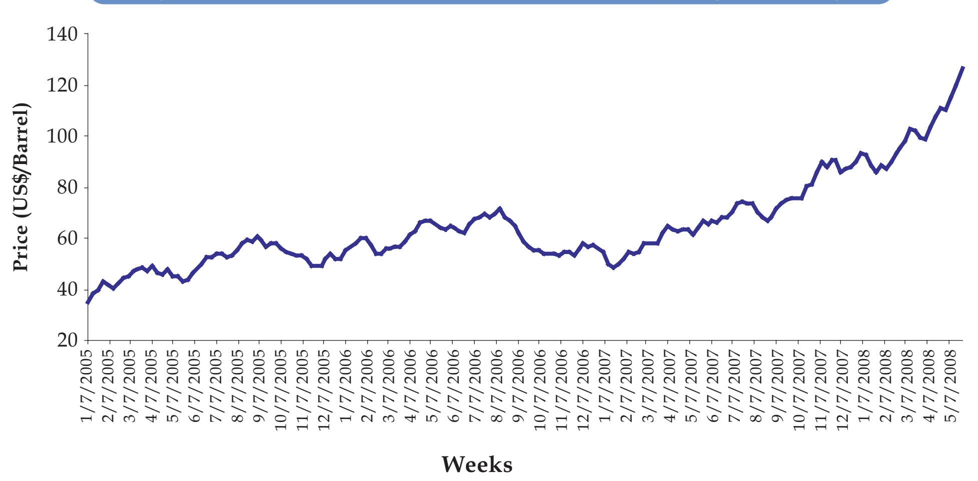
Available information suggests that total subsidy for fertiliser and other activities under the ministry of agriculture could be about Tk. 3740 crore (Tk. 3408.5 crore for fertiliser, Tk. 75.0 crore for electricity for irrigation and Tk. 250 crore for diesel for irrigation and Tk. 6.5 crore for sugarcane). During the July-February of FY2008, actual amount spent was Tk. 1900 crore.

High and rising prices of fertiliser and diesel in the international market also have implications for the next Budget. Given the global situation of export restrictions on foodgrains, particularly on rice, Bangladesh's only option appears to be to produce more foodgrains. To do so, estimated fertiliser requirement in Bangladesh in FY2009 is likely to be 35.2 lakh metric tonnes of Urea, 5.9 lakh metric tonnes of TSP, 5.0 lakh metric tonnes of MoP and 3.2 lakh metric tonnes of DAP. Bangladesh will need to estimate and allocate the subsidy on fertiliser accordingly. In designing the strategy for fertiliser subsidy, attention should be paid to the need for promoting use of balanced fertilisers. If the government can not find adequate resources to provide adequate subsidy to supply the required amount of fertiliser, it will be forced to increase the administered price of fertiliser so that subsidy provided on per kg fertiliser will be reduced, but perhaps it will be easier to ensure timely and adequate availability of fertiliser.

Fuel Subsidy: Government has been providing huge amount of subsidy to the Bangladesh Petroleum Corporation (BPC), over a long period of time, because administered prices of various types of fuels were consistently lower than the global prices. In April 2007, per litre prices of petroleum products were increased from Tk. 33.00 to Tk. 40.00 for Kerosene and Diesel, from Tk. 56.00 to Tk. 65.00 for Petroleum, and from Tk. 58.00 to Tk. 67.00 for Octane, to adjust to global prices. In the Budget for FY2008, the government had taken the liabilities of BPC worth Tk. 7523 crore which was financed through the issuance of Bonds. It was expected that it would allow BPC to operate with a clean slate, and possibly without the need for further subsidy.

International price of crude and refined petroleum products has increased substantially since the last adjustment. Between June 2007 (Budget announcement) and May 2008, per unit price of crude oil had increased from 65.37 US$/ barrel to 126.57 US$/ barrel (93.6 per cent increase) (Figure 16). Price of crude oil in May 2008 (US$ 126.57 per barrel) was about 2.9 times of that in May 2005 (US$ 43.67). This sky-rocketing price of fuel also had an adverse impact on the subsidy for fuel. Current (last week of May 2008) cost of import of refined products is as follows: Diesel and Kerosene: Tk. 97.40 per litre, Octane: Tk. 80.35 per litre, Jet Fuel: Tk. 97.57 per litre. On the other hand, per litre administered price of Diesel and Kerosene is Tk. 40.00, Octane Tk. 67.00, and Jet Fuel Tk. 72.00. Thus, subsidy provided to per litre of diesel and Kerosene is Tk. 57.40, Octane Tk. 13.35 and Jet Fuel Tk. 25.57. As a consequence, the government is being required to pay a significant amount of subsidy. It is estimated that subsidy on account of Bangladesh Petroleum Corporation (BPC) and Power Development Board (PDB) would amount to about Tk 5760 crore by June 2008. Given the

Figure 16: International Crude Oil Price (all country weighted average)



severe burden on the exchequer, this may not be a sustainable option for the government and it may have to go for some readjustments of fuel prices. However, if and when it does so, it will need to design a mechanism so that both food safety and equity concerns are adequately addressed.

Subsidy for Food: In National Budget for FY2008, allocation as subsidy for food was Tk. 786 crore. In view of high price of food and damage caused by floods and *Sidr*, the government distributed a significant amount of rice and wheat under Public Foodgrain Distribution System (PFDS). These were either sold at a subsidised price or provided at free of cost. During the 1 July- 8 May of FY2008, amount of food grains distributed under various PFDS channels was about 13.94 lakh metric tonnes; distribution through non-priced channel was 9.21 lakh metric tonnes. Till the first week of May 2008 total expenditure on account of food subsidy was Tk. 651 crore.

Subsidy for Export and Other Sectors: Bangladesh provides subsidy to a number of export oriented activities. These include cash incentive @ 5.00 per cent for RMG, @7.50 per cent for jute, @10.00 per cent for textile products and @ 15.00 per cent for agricultural and agro-processing sector. Tk. 1000 crore was allocated in the Budget FY2008 as export subsidy. During the July-February of FY2008, actual amount of subsidy for export was Tk. 700 crore. It is estimated that total subsidy on account of export and 'other' sectors by the end of June, 2008 could reach Tk 1270 crore.

Subsidy is also given to a number of other activities. Allocation of subsidy for inland water transport was Tk. 50 lakh; actual amount spent during July-February of FY2008 was Tk. 25 lakh. Allocation of subsidy for other activities was Tk. 55 crore out of which Tk. 48 crore has been spent during July-February period.

6

MANAGEMENT OF FOOD SECURITY AND SOCIAL SAFETY NET

Price hike of agricultural commodities in FY2008, particularly rice and wheat, posed a major challenge in terms of ensuring food security in Bangladesh. Production loss due to consecutive floods and devastating cyclone *Sidr* was a major challenge. Imports from international market could have offset the reduction in availability caused by natural disasters but restrictions on exports by major rice exporting countries created a serious problem of food availability in the international market. At one point of time rice export was banned by all major exporters including India, Vietnam, Cambodia and Egypt.

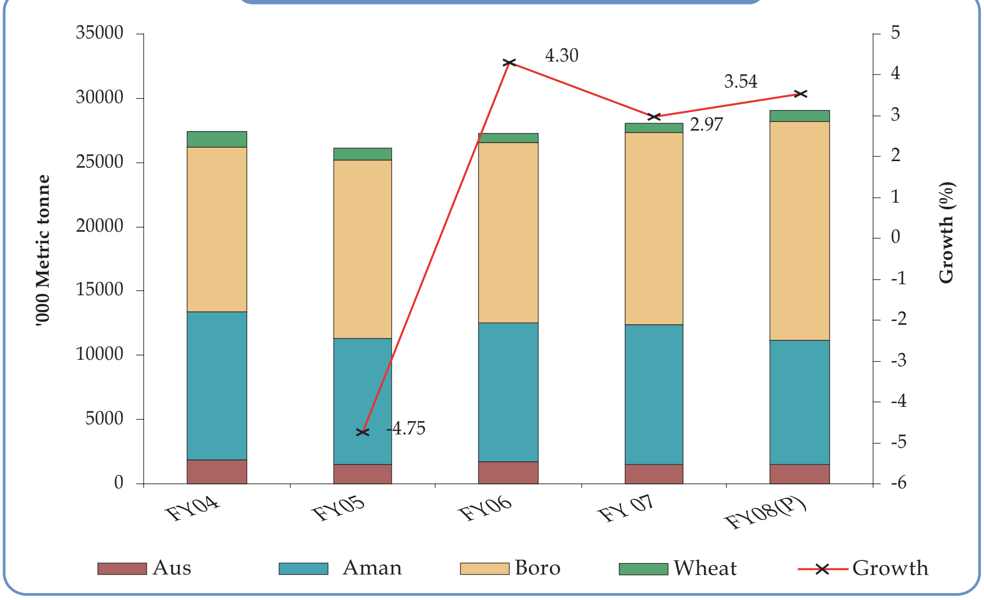
Attaining food security at the national level depends on the availability of food from domestic production and imports from the international markets. On the other hand, food security at the household level depends not only on the availability of food but also on the ability to purchase food by the household. Households with adequate income can buy food from the market if it is available but low income households face problems in doing so when food prices are high. For such low income groups, government distribution of food through priced (such as OMS) and non-priced channels (VGD, VGF, Food for Works, etc.) are critically important.

Production of Foodgrains: According to the final estimates of the Bangladesh Bureau of Statistics (BBS), total foodgrains (rice and wheat) production in FY2007 was 28.07 million metric tonnes (mmt) (Aus: 1.51 mmt, Aman: 10.86 mmt, Boro: 14.97 mmt and wheat: 0.74 mmt) which was 2.97 per cent higher than the previous year (FY2006). However, it was 14.6 per cent less than the foodgrain production target (32.87 mmt in FY2007). Total production of foodgrains in FY2007 increased due to increase in rice production. It is to be noted that wheat production has been on a gradual decline since 1999.

Department of Agricultural Extension (DAE), initially set the operational target for foodgrains production in FY2008 at 33.05 million mt (Aus 2.22 mmt, Aman 13.05 mmt, Boro 16.95 mmt and wheat 0.84 mmt) which was 15.04 per cent higher than actual production in FY2007. After the floods and *Sidr*, DAE planned for a massive agricultural rehabilitation programme and revised its target for Boro rice production. As per the revised target, DAE planned a production target of 17.50 million tonnes of Boro rice from 4.50 million ha of land comprising of 1.250 million ha Hybrid rice, 3.125 million ha of HYV rice and 0.125 million ha of local Boro rice in FY2007/08. It is pertinent here to recall that both Aus and Aman rice was affected by two consecutive floods in 2007 and super cyclone *Sidr* had also destroyed the standing Aman crops. According to the estimate of CPD and BRAC, about two million metric tonnes of rice was lost due to flood and *Sidr*.

According to the BBS, Aus and Aman production in FY2008 was 1.51 million metric tonnes and 9.66 million metric tonnes, respectively. Farmers are currently harvesting Boro rice which will continue until the end of June. According to the CPD estimates, likely production of Boro rice may be about 17.0 million metric tonnes. Wheat production is estimated at about 0.90 million metric tonnes. Thus, total production of foodgrains in FY2008 may be about 29.07 million metric tonnes (Figure 17). In other words, total production of foodgrains in FY2008 is likely to be 3.5 per cent higher compared to that of last year.

Figure 17: Estimated Foodgrain Production in FY08



Considering the good production of Boro rice, the pertinent question is whether the price of rice will experience a downturn in the coming days? Our understanding is that rice price would be reduced only insignificantly and is likely to remain high in near future.

Food and Agriculture Organization (FAO) in its latest Food Outlook report (May 2008) also predicted similar trends for global price of rice. According to the FAO forecast, this year's (2008) cereal production will increase by 3.8 per cent compared to that of the last year. The Report added that rice production is expected to hit a new record of some 670 million tonnes world wide, an increase of 2.3 per cent. Production in Asia is expected to increase – large increase is forecasted in Bangladesh, China, the Philippines, Thailand and Vietnam. The FAO Food Outlook report also added that global rice prices may fall to some extent but will still remain at high levels.

Food Aid and Commercial Import: Imports of foodgrains to Bangladesh are sustained from two sources: food aid and commercial imports. The latter comes through both government and private channels. During July-May of FY2008, total import of foodgrains (food aid and commercial imports) was 3380 thousand mt out of which 239 thousand mt was food aid, 254 thousand mt as commercial import by public sector, and 2887 thousand mt was imported by the private sector (Table 7). It may be noted that private sector import of total foodgrains during the comparable months of FY2007 was 2049 thousand mt. Private sector import of rice in FY2008 was 1681 thousand mt against 627 thousand mt. On the other hand, wheat import by private sector during July-May of FY2008 was 1208 thousand mt against 1421 thousand mt for comparable months of FY2007. Total import of foodgrains and rice during July-May of FY2008 were respectively 52.0 and 208.0 per cent higher than that of comparable months in FY2007. After two consecutive floods, when it was clear that there was substantial production loss and price was increasing in the domestic market, private sector started to import large quantities of rice. Import would have been much higher if there was no restriction of export of rice and other foodgrains by various countries. Even though import of foodgrain in FY2008 was much higher (11.6 lakh mt more) than that of last year (FY2007), it failed to meet the gap in view of requirement and production loss caused by flood and Sidr (20 lakh mt), leading to price volatility in the market.

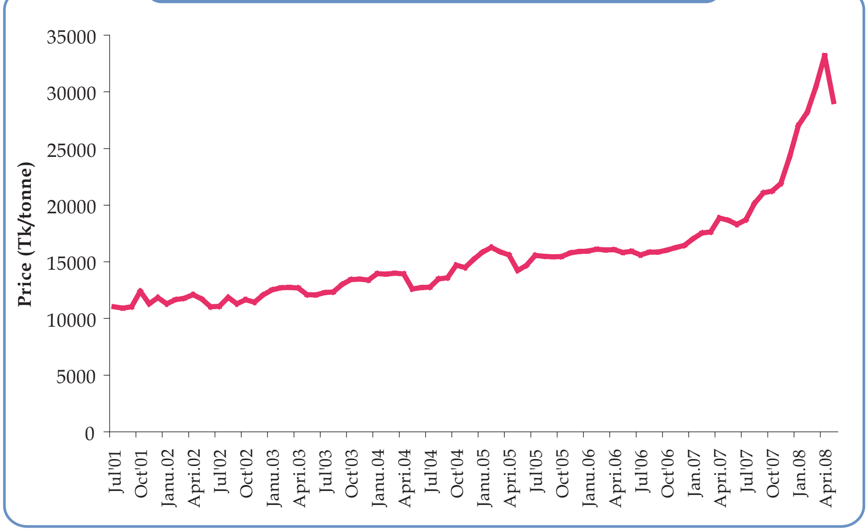
Table 7: Import of Foodgrains in FY2008

(in '000 metric tonnes)

Category of Imports	FY2007 (July-May)			FY2008 (July-May)		
	Rice	Wheat	Total Foodrains	Rice	Wheat	Total Foodrains
Food Aid	25	66	91	73	166	239
Public Commercial Import	0	85	85	254	0	254
Private Import	627	1421	2049	1681	1206	2887
Total	**652**	**1572**	**2224**	**2008**	**1372**	**3380**

Rice Price: In the beginning of FY2008 (i.e. July 2007) the wholesale price of coarse rice in Bangladesh was Tk. 18,700 per mt which gradually increased to Tk. 29,000 per mt in early January 2008 and reached record high levels in April (Tk. 33,196) and then declined to Tk 29,141 in May 2008 after harvest of new Boro rice (Figure 18). Domestic prices (both for wholesale and retail) of coarse and medium rice (Figure 18 to Figure 20) increased exponentially during the last one year. It becomes evident from price analysis that domestic price of rice has increased sharply with the announcement of minimum export price by India. This was true for both the retail and wholesale market. It may be recalled here that India initially fixed minimum export price (MEP) of non-basmati rice at US$ 425 per mt on 25 October 2007. Subsequently, India increased MEP US$ 505 per mt on 27 December 2007 and US$ 650 per mt on 19 March 2008. Finally, India announced minimum export price of US$ 1000 per mt for non-basmati rice and US$ 1200 per mt for basmati rice on 28 March 2008. India banned rice export on April 1, 2008.

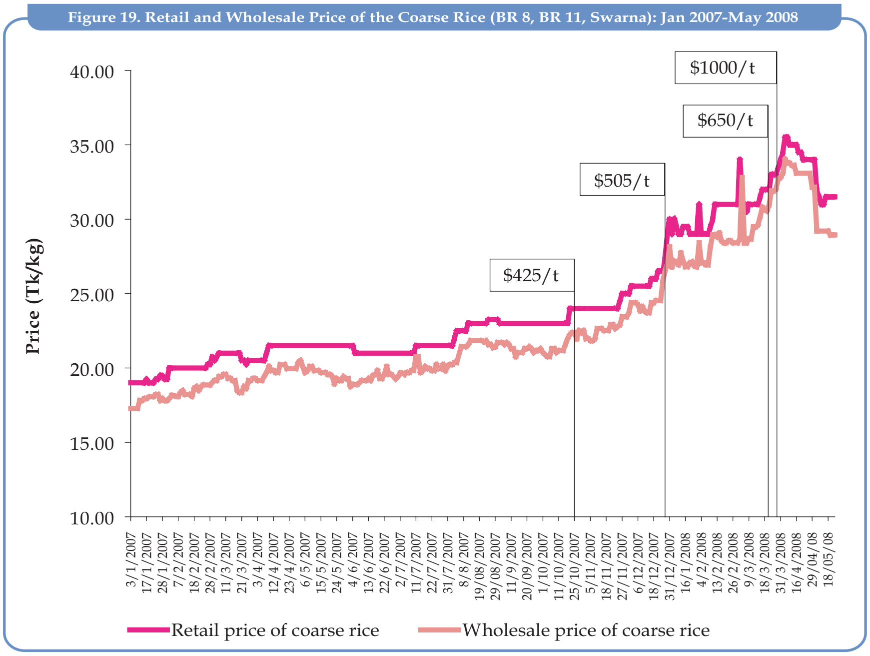
Figure 18 : Wholesale Price of Coarse Rice: July 2001 - May 2008



It is possible that minimum export price fixed by the government of India also had an effect on the global rice price (Figure 21). Policies taken by India had, to some extent, influenced those of other countries such as Vietnam, Cambodia, and Egypt who were persuaded to rethink their export strategy. At some point in time these countries also had imposed temporary ban on export of rice.

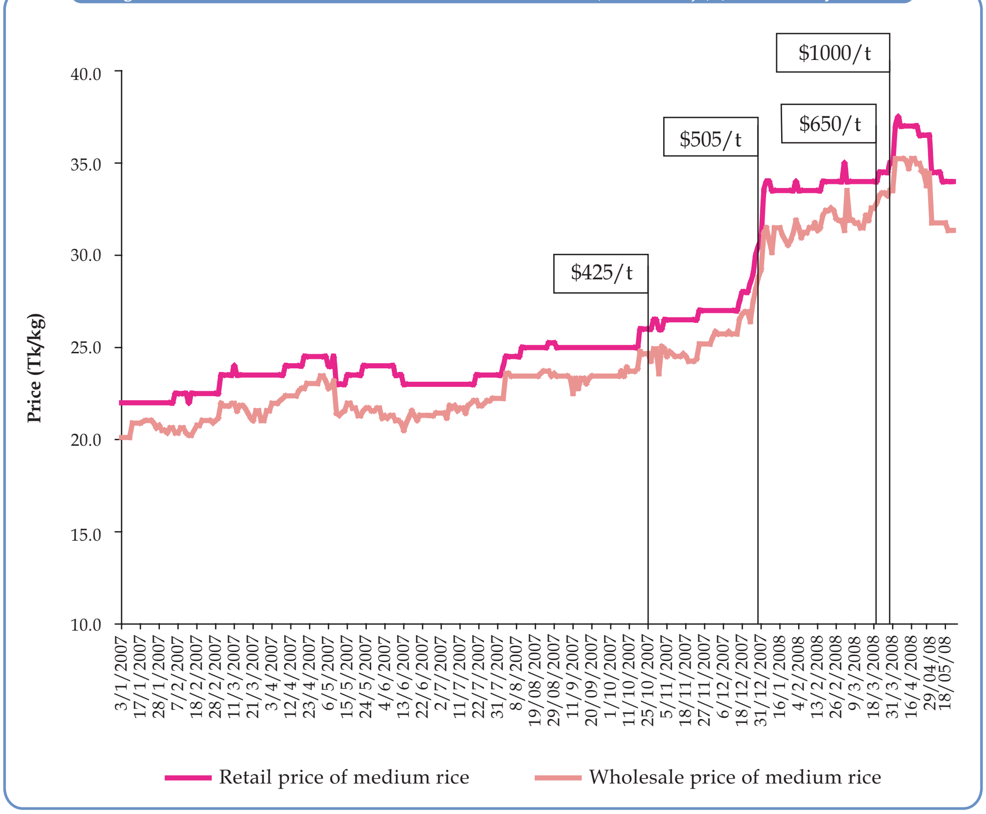
It may be recalled here that in 1998 and 2004, following floods, Bangladesh was able to import huge quantities of rice and wheat from international market to offset the production loss caused by flood. Due to restrictions imposed on rice exports by major exporters, import of rice was a problem in the current fiscal year of FY2007/08. However, it is evident from Figure 22 that the private sector of Bangladesh has responded well to the domestic and international prices and to policies aimed at bridging the gap between demand and supply of rice in Bangladesh.

Figure 19. Retail and Wholesale Price of the Coarse Rice (BR 8, BR 11, Swarna): Jan 2007-May 2008



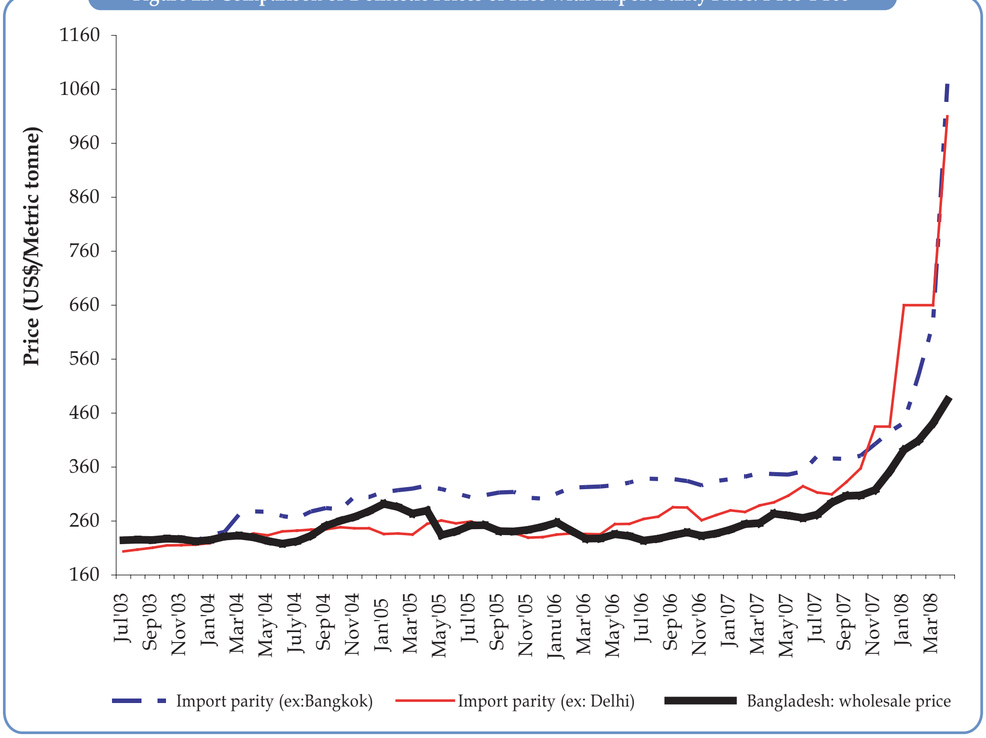
We must be cautious about the future production and prices of foodgrains in Bangladesh and total global production. There are a number of medium and long term factors which will have an impact on future food production, to varying extent. *First,* the *conflict between food and fuel* will increase with high demand for fuels by the rich countries and also the big emerging economies, such as India and China. The distribution of land for agriculture and land for fuels will be a major factor contributing

Figure 20. Retail and Wholesale Price of the Medium Rice (BR 28, Parija): Jan 2007-May 2008



to limited food production. *Second,* the ongoing Doha Round Negotiations of the World Trade Organisation (WTO) on agriculture will have an impact on net food importing countries. The objective of agriculture negotiation in the WTO is to withdraw domestic support given by the developed and developing countries including USA and the European Union. This will imply that net food importing countries such as Bangladesh will have to buy food at a higher price from the global market. *Third,* the impact of climate change will be felt more frequently and severely by low lying poor countries such as Bangladesh. Frequent flood, cyclones and other extreme weather are early indications of this danger. This will not only destroy production, but also reduce the fertility of land and change the cropping pattern. *Fourth,* every year 90 million people are being added to the global population leading to increased demand for food.

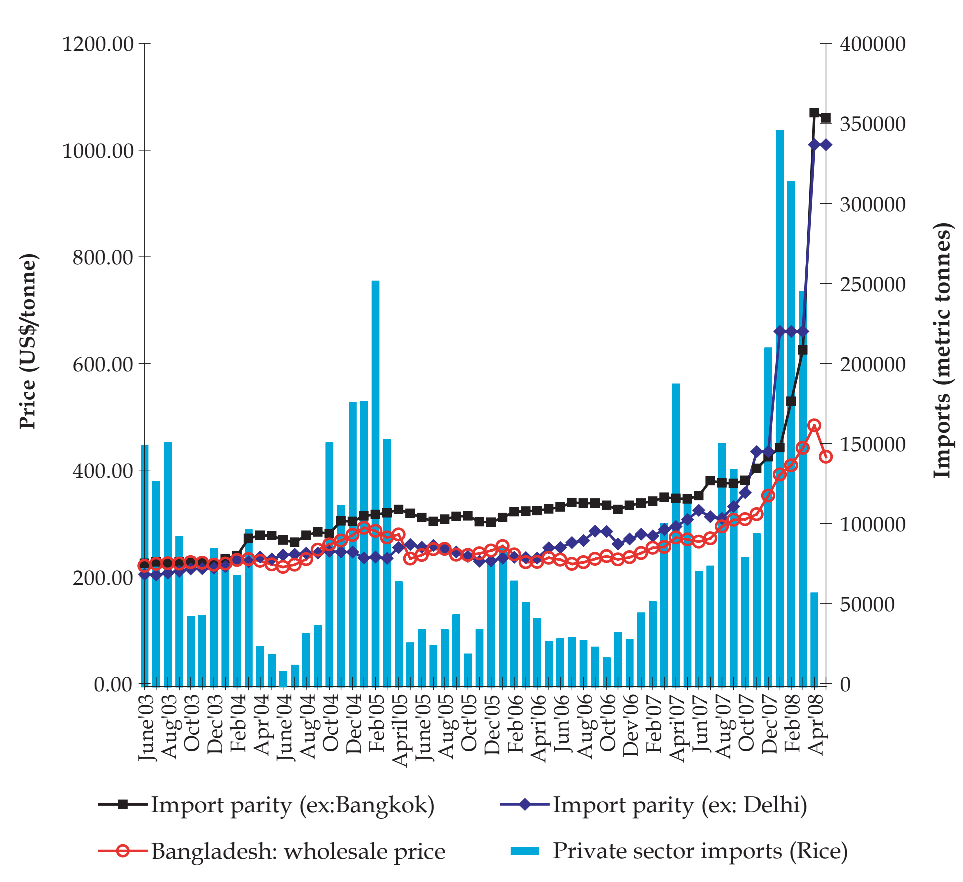
Figure 21. Comparison of Domestic Prices of Rice with Import Parity Price: FY03-FY08



In view of the debate about estimation of food demand and actual production estimates, BBS should resolve this on an urgent basis by undertaking a thorough and consultative review exercise with concerned experts.

Social Safety Net: To ensure food security for the lower income group,

Figure 22: Rice Prices and Quantity of Private Rice Imports in Bangladesh, June 2003 - May 2008



government's main strategy is to distribute rice and wheat under the *Public Foodgrain Distribution System* (PFDS) through priced (monetized) and non-priced or non-monetized (targeted) channels. Monetized distribution is the sale of rice and wheat through Essential Priority (EP), Other Priority (OP), Large Employee Industries (LEI), Flour Mill (FM), Open Market Sale (OMS), and Fair Price Card (FPC). Non-monetized (targeted) channels include targeted safety net programmes such as Food for Works (FFW), Test Relief (TR), Gratuitous Relief (GR), Vulnerable Group Development (VGD), Vulnerable Group Feeding (VGF) and other relief channels. During 1 July- 8 May of FY2008, amount of foodgrains distributed under various PFDS channels was about 13.94 lakh metric tonnes against 12.63 lakh metric tonnes distributed during the comparable period of the previous year. In other words, during the first 11 months of the current fiscal year total distribution under PFDS was 10 per cent higher than that of last year (Table 8). Distribution through non-priced channel (9.21 lakh metric tonnes) was 52 per cent higher compared to last year. On the other hand, distribution under priced channel during

Table 8: Sector-Wise Public Distribution of Foodgrains

(*in thousand metric tonnes*)

	1st July 2006-24 May 2007			1st July 2007-22 May 2008		
	Rice	Wheat	Total	Rice	Wheat	Total
Priced Channel						
EP	136.94	95.43	232.37	116.17	71.89	188.06
OP	9.63	6.64	16.26	12.25	5.39	17.65
LE	3.43	8.78	12.21	5.88	4.42	10.30
OMS	408.01	0.00	408.01	265.01	0.00	265.01
Others	0.00	0.03	0.03	0.01	0.00	0.01
Sub total	558.00	110.89	668.89	399.32	81.70	481.02
Non Priced Channel						
FFW	79.15	2.26	81.41	77.61	45.67	123.28
TR	114.30	0.00	114.30	65.55	10.37	75.92
VGF	230.07	0.00	230.07	187.36	0.00	187.36
VGF (Aid)	0.00	0.00	0.00	205.32	2.84	208.16
VGD	84.89	38.72	123.61	181.49	55.47	236.96
GR	25.57	0.00	25.57	36.40	0.00	36.40
Others	43.87	14.14	58.00	63.78	21.05	84.82
Sub total	**577.85**	**55.11**	**632.96**	**817.50**	**135.39**	**952.89**
Total	**1135.85**	**166.00**	**1301.85**	**1216.82**	**217.09**	**1433.91**

Source: *Directorate of Food.*

1 July- 8 May of FY2008 was 4.73 lakh metric tonnes which was 28 per cent lower than comparable period of the previous fiscal year. About 98.45 lakh families were benefited through the VGF programme in FY08, but the extent of support provided to these families were of varying degrees (one month to 6 months). On the other hand, about 2.5 lakh women were benefited from the VGD programme in FY2008.

In view of high global food prices in the coming years, government will need to continue distribution under PFDS and expand the social safety net programmes in the next fiscal year (FY2008/09). The government may have to go for an increased distribution under PFDS in 2008-09 to the tune of 3.0 million tonnes of rice and wheat. This would require a foodgrain rolling stock of about 12-15 lakh tonnes. Government does have the physical facility to maintain this stock. Procurement will have to be made mainly in the Boro and Aman seasons with distribution being made throughout the year, with greater allocation during October-November and March-April period. Social Safety Net Programme needs to be designed in such a way that hard core poor families are adequately covered. To this end, an *independent monitoring mechanism* needs to be put in place to ensure that the VGF and VGD beneficiaries are appropriately targeted, and that those in needs are not overlooked. Regular feedbacks from this oversight exercise will enable the government to closely calibrate the programme to mitigate distress promptly and effectively, and also to avoid wastage and rent seeking in the distribution process.

Effective operation of PFDS requires procurement from both domestic and international sources. Ministry of Food has declared its procurement target of Boro rice as 1.2 million metric tonnes of rice and 0.3 million metric tonnes of paddy and set procurement price of Tk. 18 for per kg paddy and Tk. 28 for per kg rice. As of 27 May 2008 actual procurement was about 20 thousand metric tonnes of paddy and 191 thousand metric tonnes of rice. Mechanisms to promote procurement of foodgrains need to be explored so that farmers receive better price. Public stock of foodgains currently stands at about 583 thousand metric tonnes. If the government is able to materialise its plan for food procurement from domestic sources and is able to realise import of 500 thousand metric tonnes from India, it would be within the *comfort zone* in terms of operating its safety net programmes adequately and appropriately. Given that food security originates both from cyclical and transitory factors, both of these aspects will have to be kept in mind while designing food security strategy for FY2009.

7

INDUSTRIAL SECTOR: FROM A SLUGGISH BEGINNING TO A MODEST UPTURN

Industrial sector has gradually picked up in the second and third quarters following sluggish growth registered in the first quarter of FY2008. All major indicators including production in manufacturing and service sectors, loans and advances to industrial enterprises, import of raw materials and capital machineries by industrial units, inflow of FDIs, particularly in EPZs and performance of capital market have registered positive trends when July-April, 2008 period is considered. However, since FY2007 was not a normal year, perhaps the reference point should be FY2006, and it is to be noted that performance in FY2008 was way below the level achieved in FY2006 (16.3 per cent).

Production: Large and medium enterprises, especially apparels, textiles, food and beverage, basic metals etc. have registered a modest growth during the first three quarters of FY2008 (overall growth was 6.4 per cent) (Figure 23). Apparel sector, which accounts for two-thirds of the overall weight of the manufacturing sector has attained a growth of 7.4 per cent in the Q1-Q3 period; more importantly, growth of this sector was 11.8 per cent in the third quarter of FY2008 compared to that in FY2007, after a negative growth in first quarter of FY2008 (-0.4 per cent) followed by a significant rise in the second quarter (11.4 per cent). Production of processed food products such as soyabean oil, flour etc. registered low levels of growth in recent months (3-4 per cent higher in January, 2008 *vis a vis* 2007). Production of other consumer goods, which targeted the domestic market, such as furniture, soaps and detergents, perfume and cosmetics, rubber and footwear have also registered slower growth rates. Indeed, with falling purchasing power originated from high inflation, demand for consumer goods was expected to suffer. However, responses of leading business executives (CPD's *Executive Opinion Survey* conducted in February-April, 2008) bears out that business confidence is gradually improving following various initiatives by the government to create a better business environment in the country (Table 9). These included relaxation/withdrawal of several stringent measures taken earlier for monitoring business practices, formation of *Better Business Forum* headed by the Chief Advisor, establishment of *Regulatory Reforms Commission* etc. However, business executives, particularly those involved in small scale businesses, complained about lack of regular supply of electricity, high inflation, high interest rate on borrowing from banks and uncertainties originating from some of the reform measures as factors that constrained their activities.

Figure 23: QIP of Large and Medium Scale Manufacturing Industries

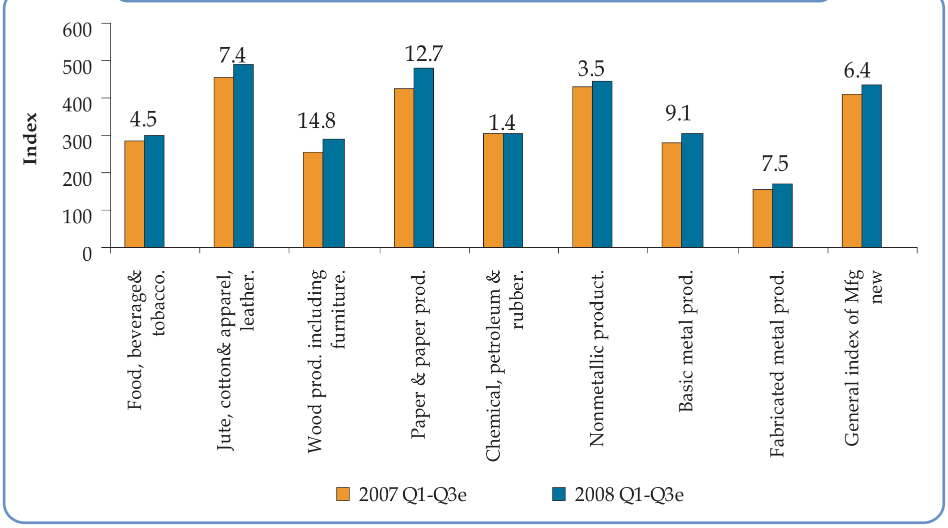


Table 9: CPD Executive Opinion Survey 2008

		Frequency	Valid Per cent
Entrepreneurs' perception on recent policy/institutional reforms of the government: whether these reforms would help to develop business environment of the country?	Disagree	8	9.8
	Indifferent	8	9.8
	Agree	66	80.4
	All	82	100
Entrepreneurs' perception on government's drive against improper business activities including corruption in 2007: whether such measures had	Negative impact	49	59.1
	Indifferent	15	18.1
	Positive impact	19	22.8
	All	83	100

Source: *CPD Executive Opinion Survey, 2008.*

With regard to specific sectors, notwithstanding the rising demand for fertiliser in the domestic market, production of fertiliser was only 45 per cent in July-January, 2008 period compared to the production during the whole year of FY2007; more importantly, production of fertiliser in the month of January, 2008 was 12.4 per cent lower compared to January, 2007. One of the major reasons for low level of fertiliser production was the decline in the supply of gas to fertiliser plants (24 per cent of total gas supply in FY2003, 17.4 per cent in FY2007 and 14 per cent till February, FY2008). In view of recent changes in the regulations of the International Maritime Organisation (IMO) as regards structure of ships, opportunities for emergence of Bangladesh as a major small scale ship building industry has increased quite considerably. During July-January, 2008 production of ship building was 2081 mt, which was 3705 mt for the entire period of FY2007; indeed production in January, 2008 was 30.7 per cent higher compared to that in January 2007. Telecom companies including mobile and PSTN have performed well during July-April period of FY2008. Total number of subscribers of mobile telephone companies was 32.4 million in July, 2007 which increased to 38.9 million in April, 2008, indicating a rise of 13 per cent in the number of subscribers. In case of PSTN, total number of subscribers increased from 1.19 million in December, 2007 to 1.26 million in April, 2008- a rise of 5.8 per cent within five months.

Disbursement of Loan: It is encouraging that industrial term loan disbursement, in line with rise in production in major manufacturing sectors, has increased by about 66 per cent during July-March, 2008 period (total disbursement was Tk.14574.3 crore) (Table 10). However, the amount of overdue loans has increased in January-March, FY2008 (16 per cent) which is a disquieting signal both for banks and industries. Bank advances for small scale enterprises under 'EEF' programme, a good initiative in itself, could not meet the growing demand of eligible businesses to the required extent. In view of the demand for the reduction of the interest rate, banks recently have decided to lower the lending rate of term loan and working capital, and fixed this at a maximum of 14 per cent. This will require 23 private commercial banks to reduce

Table 10: Industrial Term Loan

(crore Tk.)

	2006-07			2007-08		
	Disbursement (a)	Recovery (b)	Net (a-b)	Disbursement (a)	Recovery (b)	Net (a-b)
July-September	2660.3	1740.9	919.4	3784.8	2625.2	1159.6
				(42.3%)	(50.8%)	(26.1%)
October-December	3204.5	2394.0	810.5	5878.5	3311.5	2567.0
				(83.4%)	(38.3%)	(216.7%)
January-March	2911.4	2297.1	614.3	4911.1	3770.0	1141.1
				(68.7%)	(64.1%)	(85.8%)
July-March	8776.2	6432.0	2344.2	14574.3	9706.7	4867.6
				(66.1%)	(50.9%)	(107.6%)

Source: *Bangladesh Bank.*

Table 11: Number of Banks Having Lending Rate Higher than 14 Per cent

Range	Term Loan to Large & medium scale Industry (no.)	Term Loan to small industry (no.)	Working Capital to Industry (no.)
14< r* <14.5	6	6	11
14.5 < r <14.75	5	2	2
14.75 < r <15	4	3	5
15 < r <16	7	7	5
Total	**22**	**18**	**23**

Source: *Author's Estimate.*
* r denotes the rate of interest

interest rates at varying levels with a maximum reduction of 2 per cent (Table 11). This is expected to reduce entrepreneur's cost of borrowing from banks.

Import of Raw Materials and Capital Machineries: Import of intermediate goods and raw materials has increased by about 11.5 per cent during July-April FY2008 compared to the same period of the previous year. However, import of capital machineries has decreased by 8.5 per cent during the same period. Import of intermediate goods, industrial raw materials, and capital machineries is likely to increase in the fourth quarter as is indicated by the growth of LCs opened in recent months (July-March, FY2008). Growth of LCs opening for industrial raw materials and capital machineries were 40 per cent and 15 per cent respectively during July-April of FY2008 (Table 12). Import of industrial raw materials such as edible oil, textile fabrics, pharmaceutical raw materials, raw cotton, cotton yarn etc. is likely to increase substantially (40 per cent). In line with this, settlements of LCs for these have increased by 28 per cent. Although import of capital machineries posted negative growth of -7.2 per cent during July-September, 2007, indicating a slow down in new investments, the rise in LC openings in the following periods of FY2008 compared to the same period of the FY2007 signals a positive upturn in recent months. Imports of capital machineries particularly for such sectors as textile, garment, and pharmaceuticals have increased during July-April, 2008, to varying degrees.

Table 12: Changes in Fresh Opening and Settlement of LCs During July-April Period of 2007 and 2008

	Fresh LCs opening	Settlement of LCs
Industrial raw materials	*40.0*	*27.9*
Edible oil & oil seeds	69.7	76.3
Textile fabrics (B/B & others)	17.5	4.4
Pharmaceutical raw materials	58.3	22.2
Raw cotton	43.5	43.1
Cotton yarn	46.6	20.5
Synthetic yarn	46.5	21.3
Chemicals & chemical products	61.8	43.8
Capital machinery	*14.9*	*-9.8*
Textile machinery	33.3	-23.8
Leather / tannery	-1.3	50.1
Jute industry	-1.75	-27.9
Garment industry	19.9	1.7
Pharmaceutical industry	15.3	-22.5
Plastic Industry	80.7	-61.6
Packing industry	-20.8	43.0

Source: *Bangladesh Bank.*

Foreign Direct Investment: Country's overall FDI trends in the first eight months show signs of stagnation. During July-February, 2008 period foreign investment including portfolio investment amounted to US$561 million, which was 3.6 per cent lower compared to the corresponding period of the previous year (Table 13). However, it is to be noted that investment in EPZs was US$266 million during July-April, 2008 period which was 100 per cent higher compared to the matched period of the previous year. Inflow of portfolio investment has also increased in recent months. Registration of FDI in 2007 was only US$318 million in case of the BOI (significantly below the level of 2006), while it was US$943 million for the BEPZA. Manufacturing sectors including apparels, textiles, garment accessories etc. received a number of new investment proposals, while in all other sectors including power, gas, agriculture and food, services, telecommunications there was a substantial reduction in terms of investment proposals. A rise in the inflow of FDI and registration of new FDIs with EPZs were partly because of new investment opportunities created at two recently established EPZs, namely the Adamjee and Karnaphuli EPZs.

Table 13: Inflow of FDI

(million US$)

Item	2005 (Jan-Dec)	2005 (Jan-Dec)	2005 (Jan-Dec)	2005 (Jan-Dec)	2005 (Jan-Dec)	2005 (Jan-Dec)
Foreign direct investment (net)	734.4	792.5	749.3	540	491	-9.1
Portfolio investment	110.8	30.9	201.1	42	70	66.7
Total FDI	**845.3**	**823.4**	**950.4**	**582**	**561**	**-3.6**

Source: *Bangladesh Bank.*

According to Table 14, a large amount of outward transfers of FDI-related investment has taken place in the

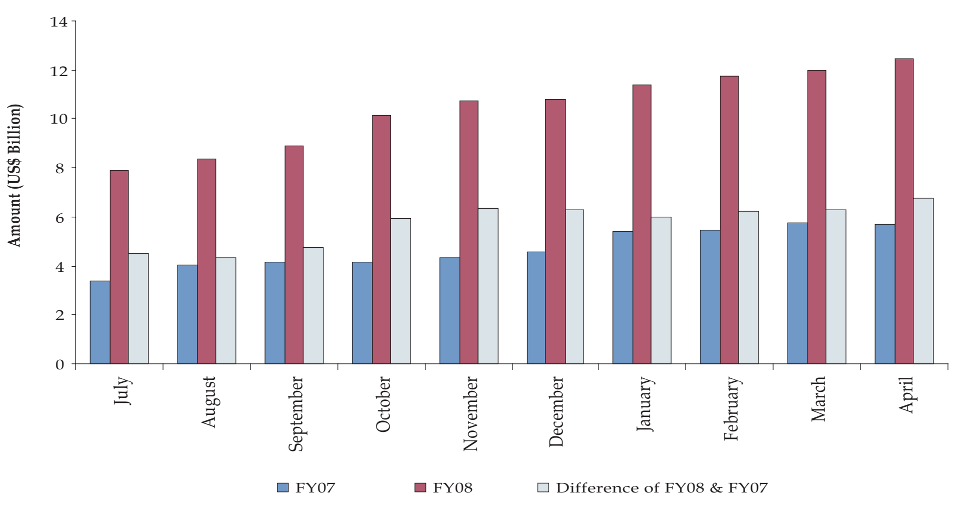
Table 14: Net Inflow of FDI

Item	2006 Jan-Dec	2007 Jan-Dec	% change in 2007 over 2006
FDI Inflow	823.4	950.4	15.4
Transfer of FDI related Income	465.7	705.4	51.5
Royalties and license fee	4.8	7.7	61.8
Profit and Dividends	143.2	190.9	33.3
Earnings of Oil, Gas and Power companies	317.7	506.8	59.5
Net FDI Inflow	**357.7**	**245**	**-31.5**

Source: *Bangladesh Bank.*

current fiscal year. During 2007, outward transfers amounted to be US$705 million; the figure was US$466 million in 2006. A substantial amount of transfers, especially on account of oil, gas, and power companies have taken place. This amounted to US$507 million in 2007 (corresponding figures for 2006 was US$318 million). This has consequently reduced net inflow of FDI in the country to a significant level (by 3.6 per cent); net inflow of FDI amounted to only US$358 million in 2006 and US$ 245 million in 2007. Reinvestment of profit and income of foreign companies will need to be encouraged although this is related with ensuring conducive business environment in the country. Large scale companies should be encouraged to offload part of their shares in the capital market. Prompt decision will also need to be taken with respect to major investment proposals.

Figure 24: Market Capitalisation of DSE



Source: *Dhaka Stock Exchange (DSE)*

Capital Market: Bangladesh's capital market, in contrast to the slow growth of production and investment in industrial sectors, experienced remarkable buoyancy beginning from the early months of FY2008. Market capitalization, share price indices including all share price index, general index, and top 20 index, for both DSE and CSE, have escalated during this period. Market capitalization including DSE and CSE reached US$ 23.2 billion in April, 2008 from US$14.4 billion in July, 2007 (61.1 per cent rise) (Figure 24). New and small scale investors are once again showing interest in capital market. It seems that some transfer of funds has taken place from the banking sector to capital market; this is corroborated by the fact that outstanding stock of total bank deposits including demand and time deposits has decreased in July-February, 2008 compared to the corresponding period of the previous year (from Tk.15252 crore to Tk.15199.7 crore). Strict monitoring of bank transactions, better incentive in the form of capital gains tax waiver for investment in the capital market, and low levels of real return from bank deposits in the wake of high inflation have contributed to this. Movement of the various share prices in the DSE (also in CSE) reveals that price of all types of shares has increased including 'Z' category shares in FY2008. Many small investors are buying shares at high prices in anticipation of further rise in the prices. Their risk exposure appears to be quite high. One will need to closely monitor how the capital market makes the necessary adjustments in the coming months in view of the relatively slow pace of growth of the industrial sector. Although investors are looking for more new and good IPOs, only 9 IPOs were offloaded so far in this fiscal year against 12 in 2007 (Table 15). Government's initiative to attract large companies to the capital market including the telecom companies, is yet to give results. Offloading of the shares of various public limited companies, announced by the government earlier, is also yet to take place. Offloading shares of large companies in the capital market is likely to attract more local and foreign portfolio investment in the country.

Table 15 : IPO's in the Dhaka Stock Exchange (DSE)

Item	FY2008 (up to 21 may)	FY2007	% change
No. of IPO's	9	12	-25
Total Issued Shares	28073270	149705920	-81.25
Sponsors' Portion (Share)	15800220	94598125	-83.30
Public Offer (Share)	12273050	55107795	-77.73
Public offer as percentage of total Issued Shares	43.72	36.81	18.76
Total Paid up Capital (after IPO) (in Tk.)	5517327000	7154943862	-22.89
Total Paid up Capital (after IPO) (in Tk.)	5517327000	7154943862	-22.89
Total over-subscription (Tk.)	21405568250	26249633100	-18.45
Over-subscription as % of total public offer	378.44	734.30	-48.46

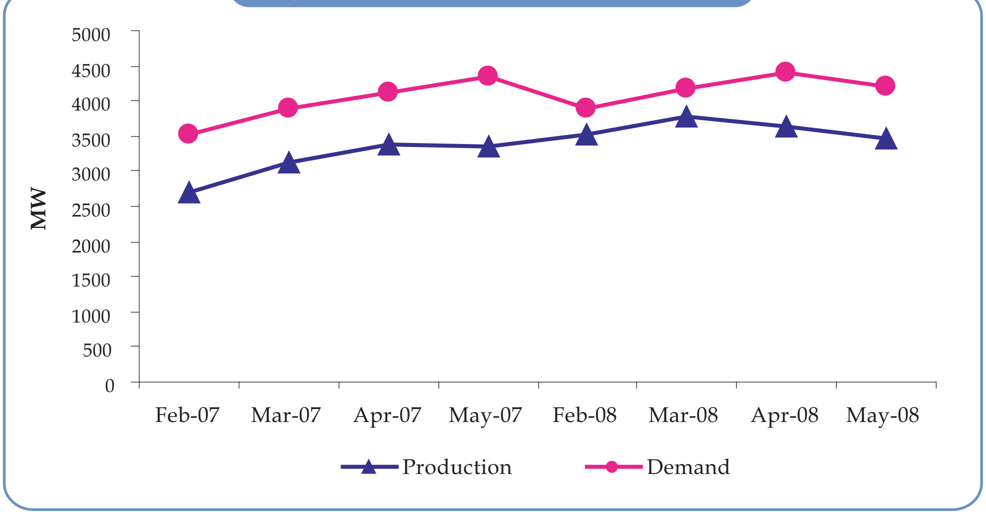
Source: *Bangladesh Bank.*

8

INCREASING POWER AND ENERGY DEFICIT EMERGING AS A MAJOR CONSTRAINT TO DEVELOPMENT

Inadequate supply of power and energy has been a major bottleneck that has severely constrained investment and business activities in Bangladesh. New industries and economic activities are not emerging because of absence of power supply; the existing ones suffer from frequent outages, leading to damage to equipments, production disruption and cost escalation originating from more costly alternative sources. A large gap (734 MW in May, 2008) exists between demand for power generation and distribution (Figure 25). As performance in FY2008 amply bears out, energy and power are emerging as the twin major factors which are severely undermining the growth potentialities of the country's industrial sector.

Figure 25: Demand-Supply Gap of Electricity



Source: *CPD IRBD Database.*

Power Sector: In spite of some increase in power supply in recent months (8.7 per cent higher in April, 2008 compared to April, 2007), load shedding has continued to be very high (1049 MW in May, 2008). A number of power plants have not been in operation due to repair and maintenance works of plants and forced stoppages, and due to shortage of gas (which caused a loss of 720 MW during April, 2008). According to the BPDB (Table 16), the highest number of power plants in operation was 90 in February, 2008, while the lowest number of power plants in operation was 78 in April, 2008. Because of frequent power outages, industries and businesses are becoming increasingly

Table 16: Operation, Generation and Load Shedding Situation of Power Plants During 2007 and 2008

		Feb. 2007	Feb. 2008	Mar. 2007	Mar. 2008	Apr. 2007	Apr. 2008	May 2007	May 2008
Plants in Operation	Highest	75	90	77	82	81	84	82	83
	Lowest	69	79	68	75	72	78	76	76
Generation (MW)	Highest	2888.6	3826	3588	3935.1	3717.8	3847.3	3557.1	3773.6
	Lowest	2455.7	3025	2500.1	3537.8	2679.9	3491.8	3205.1	3271.7
Load Shedding (MW)	Highest	931	720	1144	835	1062	907	1118	1049
	Lowest	478	110	80	000	000	310	408.00	0
Generation shortfall due to	Highest		939		728		720		710
gas shortage (MW)	Lowest		300		447		400		389

Source: *BPDB, MIS Report.*

dependent on captive power in order to ensure uninterrupted power supply to factories and business premises. As a result, various types of power generators, mainly gas based power generators, are being imported at an increasing amount in recent years. This is corroborated by the fact that consumption of gas for captive power generation has substantially increased – during FY2003 proportionate share of use of gas for captive power generation was 6.5 per cent of the total (741.4 mmcm) which increased to 11.4 per cent in FY2007 (1770.2 mmcm) and 13.5 per cent till February, FY2008 (1433.1 mmcm). Government is also encouraging large manufacturing and business units to set up captive power plants. In view of this government has provided budgetary support in the form of low import duty on generator.

Table 17: Arrears of Power Generation Companies to Gas Companies (up to Feb, 2008)

(in million taka)

Power Generation Companies	Titas	Bakhrabad	Jalalabad	Western Zone	Sylhet	BGFCL	RPGCL	Barapukuria	Total
Government	2054.16	210.1	191.5	148.53	0	0	0	0	2604.29
Non Government	781.1	0	0	80.21	0	0	0	0	861.31
Total	2835.26	210.1	191.5	228.74	0	0	0	0	3465.6

Source: *Petrobangla MIS Report.*

Major reasons for the generation shortfall in public sector power plants, according to the BPDB, are repair and maintenance works of plants and forced stoppage, and due to shortages of gas. Power generation was hampered in recent months due to shortages of gas to the tune of 939 MW in February, 2008, 728 MW in March, 2008 and 720 MW in April, 2008. One of the main reasons for lack of gas supply in public sector power plants is because of low level of supply of gas by gas companies owing to the significant amount of arrears. Petrobangla MIS report shows that public sector power plants have arrears of Tk.260 crore up to February, 2008, whereas non-government companies have arrears of Tk.86 crore (Table 17). These arrears of the power companies, according to the BPDB, are related to huge amount of unpaid bills of various government and non-government organizations as also owing to system loss.

In view of the increasing demand for electricity, a total of 30 power plants are planned to be set up in the country by 2012, of which 17 power plants are now under construction (a total of 12 power plants with a production capacity of 694 MW is planned to be built during 2008). However, only one has been established so far and others are still in construction phase. Out of this, 11 power plants will be constructed on rental terms for 3 years to 15 years. If all these power plants are built in time, a maximum of 4445 MW additional power supply will be added to the national grid. Since most of these constructed or proposed power plants is planned to use gas as raw materials, supply of the required gas in power plants will be a critical factor. According to an estimate with regard to generation of electricity in a large scale combined cycle power plant, a total of 0.16 – 0.19 mmscf gas is required for generation of 1 MW of electricity. Taking this into account, an amount of 711.2 –850 mmscf gas will be required for generating 4445 MW of electricity. It will be a challenge for petrobangla to supply the required quantity of gas to the power plants from its limited reserves for a prolonged period of time, unless it explores new sources of gas in the country. Government should take necessary measures to set up coal-based power plants by using the coal reserve of the country. The first step towards this would be to take a decision with regard to the *National Coal Policy*, which is now in the process of review by the CTG.

Table 18: Gas Production in Different Years (MMCM)

Year	Petrobangla	IOC	Total	Growth rate
2002-03	9449.125	2476.721	11925.85	
2003-04	9715.113	3106.01	12821.12	7.51
2004-05	10086.48	3696.907	13783.39	6.98
2005-06	10116.56	4804.286	14920.85	7.62
2006-07	10148.45	5771.65	15920.1	6.69
2007-08 (up to Feb 08)	6155.987	4851.867	11007.85	

Source: *MIS Report, Petrobangla*

Energy Sector: Production of gas has not increased significantly in recent years – its growth rate was 7.6 per cent in 2006, which fell to 6.3 per cent in 2007 (Table 18). During 2008 gas production was 11008 mmcm till February, FY2008, which was 61.1 per cent of the target set for FY2008 (18025 mmcm).Under the existing rate of production (1393.4 mmcm in February, 2008 from 73 wells out of 93 wells) it would be difficult to achieve the target level of production, though it may cross the production of the previous year. However, although use of gas in industrial and business activities is increasing (29.2 per cent of total gas consumption for industry and captive power till February, FY2008 against 26.1 per cent in FY2007 and 16.9 per cent in FY2003), more gas will be required to meet the growing demand of these economic activities (Table 19). Because of limited supply, government has controlled supply of gas to various economic activities, especially in industrial units. As is known, gas supply to industrial units in Chittagong has been rationed in recent times. According to energy experts, current gas reserves, estimated to be 8.0 trillion cubic feet (tcf), will not be able to meet the demand of the country after 2015; about 24 tcf gas will be required to meet the energy demand up to 2025.

To stimulate exploration of gas in view of this, Petrobangla has floated international tenders in February, 2008 to lease out 28 offshore gas blocks. It is to be noted that of these a number of blocks (12) have already been licensed by neighbouring India and Myanmar for gas exploration. To avoid possible disputes with neighbouring countries and to resolve the issue on an urgent basis, the Head of State of Bangladesh has recently constituted an expert committee to examine the relevant issue and to articulate Bangladesh's policy stance. This particular issue ought to be given priority attention by Bangladesh's policymakers in view of the critical importance of gas for energy security, FDI inflow, domestic consumption and economic development of the country.

Table 19: Share of Different Sectors in Total Gas Consumption

(in percentage)

Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-2008 (upto Feb)
Power	46.5	46.6	46.3	45.3	41.2	39.7
Fertiliser	23.9	21.7	20.6	17.9	17.4	14.1
Captive Power	6.5	7.5	8.3	9.9	11.7	13.5
Industry	10.4	10.8	11.3	12.8	14.4	15.7
Commercial	1.1	1.1	1.1	1.1	1.1	1.1
Brickfield	0.1	0.5	0	0	0	0
Tea-garden	0.2	0.2	0.2	0.2	0.1	0.2
CNG	0.0	0.5	0.8	1.4	2.2	3.6
Household	11.2	11.5	11.5	11.5	11.8	11.9

Source: *Petrobangla.*

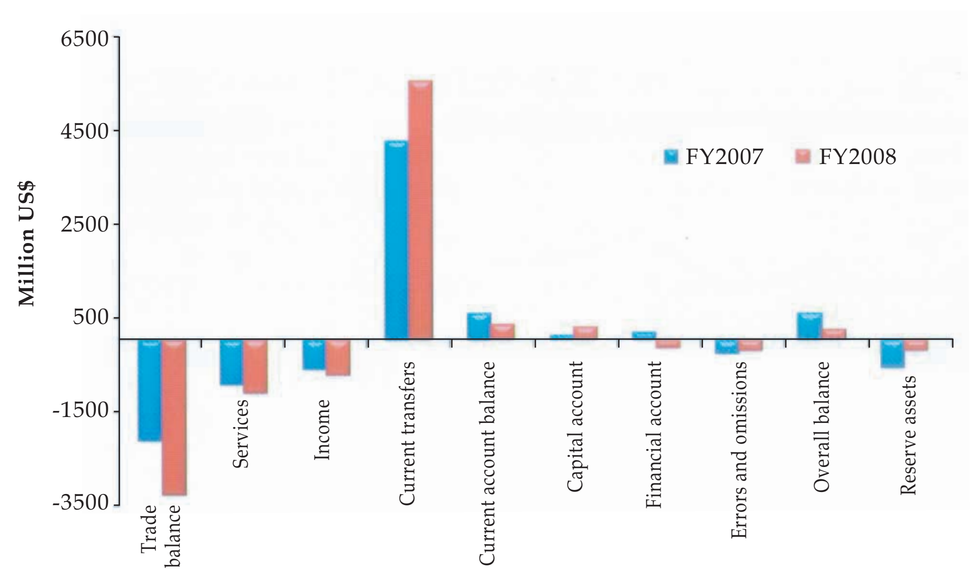
It is also important to think about developing long term debt market in the country in order to generate investible resources for large scale long term projects including areas as energy, power sector and other types of infrastructures. Big commercial banks, including foreign banks should take a lead role to finance such large-scale infrastructure projects. Currently, Infrastructure Development Company Limited (IDCOL), a non-blank financial institution, is financing two power plants namely Meghnaghat 450 MW Power Plant Project and Summit Power Ltd. 33.75 Power project with a credit support of US$90 million and Tk.90 crore. Possibility of raising resources through securitization, and greater role of private sector should also be explored.

9

PRESSURE ON BALANCE OF PAYMENTS

Bangladesh's external sector was under considerable pressure in FY2008. With export earnings of US$ 10.16 billion and import payments exceeding US$ 15.0 billion in the first three quarters, *balance of trade* approximated a deficit of about US$ 5.3 billion during July-March FY2008. The pressure prompted the government to borrow US$ 220.0 million from the IMF as balance of payment support. On the financial account side, BoP experienced a net deficit of US$ 162 million during the first eight months, against a surplus of US$ 180 million during the same period of FY2007. However, the increasingly large deficit in the trade balance was offset by the surplus in the current transfers. This surplus mainly originated from private transfers in the form of worker's remittances which recorded US$ 4841 million in the July-February period; by the end of April 2008, earnings from remittances hit a record mark of US$ 6431 million. Inspite of this, the current account balance for July-February period fell from US$ 558 million in FY2007 to US$ 328 million in FY2008. (Figure 26)

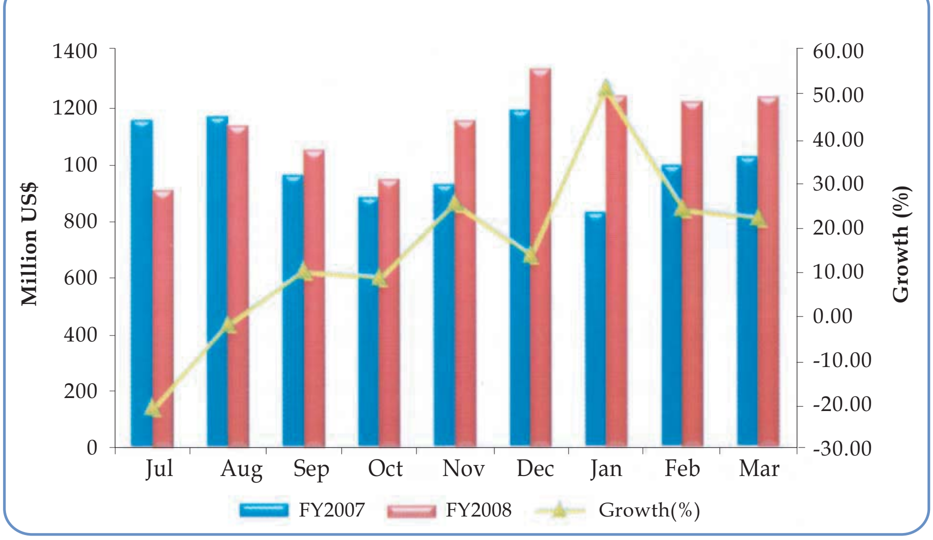
Figure 26: Balance of Payments Scenario During FY2007 and FY2008 (Jul-Feb)



Source: *CPD Trade Database, 2008.*

During the first half of FY2008 (Jul-Dec), growth of earnings from export slowed down considerably (4.49 per cent growth) whilst imports, underpinned by import of high-priced cereals and essential items, required an increasing amount of foreign exchanges (16.08 per cent growth in import). However, encouraging developments in the second half of FY2008 has eased the situation towards the end of April, 2008. Firstly, exports had picked up quite appreciably in the third quarter of FY2008, posting a remarkably high growth of 30.8 per cent with RMG registering 33.3 per cent growth. Secondly, remittance has registered quite robust growth of 31.1 per cent during the first 10 months of FY2008 ($6.43 billion), with the pace picking up further in recent months: between January-April 2008 growth of remittance was an impressive 46.3 per cent. Thirdly, imports of foodgrains, accounting for a significant share of import payments in the first half of FY2008, have started to gradually come down in the latter half of the fiscal year in view of higher domestic availability of foodgrains, particularly in view of the bumper boro production. (Figure 27)

Figure 27: Monthly Trends in Export (FY2007 vs FY2008)

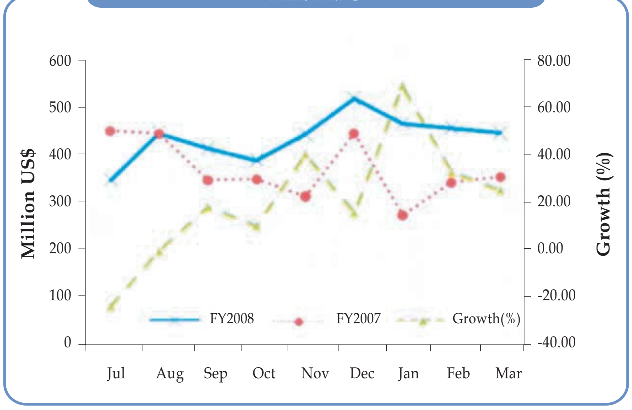


Source: *CPD Trade Database, 2008.*

Export Sector Performance: One significant development in the export sector has been the ascendancy of knitwear as a dominant player in the export basket. Growth of knitwear was 17.3 per cent as against 7.6 per cent for wovenwear during the first nine months (Figure 28). Since domestic value addition in knitwear is almost double that of wovenwear, growth of net export earnings was higher than what is suggested by the growth of gross exports, indicating higher net forex earnings from export. Indeed, during the first nine months, net export earnings from the woven sector was about US$ 1270.0 million as against US$ 2150.0 million for the knitwear sector.

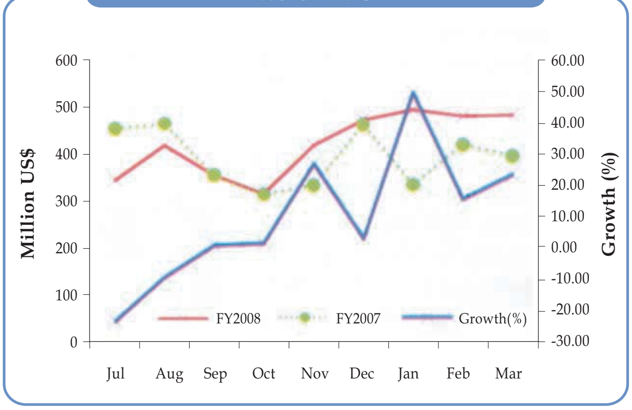
Figure 28: Monthly Trends in RMG Export (FY2007 vs FY2008)

Knit RMG



Source: *CPD Trade Database, 2008.*

Woven RMG

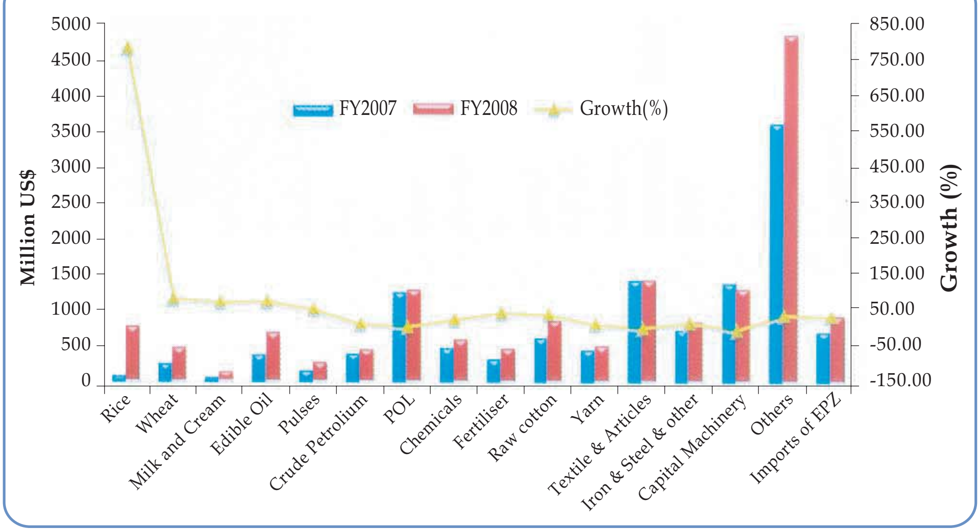


Source: *CPD Trade Database, 2008.*

One persistent feature of the structure of Bangladesh's exports has been the continuing dominance of the RMG. Three-fourth of export earnings came from RMG. Global market of apparels and textile is a formidable US$ 350.0 billion. And it is Bangladesh's good fortune that she has been able to have a strong foothold in this market. However, intra-RMG diversification has not gone much beyond shirts, trousers, sweaters and jackets. On the other hand non-RMG diversification has also not gone very far. Non-RMG items posted a growth of 13.8 per cent during the first three quarters of FY2008 compared to the corresponding period of FY2007. Seven items (knitwear, wovenwear, home textile, frozen food, raw jute, jute goods and leather) accounted for more than 87 per cent of Bangladesh's export, whilst EU and USA accounted for about 80 per cent of the market. Renewed efforts at diversification, both commodity-wise and market wise, is required. It is, however, to be noted that non-traditional sectors such as home textiles, and in very recent times ship-building, have demonstrated high promise. Indeed exports by small-scale ship-building sector with a global market of about US$ 44.0 billion, (below 15-20 thousand DWT), has emerged as a new addition to Bangladesh's export basket. Support in the form of zoning policy, bank guarantee, bonded warehouse facility, infrastructure development, tax holiday and skill development will be required to realize the full potentialities of this export-oriented sector.

The need for higher export earnings is also underpinned by the demand for foreign exchange to underwrite the growing import payments in the context of rising global prices. Imports payments during the first nine months were to the tune of US$ 15.5 billion, posting a growth of 25.1 per cent compared to the corresponding period of FY2007 (Figure 29).

Figure 29: Import of Some Selected Commodities (Jul-Mar)

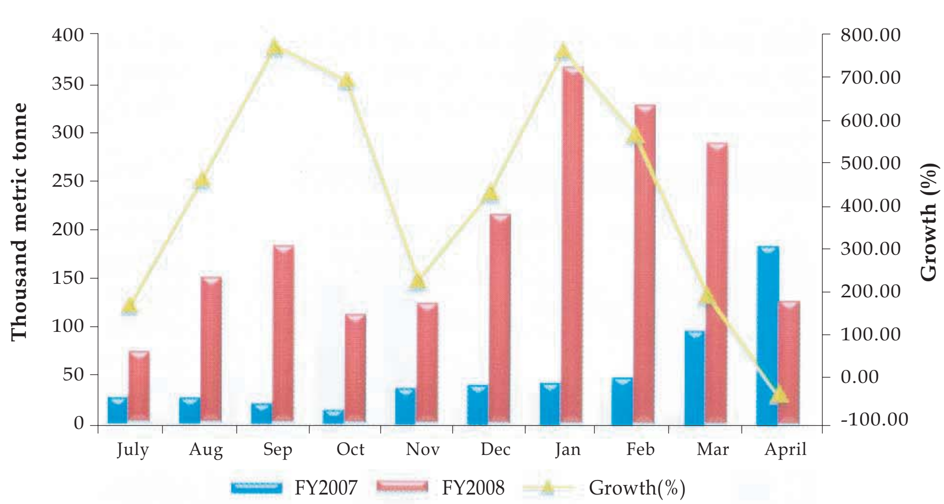


Source: *CPD Trade Database, 2008.*

Import Trends: Import payment for foodgrains registered a rise of 254.7 per cent with imports of rice rising by a staggering 8.8 times (from $84.1 million to $743.8 million in first nine months). During the first 10 months of FY2008 (July-April), import of rice was 1957.70 thousand metric tonnes, 263.35 per cent higher than the corresponding period of the previous fiscal. Relatively higher growth rate in value terms indicate the effect of rising prices of rice in the international market. Whereas, on average, import price of rice was US$ 238.67/tonne during the first 9 months of FY2007, it stood at US$ 353.55/tonne in the first 9 months of FY2008 (an increase of 48.13 per cent in unit price). (Figure 30)

Oil prices which was about $70/barrel at the beginning of the fiscal year, rose to $132 in May, 2008 resulting in a 52.4 per cent rise in import payments for crude petroleum; the bill for POL was $1266.3 million in the first nine months. Import payments are likely to rise in the coming months as is evidenced by figures of L/C openings which was 39.8 per cent higher ($20.14 billion) in the first 10 months compared to the matched period of FY2007.

Figure 30: Monthly Trends in Rice Imports, in Volume Terms (July-April)

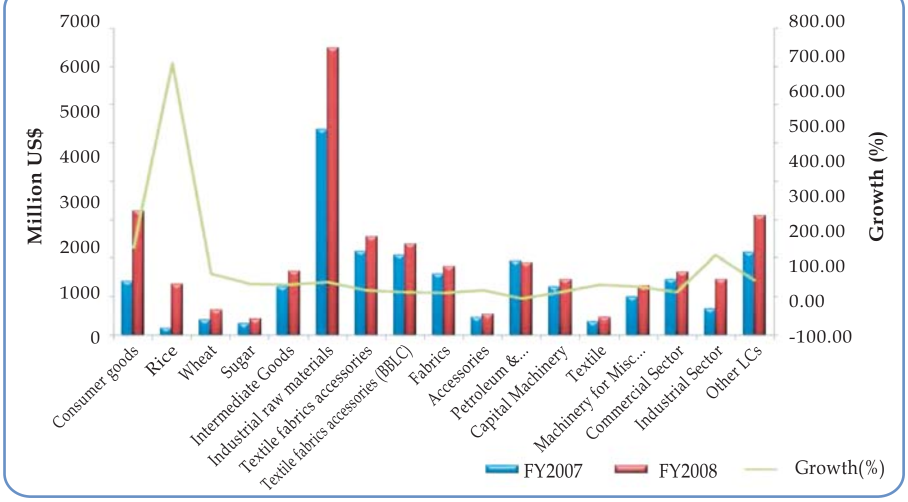


Source: *Analysis from Information collected from Food Directorate, Ministry of Food and Disaster Management*

It is to be noted that during the first nine months import of textile and articles have come down (-2.3 per cent), whilst import of raw cotton has gone up by 34.9 per cent. This was perhaps because of higher demand for cotton from composite knitwear units. However, import of capital machineries posted a negative growth of (-) 8.2 per cent which is quite disquieting in view of its critical importance for investment. This is somewhat paradoxical

Pressure on Balance of Payments

Figure 31: Opening of L/C (Jul - Mar)

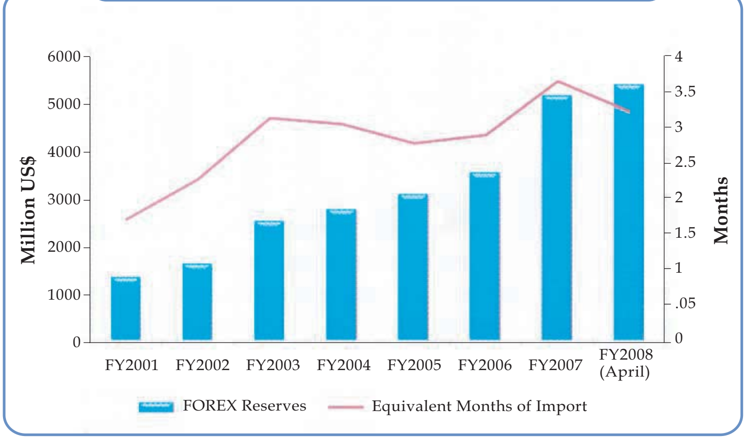


Source: CPD Trade Database, 2008.

because term loan disbursement figures for the corresponding period registered healthy growth. However, it is encouraging to note that L/C opening figures for capital machineries in the first ten months shows a rise of 14.9 per cent compared to the corresponding period of FY2007, which augur well for investment in coming months. This statement is also supported by L/C openings figures for industrial raw materials, and to some extent, intermediate inputs. Performance of the industrial sector in the third quarter also testifies to this observation. (Figure 31)

Remittance Flow: As was noted, high growth of remittance earnings, underwritten by record number of workers (833 thousand) going abroad in 2007 alone, has provided a valuable cushion in bridging the yawning trade gap. While UAE, Saudi Arabia and Kuwait remained major traditional destinations, other countries including particularly Malaysia, and South Korea and even Russia (recruiting some workers from Bangladesh for the first time) were emerging as important destinations. However, more than half of these workers belonged to the unskilled group. Average wage and salary of Bangladeshi migrant workers was about 20-30 per cent of those from the Philippines which earned about two and half times more with about half the number of Bangladeshi workers. In view of the need for energetic steps for skill upgradation of migrating workers, initiatives such as private-public partnerships in vocational training targeted at aspiring workers ought to be given high priority if Bangladesh is to take advantage of this expanding market. Safeguarding the interest of these workers both before they leave for jobs and when they are abroad needs to be ensured. Support to the returnee workers and creating investment opportunities for them should be seen as priority tasks by the policymakers. In view of the positive income and equity effect of remittances, there is also a growing need for providing support to facilitate aspiring migrant workers from low income households and backward regions in the form of credit and other support. Recently, PKSF has decided to team up with BMET and provide support through easy term loans for aspiring migrant workers from hard core poor families in monga-prone areas. This is a welcome initiative.

Figure 32: FOREX Reserves and Equivalent Months of Import



Source: CPD Trade Database, 2008.

Steady rise in remittance has also been contributing to the rising foreign exchange reserves which at present stands at US$ 5.67 billion or equivalent to 3.3 months of import (Figure 32). After the ACU payment of US$ 684 million made on 5 May 2008, forex reserves came down to the tune of US$ 5.33 billion (as of May 29, 2008), or equivalent to 3.1 months of import at the end of May 2008. At a time of high growth of imports foreign exchange reserves needs to be higher to provide a comfort zone to Bangladesh. Also, Bangladesh may have to rethink about the composition of her forex reserves. The composition of reserves at present more or less reflects the business carried out in major currencies. However, given the persistent fall in the value of dollar, there may be a need to have a forward looking strategy with regards to forex composition.

10

DETERIORATING TERMS OF TRADE

A major emerging concern which had an adverse impact on the balance of trade in FY2008 had been Bangladesh's deteriorating terms of trade. At a time when commodity prices have seen unprecedented rise in the global market, with consequent high burden for Bangladesh on account of import payments, Bangladesh's export prices have experienced a continuing fall. If price level of 2000 is taken as base (100.0), Bangladesh's terms of trade had declined to 85 by 2007. The decline in the average prices per unit of major exportables has continued in FY2008 (Figure 33). A decomposition of the export growth shows that on average prices have declined by 1.5 per cent in this period, and the 12.4 per cent growth was attained only through a growth of volume to the tune of 13.9 per cent. If Bangladesh was required to export 2.3 dozen apparels to import a barrel of oil in 2006, at present she requires about 4.5 dozens; similarly if Bangladesh was required to export 0.52 tonnes of jute to import one tonne of rice in 2006, she needs to export 1.71 tonnes of jute at present. Given the increasing competition in the markets for Bangladesh's traditional exports, and the rising commodity prices, terms of trade is unlikely to see radical positive change in near future (Table 20).

Figure 33: Commodity-wise Analysis of Export Growth in FY2008

Source: *CPD Trade Database, 2008.*

Price dynamics in the world market indicates that competition in the lower segment of the demand curve where Bangladeshi products compete is likely to intensify in the coming months. In view of this, the need to diversify exports and markets and the urgency of moving into higher value items through process and product upgradation, and productivity enhancement is becoming increasingly important tasks for Bangladesh. In view of this Bangladesh should make every effort to get a fair share of the financial support envisaged under the proposed aid for trade (AfT) of the WTO. Bangladesh and LDCs should argue for more support for trade related capacity building and infrastructure development, rather than only technical support under the AfT.

Table 20: Falling Purchasing Power of Bangladesh Exports

	dozens of RMG		Rise (in multiples)	tonnes of Jute Goods		Rise (in multiples)
	2006	2008		2006	2008	
1 barrel of oil (fuel)	2.34	4.47	1.9	0.11	0.21	1.9
1 tonne of rice	10.97	37.24	3.4	0.52	1.71	3.3
1 tonne of wheat	6.23	16.76	2.7	0.30	0.77	2.6
1 metric tonne soya bean oil	21.19	51.93	2.5	1.00	2.38	2.4
1 Metric tonne whole milk powder	77.87	156.39	2.0	3.69	7.18	1.9

Source: *Estimated from CPD Trade Database, 2008*

11

CONCLUDING REMARKS AND OUTLOOK FOR FY2009

As the analyses presented in this report bear out, the economy has experienced formidable challenges in the current fiscal year in each of the areas which constituted the building blocks of the macroeconomic framework in FY2008. Inflation has gone up further in FY2007-8 with consequent erosion of purchasing power of the average citizens, fall in real wages and salaries, and with more people falling below the poverty line. The CTG has tried to tackle the issue of food security through energetic policies to enhance food production, by widening the coverage of safety net programmes, and through open market sales at controlled prices. The post-*sidr* relief and rehabilitation efforts of the CTG have also been impressive. However, prices of essential items are still at high levels and inflation remains a major concern. These are having an adverse effect not only on consumers, but also on the producing sectors and the economy as whole. Whilst initiatives such as *Better Business Forum* and setting up of *Regulatory Reform Commission* do have the potential to contribute to establishing better business climate and good corporate governance, prevailing uncertainties at a time of energetic anti-corruption drive and state of emergency did have an adverse impact on investment climate which led to a slowdown of the GDP growth rate. However, one good sign is that investment appears to have been picking up in the third quarter of FY2008 as manifested by import structure, disbursement of industrial term loan and performance of export-oriented sectors.

It is perhaps to be accepted that many of the major challenges which inhibited the economic performance in FY2008 are likely to be continued in FY2008-9. The budget for FY2009 will need to have adequate measures to address those concerns so that the growth rates projected in the PRS-II, of 7 per cent, could be achieved. The challenge in the forthcoming fiscal year will also be that elections will have to be held by the end of 2008 and a major part of the planned activities will be implemented by the newly elected government.

Inflation control and investment promotion appear to be the two major challenges as the economy approaches the new fiscal year. Latest figures indicate that the spiralling prices have stabilised to some extent in April-May period with inflation rates coming down, albeit only insignificantly. A bumper boro crop of about 17.0 million tonnes has ensured that the crop losses of about 2.0 million tonnes would be largely offset and total foodgrains availability will be at levels similar to those of FY2007. This is likely to have positive impact on food prices and inflation, although significant reductions are unlikely. According to FAO projections, global production and supply of foodgrains in 2008 is likely to increase in view of better weather conditions; however, high foodgrains prices will perhaps persist. In view of this, all out effort to increase domestic foodgrains production will need to be given the highest priority in FY2009. Timely availability of fertiliser, electricity, diesel and hybrid and good quality seeds will have to receive urgent attention.

Although gas prices have been rationalised, adjusting the currently highly subsidised fuel and fertiliser prices will be a challenge. Experience of FY2008 indicates that some adjustment of the subsidy on fertiliser, in view of the growing subsidy burden in the context of rising global prices of fertiliser and higher domestic market prices of rice, may have to be considered. In this connection, timely and adequate supply of fertiliser should be ensured during the upcoming aus and aman crops. Some readjustment of petrol, diesel and octane may also be needed in FY2009. Mechanisms will have to be designed so that marginal farmers and low income people get the necessary transfers to offset the adverse incidence of any such price adjustments. Support given to farmers this year to adjust to diesel prices could serve as a reference point in this context. Since food availability in the global market itself could become a concern, the compelling need of ensuring food security ought to be given precedence whilst making any adjustment in the subsidy policy.

A major challenge in FY2008-9 will be to address the growing fiscal deficit which is likely to cross 5 per cent in FY2008. The government has gone for high borrowings from domestic sources (which was 1.8 times higher than that of the preceding fiscal, and primarily from the banking sector). At a time of global inflationary pressure and the need for higher levels of public expenditure, high fiscal deficit of 5-6 per cent of GDP will perhaps need to be tolerated. However, in view of future expenditure burden (on account of higher domestic debt-burden), the deficit will have to be carefully managed. Although ADP implementation rate has been sluggish in FY2008 (unlikely to exceed 65-70 per cent of the original ADP or 75-80 per cent of the revised ADP in FY2008) it will not be advisable to go for any drastic reduction in the size of the ADP in FY2009 given the high developmental demands in the economy. The ADP for FY2009 will possibly need to be of the same size as the original ADP for FY2008. A renewed emphasis will have to be put on ensuring ADP implementation, both in terms of quantity and quality. Creation of employment opportunities in the economy is also closely associated with ADP implementation. CTG's plan to go for a substantive *employment guarantee scheme* is a welcome initiative; however, there should be appropriate institutional mechanisms in place to implement such a large-scale scheme successfully.

Cost of doing business in Bangladesh has seen substantial rise in FY2008. With continuing inflation at near double digit level this is expected to remain so in FY2009. Positive signals in terms of business confidence, evident in the latter half of FY2008, will need to be supported with concrete policies. The agreement to fix the highest lending rates for term and working loans at 14 per cent is to be appreciated in this context. However, the demand by the private sector to borrow from international market will also need to be given careful examination. In view of its critical importance for investment, ensuring the required amount of power must be seen as one of the most urgent tasks.

The accommodating monetary policy pursued by the central bank in view of the inflationary pressure appears to have been the right policy under the circumstances. A contractionary monetary policy through higher interest rates could have further dampened investment stimulus at a time when investment was sluggish. However, the envisaged dearness allowance and some of the other budgetary measures are likely to increase money supply in the economy with consequent inflationary pressure. In view of this, FY2009 must see a renewed effort to stimulate production and also productivity. Expenditure on R&D will need to be radically enhanced; and import policy for FY2009 should facilitate import and adoption of new technologies that augment process, product and quality upgradation.

FY2009 is likely to see continuing pressure on balance of trade and balance of current account because of higher burden of import which is likely to approximate about US$ 20 billion in FY2008 and will perhaps be higher in the next fiscal. Efforts will need to be strengthened towards both intra-RMG and extra-RMG diversification. Arresting the continuing downward sliding of terms of trade ought to be given attention. Special package of support will need to be designed for emerging sectors with high promise including home textile, high value RMG and shipbuilding. It appears that high remittance earnings will continue to be a major factor in ensuring positive balance in the current account. Indications are there that the recently seen high demand for migrant workers is likely to continue in 2008 and 2009. Strategies will need to be put in place to take the fullest advantage of the global job market openings.

The ongoing WTO negotiations in Geneva are at a crucial juncture at this point. Ensuring LDC interests in the negotiations on agriculture, non-agricultural market access (NAMA), services and other areas of interest to Bangladesh, is important since these are likely to have critical implications for Bangladesh's short, medium and long term economic interests. This is important also in view of the high possibility of a deal being struck in the next few months with regard to the *Doha Round agenda*.

It was mentioned at the outset that FY2008-9 will be a threshold year for Bangladesh. It is hoped that the *roadmap* for transition to democratic governance will be implemented in 2008 and a conducive environment for investment and economic activities will prevail, so that the country is able to focus its attention on the manifold challenges that remain to be addressed, only some of which have been mentioned in the above sections.

Annex

Consultation with Experts on Interim Review 2008
held at CPD on 1 June 2008

List of Participants (in alphabetical order)

Mr Siddiqur Rahman Choudhury
Chairman, Agrani Bank and
Former Secretary, Finance Division

Mr Abdul Muyeed Chowdhury
Chairman, BRAC BD mail Network Limited
Former Chairman, NBR and
Former Executive Director, BRAC

Dr Mohammed Farashuddin
Former Governor, Bangladesh Bank

Mr Zobdul Hoque
Former Deputy Director General
Bangladesh Bureau of Statistics

Mr Motahar Hossain
Chief, GED
Planning Commission
Government of Bangladesh

Dr Saadat Husain
Chairman
Bangladesh Public Service Commission and
Former Cabinet Secretary

Dr Mustafa Mujeri
Chief Economist
Bangladesh Bank

Mr Kazi Mahmood Sattar
Managing Director
The City Bank Limited and
President, Bankers' Association of Bangladesh

Dr Quazi Shahabuddin
Director General
Bangladesh Institute of Development Studies

Mr M Syeduzzaman
Member, CPD Board of Trustees

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Centre for Policy Dialogue (CPD)
House 40C, Road 11, Dhanmondi, Dhaka 1209
Tel (880-2) 9145090, 9141703, 9141734, 8124770
Fax (880-2) 8130951, E-mail info@cpd.org.bd
Website www.cpd.org.bd

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