Bangladesh Economy in FY2012-13

Second Interim Review of Macroeconomic Performance

A report prepared under CPD's programme on
Independent Review of Bangladesh's Development (IRBD)

Centre for Policy Dialogue (CPD)

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About CPD

The **Centre for Policy Dialogue (CPD)** was established in 1993 as a civil society initiative to promote an ongoing dialogue between the principal partners in the decision making and implementing process. Over the past 20 years the Centre has emerged as a globally reputed independent think tank with local roots and global outreach. A key area of CPD's activism is to organise dialogues to address developmental policy issues that are critical to national, regional and global interests with a view to seek constructive solutions from major stakeholders. The other key area of CPD activities is to undertake research programmes on current and strategic issues. Major research themes are: macroeconomic performance analysis, poverty and inequality, agriculture, trade, regional cooperation and global integration, infrastructure and enterprise development, climate change and environment, human development, development governance, policies and institutions. CPD maintains an active network with institutions that have similar interests, and regularly participates in various regional and international fora. At present CPD is spearheading two global initiatives. *LDC IV Monitor* is an independent global partnership for monitoring the outcome of the Fourth United Nations Conference on the Least Developed Countries (UN LDC IV). *Southern Voice on Post-MDG International Development Goals* is a network of 48 think tanks from the developing South which seeks to contribute to the ongoing global discourses on post-MDGs. In recognition of its track record in research, dialogue and policy influencing, CPD was selected as one of the awardees of the Think Tank Initiative (TTI) through a globally competitive selection process. CPD's publications include more than 375 titles including Books, Monographs, Working Papers, Dialogue Reports and Policy Briefs. CPD publications and other relevant information are regularly posted on its website www.cpd.org.bd

CPD IRBD 2012-13 Team

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As part of the CPD IRBD tradition, CPD organised an Expert Group Consultation on 1 June 2013 at the CPD Dialogue Room. The working document of the *Analytical Review of Bangladesh's Macroeconomic Performance in FY2012-13 (Second Reading)* prepared by the CPD IRBD 2012-13 Team was shared at this in-house meeting with a distinguished group of policymakers, academics and professionals. The CPD Team is grateful to all of those present at the consultation for sharing their views, insights and comments on the draft report.

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

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Ashrafuzzaman, Senior System Analyst and *Mr Hamidul Hoque Mondal*, Senior Administrative Associate is particularly appreciated.

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

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Acronyms

ACC	Anti Corruption Commission
ADB	Asian Development Bank
ADP	Annual Development Programme
AIT	Advance Income Tax
API	Active Pharmaceutical Ingredient
ASK	Ain o Salish Kendra
BAPEX	Bangladesh Petroleum Exploration & Production Company Limited
BBA	Bangladesh Bridge Authority
BBS	Bangladesh Bureau of Statistics
BDT	Bangladeshi Taka
BERC	Bangladesh Energy Regulatory Commission
BGFCL	Bangladesh Gas Fields Company Limited
BGMEA	Bangladesh Garment Manufacturers and Exporters Association
BKMEA	Bangladesh Knitwear Manufacturers & Exporters Association
BMET	Bureau of Manpower, Employment and Training
BOOT	Build-Own-Operate-Transfer
BOP	Balance of Payments
BOT	Build-Own-Transfer
BPDB	Bangladesh Power Development Board
BRDB	Bangladesh Rural Development Board
BRPD	Banking Regulation and Policy Department
BSTI	Bangladesh Standards and Testing Institution
BTS	Base Transceiver Station
BoI	Board of Investment
CCDR	Center for Community Development & Research
CGE	Computable General Equilibrium
CNY	Chinese Yuan
CPD	Centre for Policy Dialogue
CRR	Cash Reserve Ratio
DAE	Department of Agricultural Extension
DAM	Department of Agricultural Marketing
DFI	Development Financial Institution
DF-QF	Duty-Free Quota-Free
ECF	Extended Credit Facility
ECNEC	Executive Committee of National Economic Council
EEF	Equity Entrepreneurship Fund
EPB	Export Promotion Bureau
ERD	Economic Relations Division

ETP	Effluent Treatment Plant
EU	European Union
FBCCI	Federation of Bangladesh Chambers of Commerce and Industry
FCB	Foreign Commercial Bank
FDI	Foreign Direct Investment
FFW	Food for Work
f.o.b	Free-on-Board
GBP	British Pound
GDP	Gross Domestic Product
GNI	Gross National Income
GSP	Generalized System of Preferences
GoB	Government of Bangladesh
G2G	Government-to-Government
HFO	Heavy Fuel Oil
HIES	Household Income and Expenditure Survey
HSD	High Speed Diesel
ICT	Information and Communication Technology
IDCOL	Infrastructure Development Company Limited
IDR	Indonesian Rupiah
ILO	International Labour Organization
IMED	Implementation Monitoring and Evaluation Division
IMF	International Monetary Fund
INR	Indian Rupee
IOC	International Oil Company
IPO	Initial Public Offering
IPP	Independent Power Producer
IQR	Inter-Quartile Range
IRBD	Independent Review of Bangladesh's Development
IRS	Interest Rate Spread
IT	Information Technology
JICA	Japan International Cooperation Agency
KHR	Cambodian Riel
kWh	Kilowatt-Hour
LNG	Liquefied Natural Gas
L/C	Letter of Credit
MENA	Middle East and North Africa
MLT	Medium and Long Term (Loan)
MMT	Million Metric Tonnes
MPS	Monetary Policy Statement
MTBF	Medium Term Budgetary Framework
MW	Mega Watt
MoF	Ministry of Finance
MoU	Memorandum of Understanding
mcf	Million Cubic Feet
mmcm	Million Cubic Metres
M2	Broad Money Supply
NBR	National Board of Revenue
NEER	Nominal Effective Exchange Rate
NPL	Non-Performing Loan
NSD	National Savings Bond
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OMS	Open Market Sales
PCB	Private Commercial Bank

PFDS	Public Food Distribution System
PMBP	Padma Multipurpose Bridge Project
POL	Petroleum and Other Liquids
PPP	Public-Private Partnership
PV	Photovolatic
QIP	Quantum Index of Production
QRPP	Quick Rental Power Plant
RADP	Revised Annual Development Programme
REER	Real Effective Exchange Rate
RMG	Readymade Garments
SCB	State-Owned Commercial Bank
SD	Supplementary Duty
SEC	Securities and Exchange Commission
SEZ	Special Economic Zone
SFURTI	Scheme of Fund for Regeneration of Traditional Industries
SFYP	Sixth Five Year Plan
SHS	Solar Home System
SLR	Statutory Liquidity Ratio
SME	Small and Medium Enterprise
SREDA	Sustainable and Renewable Energy Development Authority
SSNP	Social Safety Net Programme
SoE	State-Owned Enterprise
SE4A	Sustainable Energy for All
TNC	Transnational Corporation
TR	Test Relief
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States
USD	United States Dollar
USITC	United States International Trade Commission
VAT	Value Added Tax
VND	Vietnamese Dong
WTO	World Trade Organization

Chapter 1

Analytical Review of Bangladesh's Macroeconomic Performance in FY2012-13

(Second Reading)

This report was released to the media by the Centre for Policy Dialogue (CPD) on 3 June 2013.

1.1 INTRODUCTION

Bangladesh economy experienced fluctuating fortunes in FY2012-13 with the economy moving towards a lower level equilibrium in the course of the fiscal year. On the one hand, the macroeconomic stability was partially restored and rising inflationary trends somewhat tamed, while on the other, economic growth slowed down for a second consecutive year to remain below the target set out in the Sixth Five Year Plan (SFYP). The prevailing stagnation in private investment was further aggravated by uncertainties emanating from the ongoing violence and confrontational politics. Although both remittances and exports have posted robust performance in spite of adverse global scenario, it was the domestic factors which had impacted in an overriding manner on the macroeconomic performance in FY2012-13. A number of weaknesses with regard to macroeconomic management including governance of the banking sector and the debate surrounding financing options for the Padma Multipurpose Bridge Project (PMBP) were on the policy radar screen throughout the year. The economic governance of the country's power sector was also under the spotlight as the incumbent government approached towards the finishing line of its tenure. The external sector of the country also faces formidable challenges in the backdrop of global uncertainty and faltering image of country's readymade garments (RMG) sector. In the backdrop of these challenges, it appears that confrontational and uncertain political environment had direct and indirect implications for economic performance in FY2012-13, particularly true for the second half of the fiscal year. One is apprehensive that the ongoing political impasse and the resultant adverse implications will leave an unfavourable footprint for economic performance also over the upcoming fiscal year. Overall, Bangladesh economy is likely to remain in a difficult terrain in FY2013-14. As it is, the forthcoming budget will be the last one to be presented by the present government. In the run-up to the forthcoming national elections, the government may like to revisit its pledges in the manifesto and in the SFYP, but in view of the past record, the continuing fragility of the institutions and the looming political uncertainties, many of the objectives and the indicators will likely remain unattained. The macroeconomic performance in FY2013-14 will critically hinge on the state of both economic and political governance.

The present review of Bangladesh's macroeconomic performance is the second and final reading of the state of the economy prepared by the Centre for Policy Dialogue (CPD) in the current fiscal year. Taking cognisance of the current context of the Bangladesh economy, the chapter includes six sections. Section 1.2 presents the review of the macroeconomic management in FY2012-13 and puts forward a set of recommendations for the forthcoming fiscal year. A review of banking sector's performance and the role of the central bank with regard to the governance of monetary and banking sectors is presented in Section 1.3. Section 1.4 examines the state of power sector in Bangladesh in light of the subsequent changes in the power sector development plans. Section 1.5 undertakes an evaluation of the financing alternatives for the Padma Bridge project and examines the consequent macroeconomic impacts. Section 1.6 reviews performance of the external sector and examines some of the emerging challenges. The report concludes with Section 1.7 which outlines impact of adverse political environment and politics of conflict on the Bangladesh economy.

1.2 MACROECONOMIC MANAGEMENT IN FY2012-13 AND OUTLOOK FOR FY2013-14

1.2.1 Growth Performance: Off Target

For the second consecutive year, the gross domestic product (GDP) growth rate in FY2012-13 has failed to attain the target. This is certainly a setback for the present government's plan to move the economy towards a higher growth trajectory which is a necessary factor for attaining the middle income status by 2021. According to the provisional estimates from Bangladesh Bureau of Statistics (BBS), GDP growth for the current fiscal year is expected to be 6 per cent, i.e. 1.2 percentage points lower than the target (7.2 per cent) and 0.2 percentage points lower from final GDP growth estimate for FY2011-12.[1] One may recall that, early projections by analysts were in agreement that the growth rate in FY2012-13 would remain below 6 per cent.[2] The SFYP planned to elevate the average GDP growth rate during FY2010-11 to FY2014-15 period to 7.2 per cent; thus, GDP growth rate was expected to be 8 per cent by FY2014-15. Indeed, successive failure to meet the target for GDP growth has made it difficult to attain the objectives of the medium-term plan. For example, GDP growth rate would require to be 8 per cent in FY2012-13 to meet the SFYP target. To cover the present gap between SFYP target and record of GDP growth performance, it will be required to attain a 9.6 per cent GDP growth in FY2013-14. This is a highly unlikely scenario. Consequently, the SFYP targets have by now lost their relevance in view of the track record. Setting a high target of 7.2 per cent for FY2013-14 is also not going to align trends with the SFYP targets.

In FY2012-13, per capita gross national income (GNI) of Bangladesh has been estimated to be about USD 923, which is USD 83 more than that of the preceding year. On the other hand, per capita GDP also increased to USD 838 in FY2012-13 from USD 766 in FY2011-12, i.e. USD 72 increase. The faster acceleration of GNI per capita compared to GDP per capita was attributed to robust growth of remittances. However, the slowdown of GDP growth rate with its consequences in terms of domestic multiplier impacts, is a setback when the target of Bangladesh becoming a middle income country by 2021 is considered. Even though the forthcoming revision of national income accounting in the country is likely to raise the GDP (and hence the per capita income)[3], the growth acceleration needed to move towards middle income status will remain a question.

According to BBS statistics, a repeat strong performance by the industries sector (9 per cent), particularly its large and medium manufacturing component (10.3 per cent) is a key driver of the estimated economic growth rate for FY2012-13; resilient export sector performance in spite of adverse global scenario has contributed to this (Table 1.1). Construction sector comfortably surpassed its SFYP growth target for the current fiscal year (6.8 per cent) to attain a robust 8.1 per cent growth, backed up by improved utilisation of the Annual Development Programme (ADP). On the other hand, GDP from crop production is not expected to attain the target.[4] Stabilisation of prices and escalation of production cost may have acted as

Table 1.1
GDP Growth

(in Per cent)

Sector	FY12	Target FY13	Provisional FY13
Agriculture	3.1	4.4	2.2
Crops	2.0	5.0	0.1
Industries	8.9	9.9	9.0
Manufacturing	9.4	10.1	9.3
Construction	7.6	6.8	8.1
Services	6.0	7.1	5.7
GDP	**6.2**	**7.2**	**6.0**

Source: Calculated from the Bangladesh Bureau of Statistics (BBS) data and GED (2011).

[1]Recently released revised GDP growth in FY2011-12 shows marginal deceleration (by 0.1 percentage point) over its provisional estimate. Indeed, the growth rates of industries sector and services sector were revised downward (from 9.5 per cent to 8.9 per cent and from 6.1 per cent to 6 per cent respectively). In contrast growth rate of agriculture sector was revised upward (from 2.5 per cent to 3.1 per cent) which was solely driven by crops sector. It may be recalled that CPD in its earlier annual review of Bangladesh economy also expected an upward revision of agriculture sector and a downward revision of industries sector (CPD 2013a).

[2]CPD (2013a), in January, indicated that GDP growth in Bangladesh could be below 6.3 per cent. ADB (2013) projected a 5.7 per cent growth for Bangladesh in FY2012-13. The projection of International Monetary Fund (IMF) was even lower at 5.5 per cent (IMF 2013). Bangladesh Bank (2012) also predicted that the GDP growth in FY2012-13 could be between 6.1 and 6.4 per cent.

[3]It is expected that a revision of national income accounting will increase the GDP of the country by about 15 per cent.

[4]The GDP estimation from crops sector has considered the production figures of Aus and Aman production only, which declined by (-) 0.5 per cent in FY2012-13.

a disincentive in the backdrop of previous periods when prices were posting considerable rise. Services sector also fell below its traditional 6 per cent growth rate for the first time since FY2004-05.

To ascertain the sources of decline in GDP growth rate, a comparative decomposition exercise of the GDP growth rates of FY2011-12 and FY2012-13 was undertaken. Such a scrutiny reveals that the fall in crops sector's (and hence agriculture sector's) contribution to the GDP growth corresponds to the overall fall in total GDP rate (0.2 percentage points) (Table 1.2). One may interpret that the decline in GDP growth has been mainly predicated by the depressed performance in crops sector growth. Services sector's contribution to GDP growth is also expected to decline to 2.7 per cent from 2.9 per cent of preceding year. In contrast, industries sector will improve its GDP growth contribution marginally.

Table 1.2
Contribution to Growth

(in Per cent)

Sector	FY12	FY13	Difference (FY12 and FY13)
Agriculture	0.6	0.4	-0.2
Crops	0.2	0.0	-0.2
Industries	2.6	2.7	0.1
Services	2.9	2.7	-0.2
Import Duty	0.2	0.2	0.0
GDP	**6.2**	**6.0**	**-0.2**

Source: Estimated from the Bangladesh Bureau of Statistics (BBS) data.

The provisional estimate of GDP for FY2012-13 is expected to be revised at a later date based on the data for full fiscal year. Indeed, this estimate did not fully capture the adverse impact of the prolonged disruption of economic activities arising from volatile political environment. Hence, a number of adjustments would need to be made in finalising the GDP estimate for FY2012-13. The provisional estimates of growth rates for industries and services sectors and import duty may require downward adjustments, whilst crops sector's (and hence agriculture sector's) growth rate may call for some upward revision. Overall, the final estimate of GDP may be revised downward to below the 6 per cent threshold.

The deceleration of GDP growth in FY2012-13 is expected to be accompanied by drastic fall in private investment (see Section 1.2.2 for details). In a welcome development, public investment will compensate for this decline and will likely pull the total investment above the level of preceding fiscal year, according to the provisional estimate by BBS (see Section 1.2.3 for details). As a result, total investment as a share of GDP will improve to 26.8 per cent in FY2012-13 from 26.5 per cent in FY2011-12. However, public investment figure is expected to be revised downward following the trend of previous years under the present government. On the other hand, in FY2012-13, domestic savings as share of GDP remained stagnated at 19.3 per cent while national savings as share of GDP somewhat improved to 29.5 per cent (29.2 per cent in FY2011-12) perhaps in the backdrop of robust remittance flows.

1.2.2 Private Investment: Faltering

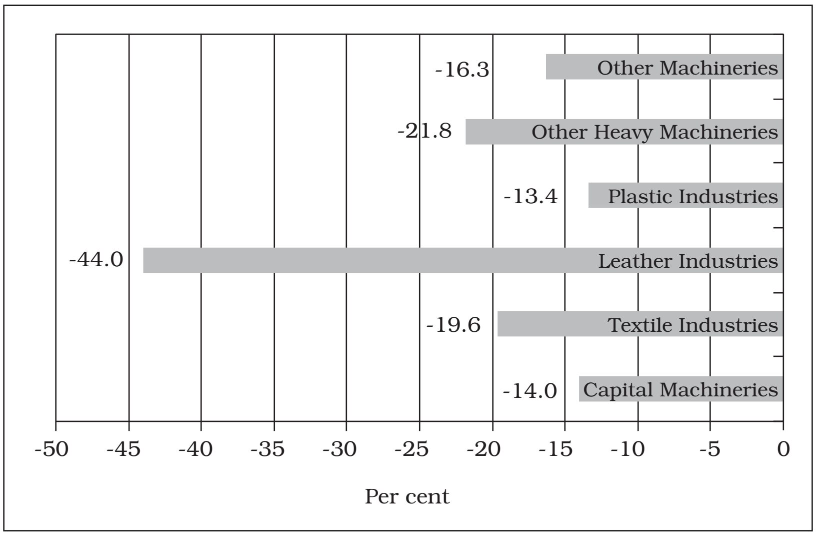
FY2012-13 has been one of worst years for private investment. The provisional estimate by BBS for FY2012-13 anticipates a distinctive fall in the share of the private investment in GDP. It shows that private investment is expected to decline as a share of GDP to 19 per cent in FY2012-13 from 20 per cent in FY2011-12. This is an outlier because such a fall in private sector's share has never been experienced in the history of Bangladesh (since FY1980-81).[5] This would mean that level of private investment would

[5]The previous 'worst' year was FY1982-83 when private investment fell by 0.8 percentage points.

now move back to the level of FY2006-07. This would also mean that, private investment in FY2012-13 will be 3.7 percentage points lower than the SFYP target. This will surely have a dampening consequence from the perspective of the expected acceleration of growth rates.

Indeed, almost all private investment-related indicators evince a subdued scenario. Import payments for capital machineries declined by (-) 10.6 per cent during July-March period of FY2012-13 compared to the corresponding period of FY2011-12. Detailed information is available for July-February period, which shows that for most manufacturing industries, capital machinery import fell by a significant margin (Figure 1.1).

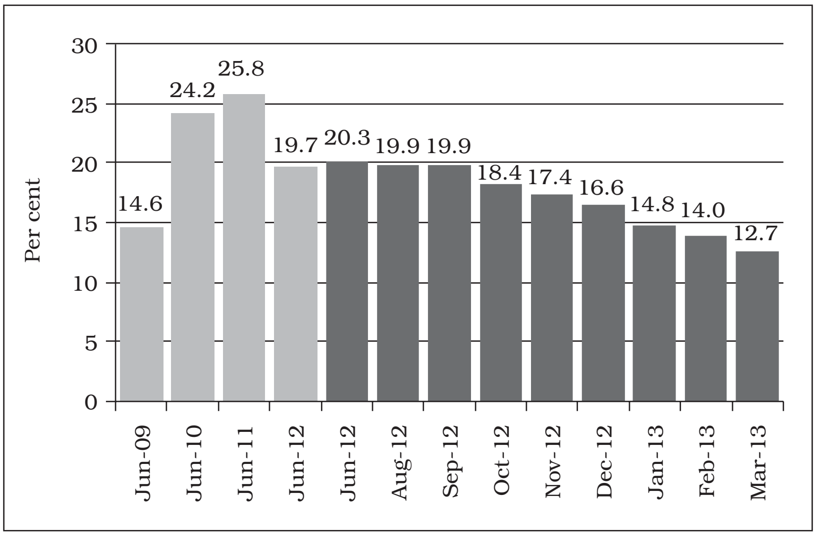
Growth of credit to private sector continued to fall since July 2012. As of March 2013, growth of private sector credit declined to 12.7 per cent[6] (Figure 1.2). One may recall that the target for private sector credit growth at the end of FY2012-13 was 18.5 per cent.



Source: Estimated from the Bangladesh Bank data.

Figure 1.1

Growth of Import Payments for Capital Machineries: FY2012-13 (July-February)



Source: Estimated from the Bangladesh Bank data.

Figure 1.2

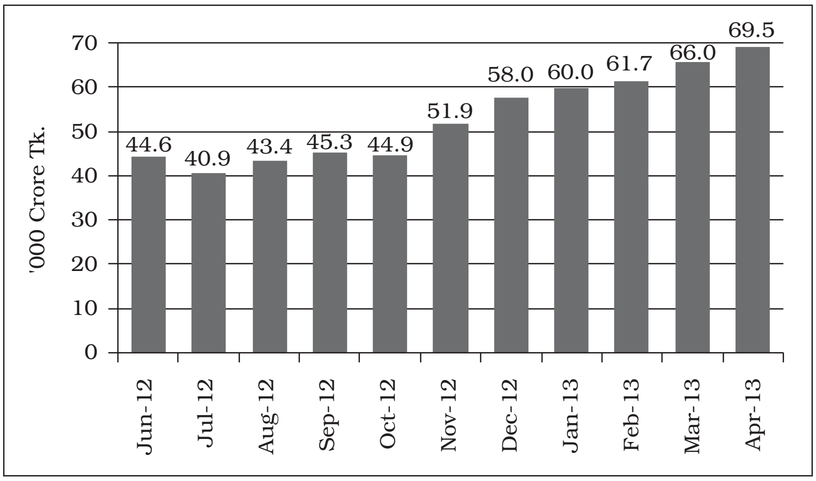
Private Sector Credit Growth

[6]Private credit growth in March 2012 was 19.5 per cent.

The lack of demand for private sector credit also resulted in significant excess liquidity in the banking system. At the end of April 2013, excess liquidity in the banking system reached Tk. 69,500 crore (Figure 1.3). Indeed, credit-deposit ratio in the banking system is now (May 2013) hovering around 72 per cent. One may recall that credit-deposit ratio was around 85 per cent in the middle of FY2011-12 and the central bank had to advise commercial banks to control credit disbursement.

Figure 1.3

Excess Liquidity Position



Source: Estimated from the Bangladesh Bank data.

Share of classified loan to total outstanding had also increased to 11.9 per cent as of March 2013 which was only 7.2 per cent at the end of FY2011-12. Indeed, the new loan provisioning guidelines issued in October 2012 had an impact; this has been changed recently (see Section 1.3 for details). Curiously, at a time when private investment situation is depressed, high growth of industrial term loan disbursement has been observed during the first three quarters (27.9 per cent). A further scrutiny is perhaps required to understand this dynamics and use of industrial term loans for particular purposes.

The worrisome investment climate has been a cause of concern in FY2012-13. One can list a number of plausible reasons. *First*, a number of measures were put in place by the government to stabilise the economy which eventually held back private investment. *Second*, slow recovery of global climate did not incentivise domestic investment. *Third*, the ongoing political turmoil also took its toll on investment decisions. *Fourth*, a number of scams afflicting the banking sector led to restrained behaviour on part of the banks. And *fifth*, developments in the RMG sector and frequent labour unrest may have also discouraged investors in making new investments in the industrial sector.

1.2.3 Public Investment: Enhanced

In contrast to the depressed private investment, public investment has increased steadily since FY2008-09 and surpassed the SFYP target in FY2012-13 (6.9 per cent of GDP) by about 1 percentage point. According to provisional estimates of BBS, public investment is expected to be about 7.9 per cent of GDP in FY2012-13. This implies that public investment (as a share of GDP) will improve by 1.4 percentage points in a single fiscal year – such an improvement had never happened before! Indeed, public investment as a share of GDP will also be the highest in the history.[7] Public investment in FY2012-13 increased by 36.6 per cent compared to the previous fiscal year. One may reckon that the provisional estimate of public investment has considered a fuller utilisation of original ADP (to the tune of Tk. 55,000 crore). ADP was later downsized (Revised ADP (RADP)), and hence, the final expenditure figure should be

[7]Comparable national income accounting is available from FY1980-81. In FY1999-00 public investment stood at 7.4 per cent of GDP, the previous highest.

lower. Nevertheless, it appears that public investment beyond ADP has also experienced a considerable rise.[8] It appears that, the estimate for public investment in FY2012-13 is somewhat on the high side. However, significant rise in public investment (as a share of GDP) may be expected in FY2012-13, when the final estimate will be prepared.

A number of positive features with regard to ADP implementation may be observed from the available data. *First*, overall ADP implementation has improved in FY2012-13. During the first three quarters of the fiscal, 49.5 per cent of the ADP allocation was implemented which was 44.8 per cent in FY2011-12. *Second*, the top five ministries[9] (with highest allocations) did better than the average, as they spent about 57.5 per cent of total allocation during the above mentioned period. Particularly, among the top five ministries, performance of Local Government Division, Power Division and M/O Primary and Mass Education were notable as they spent more than 60 per cent of their allocation during the aforesaid period. Indeed, 12 among 53 implementing ministries/divisions implemented more than 60 per cent of their respective allocations. *Third*, the aforesaid improvement was driven by better project aid utilisation. 42.4 per cent of total project aid allocation was spent during July-March period of FY2012-13 (only 32.8 per cent in FY2011-12). This also had a positive impact on financing of budget deficit and on the balance of payments (BOP). However, the top 20 aided projects with highest allocations in FY2012-13 also spent 43.1 per cent of their aid component (45.2 per cent of their allocated total). Moving on, the big 20 projects which were approved at different times during the tenure of the current government had also utilised 65.5 per cent of project aid allocation during the first three quarters in FY2012-13. However, one needs to consider the fact that a single project[10] from Power sector contributed 11.8 per cent of total aid utilisation of the entire ADP during the reporting period. If we keep aside the aforesaid project, the project aid utilisation of the other top 19 aided projects with highest allocations in FY2012-13 drops to 34.5 per cent. This implies that the improvement in project aid utilisation may not be a broad-based phenomenon. Furthermore, it is also observed that the progress during the early months somewhat lost its momentum during the last two months (February and March) (Figure 1.4). Hence, ADP implementation may once again rely on the performance during last quarter.

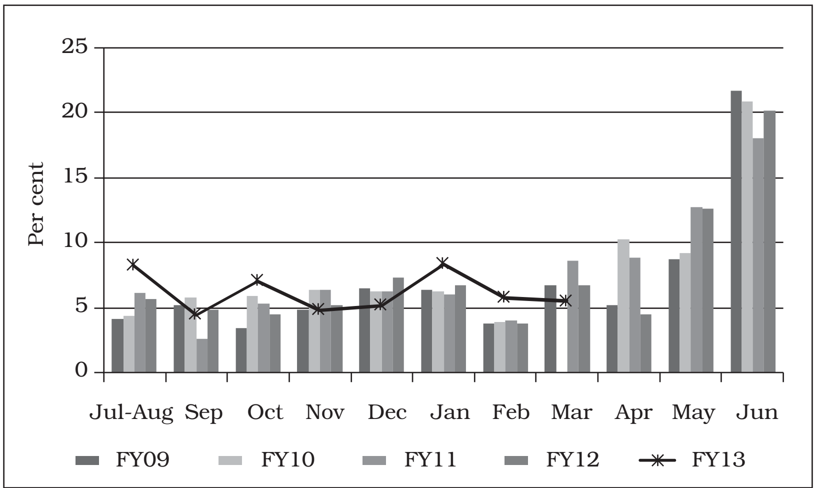


Figure 1.4

Monthly ADP Expenditure as Per cent of Allocation

Source: Calculation based on the Implementation Monitoring and Evaluation Division (IMED) data.

[8]If total ADP expenditure is considered as public investment, the non-ADP portion in public investment increased by 22.4 per cent.

[9]The list includes Local Government Division, Power Division, M/O Primary and Mass Education, M/O Health and Family Welfare, and M/O Railway, and bears 53.5 per cent of total ADP allocation.

[10]'Construction of Haripur 360 MW Combined Cycle Power Plant and Associated Sub-station' project alone made use of Tk. 1,074 crore project aid out of the total aid expenditure of Tk. 9,110 crore within ADP during July-March, FY2012-13. Indeed, during the first three quarters, the project spent 65.2 per cent above its stipulated allocation for FY2012-13.

One may recall that the ADP for FY2012-13 envisages allocation of 46.4 per cent of the total allocation for either concluding projects or carryover projects. Among the major sectors, Power and Transport sectors had more than 50 per cent of their allocations for such projects. As those projects approach their finishing lines, it is plausible that their implementation could have gained momentum. However, CPD analysis shows that even fuller utilisation of FY2012-13 allocation for these projects will not be enough to complete them. The gaps (between cumulative allocation up to FY2012-13 and total project cost) were 28.3 per cent and 49.2 per cent of aggregated project costs for Power and Transport sectors respectively. However, on a positive note, in RADP, allocation for Power and Transport sectors were increased by 8.5 per cent and 2.3 per cent from their original allocations. It needs to be mentioned that subsequently total ADP allocation was slashed by 4.8 per cent. All (14) other sectors, except Rural Development and Institutions, experienced substantive cuts in their budget. The decline in allocation for Education and Religious Affairs Sector was the highest (Tk. 774.3 crore).

1.2.4 NBR Revenue Collection: Fell Short of Target

Revenue mobilisation by the National Board of Revenue (NBR) has been one of the areas of success for the present government. For the first time in last four fiscal years, it is now anticipated that NBR revenue will likely fall short of the target. Lack of import, lower commodity prices in the international market, deceleration of financial institutions' profit, unrealised revenues from state-owned enterprises (SoEs) are among the major reasons causing low intake of NBR revenue collection. Indeed, in FY2010-11 and FY2011-12, NBR managed to surpass the revised targets which were later set at higher levels compared their respective targets in the original budget (Table 1.3). Furthermore, revenue collections from non-NBR tax and non-tax sources have not been very impressive.[11]

Table 1.3

Trends of NBR Revenue: Growth Targets and Achievements

(in Per cent)

Year	Budget Target over Revised Budget	Budget Target over Actual Collection	Revised Target over Actual Collection	Actual Growth Achieved
FY2009	18.6	14.9	11.7	10.7
FY2010	15.1	16.1	16.1	18.1
FY2011	19.0	17.0	21.9	28.0
FY2012	21.5	15.7	16.3	19.3
FY2013	21.5	18.5	N/A	16.1*

Source: Compiled from the Budget documents and National Board of Revenue (NBR) monthly reports.
Note: *Up to April 2013.

During July-April period of FY2012-13, the NBR source was able to collect 74 per cent of its annual revenue target. As a result, growth of NBR revenue was 16.1 per cent against a target of 18.5 per cent for FY2012-13[12] (Table 1.4). Contribution from income tax was particularly impressive during this period and likely to surpass its target (24.9 per cent). Recent drive towards expanding larger tax-payers' base may have contributed in this regard. In contrast, tax collection from import duty has been rather dismal. Indeed the shortfall in NBR's revenue mobilisation will be mainly on account of weak import duty collection.

[11]Non-NBR sources attained 14.4 per cent revenue growth in July-December period of FY2012-13 against the corresponding period of FY2011-12 while their annual target was 25.7 per cent. Non-tax revenue collection posted 17.8 per cent growth during the first half of FY2012-13 as against annual growth target of 23.2 per cent.

[12]Backed by surpassed revenue generation (Tk. 2,384 crore) in FY2011-12, the growth target for NBR reduced from 21.5 per cent.

Table 1.4

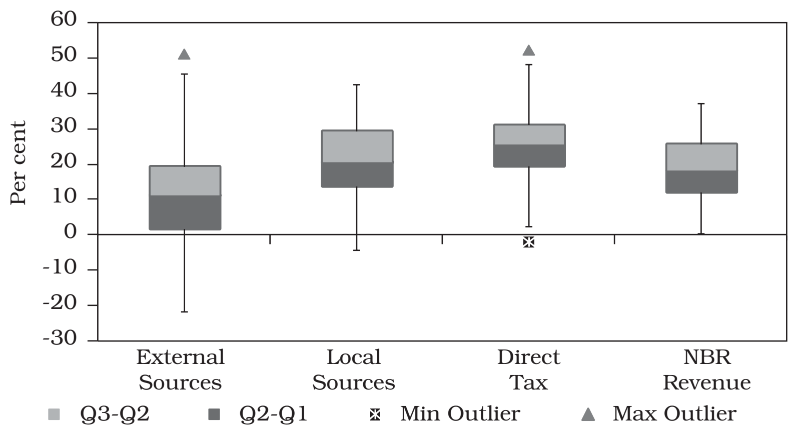
Targets and Achievements of NBR Components in FY2012-13

(in Per cent)

Source	Actual Growth FY12	Annual Target FY13 (Crore Tk.)	Annual Growth Target FY13	Achieved Growth FY13 (Jul-Apr)	Required Growth FY13 (May-Jun)
Import Duty	14.6	15,419	16.2	0.9	78.6
VAT (Import)	11.4	14,714	6.9	9.9	1.3
SD (Import)	9.3	5,467	25.2	0.6	140.8
External Total	**12.5**	**35,600**	**13.3**	**4.7**	**51.0**
VAT (Local)	23.3	24,628	12.1	18.6	-6.9
SD (Local)	22.9	14,769	23.9	3.7	100.0
Local Total	**23.4**	**40,400**	**16.9**	**13.4**	**30.9**
Income Tax	22.8	35,300	24.9	34.6	4.4
Total Direct Tax	**22.7**	**36,259**	**26.2**	**34.4**	**8.6**
Grand Total	**19.3**	**112,259**	**18.5**	**16.1**	**27.4**
VAT (Combined)	*18.4*	*39,342*	*10.0*	*15.2*	*-7.4*
SD (Combined)	*18.9*	*20,236*	*24.2*	*2.8*	*108.6*

Source: Calculated from the National Board of Revenue (NBR) data.
Note: VAT: Value added tax; SD: Supplementary duty.

A CPD exercise analysing 70-month long NBR revenue data (July FY2007-08 to April FY2012-13) reveals that contribution of direct taxes was most consistent (with high median growth and low IQR) (Figure 1.5). Revenue mobilisation from domestic sources was higher than the average growth targets albeit some volatility, while tax collection from the external sources was found to be more volatile. This implies that target setting for NBR's tax collection from external sources will require a more cautious approach.[13]



Revenue Source	Exponential Annual Average FY09-FY12	Median Growth FY09 (Jul) - FY13 (Apr)	IQR FY09 (Jul) - FY13 (Apr)
External Sources	12.2	11.0	17.5
Local Sources	22.4	20.3	15.3
Direct Tax	23.9	25.5	11.5
NBR Revenue	**18.9**	**18.2**	**13.4**

Figure 1.5

Median Growth (MoM) of NBR Revenue Sources on Box-and-Whiskers Plot (Reporting Period: July FY2008-09 to April FY2012-13)

Source: Calculated from the National Board of Revenue (NBR) data.
Note: IQR stands for inter-quartile range between Q1 and Q3.

[13]Median growth (MoM) of revenue intake from external duties and taxes was found to be only 11 per cent. Whereas revenue growth targets for external sources from FY2008-09 to FY2012-13 were 26.5 per cent, 3.1 per cent, 11.2 per cent, 19.1 per cent and 15.7 per cent respectively.

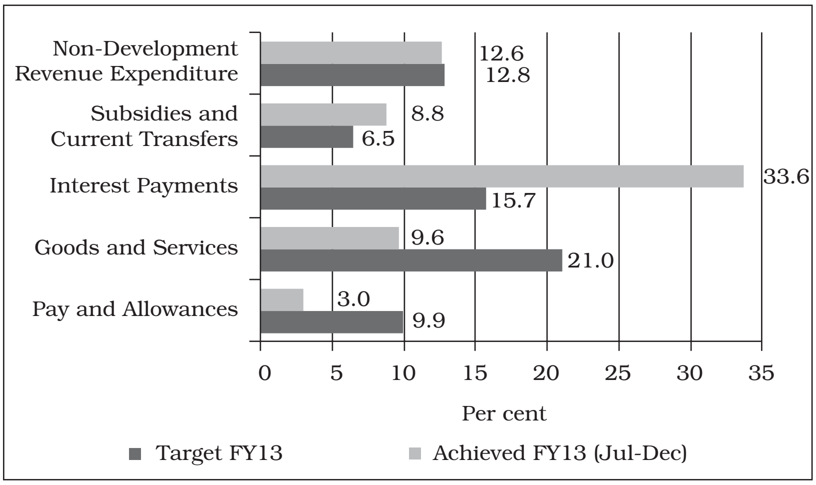
On the basis of above discussion, one may apprehend that any overambitious target for FY2013-14 could put the overall budget framework under some risk. It also needs to be noted, with some caution, that an evident shortfall (between Tk. 3,000 and Tk. 4,000 crore) in FY2012-13 will mean that the actual growth target will be higher.

1.2.5 Financing of Budget Deficit: From Ideal Plan to Harsh Reality

During the first half of FY2012-13 non-development revenue expenditure was in line with the budget allocation. Overall, net revenue expenditure recorded 12.6 per cent growth during the first six months compared to the matching period of the previous year, while target growth for FY2012-13 was 12.8 per cent (Figure 1.6). Among the components, the most visible deviation from the non-development revenue expenditure target was recorded for interest payments. Interest payments increased by 33.6 per cent during the first half of FY2012-13 against its target of 15.7 per cent, a consequence of the high borrowing by the government in FY2011-12. As the fiscal year moves toward the end, the requirement of government borrowing is likely to rise, and hence it will be difficult for the government to bring down the expenditure pressure to the programmed level.

Figure 1.6

Growth in Revenue Expenditure Components



Source: Calculated from the Ministry of Finance (MoF) data.

Traditionally, during the first half of the fiscal year, budget deficit remains within the safe zone. Fiscal deficit in the first half of FY2012-13 was limited to only Tk. 3,991 crore (only 7.7 per cent of planned budget) (Table 1.5). As a result, low off-take of foreign grants (5.4 per cent of planned budget) and net foreign borrowing (11 per cent of planned budget) did not put any serious pressure on the budget deficit financing till now (up to the first half of FY2012-13). The large revenue surplus was in fact used to repay the government borrowing from non-bank sources (sources outside borrowing from sale of National

Table 1.5

Financing of Budget Deficit

Description	Budget FY13 (Crore Tk.)	Actual FY13 (up to Dec) (Crore Tk.)	Share (%)
Revenue Collection	**139,670**	**59,912**	**42.9**
Total Expenditure	**191,731**	**63,903**	**33.3**
ADP Expenditure	55,000	12,815	23.3
Non-ADP Expenditure	136,731	51,091	37.4
Overall Deficit (excl. Foreign Grants)	***-52,061***	***-3,991***	***7.7***

(Table 1.5 contd.)

(Table 1.5 contd.)

Description	Budget FY13 (Crore Tk.)	Actual FY13 (up to Dec) (Crore Tk.)	Share (%)
Financing			
Foreign Grants	**6,044**	**325**	**5.4**
Foreign Borrowing (Net)	**12,541**	**1,376**	**11.0**
Foreign Loan	20,398	4,982	24.4
Amortisation	-7,858	-3,606	45.9
Domestic Borrowing	**33,484**	**2,289**	**6.8**
Bank Borrowing (Net)	23,000	8,377	36.4
Non-Bank Borrowing (Net)	10,484	-6,088	-58.1
National Savings Schemes (Net)	7,400	177	2.4
Others	3,084	-6,265	-203.1

Source: Calculated from the Ministry of Finance (MoF) data.

Savings Bond (NSD) certificates). Borrowing from the banking system was only Tk. 8,377 crore (36.4 per cent of planned budget). However, less than expected net sale of NSD certificates may give rise to some concern as regards management of the deficit financing in the latter half of the fiscal year.

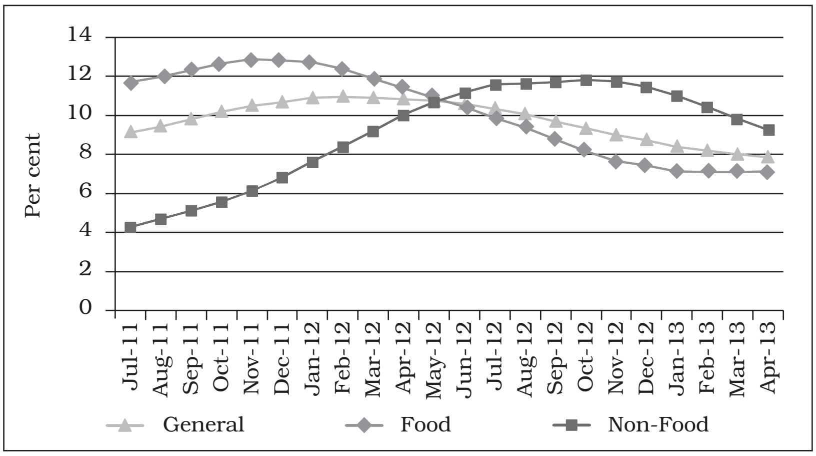
One may recall that CPD had earlier termed the framework proposed in the budget FY2012-13 for financing the deficit as an 'ideal' one (CPD 2013b). While approaching the finishing line of FY2012-13, the plan is expected to face a harsh reality. According to anecdotal information, the target of bank borrowing by the government is expected to increase by Tk. 5,500 crore from the budget target. This may imply that of the total budget deficit more than 60 per cent will be financed by bank borrowing which was planned to be only 44 per cent. On the other hand, borrowing target from the national savings schemes is likely to be slashed by about Tk. 5,800 crore. Indeed, revised budget target for borrowing from the national savings schemes (Tk. 1,600 crore) will be a challenging one to attain as only Tk. 693 crore was collected during the first three quarters. Information as regards revised target for NBR's revenue collection is not available in public domain. If the possible shortfall in NBR revenue collection from the budget target was not considered, and if the actual public expenditure remains same as the revised budget target, bank borrowing may remain the only source to underwrite the difference. On the expenditure side, the subsidy requirement is expected to surpass the target set by the budget (according to some media report). One will also need to consider that subsidy requirement arising from liquid fuel had perhaps somewhat come down due to frequent *hartals* (strike) and favourable weather condition. Nevertheless, it appears that once again the financing of budget deficit will heavily rely on bank borrowing following the trend of the last two fiscal years. Of course the spillover adverse impact on the economy could be somewhat moderate in view of the higher excess liquidity with the commercial banks and lower demand from the private sector.

1.2.6 Inflation: Moderated but High

The steady fall in food inflation helped to ease the overall inflationary pressure during the first half of FY2012-13. Since November 2012, non-food inflation also started to plunge (Figure 1.7). The latest available figure from BBS suggests, in April annual average inflation was 7.8 per cent. One may recall that, CPD in January expected inflation to come down to 7.7 per cent at the end of the year (CPD 2013a). Food inflation came down to 7.2 per cent (from 10.5 per cent in June 2012), while non-food inflation was 9.3 per cent (from 11.1 per cent in June 2012).[14] The disaggregated figures of inflation of various product

[14]As is known, BBS introduced a new measure of inflation with a new base year (2005-06) to replace the present measure of inflation (with the base year of 1995-96). According to the new base year, in April, annual average inflation was 6.4 per cent (8.7 per cent in June 2012). Food inflation came down to 4.3 per cent (from 7.7 per cent in June 2012), while non-food inflation was 5.7 per cent (from 10.2 per cent in June 2012). Curiously, according to this measure, inflation (both food and non-food) showed upward trend.

Figure 1.7
Annual Average Inflation



Source: Estimated from the Bangladesh Bureau of Statistics (BBS) data.

groups suggest that only average inflation rate for gross rent, fuel and lighting in April 2013 remained higher than that of June 2012.

A decomposition of inflation figures of June 2012 and April 2013 indicates that of the 10.6 per cent inflation in June 2012, 6.8 per cent came from food inflation, while the rest 3.8 per cent came from non-food inflation (Table 1.6). Of the 7.8 per cent inflation in April 2012, 5.3 per cent was contributed to by food inflation and 2.5 per cent was on account of non-food inflation. This would imply that both food and non-food components of inflation had an equal share in the reduction of overall inflation.

Table 1.6
Sources of Annual Average Inflation

(in Per cent)

Commodity Group	Moving Average Inflation		Sources of Inflation	
	FY12 (Jun)	FY13 (Apr)	FY12 (Jun)	FY13 (Apr)
General	**10.6**	**7.8**	**10.6**	**7.8**
Food	**10.5**	**7.2**	**6.8**	**5.3**
Non-food	**11.1**	**9.3**	**3.8**	**2.5**
Clothing & footwear	17.6	12.6	1.0	0.6
Gross rent, fuel & lighting	10.3	10.8	1.4	0.8
Furniture, furnishing, household	11.8	9.1	0.3	0.2
Medical care & health expenses	5.9	6.4	0.1	0.1
Transport & communication	11.3	6.6	0.5	0.3
Recreation, entertainment	2.3	3.1	0.1	0.1
Misc. goods & services	13.5	8.5	0.4	0.3

Source: Estimated from the Bangladesh Bureau of Statistics (BBS) data.

One can also find a number of explanations for the declining pace of inflation, including:

(i) stable price of rice
(ii) declining international commodity prices
(iii) stronger domestic currency and
(iv) slowdown in domestic demand

Falling rice price is the major driver of decline in inflation rate in FY2012-13 (CPD 2013a). Data from the Department of Agricultural Marketing (DAM) suggests that during the last 12 months, moving average price of retail coarse rice price has declined by (-) 10.1 per cent in May 2013. However, this had indeed affected the incentive for farmers to go for a higher crop production as demonstrated by stagnating growth of crop production. International commodity prices also declined in the period under purview. According to the International Monetary Fund (IMF) data, annual average international commodity price index in April 2013 plunged by (-) 5.1 per cent. The prices of major commodities for which Bangladesh relies primarily on imported sources also shows a similar picture.[15] One also needs to consider that throughout FY2012-13 Bangladeshi Taka (BDT) gained its value against the currencies of major trading partners of Bangladesh, thanks to favourable BOP situation. In April 2013, BDT was appreciated by 4.7 per cent against United States Dollar (USD), 1.4 per cent against Indian Rupee (INR) and 3.6 per cent against Chinese Yuan (CNY). Combining these two factors (declining international commodity prices and stronger domestic currency) one may expect an easing environment for the domestic price level. If we compare the domestic retail prices it is found that annual average price of sugar in the domestic market declined by 17.6 per cent during the period under purview, however, the price of soybean oil increased by 3.3 per cent. This implies that mechanisms informing transmission of declining global prices into domestic prices remained weak. Furthermore, weak domestic demand as manifested by slower economic growth also had an impact on commodity prices. Weak domestic demand is also corroborated by the decline in private sector credit growth and lower import demand for consumer products. One may also argue that the contractionary monetary policy pursued by the central bank has played a role in bringing down inflationary pressure. Volatile political environment has often disrupted commodity supply chains which had an adverse impact on the prices of daily essentials. Robust remittances inflow on the other hand had a positive impact on domestic consumption demand. Overall, the easing of inflationary pressure was accompanied by low level of economic activities. One should also be mindful to the fact that price level has continued to remain high in spite of some decline in the inflation rate because of past high trends.

1.2.7 Balance of Payments: Substantial Surplus

In the backdrop of the volatility observed in FY2011-12, the first nine months of FY2012-13 experienced a significant BOP surplus. The overall balance reached USD 3,948 million in July-March period of FY2012-13 from a negative balance of (-) 419 million USD for comparable period in FY2011-12. Concurrently, current account balance stood at USD 2,825 million for the reported period of FY2012-13 which was (-) 120 million USD for the corresponding months of FY2011-12. A decomposition analysis suggests that the large surplus recorded by the BOP was originated by the lower trade deficit (43.3 per cent) followed by the impressive inward remittances (36 per cent) (Table 1.7). Improved trade balance was a result of impressive

Table 1.7

Sources of Balance of Payments

Component	**Changes between FY12 and FY13 (Jul-Mar) (Million USD)**	**Incremental Share (%)**
Trade Balance	1,890	43.3
Workers' Remittances	1,574	36.0
Other Current Account Balance	-519	-11.9
Capital Account	-3	-0.1
FDI	103	2.4
MLT Loans	432	9.9
Other Financial Account	265	6.1
Errors and Omissions	625	14.3
Overall Balance	**4,367**	**100.0**

Source: Estimated from the Bangladesh Bank data.
Note: FDI: Foreign direct investment; MLT: Medium and Long Term (Loan).

[15] For example, according to World Bank data, annual average prices of crude oil, soybean oil and sugar declined by (-) 4.7 per cent, (-) 7.1 per cent and (-) 20 per cent in April 2013. In contrast wheat price increased by 10 per cent.

export growth (10.1 per cent in July-April period) in conjunction with the falling import payments (by (-) 6.1 per cent in July-March FY2012-13). Also remittances inflow increased by 15.9 per cent during the first ten months of FY2012-13. At the same time, higher inflow of net foreign aid (by 29.8 per cent during the first three quarters of FY2012-13), thanks to better utilisation of project aid, contributed towards this high figure.

Large BOP surplus in FY2012-13 was accompanied by significant rise in foreign exchange reserves. This led to steady appreciation of BDT against USD and other major currencies. Gross foreign exchange reserves stood at USD 14.5 billion as of 28 May FY2012-13, which was equivalent to more than five months worth of imports bills. Indeed, foreign exchange reserve as of May 2013 was about 52.4 per cent higher than the same period in 2012. These recent developments posed a new set of challenges for the central bank. The new challenge is to be able to maintain stability of the value of BDT. It has also raised hope that in the event demand for more foreign currency will go up in the near future (e.g. to finance the construction of PMBP mostly by local fund), the reserve may be used to maintain stability in the foreign exchange market. However, the central bank will perhaps be hesitant to see piling up of foreign exchange reserves, driven by lax import performance and which could have inflationary impact in the economy. Indeed faster accumulation of net foreign assets alone held the level of broad money supply (M2) above the target level (see Section 1.3 for details). Bangladesh Bank in the course of FY2012-13 made a number of amendments in regulations to manage the foreign exchange market. However, the rising BOP surplus is expected to moderate during the last quarter of the current fiscal year, as it is expected that import payments are likely to rise while growth rates for export and remittances slow down for the remaining period of FY2012-13.

1.2.8 Macroeconomic Management in FY2013-14

As is known, the national budget for FY2013-14 will be the last one to be presented by the incumbent government; not to mention that this budget will be implemented under more than one policy regime. It is also important to recognise that this budget will have to consider the ongoing Extended Credit Facility (ECF) programme of the IMF which advises a consolidated budget, a higher revenue target, a lower subsidy provision and a smaller budget deficit for FY2013-14. Considering the present macroeconomic scenario and the developments emerged in both global and domestic fronts, CPD has recently argued for a more cautious and pragmatic stance in the designing of the budget. Even though the framework and proposals of the budget will be announced on 6 June 2013, based on media reports and statements of the Finance Minister (and other responsible policymakers), one is able to glean some ideas about the forthcoming national budget for FY2013-14.

(i) The ADP for FY2013-14 has already been approved by the Executive Committee of the National Economic Council (ECNEC) and is proposed to be to the tune of Tk. 65,870 crore which is 19.8 per cent higher than that of FY2012-13. As can be assumed, incremental allocation is dominated by allocation towards PMBP.

(ii) 25 per cent reduction in the subsidy payments (compared to the allocation for the current year) may also be planned, as reported by the media.

(iii) The target for NBR's tax mobilisation could be more than 21 per cent higher than that of FY2012-13. In fact if one considers the potential revenue collection shortfall in FY2012-13 the actual target would be much higher.

(iv) The budget deficit is expected to be about 4.8 per cent of the GDP. The government may aim to bring down the bank borrowing from the level of FY2012-13 to finance only 45 per cent of the stipulated deficit. This implies foreign financing will have to rise significantly.

It is anticipated that the proposed fiscal framework will be formulated by ignoring the economic and political realities. As a result, the new government, which is expected to take charge during the second half of the fiscal year, may face considerable challenges. While implementing the budget FY2013-14, the government(s) may consider the following recommendations with regard to macroeconomic management in FY2013-14: (i) consolidate public expenditure to the extent possible; (ii) prioritise implementation of the long list of carryover and concluding projects under the ADP along with the projects with aid components; (iii) put greater emphasis on revenue mobilisation; (iv) create a conducive environment for private investment by ensuring both economic and political stability; (v) ensure adequate incentives to farmers; (vi) restore good governance and confidence in the banking sector; and (vii) formulate a complementary monetary policy including a prudent foreign exchange management. Additionally, the government should delink the macroeconomic framework as proposed by the SFYP. Surely, there is no economic sense in setting up macroeconomic targets at an overambitious level. In view of this, it is necessary to consolidate the macroeconomic targets for FY2013-14 accordingly and streamline the targets for the subsequent years. Indeed, FY2013-14 should be a year of reconciliation and a period of preparing the launch pad for the next government towards its medium term development plan. Of course, an early consensus, before FY2013-14, between the two political coalitions in the country should be the top most priority.

1.3 PERFORMANCE OF THE BANKING SECTOR

The banking sector in Bangladesh has come under criticism in the recent past due to increased number of financial scams and the rising size of loan default. Undoubtedly, the size of the industry has expanded in terms of total banks and their branches, deposits and credits, which in turn have contributed to the economic development of the country. The performance of the banking sector has also improved over the years according to various indications such as capital to risk weighted asset, rate of non-performing loan (NPL) to total loan, expenditure-income ratio, return on asset, return on equity, and liquidity. This has been possible due to various reform measures and policy support of the consecutive governments. Unfortunately, the health check fails to conceal the problems suffered by the sector from time to time. The current situation of large financial frauds and high NPL of banks calls for a close scrutiny of the sector and necessitates taking required measures. The first reading of the Indepent Review of Bangladesh's Development (IRBD) of CPD prepared in January 2013 presented a detailed analysis of the trend and the governance of the banking sector in the context of the Hall-Mark scam (Khatun 2013). This section will focus on a selected set of issues relating to some of the emerging concerns.

1.3.1 Non-Performing Loans Piling up in the SCBs

The soundness indicators of the banking sector performance reveal that since 2009 the overall performance of the sector has been unsatisfactory. As Table 1.8 shows, capital to risk weighted assets is on the decline while the percentage share of NPL to total loans is increasing. Similarly, return on asset and return on equity have sharply declined. A disaggregated scenario indicates that NPL in the state-owned commercial banks (SCBs) is the highest among all categories of banks in Bangladesh. This is a reflection of the fact that financial malpractices such as Hall-Mark and Bismillah Groups which embezzled large amount of money from SCBs have started to tell upon the health of SCBs. It is apprehended that there could be many more cases of forgeries which may be unearthed in course of time and pose further threats towards the stability of banking sector. Unfortunately, actions against such frauds have been slow (see Box 1.1). High NPL pushes the interest rate of banks upwards as they try to make up for their losses from bad loans. Apart from weak monitoring and supervision of loans, the reason for high NPL is also linked to the governance issue (Khatun 2013). Given the inefficiency of SCBs, there have been propositions to privatise those, except for one which will perform the treasury activities of the government.

Table 1.8

Soundness Indicators related to the Banking Sector

Indicator	Bank Type	2000	2009	2010	2011	2012
Capital Adequacy	**Capital to Risk Weighted Asset (%)**					
	SCBs	4.40	9.02	8.90	11.68	8.13
	DFIs	3.20	0.36	-7.30	-4.49	-7.78
	PCBs	10.90	12.12	10.10	11.49	11.38
	FCBs	18.40	28.13	15.60	20.97	20.56
	Total	**6.70**	**11.67**	**9.30**	**11.35**	**10.46**
Asset Quality	**NPL to Total Loans (%)**					
	SCBs	38.60	21.38	15.70	11.27	23.87
	DFIs	62.60	25.91	24.20	24.55	26.77
	PCBs	22.00	3.92	3.20	2.95	4.58
	FCBs	3.40	2.27	3.00	2.96	3.53
	Total	**34.90**	**9.21**	**7.27**	**6.12**	**10.03**
Management	**Expenditure-Income Ratio (%)**					
	SCBs	99.40	75.60	80.70	62.70	N/A
	DFIs	175.30	112.10	87.80	88.60	N/A
	PCBs	90.80	72.60	67.60	71.70	N/A
	FCBs	77.70	59.00	64.70	47.30	N/A
	Total	**99.90**	**72.60**	**70.80**	**68.60**	N/A
Profitability	**Return on Asset (%)**					
	SCBs	0.10	0.96	1.10	1.34	-0.56
	DFIs	-3.70	-0.37	0.20	0.03	0.06
	PCBs	0.80	1.55	2.10	1.59	0.92
	FCBs	2.70	3.18	2.90	3.24	3.27
	Total	**0.00**	**1.37**	**1.78**	**1.54**	**0.64**
	Return on Equity (%)					
	SCBs	1.70	26.15	18.40	19.66	-11.87
	DFIs	-68.00	-171.68	-3.20	-0.92	-1.06
	PCBs	17.00	20.95	20.90	15.69	10.17
	FCBs	27.30	22.38	17.00	16.58	17.29
	Total	**0.30**	**21.72**	**20.97**	**17.02**	**8.20**
Liquidity	**Liquid Asset (%)**					
	SCBs	26.50	25.10	27.20	34.70	N/A
	DFIs	16.20	9.60	21.30	12.30	N/A
	PCBs	24.80	18.20	21.50	23.90	N/A
	FCBs	34.70	31.80	32.10	30.50	N/A
	Total	**26.10**	**20.60**	**23.00**	**26.50**	N/A
	Excess Liquidity (%)					
	SCBs	6.50	17.60	8.20	15.70	N/A
	DFIs	9.90	7.10	2.30	2.50	N/A
	PCBs	6.80	5.30	4.60	7.00	N/A
	FCBs	14.80	21.80	13.20	11.80	N/A
	Total	**7.50**	**9.00**	**6.00**	**9.30**	N/A

Source: Bangladesh Bank.
Note: DFI: Development financial institution; PCB: Private commercial bank; FCB: Foreign commercial bank.

Box 1.1
Follow-up on the Hall-Mark Embezzlement

A chronology of the measures taken by the concerned authorises in view of the huge fraudulent of resources from Sonali Bank indicates that there has been very little progress in the effort towards the recovery of the money. The owner of the Hall-Mark was arrested following the commotion created after the incidence was brought to light. However, in March 2013, the Managing Director of the Hall-Mark Group was out in bail, and applied to the government to save the 40,000 workers and their families working in various factories of the group which also houses some Tk. 500 crore worth of equipments. Consequently, the Ministry of Finance (MoF) advised Sonali Bank to prepare a document advising on how to regularise debts of the company and restart this factory. However, the Ministry denies that anyone related with the graft will be freed of their charges.

As of May 2013, no action was taken against Sonali Bank for the financial scam of Hall-Mark which involved an amount of Tk. 3,648 crore. There has also been no trace of the money which was appropriated through unauthorised loans and advances by the said company in connivance with bank officials. Bangladesh Bank froze the accounts of the owner and relatives of the Hall-Mark and retrieved Tk. 30 core. The Finance Minister informed the National Parliament in April 2013 that Tk. 405 crore have been realised from the Hall-Mark group so far. According to Bangladesh Bank, the Anti Corruption Commission (ACC) is responsible for tracing the money back. The ACC is seeking account information of officials and relatives of the Hall-Mark Group from the central bank. In February 2013, a six member team of the ACC interrogated top officials including a former member of the Board of Directors of Sonali Bank, who allegedly took bribes amounting to Tk. 3 crore from the Hall-Mark to sanction the loans in favour of the company. Several names of high officials of Sonali Bank and an Advisor to the Prime Minister came up from unofficial sources as accomplices to this fraud. The ACC requested to the former Chairman, eight members of the Board of Directors, and two high officials of Sonali Bank, to submit their wealth statements to the Commission by April 2013.

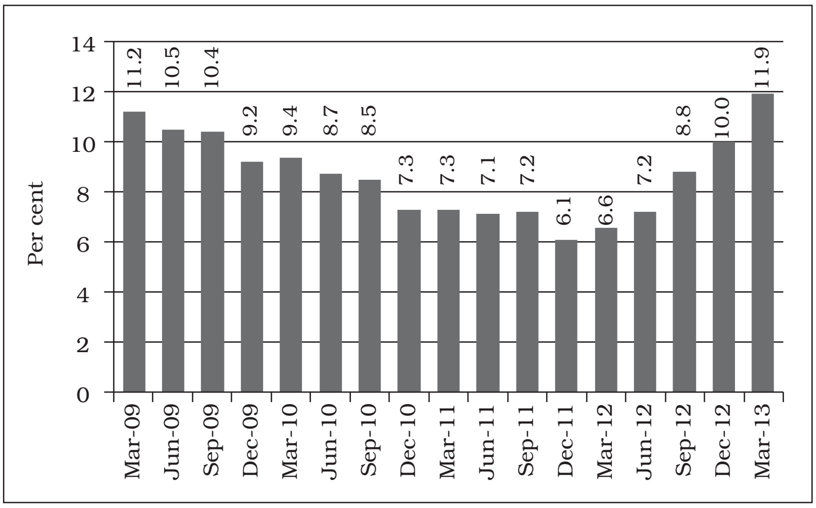
1.3.2 Loan Classification and Provisioning: A False Attempt to Increase Profit

Within a period of five months, Bangladesh Bank has changed the rules of loan classification and provisioning. On 23 September 2012, the Banking Regulation and Policy Department (BRPD) of Bangladesh Bank issued a circular with new provisions for loan and rescheduling stating, "Bangladesh Bank is concerned that rescheduling (also known as "prolongation"or "evergreening") may sometimes result in an overstatement of capital when loans that have a low profitability of repayment are carried at full value on banks' balance sheets" (www.bangladesh-bank.org). The new BRPD Circular no. 05 dated 29 May 2013 relaxed the period of rescheduling to six years instead of 4.5 years at present. The time limit for first rescheduling of a classified loan will now be 36 months since the repayment of last installment, instead of the present 24 months. Additionally, time limits have been reset at 24 months and 12 months for second and third rescheduling respectively. Loan provisioning requirement has been reduced to various levels in various sectors. According to the new circular, banks have to make provision of just 1 per cent instead of 5 per cent for a special mention account. The provisioning requirement will be 2 per cent for housing, professional and investment banks.

While the circular does not explain the reason for such relaxation, officials and Bangladesh Bank told the media that these measures have been taken in view of the rise in classified loans. They also expect to create an additional Tk. 500 crore investable funds for banks through these measures. As Figures 1.8 and 1.9 show, classified loans have doubled during January to March 2013 compared to the same period in 2012. Both in SCBs and PCBs, the amount of classified loans doubled during these two compared periods. Though Bangladesh Bank made this move to save the loss making banks and increase the profitability of banks, this is rather a very simplistic way to assess the problems of the sector. If one looks at the long time trend of the performance of the sector, it is clear that SCBs have consistently been

Figure 1.8

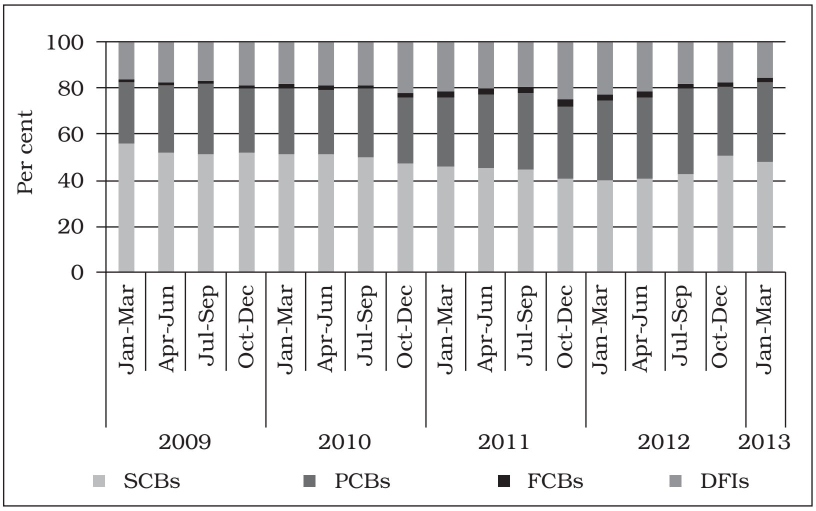
Share of Classified Loan to Total Outstanding Loans



Source: Bangladesh Bank.

Figure 1.9

Bank-wise Classified Loan as Per cent of Total Outstanding Loans



Source: Bangladesh Bank.

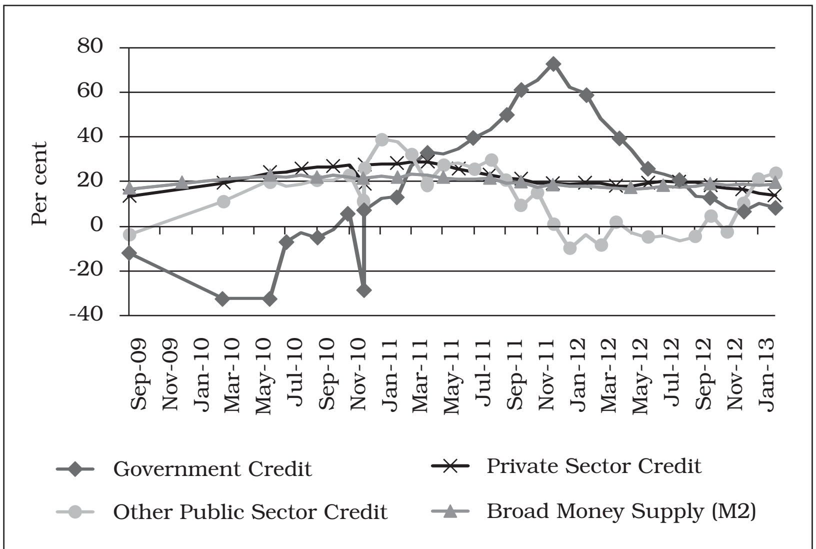
underperformers compared to other players in the sector. Partly, this may be due to various services they have to provide as government-owned banks. For example, SCBs have been disbursing higher agricultural credit or providing banking services to the larger section of people with limited income across the country. However, the major reason for high NPL and classified loans lies in its inherent weak mechanism to undertake banking activities by following the existing guidelines of the central bank (for details, Khatun 2013). Hence, the new announcement is only a window dressing to show an artificial increase of bank profitability.

1.3.3 Credit Disbursement Shows Low Appetite of the Private Sector

In FY2011-12, Bangladesh Bank followed a monetary tightening policy in order to reduce the inflation rate from double digit to single digit. As a result, inflation rate reduced, but at a cost. This had a negative impact on the credit flow. For example, in July 2011, credit to private and public sectors grew by 24.36 per cent and 39.87 per cent respectively. In June 2012, credit to both private and public sectors reduced significantly to 19.72 per cent and 25.43 per cent respectively. Such a decline is apprehended to have an impact on the investment and growth situation of the country. In its half yearly monetary policies of FY2012-13, Bangladesh Bank focused more on GDP growth through more productive investment and containing inflation. As a result, during the first eight months of FY2012-13 there has been an increase in money supply. This, however, was not accompanied by increased flow of credit.

The Monetary Policy Statement (MPS) of Bangladesh Bank for the period January-June 2013 set targets at 17.7 per cent for the growth of the M2 and 18.5 per cent for the growth of the private credit. The early signals of the monetary indicators are, however, not very promising. At the end of February 2013, M2 grew by 18.9 per cent as opposed to 18.19 per cent in February 2012. In case of credit flows, both public and private sectors suffered sharp decline compared to the last fiscal year. The growth of credit to the public sector was a mere 8.57 per cent in February 2013 compared to 59.92 per cent in February 2012. On the other hand, the flow of credit to the private sector experienced a decline from 19.55 per cent in February 2012 to 13.96 per cent in February 2013.

The decline of credit to the public sector signifies a lower dependence of the government on the banking system and availability of more resources with banks for the private sector. However, the slow growth of credit to the private sector is again a reflection of low appetite of the sector for credit which is mainly related to dampened investment climate of the country due to lack of infrastructure including power and gas supply and political turmoil. Figure 1.10 presents the growth of credit and money supply in the recent period.



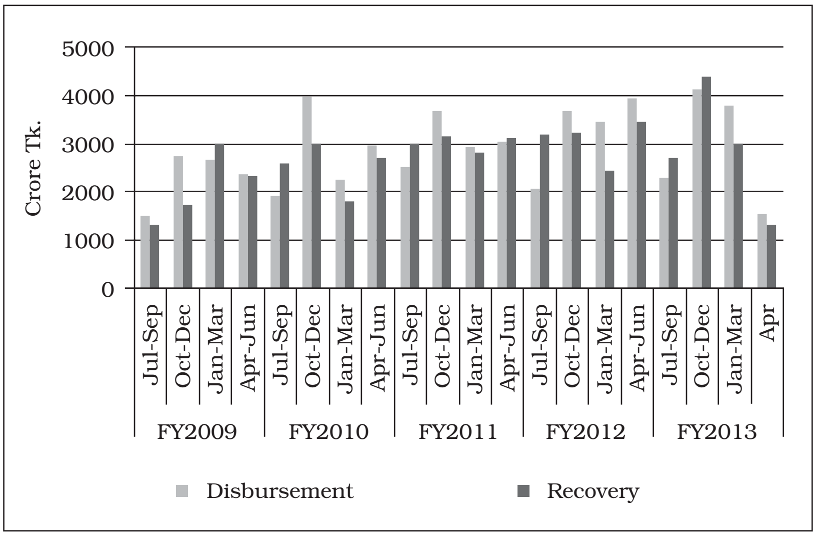
Source: Bangladesh Bank.

Figure 1.10

Growth of Credit and Money Supply (Year-on-Year)

There have been policy directives by Bangladesh Bank favouring agricultural credit. As a result, commercial banks are mandated to disburse agricultural loan to various sectors including crops, livestock and fisheries. However, the growth of agricultural credit during January-March 2013 was only about 9 per cent compared to the same period in 2012 (Figure 1.11). A disaggregated data reveal that since 2009 the share of crops sector is consistently increasing in the total agricultural credit, so is the case with livestock and fisheries. However, allocation for poverty alleviation activities has mostly been declining (Table 1.9). Given the ambition of supporting inclusive growth in the country, efforts towards poverty alleviation programmes demand more attention.

Figure 1.11
Agricultural Credit by All Scheduled Banks and Bangladesh Rural Development Board (BRDB)



Source: Bangladesh Bank.

Table 1.9
Sector-wise Distribution of Agricultural Credit

(in Per cent)

Sector	FY09	FY10	FY11	FY12	FY13
Crops	40.82	40.09	40.04	40.82	45.97
Purchase and installation of irrigation equipments	0.09	0.63	0.58	0.09	2.06
Livestock	4.51	4.93	4.64	4.51	12.05
Fisheries	4.89	0.75	0.33	4.89	8.93
Grain storage and marketing	1.13	4.82	5.05	1.13	1.63
Poverty alleviation	17.66	16.44	17.69	17.66	11.11
Other agricultural activities	30.91	32.33	31.68	30.91	18.26

Source: Bangladesh Bank.

1.3.4 Paradox of High Excess Liquidity and High Interest Rates

Excess liquidity of the scheduled banks has almost doubled during January 2012 to February 2013. The growth of excess liquidity in the banking system has influenced the money market by bringing down the call money rate significantly, from 19.66 per cent in January 2012 to 8.95 per cent in February 2013. The call money rate hovered around 10 per cent during January 2009 to October 2010, but increased sharply to 33.5 per cent in December 2010 because of the adjustment in cash reserve ratio (CRR) and statutory liquidity ratio (SLR) rates by Bangladesh Bank.

Throughout FY2010-11, the excess liquidity in the scheduled banks was more or less stagnant, but started to rise again since January 2012. High excess liquidity is not, however, accompanied by low interest rate, as logic would suggest. In addition to low investment and consumer demand, movements in the stock market have also implications for the liquidity situation of the banking sector in Bangladesh. Thus the provision of putting a ceiling on the exposure on stock market for banks has also contributed to excess liquidity in banks in the recent period. Commercial banks are probably trying to make up for their lower profit through high lending rates which reached as high as 13.95 per cent in October 2012 and reduced slightly to 13.73 per cent in February 2013 (Figure 1.12). However, deposit rate, though increasing since June 2010 has been much lower than lending rates. As a result during the whole period between June 2012 and February 2013, the interest rate spread (IRS) was above 5 per cent which is

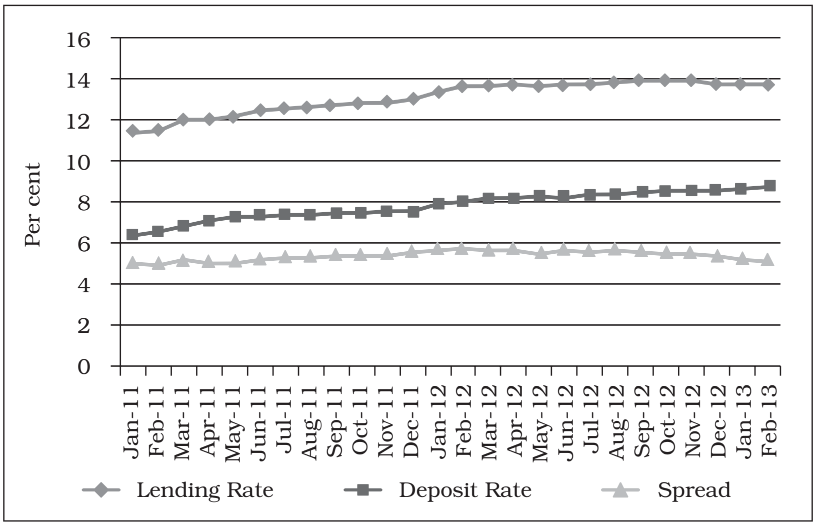


Figure 1.12
Interest Rate Spread

Source: Bangladesh Bank.

considered to be a tolerable level. It is only recently IRS is coming down due to a slight reduction in lending rate and increase in deposit rate. Thus in February 2013, the IRS reduced to 5.05 per cent from a peak of 5.68 per cent in February 2012.

1.3.5 Concluding Remarks

The recent trend in the banking sector is not supportive to a sustained economic development as it is encumbered with inefficiency and malpractices. The accumulation of excess liquidity is not only a reflection of low demand for funds, it also indicates weak supervisory and poor portfolio management of commercial banks. Several malpractices of commercial banks have also contributed to the weak performance of the banking system. In view of this, there should be further reform measures to streamline the activities of the sector towards improving its performance.

1.4 REVIEW OF THE DEVELOPMENT OF POWER SECTOR: ACCESS TO ELECTRICITY, EFFICIENCY IN GENERATION AND DIVERSITY IN SOURCING

The power sector has undergone significant changes over the last four years with a view to raising generation and supply capacities taking cognisance of the emerging urgency. As is known, the country suffered from significant power deficit when the present government came to power in 2009 – total generation of electricity was only 3,268 mega watts (MW) at the time with a per capita access to electricity being only 183 kilowatt-hour (kWh). In this backdrop, the government undertook short, medium and long-term programmes based on the national plan for power sector development. The major target of the plan was to ensure a moderate rise in access to electricity in the shortest possible time. This target has partly been attained over the last four years, but at a significant cost which has been elaborated below.[16] The discussion in this section highlights four key issues, which include (i) access to electricity; (ii) efficiency in generation of electricity; (iii) use of renewable energy as diversified source of electricity; and (iv) reforms in policies and institutions.

[16]The development of the power sector will, however, need to go a long way to attain the goal of 'Sustainable Energy for All (SE4A) by 2030 according to the United Nations (UN) in 2012. The objectives of UN initiatives are three folds: a) ensure universal access to modern energy services; b) double the global rate of improvement in energy efficiency; and c) double the share of renewable energy in the global energy mix.

1.4.1 Access to Electricity

Access

Some progress has been made in terms of access to electricity, thanks to the rise in generation of electricity over the past four years. According to the Bangladesh Power Development Board (BPDB), about 60 per cent of total population has access to modern power supply facility in FY2012-13 against 43 per cent four years back. Per capita electricity consumption has increased to 292 kWh in April 2013 from 183 kWh in FY2008-09 (Table 1.10). However, because of poor benchmark condition, the improvement in access to electricity is yet to reduce the gap with Bangladesh's major competing countries (e.g. per capita electricity consumption for selected countries in 2010 was as follows: India: 626 kWh; Indonesia: 641 kWh; Vietnam: 1,035 kWh; and China: 2,944 kWh).

Power Generation

Developments in the power sector were underwritten by significant public and private investment in generation of electricity. Since 2009 a total of 60 new and mostly small-scale power plants were set up with a generation capacity of 3,845 MW (Table 1.10). This was facilitated through a number of reforms in policies and acts including introduction of *Special Provision Act 2010* for fast tracking projects, without going into tendering process, and changes in the policy focus towards small-scale power plants which could be set up within a short period of time.[17] Despite the success of implementing a good number of small-scale projects under the amended act, concerns were raised with regard to transparency in project selection process and selection biases. Evidence, however, indicates that these consequently suffered from inefficiency in power generation, poor utilisation of fund, and gave opportunities for rent-seeking and misuse of public resources (discussed later).

Table 1.10

Generation of Electricity: FY2008-09 to FY2012-13

Indicator	FY09	FY10	FY11	FY12	FY13
Installed Capacity (MW)	5166.0	5271.0	6639.0	8100.0	8525.0
Average Generation (MW)		3926.9	4101.2	4935.6	5407.3 (Apr)
Maximum Generation (MW)	4162.0	4606.0	4968.5	6066.0	6350.0 (Apr)
Per Capita Electricity Coverage (kWh)	183.0	236.0	252.0	275.0	292.0
Gap between Installed Capacity and Generation (MW)	1004.0	1344.0	2538.0	3164.0	3118.0
Time required to get electricity (days)	137	142	295	404	

Source: Bangladesh Power Development Board (BPDB); World Bank database.

Transmission and distribution systems have also made some progress during this period. A total of 19 grid substations with the capacity of 2743 MVA and 644 circuit kilometres of additional distribution lines have been set up. In the ADP of FY2012-13, a total of 27 out of 48 investment projects are being implemented which are at different phases of completion. These are mainly related to the improvement of transmission and distribution system of the power sector.

Gap in Power Generation

Concerns have been raised with regard to access to power. Although installed capacity till April 2013 (8,525 MW) has crossed the forecasted demand till then (8,349 MW), the actual generation was well below

[17]Large-scale power plants usually require long period for installation.

this level. The 'effective' generation of electricity in terms of maximum and average generation was 25.5 per cent and 36.7 per cent lower compared to the installed capacity. More importantly, the gap between installed capacity and generation has been widening over the past years (from 1,004 MW in 2009 to 3,118 MW in April 2013). This has happened mainly because of low level of capacity utilisation of quick rental power plants (QRPPs). This huge unrealised capacity raised questions about the quality of power plants especially of the QRPPs. Moreover, setting up oil-based generation capacity on a large scale during this period without taking into account the possible fiscal and financial burdens driven by the cost of bulk supply of oil is a major reason which has led to underutilisation of the capacity. Thus, a large amount of capacity has turned out to be 'standby' capacity. Adding to that, getting new electricity connections remains difficult; rather this has become more time consuming now (Table 1.10). However, the improvement in monitoring system has reduced the system loss from 15.7 per cent in 2009 to 12.3 per cent in 2013, while the target is to bring it down to 10 per cent by 2015.

Lack of Diversity in Sources of Fuel

Power generation in Bangladesh is overwhelmingly dependent on natural gas mainly because it is easily available and the low cost involved in generating electricity. Given the limited gas reserves and lack of diversity in the sources of fuel, the government has planned to reduce dependence on gas by putting more emphasis on the use of alternate sources. The use of gas in total share of energy has reduced over the years while the use of other fuels such as heavy fuel oil (HFO) and furnace oil has been on the rise (Table 1.11). However, the use of non-gas fuel including coal is still low. Ensuring long-term supply of primary energy for power generation is increasingly becoming a major concern for enhancing power supply. Hence the long-term target for fuel diversification in a manner that includes 25 per cent coal, 50 per cent natural gas and 25 per cent other fuels by 2030 appears to be difficult to attain.

Table 1.11

Use of Different Types of Fuel in Power Generation

(in Per cent)

Fuel Type	FY09	FY10	FY11	FY12	FY13 (May)
Furnace oil/HFO	3.8	2.8	5.0	11.0	11.7
Diesel/HSD	1.9	1.8	6.0	6.0	5.5
Hydro	1.6	3.4	4.0	3.0	4.5
Coal	3.9	3.8	2.0	2.0	1.6
Gas	88.8	88.3	83.0	78.0	78.3
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bangladesh Power Development Board (BPDB).
Note: HSD: High Speed Diesel.

Investment

At present the respective share of the public and private sectors in power generation is almost equal (51 per cent and 49 per cent respectively). Although both local and foreign investments have been made in independent power producers (IPPs) and QRPPs, the inflow of foreign direct investment (FDI) in the power sector has decelerated in recent times. Unlike the early 2000s, FDI inflow has dropped in recent years which led to a decline in the share of FDI stock in the power sector (Table 1.12). Anecdotal information indicates that the power sector has received about USD 9 billion worth of investment (including FDI) since 2009.

With a view to increase power generation within a short period of time, the government planned to set up costly QRPPs along with power plants set up by the BPDB and as well as IPPs. At present, the share of QRPPs is about one-third of the total generation capacity (Table 1.13). Because of very high purchasing

Table 1.12

FDI in Power Sector

Indicator	FY01	FY05	FY09	FY10	FY11	FY12
Inward flow (Million USD)	174.6	29.7	23.4	36.8	52.6	64.2
Share in total flow (%)	31.0	3.7	2.4	4.0	6.8	5.4
Inward stock as of June (Million USD)	218.4	284.2	256.9	288.2	331.9	294.7
Share in total stock (%)	10.4	8.4	5.0	4.8	5.3	4.7

Source: Bangladesh Bank.

Table 1.13

Share of BPDB, IPPs and QRPPs in Power Generation (Average for April 2013)

(in Per cent)

Indicator	BPDB	IPP and Alike	Quick Rental and Others	Total
Derated Capacity	51.3	17.7	31.0	100.0
Day Peak	40.8	26.7	32.6	100.0
Evening Peak	44.1	23.4	32.5	100.0

Source: Bangladesh Power Development Board (BPDB).

price of electricity from QRPPs (Tk. 18-21 vis-à-vis Tk. 3.5-4.5 from BPDB) the BPDB is having to incur a significant burden of subsidy. Taking this into account, the government has planned to reduce the share of electricity generation through QRPPs by exiting those plants once their contract periods were over, primarily by FY2012-13. But the government was not able to carry out its exit plan and consequently, its fiscal burden in the coming years is likely to remain high.

Frequent Revisions of Power Generation Plan

The power generation plan has been revised a number of times over the last four years (Table 1.14). The initial plan formulated in 2010 was revised in 2011, and then again afterwards. Targets set forth for implementation of public and private sector power projects for various years were also revised. The revisions were carried out because of a number of reasons including lack of adequate supply of gas for newly installed power plants, slow progress in the completion of large-scale IPPs and BPDB power plants, and institutional weakness to monitor timely implementation of projects. Problems in supply of primary

Table 1.14

Changes in Power Generation Plan

(MW)

Year-wise Plan	Public			Private			Import			Total		
	Plan Declared in 2010	Plan Declared in 2011	Present Plan	Plan Declared in 2010	Plan Declared in 2011	Present Plan	Plan Declared in 2010	Plan Declared in 2011	Present Plan	Plan Declared in 2010	Plan Declared in 2011	Present Plan
2010	360	255		432	520					792	775	
By 2011	920	851			1343					920	2194	
By 2012	505	838	632	1764	1319	1354				2269	2157	1986
By 2013	725	1040	1467	950	1134	1372		500	500	1675	2174	3339
By 2014	1170	1270	1660		1053	1637				1170	2323	3297
By 2015		450	1410	2600	1900	772				2600	2350	2142
By 2016		1500	750		1300	1600					2800	2350
Total		6204	5919		8569	7235					15273	13154

Source: Ministry of Finance (MoF).

energy for the existing and upcoming power plants and inadequate investment including FDI, are two major constraints that led the government to undertake frequent revisions in the power generation plan. This undermined effective and timely implementation of the plan.

1.4.2 Efficiency in Power Generation, Power Use and Resource Utilisation

Inefficiency in Power Generation

Efficiency issues in power generation have suffered from serious neglect. First, realising the high fiscal burden of operating QRPPs, the government announced an exit policy for these plants in the period between 2013 and 2016. But the government could not stick to its plan, rather extended the contracts with seven QRPPs. A few more are waiting for getting renewals. Despite the fact that the subsidy burden has partly come down because of the reduced import price of oil and revision of the power tariff, a part of subsidy burden will remain due to further time extension of QRPP projects along with setting up the new diesel-based plants. Second, the inefficiency of using QRPP is likely to increase further if the government gives extension to most of these plants without taking into consideration their level of efficiency.[18] Third, such inefficiency may aggravate further if the QRPPs (even though they are efficient) are upgraded as 'IPPs' and are given the permission for operating under long-term contract by ignoring their limitations for gradual reduction in the generation capacity as well as high cost incurred due to rise in consumption of fuel. Fourth, the terms and conditions in the event of extension of the contract with QRPPs, particularly purchasing price of electricity for BPDB, will need to be renegotiated taking into account the changing cost structure where no fixed costs is involved for those plants. Failure to reduce the purchase price (well below the existing level and near to that of the IPPs) will once lead to inefficiency in generation of power. Fifth, relatively low generation capacity of QRPPs (55-68 per cent) compared to that of IPPs (80-86 per cent) has raised concerns about the quality of investment (Table 1.15). This may occur due to the use of low quality and outdated machineries which has resulted in low return from costly investment for QRPPs. Sixth, a recent investigation by the Power Division has revealed that 11 out of 18 rental power plants use fuel in excess of the stipulated limit for generation of 1 kWh of electricity. As a result, BPDB has to supply an additional 35 ml of fuel for producing one kWh of electricity, and this has led to extra financial burden. Besides, heating contents of these power plants are higher than the stipulated limits, which is a breach of contract. Seventh, BPDB is having to bear additional financial burden. For example Tk. 3.36 million per day has to be paid to 50 MW oil-fired rental or quick rental power plant as 'capacity payment' in case the required amount of gas cannot be supplied. In one incidence, BPDB had to pay to a QRPP about USD 30.69 million per month as capacity payment for its default in lack of gas supply.[19] It has been alleged that the BPDB, because its huge financial strains, has taken measures to reduce its burden by suspending the contract for taking electricity from a number of QRPPs even by paying 'capacity payment' since this was estimated to be a less burdensome option. Eighth, it is plausible that there are vested interest groups which are working to slow down the progress of large-scale power plants, delay initiatives to repair existing power plants and undercut supply of the required gas to the power plants. All these

Table 1.15

Capacity Utilisation: Comparison between BPDB, IPPs and QRPPs

(in Per cent)

Indicator	BPDB	IPP and Alike	Quick Rental and Others
Day Peak	42.0	79.7	55.4
Evening Peak	55.9	86.0	67.9

Source: Bangladesh Power Development Board (BPDB).

[18] Anecdotal information shows that level of efficiency is widely varied between QRPPs.
[19] Report published in the national daily the Financial Express on 24 May 2013.

activities could put into effect the notion that QRPPs were 'inevitable' medium-term options for power generation, and thereby, extract 'rent'. Overall, the power sector is being burdened with increasing inefficiency which is creating significant extra financial burden. As a result, the possibility of supplying low-cost electricity is undermined and consumers are having to pay higher power tariff.

Inefficiency in Revision of Power Tariff

According to the Bangladesh Energy Regulatory Commission (BERC), average power generation cost has doubled since 2009 – from Tk. 2.59 per kWh to Tk. 5.57 in 2013, which has caused increased financial burden on the BPDB. As part of reform initiatives, electricity tariff has been revised six times since March 2010 in order to reduce some of the financial burden. Average retail price of electricity has increased to Tk. 6 per kWh during the last revision in September 2012, from Tk. 3.76 in March 2010 (Table 1.16). The revision of power tariff has been done taking into account the equity aspect in case of the burden for different categories of consumers – lower levels of upward revision for low-income households and agricultural activities and higher tariffs for heavy and medium industries and commercial activities. On average, payment by the consumers has increased by about 60 per cent since March 2010. Such revisions of tariff places the country's power tariff at par and even at higher levels compared to her major competing countries (Table 1.17). The question is whether the revisions in power tariff could effectively reduce the overall fiscal burden of the BPDB. In fact, the huge burden of subsidy on account of continuous dependence on QRPPs which is occurred due to inefficient operation of the BPDB and poor implementation of large-scale power plants, has been partly shifted to the consumers through periodic revisions of power tariffs.

Table 1.16

Revision of Power Tariff: 2010-2013

(Taka)

Sector	Mar 2010 (After 5% Average Increase)	Feb 2011	Dec 2011	Feb 2012	Mar 2012	Sep 2012	Changes since Mar 2010 (%)
Residential (0-100 units)	2.60	2.60	2.73	2.87	3.03	3.31 (0-75 units)	27.3
Residential (101-400 units)	3.30	3.46	3.81	4.04	4.29	4.73-4.93 (76-400 units)	43.3-49.4
Agriculture	1.93	1.93	2.03	2.13	2.26	2.51	30.1
Small industries	4.35	4.56	5.27	5.67	6.02	6.95	59.8
Heavy industries (32 kV)	3.10	3.25	4.59	5.02	5.33	6.16	98.7
Heavy industries (33 kV)	3.92	4.11	4.88	5.28	5.61	6.48	65.3
Medium industries (11 kV)	4.17	4.37	5.14	5.55	5.90	6.81	63.3
Commercial	5.58	5.85	6.80	7.33	7.79	9.00	61.3

Source: Bangladesh Energy Regulatory Commission (BERC).

Table 1.17

Electricity Tariffs in Selected Countries

Country	Power Tariff (US Cents per kWh)	Effective Date
Bangladesh	7.50	September 2012
China	7.50-10.70	17 May 2012
India	8.00-12.00	1 February 2013

(Table 1.17 contd.)

(Table 1.17 contd.)

Country	Power Tariff (US Cents per kWh)	Effective Date
Indonesia	8.75	1 February 2013
Thailand	4.46-9.79	5 March 2011
Pakistan	2.00-15.07	16 May 2012
Vietnam	6.20-10.01	2011

Source: Collected from various sources.[20]

Inefficiency in Resource Utilisation

Subsidy in the power sector has increased by several times since 2009. The figures for different years are: Tk. 981 crore in FY2008-09, Tk. 1,200 crore in FY2009-10, Tk. 4,000 crore in FY2010-11, and Tk. 6,000 crore in FY2011-12. Till January FY2012-13, the subsidy for BPDB was Tk. 3,800 crore; considering the upcoming use of electricity in Boro production it is estimated to increase to Tk. 7,000 crore by the end of the fiscal. Mujeri *et al.* (n.d.) show that subsidy to the rental power plants in FY2011-12 was about 44 per cent of total subsidy to the power and energy sector.[21] Despite several tariff adjustments since 2009, subsidy burden per unit of generation of electricity did not decrease; rather it has increased significantly till FY2011-12 – from Tk. 18.9 lakh per MW in 2009 to Tk. 74 lakh in 2012; however, it has declined in FY2012-13 (Tk. 44.5 lakh by January 2013). Given the inefficient operation and slow implementation of some of the large-scale low-cost power plants, periodic price adjustments are having only partial impact in reducing the subsidy burden.

The increase in overall subsidy, which reached 4 per cent of GDP, has caused serious fiscal burden on the government. As part of the conditionalities under the IMF-ECF, this burden has to be reduced to 3.5 per cent of GDP.[22] The latest rise in electricity price by 16 per cent in September 2012 and fuel prices by 11 per cent in January 2013 were part of meeting those undertakings. The government perhaps has tried to keep subsidies low by generating lower levels of electricity by keeping some of the installed capacity underutilised. This is particularly true for the QRPPs. In other words, the government will find it difficult to maintain a balance between higher electricity supply and keeping the subsidy-GDP ratio at the agreed level (3.5 per cent of GDP).

Lack of Progress in Implementing Large-Scale Power Plants

A number of large-scale projects have stalled at different phases of implementation. These include Bibiyana phase one (341 MW) gas-fired power plant due to lack of on time financing and delay in handing over of land; Bhola (225 MW) gas-fired plants due to delay in selecting the awardee through tender process; and Siddhirganj (450 MW) due to procedural delays. Overall, nine out of 11 public sector low-cost projects (generation capacity of 1,700 MW) are likely to be delayed by two years.[23]

Power Division has implemented 54 projects during FY2012-13 with an allocation of Tk. 7,900 crore. Till March 2013 the Division has spent Tk. 5,375 crore which was 68 per cent of their total allocation. The

[20]For China: http://english.sz.gov.cn/ln/201205/t20120517_1914423.htm; for India: http://in.answers.yahoo.com/question/index?qid=20111010003627AAu0bhu; for Indonesia: http://finance.detik.com/read/2013/01/02/165502/2131496/1034/tarif-listrik-naik-pemerintah-masih-subsidi-rp-258270-bulan-rumah; for Thailand: http://www.boi.go.th/index.php?page=utility_costs&language=en; for Pakistan: http://www.fesco.com.pk/newtariff.asp; for Vietnam: http://af.reuters.com/article/commoditiesNews/idAFL3E7NJ28I20111219 (accessed on 31 May 2013).

[21]The subsidy to different users of the power sector was about 3 per cent in FY2011-12. See also, www.iisd.org/gsi/sites/default/files/ffs_dhaka_bids.pdf?

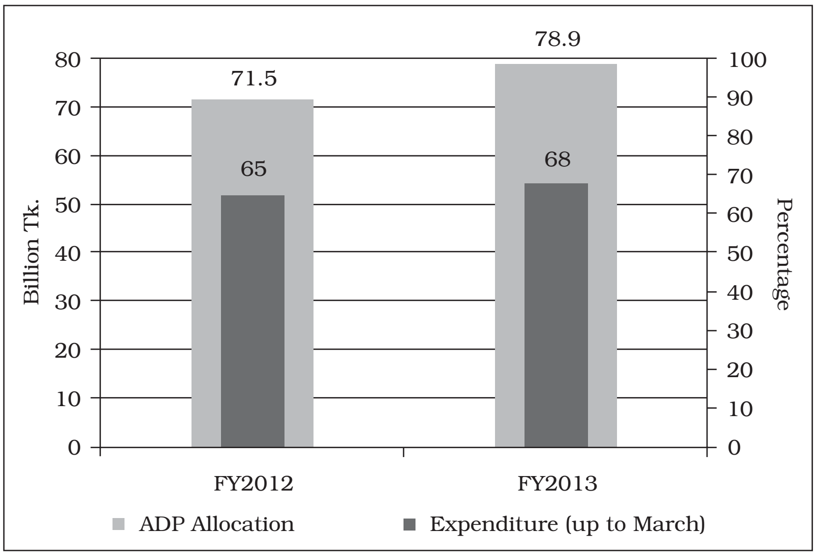
[22]This is factored in government capitalisation of all earlier subsidy-related loan losses at the SCBs (equivalent to 0.5 per cent of GDP), with no new accumulation of these debts.

[23]See, http://newagebd.com/detail.php?date=2013-01-27&nid=38106#.Uag2PNJHKiw

status of implementation is relatively better compared to that in the previous year (Figure 1.13). Out of 48 projects being implemented under the investment programme, 13 projects are related to power generation, 29 are related to transmission and distribution, and six are related to the use of renewable energy. The failure to set up a number of large-scale power plants as per the plan is a major management failure of the power sector.

Figure 1.13

ADP Allocation and Expenditure of Power Division during FY2011-12 and FY2012-13



Source: Ministry of Finance (MoF).

Similarly, a number of private sector plants have been deferred by the Power Division of which two plants (300 MW) have been deferred for one year from the original plan of setting these up in 2012; and another four (1,000 MW) out of six plants have been deferred for two years from their original plan of setting up by 2015. Installation of another three private sector plants is still uncertain. Besides, no notable progress has taken place in case of supply of gas which may cause further delay in completion of gas-based power plants. Although 500 MW of electricity is supposed to be imported from India by June 2013 as per the plan, this has become uncertain due to lack of development of infrastructure on the Indian side. While the guaranteed supply of 250 MW (out of 500 MW) from India would be available at Tk. 5/kWh, the remaining 250 MW will be traded at market rate prevailing in the respective region, which appears to be expensive as the peak hour rate of the electricity is about Rs. 17-18 per kWh. Similarly, 2,000 MW Rooppur nuclear power plant which has been negotiated with Russia is still in its early phase. A number of issues and concerns have already been raised about this project. One is the assurance of required level of financing from Russia as per proposed terms and conditions as initially discussed (i.e. USD 1,500 million to be disbursed after the construction initiated at LIBOR+1 per cent which is equivalent to be about 2 per cent). Another issue is the safety standards of the proposed nuclear reactor (i.e. VVER1000 vis-à-vis newer model of VVER1200).[24]

Under these circumstances, maintaining the power generation plan is rather to be a difficult enterprise. A number of revisions have been made both in plan and actions including reduction of generation target by over 1,000 MW, extending contracts with seven rental power plants for another one to two years under Special Provision Act 2010, and extension of the enforceability of this Act for another two years. Thus, the power sector, in the medium-term, perhaps will continue to be burdened with unwarranted subsidy which may cause further tariff hike that could otherwise be avoided.

[24]See, Rahman (2013).

Slow Progress in Enhancing Production and Supply of Alternate Fuels

Ensuring long-term supply of primary energy for power generation is perhaps the major challenge for the development of the power sector at present. The expected rise in the generation of gas is at stake due to limited progress in exploring additional gas from new and old gas-wells. Moreover, supply from some of the existing wells has declined. For example, offshore Sangu-11 gas-well has dried up at a faster pace and the supply has dropped by 33.6 per cent to 80 million cubic feet (mcf) per day in recent time.[25] Exploration of gas in the onshore blocks will need to be significantly expedited.

Although the government has set the target of generating 8,000 MW of electricity by 2016 from coal-based power plants, no observable improvement has taken place as regards their establishment, and more importantly, of extraction of coal. At present, power generated from coal-based power plant is merely 90 MW. Failure to finalise the draft coal policy is a major weakness towards this end. However, BPDB, Bangladesh and NTPC, India have recently signed an agreement to set up a coal-based power plant (1,320 MW) at Rampal.[26] Considering the proximity of this plant to the Sundabans which is only 14 km away, environmental groups are already critisising this initiative. Given the limited progress in domestic coal-based power plants, government should take initiatives to develop power plants with imported coals, although electricity generation cost for the latter would be higher (Tk. 7-8 vis-à-vis Tk. 4-5 in local coal-based one). By and large, exploring alternate sources of primary energy for diversification of power sector has remained unattended.

Low Level of Use of Energy Saving Technologies

A number of energy saving measures and demand-side management programmes have been introduced as part of saving power and energy. These include: a) inclusion of energy saving issues in the national building code; b) distribution of 1.05 crore energy saving CFL bulbs in order to encourage people to use energy saving technologies; c) maintenance and refurbishment of inefficient and old power plants; d) implementation of result-based management to reduce system loss; d) introduction of energy star labelling programme to encourage using energy saving technologies; and e) introduction of pre-paid metering, renewal of transmission and distribution lines and modernisation programme. Estimates showed that use of CFL bulbs will reduce power consumption by 312 gigawatts and save USD 11.5 million a year.[27] While these initiatives are only a start towards increased use of energy saving and energy efficient technologies, more initiatives are required towards this end. In this context, government should formulate an energy conservation law to increase energy efficiency in the country.

1.4.3 Progress towards Enhancing Use of Renewable Energy

Use of higher amount of renewable energy is being considered as a strategy in the long-term plan for sustainable development of the energy sector. A total of 800 MW worth of electricity was initially planned to be generated from renewable sources by 2015 which would be about 5 per cent of total energy demand. But the progress thus far has been insignificant – till now about 37.2 MW of renewable energy generation capacity has been installed while another 36.4 MW of capacity to be installed in FY2013-14 (Table 1.18). Bangladesh has started to implement renewable energy projects from scratch. A number of programmes such as solar home system (SHS) which covered over one million homes, is now under implementation. The SHS of Bangladesh is regarded as the fastest growing such programme in the world. These programmes have been implemented by the Infrastructure Development Company Limited (IDCOL), a public-private infrastructure financing entity. For detailed information, please see the Annex at the end of this chapter.

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[25] See, http://www.thefinancialexpress-bd.com/index.php?ref=MjBfMDRfMDlfMTNfMV8xXzE2NTg4MQ==

[26] BPDB and NTPC will finance the project equally while BPDB will purchase electricity from the plant for 25 years.

[27] http://www.the-esa.org/news/articles/-/energy-saving-bulbs-to-be-distributed-in-bangladesh

Table 1.18
Renewable Energy: Installed Capacity

Source	Installed Capacity	
	FY2013	FY2014 (Projected)
Solar Home System	33 MW	30 MW
Biogas Plant for Cooking	29900 m^3	44850 m^3
Solar Mini Grid	1.0 MW	1.0 MW
Solar Irrigation Pump	1.6 MW	2.4 MW
Biogas-based Power Plant	0.6 MW	2.0 MW
Biomass-based Power Plant	1.0 MW	1.0 MW

Source: Infrastructure Development Company Limited (IDCOL).
Note: m^3: cubic metre.

1.4.4 Policy and Institutional Issues

The national plan for power sector development included a number of reforms relating to policies and institutions. Two new laws have been enacted including Speedy Supply of Power and Energy (Special Provision) 2010 and Sustainable and Renewable Energy Development Authority (SREDA). A number of other laws/regulations are at different phases of implementation including revision of Electricity Law 1910, updating of National Energy Policy, revision of Renewable Energy Policy, introduction of Unified Service Rule, revision of the Service Rule of BPDB, and setting up Energy Research Council. Enforcement period for the Special Provision 2010 has been extended for another two years on its expiry in September, 2012. Despite its positive role in speeding up the process of providing work orders without going into lengthy tendering process, a number of criticisms have been raised with regard to transparency in the selection process, rate of generation cost and purchasing price for the BPDB and other issues.[28]

1.4.5 Concluding Remarks

The progress in the power sector over the last four years has been made mainly in one particular area, i.e. higher access to electricity through greater generation capacity. The composition of this growth, however, calls for close examination. There is no scope for considering QRPPs as a major medium-term option for addressing the challenge of overcoming power shortage. Indeed, extension of QRPPs should be considered only under strict scrutiny: a) extension of QRPPs should not be allowed without proper assessment of their efficiency and viability for operation; b) no QRPPs should be extended by more than five years and should not be upgraded as IPPs; c) purchase price of electricity from QRPPs should be renegotiated by taking into cognisance the changing cost structure. This would imply that the purchase price of electricity from these under new contracts should be significantly low. Government should allocate the needed fund for setting up large-scale power plants and should ensure supply of gas. In this context, government should put highest effort in two areas: a) ensuring long-term supply of primary energy, and b) enhancing investment particularly FDI, in power generation. As a matter of fact, frequent revision of Master Plans had to be undertaken because of the above mentioned challenges. Exploration of gas in onshore blocks should be increased further under the Bangladesh Petroleum Exploration & Production Company Limited (BAPEX). Government may also consider providing more opportunities to the international oil companies (IOCs) in onshore blocks.

It is found that the Bangladesh power sector is lagging behind in terms of improving efficiency in power generation and resource utilisation, enhancing diversity in primary fuel use and raising access to

[28]According to Khan *et al.* (2012) increasing investment in IPPs (including QRPPs) under such provisions could create a number of risks, which include financial, as in government insolvency, high risk premiums leading to high financing cost, high-cost options raising the risk of future government default; for bidders because of corruption; and for the project as adverse selection might lead to fewer bidders.

renewable energy. Considering the huge potentiality of renewable energy in Bangladesh (it is possible to bring about 6 million households under renewable energy in the non-grid area) more fiscal and financial support is required for renewable power generation projects. In this way, renewable energy could play an important and complementary role in the power sector of the country. Government should consider introduction of 'feed-in' tariffs for renewable power generation projects so that private sector could be encouraged to invest more in this type of projects.

1.5 FINANCING THE PADMA BRIDGE PROJECT – THE LINGERING CONCERNS

Construction of the Padma Multipurpose Bridge Project (PMBP) was first planned in 1999 with the objective of connecting the country's underdeveloped southwest region with the northeast. Pre-feasibility study has been carried out by the Government of Bangladesh (GoB) and the 6.15 km-long PMBP, the longest in South Asia, is expected to transform the country's southwest zone by connecting it to the capital and other developed regions of the country. It is envisaged that economic growth will be stimulated with the PMBP by facilitating inter-regional transport, transmission of natural gas, telecommunication service expansion and electricity provision. It has been estimated that the multiplier effects on the PMBP investments would enhance the national GDP growth by 1.2 per cent and gross product in the southwest region would rise by 3.5 per cent. Furthermore, the proposed bridge is expected to become an imperative freeway for trade and transportation between Bangladesh and India; it could also facilitate links with Myanmar. Moreover, generation of employment opportunities and improved access to healthcare and education for citizens of the impoverished southwestern part of Bangladesh would be very imperative. With significant positive externalities originating from realisation of the PMBP, the project has always been a national priority which was expected to encourage both national and regional socio-economic development.

Regrettably, financing of the project has faced setbacks since the initiation of the construction process. The GoB signed a loan agreement with the World Bank and other partners in mid-2011, the point in time when the optimism for the bridge was at its peak. However, hopes came crashing down when later in the year, the World Bank raised corruption allegations associated with the tendering process. A detailed investigation was requested by the World Bank, in conjunction with a series of proposals and recommendations. Being not convinced with initiatives taken by the GoB, the World Bank put on hold this largest development finance in the organisation's history in June 2012. Moving on, the World Bank decided to revive the USD 1.2 billion loan on September 2012, after the government agreed to a set of terms and conditions including the provision of asking all public officials allegedly involved in the corruption scheme to leave their jobs till the time the probe was completed. The GoB, wanting to speed up the implementation of the project and striving to delink investigation and procurement processes, decided to call off the agreement with the World Bank in January 2013.

The government was indeed left with two other costlier options regarding the financing of the project.[29] The financing could either be through commercial loans or the government would have to resort to self-financing. New windows of financing opportunities have emerged in the form of commercial loans from different entities.

The government has received financing proposals from a number of interested parties. In this respect, Malaysia was one of the major contenders in the run to finance the project. The modality proposed by Malaysia was BOOT (build-own-operate-transfer) with a proposed financing credit of USD 2.19 billion. The proposal envisaged formation of a consortium which included Samsung, a pre-qualified firm in the PMBP. With a proposed construction period of three years and operation of the bridge for 26 years before handing it over to the GoB (the payable amount standing at USD 5.2 billion), it is estimated that the

[29]Having said this, the revival of the World Bank loan for the PMBP cannot be ignored at any point of this enduring discourse.

government will need to repay the loan at an annual interest rate of approximately 6 per cent. A Memorandum of Understanding (MoU) was signed between the Bangladeshi and the Malaysian counterparts in 2012. However, a number of stringent conditionalities informed the proposal. Spelled out by the Malaysian government, these included provisions that procurements be made tax-free and imposition of high tolls on traffic movement.

Yet another proposal came from the Chinese side. The Chinese company China Railway Bridge Bureau Group Co. Ltd. proposed to build the Padma Bridge on build-own-transfer (BOT) basis. Keeping the existing design and investing USD 2 billion (70 per cent of the total cost of USD 2.9 billion), a consortium comprising three Chinese companies and the Bangladesh Bridge Authority (BBA) was proposed. The loan would have to be repaid in 20 years, without any interest payment. One of the major drawbacks of the Chinese proposal was that the involved consortium lacked the requisite experience to handle mega projects such as the PMBP.

Having reviewed the options of commercial loan financing, the GoB has now decided to go on its own and build the bridge on the basis of self-financing. This will likely have important implications for budgetary management of Bangladesh over the coming several years. Indeed, the PMBP was first brought into the purview of public finance through the Revised ADP (RADP) of FY2007-08. The total cost of the project was estimated to be Tk. 10,162 crore at that point in time, with 68 per cent attributable to Project Aid. As the financing of the PMBP was being negotiated with prospective partners, only some allocations and expenditures were undertaken in successive years. Allocations varied from as low as 0.16 per cent of the total ADP (considering RADP) to 2.89 per cent between FY2007-08 and FY2010-11. The comparable allocation was only 1.5 per cent in FY2011-12 and 1.34 per cent in FY2012-13. The low percentages can be largely explained by the absence of operationalisation of the loan agreement with development partners. It should be noted that the expenditure pattern has been rather sluggish when compared with the allocations made for the project. Table 1.19 also shows that 91 per cent of allocated finance was utilised in FY2008-09, while the share had been on a declining drift in recent years – with 59 per cent being spent in FY2009-10, 30 per cent in FY2010-11, 67 per cent in FY2011-12 and 19 per cent in FY2012-13. Interestingly, Tk. 207 crore worth of foreign aid was utilised under the ADP for FY2011-12, which possibly underwrote project design and preparatory costs.

Table 1.19

Allocation and Expenditure on Padma Multipurpose Bridge Project: FY2008 RADP to FY2013 RADP

Year	ADP	Project Cost (Crore Tk.)			Allocation (Crore Tk.)			Expenditure (Crore Tk.)		
		Taka	Aid	Total	Taka	Aid	Total	Taka	Aid	Total
FY08	Revised ADP	3,281	6,881	10,162	36	0	36	0	0	0
FY09	Original ADP	3,281	6,881	10,162	65	0	65	287	0	287
	Revised ADP	3,281	6,881	10,162	317	0	317			
FY10	Original ADP	3,281	6,881	10,162	700	0	700	200	0	200
	Revised ADP	3,281	6,881	10,162	338	0	338			
FY11	Original ADP	3,281	6,881	10,162	300	908	1,208	316	0	316
	Revised ADP	3,281	6,881	10,162	318	720	1,038			

(Table 1.19 contd.)

(Table 1.19 contd.)

Year	ADP	Project Cost (Crore Tk.)			Allocation (Crore Tk.)			Expenditure (Crore Tk.)		
		Taka	Aid	Total	Taka	Aid	Total	Taka	Aid	Total
FY12	Original ADP	4,258	16,250	20,507	480	1,707	2,187	202	207	409
	Revised ADP	4,258	16,250	20,507	162	453	615			
FY13*	Original ADP	4,258	16,250	20,507	572	232	804	84	48	132
	Revised ADP	4,258	16,250	20,507	596	105	701			

Source: Compiled from the Planning Commission data.
Note: *The expenditure figures are up to March 2013.

Having estimated the overall cost of the PMBP at Tk. 10,162 crore in FY2007-08, the figure was revised upward to Tk. 20,507 crore in FY2011-12, i.e. the cost more than doubled. Revenue and capital expenditure increased by 19 per cent and 81 per cent respectively. Out of the revised incremental allocation of the PMBP, sectors which received the highest increased allocation include resettlement (10.8 per cent of total increase), infrastructure including river training and earth filling (17.1 per cent), approach road (8.8 per cent), and bridge construction (45.4 per cent). Table 1.20 presents a selective summary of the major sub-headings which received the highest allocations in the revised PMBP project cost. In the view of the delay in implementation of the project, a new cost-benefit analysis is needed.

Table 1.20

Difference in Original Project Cost and Estimated Project Cost

(Lakh Tk.)

Item Description	Difference				Total	Proportion of the Total (%)
	GoB (FE)	Cost				
		PA		DPA		
		Through GoB	SP Account			
Resettlement including SAP	-10605	72000	15104	35243	111742	10.80
Total Revenue	**-34934**	**72000**	**22648**	**136298**	**196012**	**18.95**
Other infrastructure (river training works) including service area and earth filling	39586	0	41385	96530	177501	17.16
Approach Road	1688.36	0	26777	62488	90953	8.80
Bridge Construction	-14666	0	145324	339103	469761	45.41
Construction Yard	25000	0	0	0	25000	2.42
Total Capital	**132594**	**0**	**217356**	**488584**	**838534**	**81.05**
Grand Total	**97659**	**72000**	**240004**	**624882**	**1034545**	

Source: Based on the Bangladesh Bridge Authority.

With a rather insignificant allocation and expenditure in FY2011-12 and FY2012-13, the GoB has now come to a decision to allocate a significant amount of Tk. 6,852 crore in the next ADP, i.e. 33.4 per cent of the total PMBP project cost. It has been reported that the comparable foreign component was Tk. 1,600 crore (23.35 per cent of the project cost in the next fiscal). However, it is doubtful whether the full amount of allocated resources can be spent in FY2013-14. It has also been reported that Tk. 7,800 crore, Tk. 5,000 crore and Tk. 300 crore, i.e. 38.04 per cent, 24.38 per cent and 1.46 per cent of the project cost respectively would be allocated over the next three years (FY2014-15, FY2015-16 and FY2016-17). However, uncertainty remains regarding the acquisition of foreign funds which are to be utilised in future in the PMBP, both in terms of source and availability.

With the PMBP expected to absorb approximately 56 per cent of the total incremental allocations in the next fiscal's ADP allocations and non-PMBP incremental allocation to be only Tk. 4,822 crore, a legitimate question may be raised regarding allocation for other priority sectors such as health, education and agriculture. Enhanced allocations of domestic resources will have significant implications for the allocative priorities under the next three-four ADPs. As a large portion of the additional ADP resources has to be allocated to PMBP, it is reckoned that not much resource will be available for other priority sectors in the areas of physical and social infrastructure. One will need to assess a fuller macroeconomic implication encompassing exchange rate, inflation and other aspects of the economy if the government decides to convert domestic currency or take up loan from the foreign currency reserve.

With diminished prospect of foreign aid, the government is considering the floatation of Sovereign Bonds for 5-10 years at the rate of 5.5 per cent to raise USD 1 billion. The proposal appears to be quite challenging looking at the experience of neighbouring countries. The third international Sovereign Bond offered by Sri Lanka in 2011 had a yield rate of 6.25 per cent. Sri Lanka's S&P rating is B+, while that by the Moody's is B1 – both measures allude to a positive outlook and both lower than that of Bangladesh's ratings. On the other hand, interest on Indian government bonds was 9 per cent (despite of India having a higher credit rating than Bangladesh); the interest rate on Pakistani government bonds are 12 per cent (Pakistan's credit rating is lower than that for Bangladesh). Thus, it is reasonable to assume that it is not only the credit ratings which are taken into account by the international investors, but also other macroeconomic attributes. Even if Bangladesh undertakes floatation of her sovereign bonds at 5.5 per cent, Bangladesh's reputation will be severely affected in case of under-subscription of the bonds given the uncertainties the country is in.

Moreover, foreign exchange reserves will definitely suffer erosion if there is no extensive external financing associated with the project. Furthermore, there were proposals of borrowing from the capital market. Borrowing from the Bangladesh capital market, which is itself suffering from both confidence and liquidity crises, would likely worsen the current market situation and outlook. Another setback of self-financing the PMBP is that Bangladesh lacks sufficient exposure to such large infrastructure projects and managing it. Nevertheless, own financing would present the government with the authority to modify and exercise policies according to its own accord for the betterment of the economy without any intervention.

Out of the two other commercial borrowing options which are currently on the table (which were discussed beforehand), the Chinese offer appears to be more preferable on the face of it with the limited credible details available for both the recommendations. However, the government may explore other concessional or low-cost foreign financing to substitute the earmarked domestic resources and release them for other competing demands. If the government is left with no other alternatives and has to go ahead with self-financing, then the government would have to strengthen domestic resource mobilisation to finance the rest of the under-resourced essential public priorities. Although the amount of current reserves are robust, drawing on the reserves could be a problem if imports pick up and there is deceleration in export earnings over the coming period. All avenues including renegotiations with aid agencies should be kept open to underwrite the construction of the bridge through a mixed bag of financial options.

1.6 EXTERNAL SECTOR PERFORMANCE: IMPLICATIONS OF DOMESTIC DEVELOPMENTS AND GLOBAL DYNAMICS

1.6.1 Overview of the World Economic Outlook and Growth Projections

The global economy continues to struggle despite some signs of economic upturn in early 2013. According to UN (2013) report, deepening of the Euro crisis, 'fiscal cliff' in the United States (US) economy, and a hard landing of the Chinese economy will likely to dictate a faltering economic recovery in 2013. Indeed, according to World Bank (2013), global GDP growth is expected to come down to 2.4 per cent in 2013 (Table 1.21), following which it is projected to increase to 3.1 per cent in 2014. UN report on *World Economic Situation and Prospects 2013* shows that several developed countries, especially in Europe, have already fallen into a double-dip recession. The Euro area, major market for Bangladesh's export, is forecasted to experience negative growth rate in 2013 ((-) 0.1 per cent). The corresponding figure for the US economy, another important market for Bangladesh, is indicative of a decline in the GDP growth rate to 1.9 per cent in 2013 from 2.2 per cent in 2012. The growth rate for Japan is also expected to come down to 0.8 per cent in 2013 from 1.9 per cent in 2012. On the other hand, growth scenarios for some of the emerging economies remain stable in the near term. The slowdown in these major markets of Bangladesh is reckoned to have important implications for the increasingly globalising economy of Bangladesh.

Table 1.21

GDP Growth Rates

(in Per cent)

Country/Region	2012	2013*	2014*	2015*
Euro Area	-0.4	-0.1	0.9	1.4
USA	2.2	1.9	2.8	3.0
OECD Countries	1.2	1.1	2.0	2.3
China	7.9	8.4	8.0	7.9
Brazil	0.9	3.4	4.1	4.0
India	5.1	6.1	6.8	7.0
Indonesia	6.1	6.3	6.6	6.6
World	**2.3**	**2.4**	**3.1**	**3.3**

Source: World Bank (2013).
Note: *Forecast. OECD: Organisation for Economic Co-operation and Development.

In view of the expected declaration in the growth of the global economy in 2013, the growth in world trade is also projected to remain sluggish in 2013 at about 3.3 per cent (Table 1.22), the trade forecast being downgraded from the earlier figure of 4.5 per cent (WTO 2013) due to the slower global growth and the looming crisis in the Eurozone (Figure 1.14). This forecasted figure was significantly below the average rate of 5.3 per cent recorded for the last 20 years (1992-2012).

Growth prospects of major markets of Bangladesh in the European Union (EU), viz. Germany, United Kingdom (UK), France and Italy, also indicate relatively slower growth rates for 2013 and 2014. Indeed, import demand in France and Germany are projected to decline by more than 10 per cent in nominal terms in 2013.

Table 1.22

Annual Growth Rate of World Merchandise Trade: 2010-2014

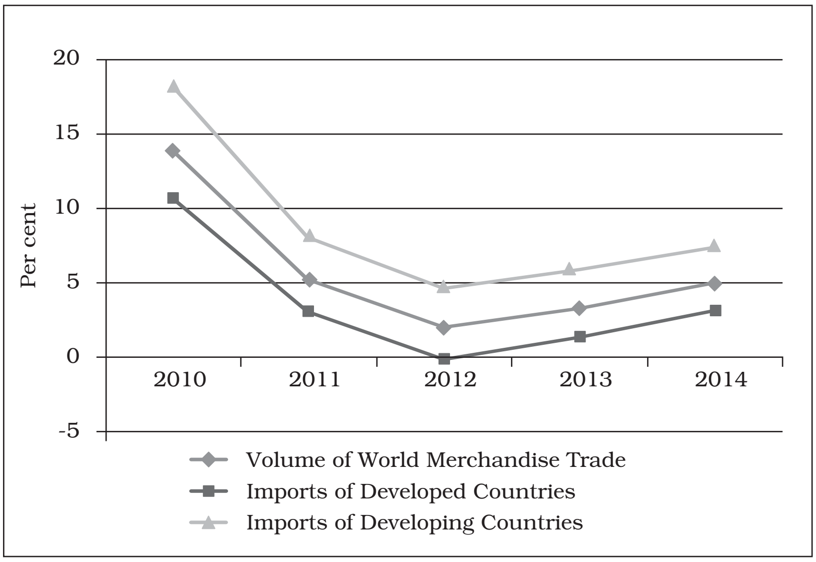
(in Per cent)

Merchandise Trade	2010	2011	2012	2013*	2014*
World Merchandise Trade	**13.9**	**5.2**	**2.0**	**3.3**	**5.0**
Exports					
Developed Countries	13.1	5.1	1.0	1.4	2.6
Developing Countries	15.3	5.4	3.3	5.3	7.5
Imports					
Developed Countries	10.7	3.1	-0.1	1.4	3.2
Developing Countries	7.3	5.3	4.6	5.9	7.4

Source: WTO (2013).
Note: *Projected.

Figure 1.14

Growth Rate of World Trade: 2010-2014



Source: Adopted from WTO (2013).

Global FDI flows also reflect a dampened picture in view of the macroeconomic fragility and policy uncertainty facing prospective investors. According to UNCTAD (2013), growth rate of total FDI outflow from EU declined significantly by (-) 25.1 per cent and by (-) 16.1 per cent from USA in 2012. Projected figures showed that FDI could rise moderately to USD 1.8 trillion in 2013 and 1.9 trillion in 2014, although the United Nations Conference on Trade and Development (UNCTAD) argues that FDI recovery will take longer than the expected timeframe if macroeconomic shocks persist. This is corroborated by the outlook of major investors – perception survey conducted by UNCTAD showed a majority of the transnational corporations (TNC) respondents were either pessimistic or neutral about global investment climate in 2013.

1.6.2 Export Sector Performance

Bangladesh's export earnings stood at USD 21.78 billion, registering a moderate growth rate of 10.14 per cent during the July-April period of FY2012-13 compared to the corresponding months of FY2011-12. Indeed, whilst this growth performance was notable by any measure, exports would need to grow by 37.8 per cent over the remaining two months of the current fiscal to attain the growth target of 15.3 per cent set for FY2012-13. It would thus be justified to project that targets will remain unattained this year.

While knit (8.9 per cent), woven (14 per cent), leather (19.6 per cent) experienced relatively high growth, raw jute ((-) 11.4 per cent), home textiles ((-) 11.8 per cent) and frozen food ((-) 14.4 per cent) posted negative growth rates during the July-April period of FY2012-13 compared to the corresponding period of FY2011-12. During the same period of FY2012-13, non-RMG sector did not exhibit a promising trend for export earnings. As Table 1.23 shows, as a group export performance of RMG was better compared to that of non-RMG, although both the groups are likely to fail in attaining the respective growth targets.

Market decomposition analysis reveals that Bangladesh's RMG export growth to the US market remained stagnant (0.96 per cent), while Vietnam achieved significant growth (9.6 per cent) during July-March period of FY2012-13 compared to the same months of FY2011-12. It is important to note that US's total RMG imports declined by (-) 0.25 per cent over the same period.

Bangladesh's woven exports rose only by 0.24 per cent in the US market whereas Vietnam posted 8.9 per cent growth over the same months in FY2012-13 (Table 1.24). Amongst Bangladesh's other major

Table 1.23

Export Growth of Major Products: FY2012-13 (July-April)

(in Per cent)

Product	Target FY13	Achieved FY12 (Jul-Apr)	Achieved FY13 (Jul-Apr)	Required FY13 (May-Jun)
RMG	*12.8*	*9.6*	*11.5*	*18.7*
Knit	11.9	3.0	8.9	24.4
Woven	13.8	16.9	14.0	12.9
Non-RMG	*24.3*	*4.4*	*5.3*	*109.9*
Raw Jute	13.4	-22.4	-11.4	147.5
Leather	21.2	10.9	19.6	27.4
Home Textiles	26.9	10.3	-11.8	193.0
Frozen Food	17.0	-0.9	-14.4	190.2
Total	**15.3**	**8.4**	**10.1**	**37.8**

Source: Estimated from the Export Promotion Bureau (EPB) data.

Table 1.24

Comparison of RMG Growth Rates between Bangladesh and Other Countries in US and EU Market: 2013 over 2012 (July-March)

(Lakh Tk.)

Country	US Market			EU Market		
	Knit	**Woven**	**RMG**	**Knit**	**Woven**	**RMG**
Bangladesh	3.60	0.24	0.96	-0.18	18.67	6.23
China	-0.90	0.53	-0.20	-9.22	-11.15	-10.25
Cambodia	-5.36	-6.48	-5.59	10.67	72.97	23.27
Indonesia	-1.14	0.96	-0.13	-7.06	-7.33	-7.21
Mexico	-7.42	-6.44	-6.87	-5.96	-4.76	-5.42
Vietnam	10.02	8.95	9.59	-5.72	3.56	1.11
Turkey	-4.35	-0.61	-1.44	5.46	8.33	6.56
Total	**-0.98**	**0.59**	**-0.25**	**-7.41**	**-7.33**	**-7.37**

Source: Calculated based on the United States International Trade Commission (USITC) and Eurostat data.

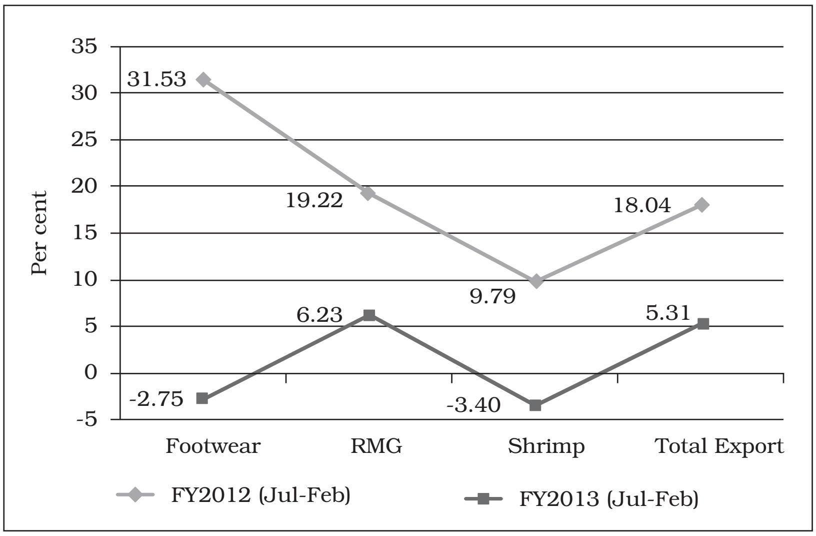
competitors in the US, China ((-) 0.2 per cent), Indonesia ((-) 0.13 per cent), Turkey ((-) 1.44 per cent) and Cambodia ((-) 5.59 per cent) experienced a negative growth for RMG exports. Non-RMG exports in the US market for Bangladesh suffered severely: footwear exports declined by (-) 4.7 per cent and shrimp exports declined by (-) 42.2 per cent. Overall, export performance in the US market was rather discouraging in FY2012-13 in the backdrop of the depressed import demand in the US.

As opposed to the US market, total exports to the EU market posted a modest growth rate of 5.3 per cent during July-February of FY2012-13 with the growth rate of 6.23 per cent from RMG exports (Figure 1.15). This contrasts notably from the performance in FY2011-12 when Bangladesh's totals export to the EU posted 12.36 per cent growth, and the figure for RMG exports was 13.95 per cent.

As a matter of fact, growth of non-RMG exports to the EU market entered into a negative terrain during the July-February period of FY2012-13: footwear and shrimp exports declined by (-) 2.75 per cent and (-) 3.40 per cent respectively. It is of interest to note that, while the total exports of China ((-) 2.77 per cent) and Indonesia ((-) 1.29 per cent) had declined, exports of Cambodia (26.54 per cent) and Vietnam (41.15 per cent) registered significant rise in the EU market during July-February of FY2012-13 compared to the matched period of FY2011-12.

Figure 1.15

Export Growth of Bangladesh in EU Market: FY2011-12 and FY2012-13 (July-February)



Source: Calculated based on the Eurostat data.

It is important for Bangladesh to identify the reasons for the ascendancy of Vietnam in US apparels market, and Vietnam and Cambodia in the EU market. Both price and non-price factors should be closely examined to this effect to find out appropriate measures to address these disquieting trends.

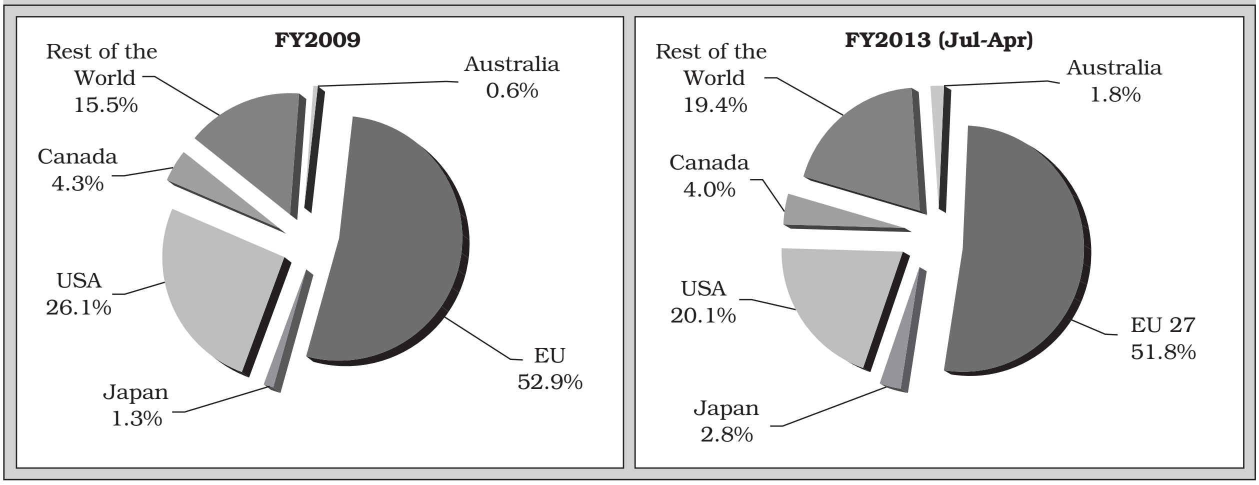
South-South Trade

Evidence suggests growing prominence for South-South merchandise trade as far as trade of developing countries is concerned. However, Bangladesh's track record in contrast has only been modest in this regard. Between FY2008-09 and FY2012-13 (July-April) share of Bangladesh's export to rest of the world (barring non-OECD countries) increased from 15.5 per cent to 19.4 per cent (Figure 1.16).

Indeed, average growth of export in this period for India (34.58 per cent), Turkey (25.15 per cent) and China (99.72 per cent) were quite notable (Table 1.25). In view of the growth demand in the economies of the South, Bangladesh should pay closer attention to exploring the export prospects through more South-South trade.

Figure 1.16

Share of Total Export in Different Countries: FY2008-09 and FY2012-13



Source: Calculated from the Export Promotion Bureau (EPB) data.

Table 1.25

South-South Trade for Bangladesh: FY2008-09 to FY2012-13*

Country	Export in FY09 (Million USD)	Export in FY13 (Million USD)	Avg. Growth Rate between FY09-FY13 (%)	Share of RMG and Non-RMG Export in FY13 (%)
India	275.67	656.93	34.58	13:87
China	97.57	486.77	99.72	30:70
Brazil	72.08	212.90	48.85	94:6
Turkey	329.92	661.84	25.15	62:38

Source: Adopted from the Export Promotion Bureau (EPB) data.
Note: *Figure for July-March of FY2012-13 has been extrapolated for the full fiscal year.

It is also noteworthy to mention that non-RMG exports constitute a significant share in Bangladesh's South-South trade (for India 87.1 per cent, for China 69.8 per cent and for Turkey 37.6 per cent), alluding to greater opportunities of product diversification for Bangladesh by way of South-South trade.

Price Dynamics in the RMG Sector

Price data indicates that the average price for top five knit and woven items have been on a declining trend over the July-April period of FY2012-13 compared to the same period of FY2011-12 (Table 1.26). However, CPD (2013a) showed that the average price for the top five knit and woven items had increased in the period between FY2009-10 and FY2011-12 (between 26 per cent and 48 per cent).

Table 1.26

Average Price (Per Unit) for Top Five Knit Items

Item	Total Export FY13 (Jul-Apr) (Million USD)	As % of Total Knit Export	Average Price per Unit (USD) FY12 (Jul-Apr)	Average Price Per Unit (USD) FY13 (Jul-Apr)	Growth in Price (%)
610910: T-shirts, singlets and other vests, of cotton, knitted	3969.48	47.36	12.89	12.20	-5.34
611090: Pullovers, cardigans and similar articles of textile materials, knitted	1227.28	14.64	16.00	15.67	-2.05
611020: Pullovers, cardigans and similar articles of cotton, knitted	649.65	7.75	17.68	16.51	-6.63
610510: Mens/boys shirts, of cotton, knitted	523.82	6.25	14.24	13.18	-7.45
610462: Womens/girls trousers and shorts, of cotton, knitted	202.95	2.42	13.89	12.57	-9.52

Source: Estimated from the Export Promotion Bureau (EPB) and the National Board of Revenue (NBR) data.

Recent Developments in the RMG Sector

Bangladesh's RMG industry has come under close scrutiny by international buyers, consumers and western governments following the collapse of the Rana Plaza that resulted in the death of more than 1,100 employees working in five RMG units. Bangladesh, *an export power house*, which has in recent years emerged as the second largest global exporter of apparels (after China), has been threatened with boycott by some of the major buyers and consumer groups, and discontinuation of preferential treatment by major importing countries. Bangladesh's track record in ensuring workers' rights, work place safety, decent working conditions and minimum acceptable wages has been put on the spotlight after the Rana Plaza tragedy. These new developments could seriously undermine Bangladesh's future export prospects in major market. The recent unrest in Ashulia following the Rana Plaza incident could also have adverse implications in terms of production and export of RMG in near-term. In a recent move the GoB has amended the Labour Act of 2006, which, inter alia, provides workers with the right to organise themselves in Trade Unions. In the aftermath of the Rana Plaza disaster concerned stakeholders have come up with a number of activities and initiatives which they plan to undertake over the short to medium-term future (Box 1.2). It will be critically important to follow up on these and do the homework, if this mainstay of Bangladesh economy does not suffer serious damage at a time when Bangladesh was passing through a *window of opportunities*.

Box 1.2

Summary of National and Global Responses for RMG Industry in Bangladesh after the Savar Tragedy

Stakeholder	Initiative(s)	Description
Government of Bangladesh	High level committee – comprised of representatives from several ministries and Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), Bangladesh Garment Manufacturers and Exporters Association (BGMEA) and Bangladesh Knitwear Manufacturers & Exporters Association (BKMEA)	• Examine the building codes and safety measures of the garment factories • Submit the recommendations to the existing Cabinet Committee • Form a new Wage Board • Decision to allow trade unions in the RMG industry
The Tripartite Partners (government, employers and workers) and the International Labour Organization (ILO)	Tripartite partners and the ILO action plan	• Labour Law reform package • Building and fire safety of all active export-oriented RMG factories in Bangladesh
Major European retailers	The Bangladesh Safety Plan	• Establish a fire and building safety programme in Bangladesh for a period of five years • Companies will pay a maximum USD 0.5 million per year or USD 2.5 million over the five years, depending on companies' annual apparel production in Bangladesh • Covers 1,000 RMG factories
Wallmart	Individual action plan	• Will carry out inspection in all of the 279 factories from where Wallmart sources its products
Gap	Individual action plan	• Provide USD 22 million for labour safety
Japan International Cooperation Agency (JICA), GIZ (Germany), North American Bangladesh Worker Safety Group and others	Several measures	• Survey factories • Promote social and environmental standards

Source: Compiled from various sources.

It can also be observed from the Box that in a recent move, major retailers from the Europe has agreed to sign the *Bangladesh Safety Plan* which is designed to improve the fire and building safety condition in Bangladesh over the next five years. US retailers have not signed on this although some have indicated their willingness to undertake measures of their own to address the problems of safe working condition in the sector.

1.6.3 Performance of the Import Sector

Departing from recent robust trends, growth rate of Bangladesh's overall import payments has declined significantly over the first nine months of FY2012-13. According to the Bangladesh Bank statistics, total import payments amounted to USD 25.3 billion, registering a negative growth of (-) 6.11 per cent during July-March period of FY2012-13 compared to the same months of FY2011-12. Conversely, commodity-wise import statistics, recorded by customs, exhibits that total imports declined by (-) 0.85 per cent over the above mentioned months of FY2012-13 compared to the corresponding months of FY2011-12. Indeed, growth rates of all major importable items including foodgrains, consumer goods and capital goods have declined significantly (Figure 1.17). Import of intermediate goods has, however, experienced a positive growth, mainly due to higher import of raw cotton, yarn, textile and articles thereof and staple fibre. In the backdrop of good performance in the agriculture sector, import of foodgrains declined by (-) 44 per cent, with rice import falling by (-) 94.1 per cent. However, international rice price may not have been behind the reason of falling rice imports as rice price remained almost stagnant (declined by only 0.03 per cent) during July-April period of FY2012-13 compared to the same months of the previous fiscal.

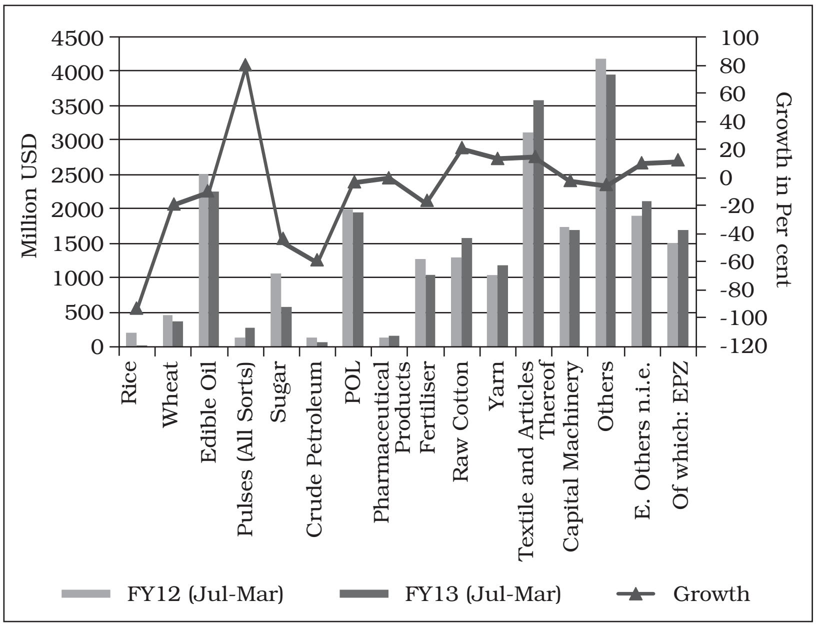


Figure 1.17

Import Payments for Selected Commodities: FY2012-13 over FY2011-12 (July-March)

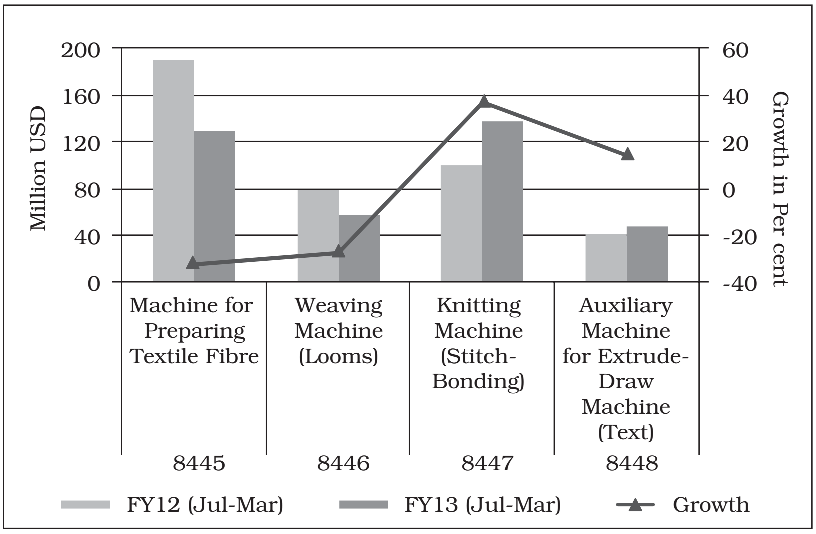
Source: Adopted from the Bangladesh Bank data.

While import of crude petroleum declined sharply by (-) 61.14 per cent, petroleum and other liquids (POL) import also declined by (-) 3.5 per cent. Import of capital machineries, one of the key variables to measure investment, fell by (-) 10.59 per cent. Declining trend in the import of capital machinery had adverse consequences for domestic investment.

Among other capital machineries, import of textile machineries evince a mixed scenario with positive growth for knitting (37.4 per cent) and auxiliary machine (14.9 per cent) and negative growth for textile fibre ((-) 32 per cent) and weaving machine ((-) 27 per cent) (Figure 1.18).

Figure 1.18

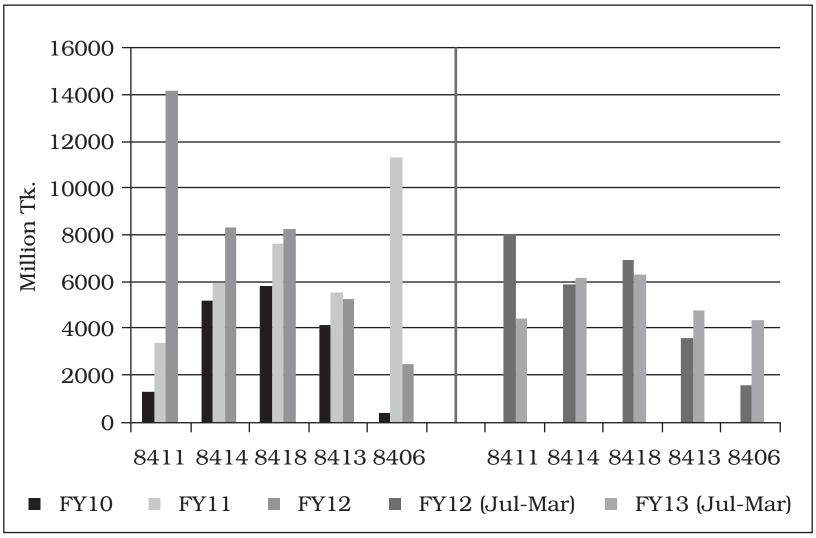
Dynamics of Textile-related Machineries Import: FY2012-13 over FY2011-12 (July-March)



Source: Estimated from the National Board of Revenue (NBR) data.

Figure 1.19

Import of Capital Machineries in Power Sector



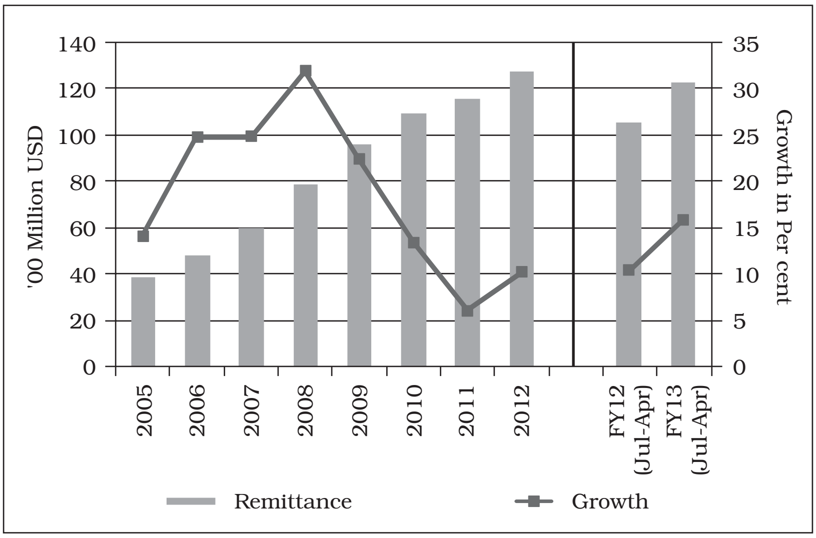
Source: Estimated from the National Board of Revenue (NBR) data.

It is important to note that capital machineries in power sector experienced remarkable growth rate during FY2009-10 to FY2011-12. Lower import growth in power sector in FY2012-13 also contributed to the lower capital machinery import in the first nine months of FY2012-13 (Figure 1.19).

Letter of credit (L/C) opening and L/C settlement declined by 2.2 per cent and 10.4 per cent respectively during July-March of FY2012-13 compared to the same months of FY2011-12. It is important to note that L/C opening for capital machineries increased by 27.4 per cent in the same period. Higher growth in energy/power (276.7 per cent), textile (14.5 per cent) and garment (33.3 per cent) industry contributed to this positive growth trends. L/C opening trends indicate that imports could continue to decelerate in the coming months although rise in import of capital machineries could have positive implications for near-term investment.

1.6.4 Remittances

Remittance inflows in the economy have been robust for the past several years; rising from USD 3,848 million in FY2004-05 to USD 12,843 million in FY2011-12 (Figure 1.20). Robust remittance earning



Source: Bangladesh Bank.

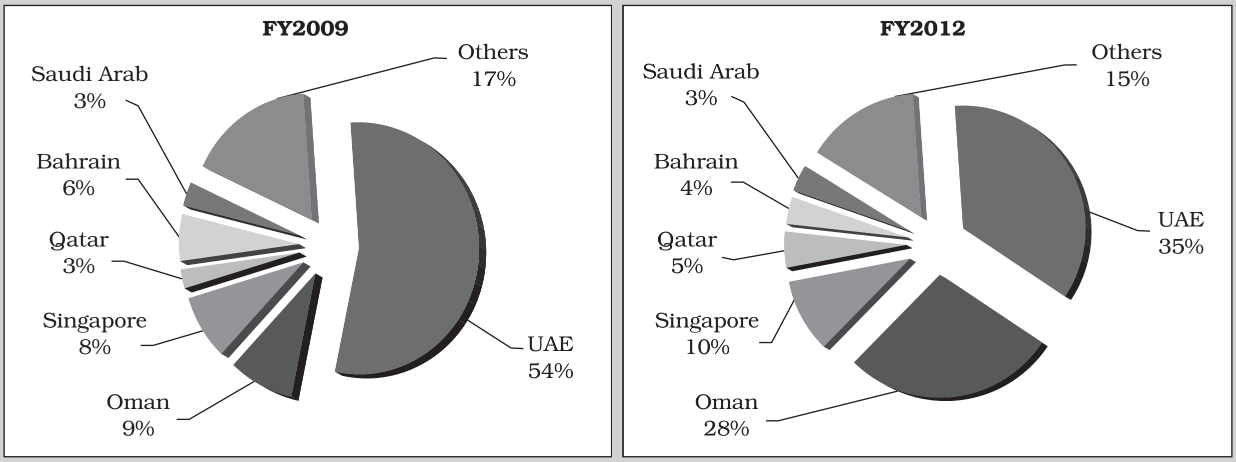
Figure 1.20
Yearly Trends of Remittance Inflow

was a hallmark of the current fiscal year. For the first time in history, monthly remittance earnings exceeded the one billion dollar mark throughout a particular fiscal year. Remittance earnings during July-April of FY2012-13 stood at USD 12,303 million, registering 15.9 per cent growth over the comparable months of the previous fiscal year. The positive implications of this rising trend for the economy could not be overemphasised.

Country-wise remittance inflow data shows that Saudi Arab remains the major source of country's remittance earning, marking 11.34 per cent growth during July-March of FY2012-13 as compared to the same months of FY2011-12. Of the other major sources, growth rates of remittance from the United Arab Emirates (UAE) (24 per cent), USA (24.3 per cent) and Malaysia (18.7 per cent) have been remarkably high.

A total of more than 0.6 million workers from Bangladesh have gone overseas as migrant workers by the end of 2012. However, as it can be seen (Figure 1.21), country-wise composition for overseas employment has changed over the years. Number of workers going to UAE has gone down in a significant way during 2009-2012, while Oman has emerged as an important destination for overseas employment in recent times.

Figure 1.21
Change in Market Composition for Manpower Export: FY2008-09 and FY2011-12



Source: Estimated from the Bureau of Manpower, Employment and Training (BMET) data.

Despite some progress in sending workers to Malaysia and Saudi Arab, the total number of workers going abroad fell to 0.3 million during July-February in FY2012-13 from 0.4 million over the same period of FY2011-12, registering a negative growth of (-) 31.7 per cent. Overseas employment fall in UAE ((-) 77.7 per cent), Kuwait ((-) 50 per cent) and Oman ((-)16.5 per cent) have contributed to this negative growth during July-February period of this current fiscal. On the contrary, overseas employment increased in Malaysia (42.8 per cent), Saudi Arab (46.5 per cent), Bahrain (35.1 per cent) and Singapore (15.8 per cent) during July-February of FY2012-13 as compared to the same months of FY2011-12. In recent times, opportunities have emerged in a number of countries including Bahrain, Singapore, Mauritius, and many of these countries have expressed their interest to take workers under government-to-government (G2G) system; many of these are interested to recruit women workers in certain sectors (Box 1.3). Bangladesh's capacities will need to be geared up in view of these emerging possibilities.

The Ministry of Expatriates' Welfare and Overseas Employment, with the technical help of ILO, is reviewing the *Overseas Employment Policy 2006* to comply with the international frameworks, labour standards of ILO and the strategic directions set by Bangladesh's government for national development. The document should reflect the needs originating from both demand and supply sides and take into account the new opportunities. The policy should also address the problems faced by Bangladeshi workers abroad. This will require institutional strengthening, skill endowment, providing credit and financial support to workers willing to go abroad, safeguarding their rights in the host countries, and strengthening of Bangladeshi missions dealing with migrant workers. Coherence as regards the policies pursued by different agencies involved in implementing the Overseas Employment Policy will be crucial in this context.

Box 1.3

New Opportunities for Overseas Employment in Different Countries

Country	Programme	Features
Malaysia	Demands for workers under G2G arrangement	• Plans to recruit 30,000 workers in plantation, industrial and manufacturing sectors • 11,758 have already left for Malaysia under the plantation programme
Saudi Arab	In a major policy change, *Iqama* transfer opportunity is being offered to Bangladeshi workers in Saudi Arab	• *Iqama* transfer opportunity will allow the Bangladeshi workers to transfer their employer or occupation • Saudi Arab has also issued a general amnesty until July for the illegal workers so that they can legalise their stay or return home without facing penalty
Bahrain	Demands for workers under G2G	• Plans to recruit 15,000-20,000 workers each year • G2G is expected to reduce the cost of migration
Hong Kong and Singapore	Demands for housekeepers under government arrangement	• About Tk. 40,000 and Tk. 24,000 will be paid as monthly salary respectively in Hong Kong and Singapore
Mauritius, Jordan and other countries	Demands for garments workers, food processors, receptionists and other posts	• Salary range is Tk. 25,000-30,000
Middle East countries	Demands for housekeepers under government arrangement	• Salary is about Tk. 15,000
General trend	Many countries are interested to have nurses and caregivers under government arrangement	• Salary range is Tk. 50,000 to Tk. 85,000 for nurses • Salary is Tk. 15,000 for caregivers

Source: Compiled by authors.

1.6.5 Exchange Rate

Following a period of continuing depreciation of the Taka against all major currencies, BDT has entered into a phase of some appreciation since the beginning of FY2012-13. The depreciation, whilst benefitting the export-oriented sectors, has also fuelled domestic inflation via inflated import prices at a time when some of the global commodity prices, along with fuel prices, were showing rising trends. As against this, in July-April period of the current fiscal, BDT has started to gain strength against all major currencies in the backdrop of the robust remittance flow, falling imports and rising forex reserves. Nominal exchange rate data shows that the BDT appreciated by 3.9 per cent against the USD, 3.17 per cent against the CNY, 7.08 per cent against the British Pound (GBP) and 2.7 per cent against the INR during July-March in FY2012-13. However, BDT depreciated against Euro by 1.33 per cent over the same months of FY2012-13.

Real Effective Exchange Rate (REER) and Nominal Effective Exchange Rate (NEER) depreciated by 8.49 per cent and 4.13 per cent respectively during July-March of FY2012-13. REER also depreciated by 1.68 per cent in FY2011-12 (Figure 1.22). Sattar (2013) has argued that modest depreciation of REER would work in favour of sustaining competitiveness of exports in Bangladesh.

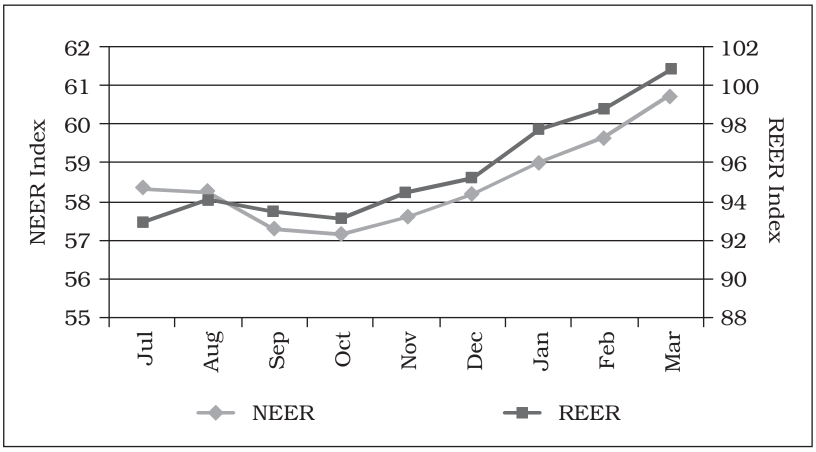


Figure 1.22

NEER and REER: FY2012-13 (July-March)

Source: Adopted from Bangladesh Bank.

As regards the dynamics of nominal exchange rates of Bangladesh's major competitors, the experience appears to be diverse across countries. While the nominal exchange rate has appreciated for Bangladesh, India and Cambodia, depreciation is observed for Vietnam and Indonesia during July-March period of FY2012-13. As was mentioned earlier, BDT appreciated against USD by 3.9 per cent in this period; as was the case with the INR and the Cambodian Riel (KHR) which appreciated by 1.49 per cent and 2.61 per cent respectively against the USD over the matched period. On the Contrary, Vietnamese Dong (VND) and Indonesian Rupiah (IDR) depreciated by 0.37 per cent and 2.90 per cent over the above mentioned period. It is important to note that, both Bangladesh and Vietnam experienced depreciation of their respective currencies (in nominal terms) between 2009 and 2012.

It is true that, in general, empirical relationship between exchange rate and trade performance has been found to be weak in the context of Bangladesh. With application of cointegration and error correction techniques, Ahmed (2009) found no robust relationship between exchange rate volatility and export growth in Bangladesh context. Alam (2010) also found that there was no causal relationship between depreciation of BDT and Bangladesh's export earnings. However, it is safe to conclude that relative comparative advantage of both export-oriented and import-substituting industries is influenced by movements in relative exchange rates, although Bangladesh's export performance does not appear to have a strong relationship with the dynamics of exchange rate movements.

1.7 ECONOMIC IMPLICATIONS OF *HARTALS* IN THE PRESENT CONTEXT

Heightened confrontational politics, marked by frequent *hartals*, particularly during the run-up to the national parliamentary elections is not uncommon in Bangladesh. It may be recalled that prior to all the three national elections that took place since the 1990s, the country experienced spells of general strikes. On previous three occasions since the 1990s, imposition of *hartals* became more frequent in the fifth year of successive democratic regimes (FY1995-96, FY2001-02 and FY2006-07). No doubt, disruptions caused by *hartals* had adverse consequences for the economy. It appears that FY2012-13 will not be an exception in this regard. In connection to this, one may recall that, CPD in January 2013 observed that "the government has settled … with moderated economic growth, investment and employment prospects. Regrettably, even this modest ambition could come under serious challenge in view of the looming uncertainties in the political front" (CPD 2013a).

Of course freedom of expression is a fundamental right in a democratic society. However, when *hartals* are imposed and enforced frequently and violently, they involve significant economic costs for producers, consumers, investors and the economy as a whole. Assessing the economic implications of *hartals* is thus important from three perspectives: (a) capturing the transmission channels of impact; (b) getting a sense about the costs; and (c) influencing the discourse towards a search for alternatives. Although other categories of political shocks also persist in Bangladesh given the current circumstances, there is value in doing a meticulous analysis of *hartals* as a standalone phenomenon.

1.7.1 Cross-Country Experience

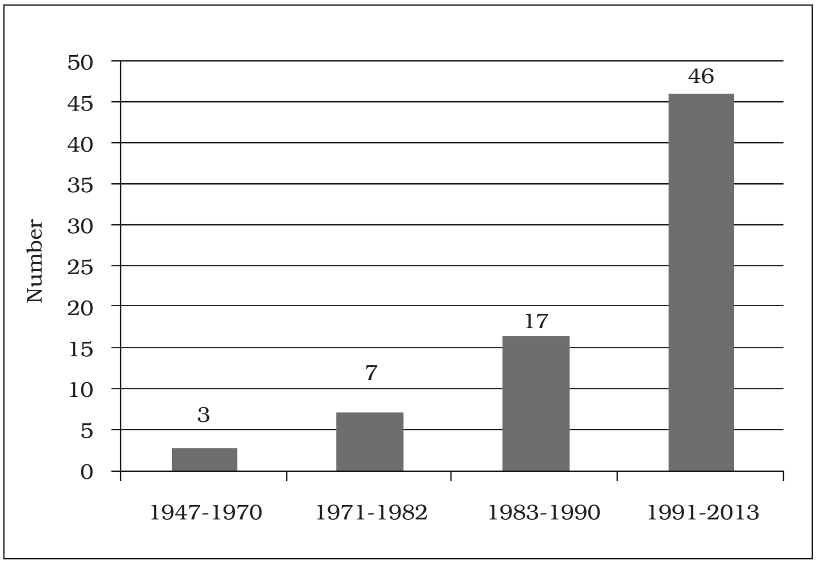
Political unrest has been a cause of concern for many countries around the world irrespective of their political regime or the state of development. Experience from global literature suggests that political conflicts can have significant detrimental impact on an economy. Indeed, domestic conflicts under certain conditions could push countries towards a fragile state status. Fragile and conflict ridden countries do not have the ability to develop mutually rewarding and constructive relationships within their societies and often suffer from a weak capacity to undertake governance functions (OECD 2011). These countries are more vulnerable to internal and external shocks, and in turn, face instability. Arguably, given the dominance of informal sector in economies like Bangladesh, adverse impact of *hartals* could be lower when compared with more developed countries.

Aisen and Veiga (2011), in a study of 169 countries and using five year periods between 1960 and 2004, found that escalated levels of political instability are associated with lower levels of GDP growth rates. According to the authors, the major transmission channels were decline in productivity growth and lower level of physical and human capital accumulation. Alesina and Perotti (1993) also found that socio-political instability adversely affects investment. Aisen and Veiga (2006) concluded that political instability leads to higher inflation in developing countries.

A recent study by Khandelwal and Roitman (2013) analysed the impact of political instability on a number of macroeconomic indicators covering eleven selected countries of the Middle East and North Africa (MENA) region in the context of the Arab Spring. The authors concluded that political instability coincided with a large decline in real GDP growth rates in the MENA region. They also estimated that output generally remained below the potential for the following four years after the initial drop due to political instability, and it takes about five years for the economy to bounce back. In case of unemployment, it would take between 4-5 years to revert back to the pre-crisis level in an economy. It was also observed that the countries in transition (e.g. Egypt, Tunisia and Yemen) experienced significant decline in real GDP in 2011 due to political instability.

1.7.2 *Hartal* Experience of Bangladesh

As evidence bears out, *hartals* in Bangladesh is becoming more frequent in recent decades. Figure 1.23 shows that average *hartals* per year were significantly higher (46 per year) under the democratic governments (1991-2013) compared to the earlier regimes. It may be observed from the same figure that the occurrence of *hartals* has been on the rise.



Source: Based on Dasgupta (2001); Ahmed (2011); Odhikar; Ain o Salish Kendra (ASK) and Centre for Policy Dialogue (CPD).

Figure 1.23
Incidence of Average *Hartals* per Year

From the recent *hartal* experience one can identify following eight stylised facts:

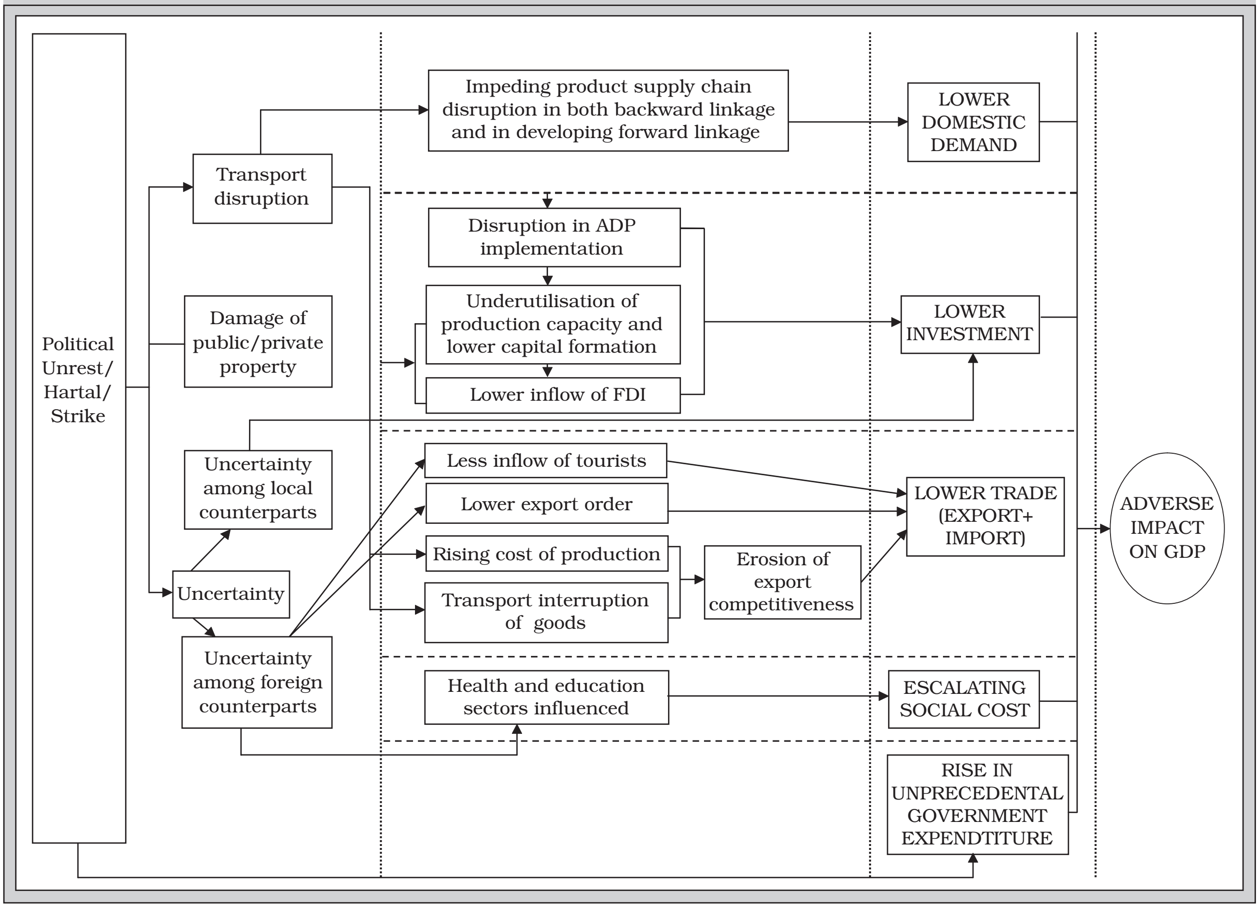
i. Frequency (incidence) of *hartals* has increased significantly;
ii. *Hartals* are now being called even during the weekends;
iii. Calling *hartals* to press economic issues is now less common;
iv. *Hartal*-opposing parties are more active during the *hartal* periods;
v. More decentralised *hartals* have emerged, e.g. at district and upazila levels;
vi. New actors are entering as *hartal* protagonists in addition to the traditional political actors;
vii. *Hartals* are becoming increasingly violent, often leading to death and injury including those not involved (e.g. the attacks on religious minority groups);
viii. Number of deaths of members of law enforcing agencies in connection with *hartals* is on the rise.

1.7.3 Economic Implications of *Hartals*

As was observed, frequent *hartals* have significant negative consequences for the Bangladesh economy. This had been true for past years, and regrettably, FY2012-13 is also not an exception. Figure 1.24 shows that in case of all three occasions in the past, GDP growth rate had declined as incumbent governments moved towards the finishing line of their regimes. It is apprehended that FY2012-13 will undergo a similar experience. Manufacturing sector's growth rates during the aforesaid three spells were also affected, while investment (as a share of GDP) stagnated. A number of attempts were made in the past to estimate the loss arising from frequent *hartals*. An assessment of the methodologies used in these studies would show that these estimates (as per the methodology) were on the high sides. It is also noted that, affected stakeholders are trying to pursue more innovative approaches to reduce losses arising from *hartals*.

Figure 1.24

Transmission Channels of Political Shocks in Bangladesh



Source: Authors' elaboration from micro information.

Hartals have significant adverse impact on such sectors as transportation and the retail sector. In contrast, there are certain sectors in the economy (e.g. mining, agriculture and energy sector) which are perhaps less affected by *hartals*. Extent of losses arising from *hartals* varies in accordance with level of enforcement and nature and gravity of the incidences which occur. Figure 1.24 presents the various transmission channels through which *hartals* impact on the economy. The tracking process is based on micro-evidence of impact of *hartals* on economic growth observed over the early months of 2013. Three primary channels were identified: transport disruption, property damage and uncertainty.

1.7.4 CGE Analysis

To quantify the losses to the economy resulting from *hartals*, a Computable General Equilibrium (CGE) exercise was undertaken as part of this study. A major long-term impact arising from *hartals* has been assumed to be the decline in capital stock. The simulation examined the impact of decline in capital stock by one per cent. The CGE results show that the decline in capital stock would reduce GDP (at market prices) by 0.9 per cent and lead to shortfall of imports and exports by 0.8 per cent and 2.4 respectively (Table 1.27). Also, revenue loss to the government would be in the vicinity of 0.7 per cent, employment of labour would be curbed by 0.9 per cent, and household consumption would decrease by 0.8 per cent.

Table 1.27

CGE Results of One Per cent Decline in Supply of Capital

Indicator	Outcome (% Change from Base Year)
GDP at Market Price	-0.9
Exports	-2.4
Imports	-0.8
Household Consumption	-0.8
Government Deficit	7.1
Revenue Loss of the Government	-0.7
Employment of Labour	-0.9
Fixed Investment	-0.1

Source: Authors' estimation.

The tradition of calling *hartal* is a longstanding one in the Bangladesh context. With rising frequency, the adverse impacts on the country's economy have also been on the rise. The increasing violence and damage of transport and public properties have both short as well as medium to long-term adverse implications for the economy, undermining both current performance as well as growth potentials of the economy.

In the current context, it is critically important to identify modalities for a mutually acceptable political solution. A conducive environment could be created through immediate cessation of all destructive and subversive activities, release of the opposition political leaders from jail to create and enable an environment for dialogue and the announcement of a roadmap along with a framework towards holding a free and fair election. The search for consensus should be undertaken in all earnest and with due urgency.

ANNEX: AN INVENTORY OF RENEWABLE ENERGY USE IN BANGLADESH

Renewable energy which includes solar, wind, biomass, hydro, geothermal and tidal waves is yet to get commercial importance in Bangladesh despite its immense potential to meet a significant part of energy demand. The national Energy Policy 2008 has envisioned a ten-fold objective with a view to increase the use of renewable energy in the country. One of the core objectives is to achieve the targets for developing renewable energy resources to meet 5 per cent of the total power demand by 2015, and 10 per cent by 2020. The other major objectives are: (i) to harness the potential of renewable energy resources and dissemination of renewable energy technologies in rural, peri-urban and urban areas; (ii) to enable, encourage and facilitate both public and private sector investment in renewable energy projects; (iii) to scale up contributions of renewable energy to electricity production; (iv) to train, facilitate the use of renewable energy at every level of energy usage; (v) to create enabling environment and legal support to encourage the use of renewable energy; and (vi) to promote clean energy for carbon emission trading. Taking into account the policy perspective, a number of targets were set up for enhancing generation of electricity from renewable sources to be attained by 2016. Indeed Bangladesh started from scratch in this regard and performance as per the majority of indicators (till March 2013) has not been up to the mark.

BPDB and Bangladesh Bank, both public sector entities, IDCOL, a public-private entity, and a number of private sector organisations including Grameen Shakti, BRAC, Rahim Afrooz and Center for Community Development & Research (CCDR) are playing the key roles in investment, promotion, dissemination and facilitation as regards introduction of renewable energy initiatives. IDCOL is the main implementing organisation for renewable energy in the country. Installation of SHS is one of its major programmes (Annex Table 1.1). Out of the target of 4 million SHS to be installed by 2016, about 50 per cent target has so far been attained mainly in the Dhaka and Chittagong regions (i.e. 56 per cent of total SHS installed in the country). The achievement in case of improved cooking stove programme is worth mentionable – it has already exceeded the target. However, progress in other programmes has been rather slow including biogas programme (28.5 per cent of the programme to be implemented by 2016), solar irrigation programme (1.4 per cent), solar mini-grid programme (3.33 per cent), and solar-based telecom BTS (Base Transceiver Station) programme (10 per cent).

Annex Table 1.1

IDCOL Programmes on Renewable Energy

Programme	Programme Target by 2016	Achievement	
		Programme Achievement	Power Generation/ Fuel Saving
IDCOL Financed Programmes (2003 to March 2013)			
SHS Programme	4 million SHS	2.08 million SHS	100 MW
Improved Cook Stove Programme	1 million people	5 million people	Save 400 tonnes firewood/year
Biogas Programme	100 thousand plants	28.5 thousand plants	Save 68,400 tonnes firewood/year
Solar Irrigation Programme	1,500 plants	21 plants	Save 63,000 litres diesel/year
Solar Mini-grid	30 plants	1 plant	100 kW
Solar-based Telecom BTS	1,000 plant	100 plants	200 kW
BPDB Financed Programmes (2011 to 2013)			
Solar PV System Projects			144.4 kWp
Wind Power Projects			900 kW

Source: Infrastructure Development Company Limited (IDCOL) and Bangladesh Power Development Board (BPDB).

Private sector organisations such as Grameen Shakti, BRAC and Rahim Afrooz have implemented renewable energy projects of their own (Annex Table 1.2). A part of their activities is financed by IDCOL. Till now, it is the Grameen Shakti which has the largest coverage as regards various renewable energy projects particularly relating to SHS and improved cooking stoves. According to IDCOL officials, lack of investible resources has emerged as the major constraint impeding timely implementation of different projects. Another important reason is lack of a proper monitoring and surveillance system which leads to inefficiency in implementation procedure. Proper monitoring is also constrained by absence of appropriate testing institution. Initiatives are thus needed to establish private testing institutions along with the strengthening of the Bangladesh Standards and Testing Institution (BSTI) for conducting testing of energy saving equipments and to facilitate related activities.

Annex Table 1.2

Private Sector Initiatives on Renewable Energy by Grameen Shakti and BRAC

Initiative	2009	2010	2011	2012
Grameen Shakti				
SHS installation (cum)	317,599	518,218	755,672	1,020,014
Improved cooking stoves (cum)	45,967	193,120	423,725	595,516
Biogas plant (cum)	9,226	14,906	20,942	2,426
BRAC				
SHS installation (cum)				72,470

Source: Based on the websites of Grameen Shakti and BRAC.

Public sector initiatives have mainly been carried out by the BPDB and by the Bangladesh Bank. During 2011-2013, BPDB's solar PV (photovolatic) system projects generated 144.4 kWp worth of electricity. Under BPDB's wind power progamme about 900 kWp worth of electricity was generated between 2010 and 2013. Total production of wind energy has registered a very slow rise due to low level of production capacity of the wind mills – from 1 MW at the end of 2005 to 2 MW at the end of 2012. In this context, proper wind mapping is required for reliable estimation of potential of wind energy.

Under the ADP for FY2012-13, a total of six projects related to renewable power are being implemented which include: a) 165BOP solar energy project (Project cost: Tk. 29.23 crore; possible completion at the end of FY2012-13: 59 per cent); b) solar street lighting programme in City Corporation (Tk. 316 crore; possible completion: 0.63 per cent); c) efficient lightening initiative (Tk. 279.28 crore; 37 per cent); d) solar power driven irrigation pump and home system (Tk. 26.79 crore; 29.8 per cent); and e) solar power system in the Parliament building (Tk. 8.8 crore; 33.2 per cent). Timely implementation of these projects is highly important.

Besides, Bangladesh Bank under its Tk. 200 crore Green Banking Refinance Scheme has extended subsidised credit facility to various renewable energy projects. The scheme includes funds for solar and biogas projects and waste treatment plants. However, the progress in disbursement of fund is rather mixed – since 2010 total disbursement was about Tk. 124.8 crore with the highest disbursement in 2012. According to the Bangladesh Bank, total disbursement for different kinds of projects are: Tk. 23.9 million for solar irrigation, Tk. 102.8 million for installation of solar home system, Tk. 262.7 million for biogas generation, Tk. 90.4 million for setting up effluent treatment plants (ETPs), Tk. 124.8 million for HHK and Tk. 248.8 million for solar PV module. Needed business support should also be extended to foreign investors. Overall promotion of renewable energy will, to a significant extent, depend on effective participation of the private sector where government should provide policy support to facilitate the process.

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Chapter 2

A Set of Proposals for the National Budget FY2013-14

This set of proposals was released to the media by the Centre for Policy Dialogue (CPD) on 20 April 2013.

2.1 INTRODUCTION: THE CONTEXT

The proposals prepared by the Centre for Policy Dialogue (CPD) in the context of Budget FY2013-14 seek to come up with a set of recommendations, both in terms of the needed overall fiscal-budgetary stance, as well as proposals that concern sectoral and issue-specific areas. In putting forward these suggestions, CPD has taken cognisance of the evolving macroeconomic scenario in the current fiscal year as it draws towards the finishing line, reviewed the implementation status of the fiscal-budgetary targets set out in FY2012-13 Budget, and has tried to anticipate the likely scenario that could emerge in FY2013-14 and which will inform the macroeconomic performance and governance in the next fiscal year.

The upcoming budget, expected to be announced in the first week of June 2013, comes in the backdrop of the fluctuating fortunes experienced by the Bangladesh economy in the course of the ongoing FY2012-13. The gross domestic product (GDP) growth rate for FY2012-13 which was fixed at one percentage point higher than that of FY2011-12, at 7.2 per cent, will perhaps only match the trend rate of six-plus per cent this year. Core concerns impacting investment levels continued to persist in FY2012-13 resulting in investment stagnation, accentuated further by uncertainties emanating from the ongoing violence and confrontational politics. The somewhat aggressive revenue assumptions have proved to be unrealistic in the face of repressed investment, declining imports and a restrained monetary policy that sought to rein-in the high credit growth rates of the recent past. Conditionalities under the Extended Credit Facility (ECF) programme of the International Monetary Fund (IMF) have set parameters that constrained government's flexibility in policymaking in a number of critical areas including fixation of fuel price, levels of subsidy and government borrowing. Slow implementation of major infrastructure projects, including in transport and energy sectors, undermined growth potentials of the economy. A number of incidences including the Padma Bridge financing debacle, and the Hall-Mark, Bismillah Group and Destiny scams have exposed serious weaknesses in economic management and governance. On the other hand, in the backdrop of robust remittance flows and negative import growth, balance of payments (BOP) position has continued to improve, with swelling foreign exchange reserves providing import security and stabilisation, and even some appreciation, of the exchange rate of the Bangladeshi Taka (BDT). Improved export performance in recent months, despite the slow recovery in the major European and the North American markets, has reinforced this trend. Inflation had started to ease helped by falling food prices, and also in view of declining non-food inflation.

By any reckoning, Bangladesh economy will enter a difficult terrain in FY2013-14 characterised by a number of defining features which are likely to accentuate the downside risks mentioned above. The ongoing political uncertainty, in the last year of the incumbent government, if deepens further, will have serious implications for the implementation of the fiscal-budgetary measures to be proposed in the FY2013-14 budget. The consequent depressed investment scenario could negatively impact on revenue generation and overall GDP growth. The departure from the Medium Term Budgetary Framework (MTBF) and the Sixth Five Year Plan (SFYP) growth targets is likely to continue in FY2013-14 in view of the emergent situation. Thus, it will perhaps be prudent to set the GDP target more in line with what is realistic in view of current and likely scenarios. Rather than going for populist measures this will warrant a stability-centric stance that does not necessitate expansive government borrowing, which could fuel inflation and result in fiscal deficit that is beyond reasonable limit. The IMF-ECF, entering in its second year, will entail significant new commitment on the part of the government along with the policies to be pursued in line with earlier commitments. Financing of fiscal deficit will need to take this into cognisance. Despite signs of upturn in the global economy, the pace of global recovery in the coming year is likely to continue to be slow, with concomitant impact on export and migration from Bangladesh.

The emerging challenges anticipated for FY2013-14 period will call for policy adjustments and prudent target setting with respect to resource mobilisation and expenditure commitments, fiscal deficit and its financing. The fiscal-budgetary proposals in FY2013-14 Budget ought to be informed by these anticipations.

In the backdrop of the aforesaid assessment, the CPD budget proposals for FY2013-14 focus on a number of key areas. These are:

(i) an assessment of macroeconomic developments in FY2012-13 and recommendations for the needed macroeconomic policy stance for FY2013-14;
(ii) a review of the status of key deliverables of FY2012-13;
(iii) proposals for fiscal-budgetary recommendations in a number of key areas including investment, energy sector, rural economy and external sector;
(iv) fiscal-budgetary implications of different options for financing the Padma Multipurpose Bridge Project (PMBP); and
(v) a number of implementation-related suggestions with a view to raising efficacy of realising FY2013-14 Budget proposals at a time of formidable challenges and great uncertainties.

2.2 MACROECONOMIC BACKDROP IN THE RUN-UP TO THE NATIONAL BUDGET FOR FY2013-14

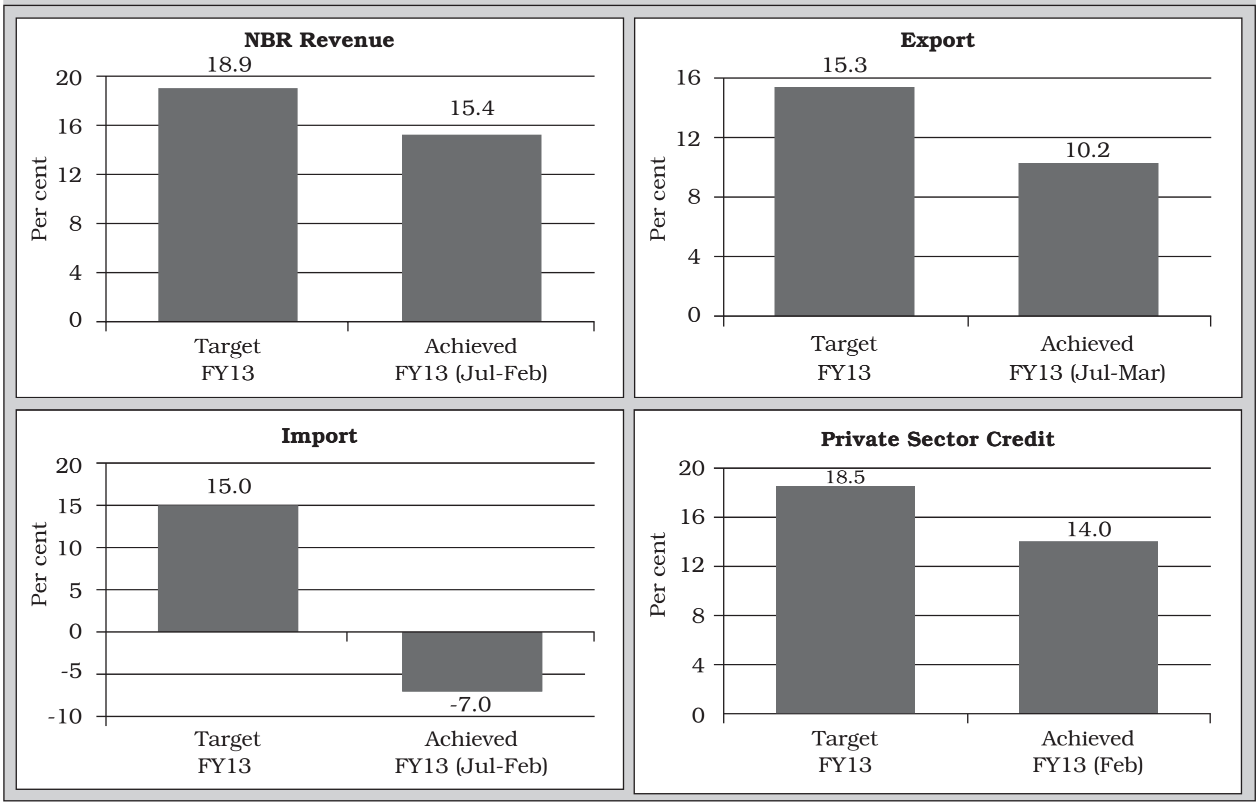
Implementation of the budget, on one hand, has a critical role to play towards the macroeconomic performance of the economy. On the other hand, as CPD suggested earlier, the performance of the economy will also determine, to a large extent, the implementation of the proposed budget (Bhattacharya *et al*. 2010). Hence, the budgetary framework and the fiscal measures proposed in the national budget for FY2013-14 will need to take cognisance of the prevailing macroeconomic scenario in FY2012-13 and the outlook for FY2013-14. While preparing the proposals for the national budget for FY2013-14, the present section will undertake an analysis of the major features of the economy in FY2012-13.

2.2.1 Bangladesh Economy is Off-Target – Both in the Short and Medium-Terms

Compared to FY2011-12 when the previous national budget was announced, macroeconomic situation became more stabilised as the economy moved towards the finishing line of FY2012-13. In January 2013 CPD observed that, this stability was underpinned by a number of risks which in effect could result in moderate economic growth, investment and employment outcome (CPD 2013). Indeed, the latest available data on major macroeconomic correlates reflect a number of disquieting trends. Revenue mobilisation by the National Board of Revenue (NBR), the most dependable performer among the macroeconomic indicators during this government's regime, has been found wanting and may witness a shortfall (of Tk. 3,000 crore). Over the first eight months, during July-February period, growth of NBR revenue was 15.4 per cent against the target of 18.9 per cent for FY2012-13 (Figure 2.1). Also, growth of export earnings during the first three quarters of FY2012-13 (10.2 per cent) was well below of its annual target (15.3 per cent). A year ago, during the second half of FY2011-12, a set of concerned policies were undertaken towards restraining growth of import payments. In FY2012-13, import payments continued to fall ((-) 7 per cent during the first eight months), and getting anywhere near the annual target of 15 per cent is now out of question. Likewise, the growth rates of domestic credit (13.4 per cent) and private sector credit (14 per cent) are unlikely to meet their annual targets (18.9 per cent and 18.5 per cent respectively), as the private sector lost its appetite for credit.

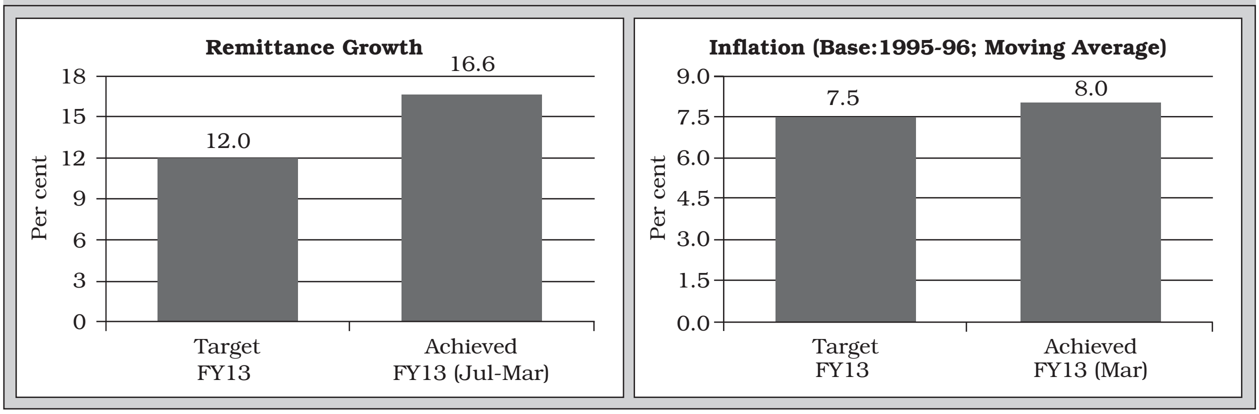
As opposed to the above scenario, there also prevail a number of positive signs in the macroeconomic landscape. Remittance inflow during the first nine months of FY2012-13 recorded 16.6 per cent growth against the annual target of 12 per cent (Figure 2.2). FY2012-13 also witnessed noteworthy improvement in the Annual Development Programme (ADP) implementation. During July-March period, 49 per cent of total ADP allocation was spent which was 45 per cent in FY2011-12. Expenditure on project aid has also seen substantial improvement – 42 per cent was spent during the July-March of FY2012-13 which was 33 per cent during the corresponding period of the preceding year. Consequently, the inflow of foreign aid

Figure 2.1
Growths: Target vs Actual



Source: Calculated from the data of Bangladesh Bank, Export Promotion Bureau (EPB), Ministry of Finance (MoF) and National Board of Revenue (NBR).

Figure 2.2
Remittance Growth and Inflation: Target vs Actual



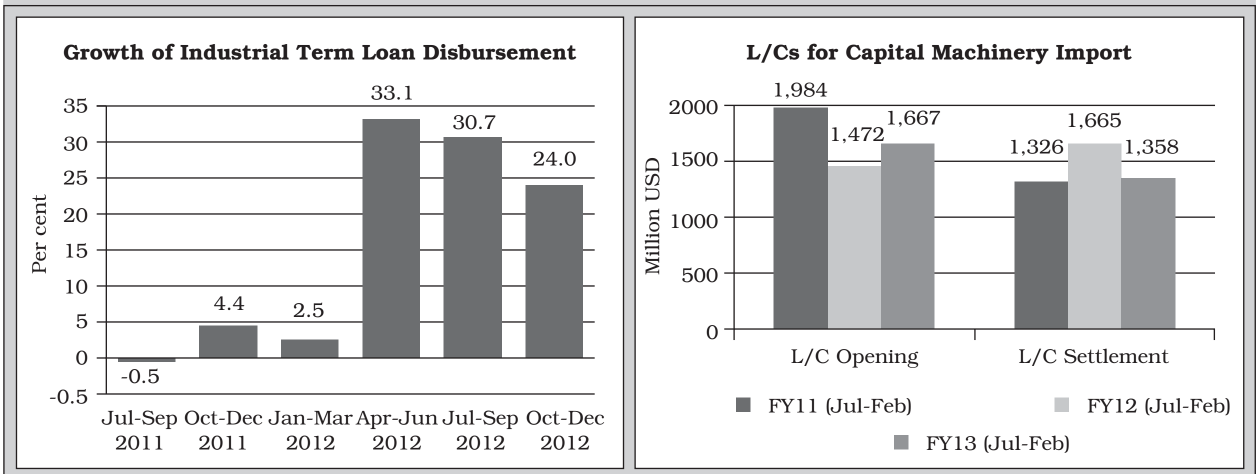
Source: Calculated from the data of Bangladesh Bank and Bangladesh Bureau of Statistics (BBS).

increased to USD 1.5 billion during the first eight months of FY2012-13 which was USD 1.2 billion during the same period of FY2011-12. The buoyant remittance inflow along with falling import payments and improved foreign aid inflow pushed the BOP situation into a safe terrain. During the July-February period both current account balance and overall balance witnessed a healthy surplus (USD 1.4 billion and USD 3.5 billion respectively). The surpluses in BOP helped the foreign exchange reserve to reach newer heights – about USD 14 billion at the end of March 2013. Concurrently, during the first nine months of FY2012-13 the BDT appreciated by 4.6 per cent against the United States Dollar (USD). This may have helped to stabilise the prices of imported commodities, but created disincentive to exporters. The inflationary pressure eased to some extent in FY2012-13, thanks to stable food production, slowdown in domestic demand, restrained monetary policy and stronger BDT against USD.

2.2.2 Outlook for Investment is Not Promising

Private investment has been a matter of concern for the last four years. In FY2011-12 private investment as a share of GDP declined to 19.1 per cent from 19.7 per cent in FY2008-09. The investment situation in FY2012-13 and outlook for FY2013-14 does not look promising. Although overall disbursement of industrial term loan increased by 26 per cent during the first half of FY2012-13, one observes a deceleration of the quarterly growth. Import of capital machinery in July-February of FY2012-13 was (-) 11.2 per cent lower compared to the corresponding period of the previous fiscal year. Indeed, this decline was faster than the overall decline in import payments ((-) 7 per cent). Value of letter of credit (L/C) opening for capital machinery import during the first eight months was higher than the preceding year (FY2011-12), but lower than FY2010-11 (Figure 2.3). Curiously, L/C settlement figures in FY2012-13 have been largely lower than FY2011-12.

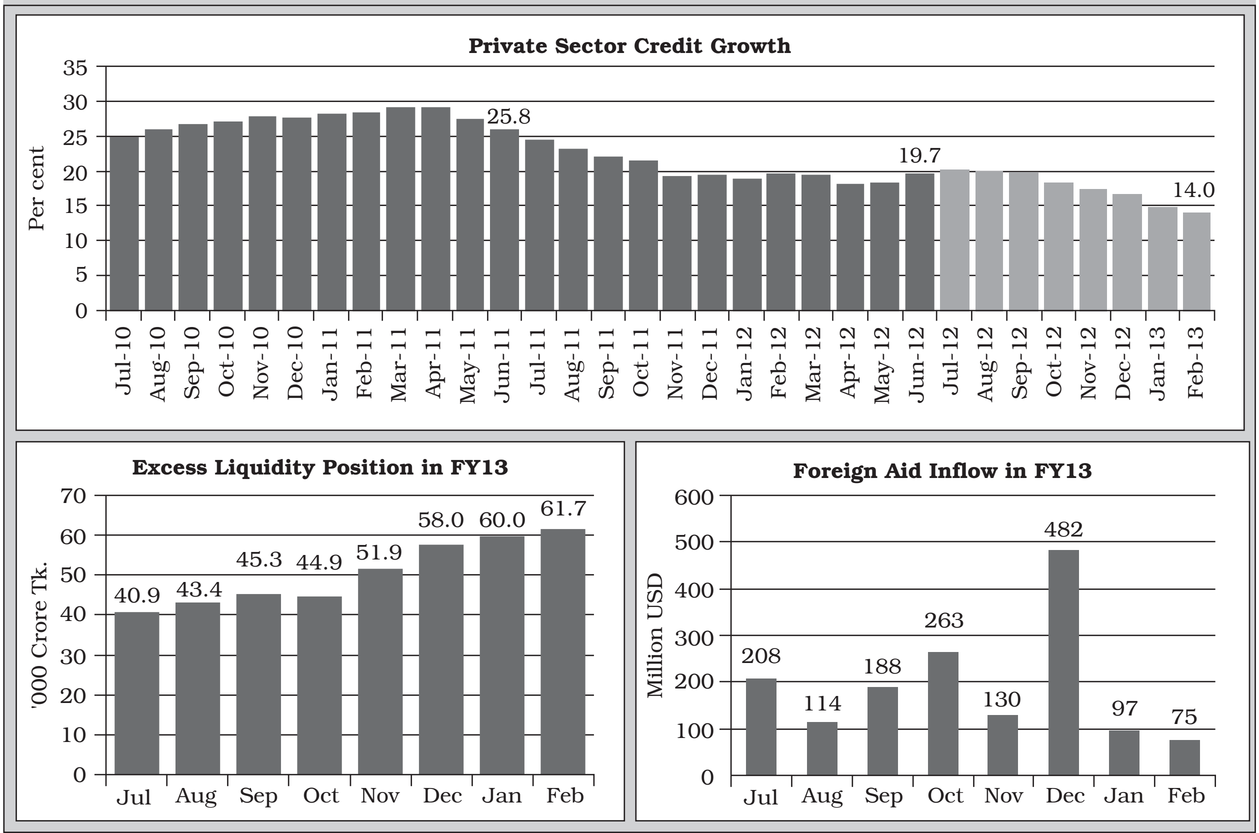
Figure 2.3
Investment Related Indicators



Source: Calculated from the Bangladesh Bank data.

Growth of the private sector credit continued to fall in recent months (Figure 2.4). The growth rate as of February 2013 is indeed the lowest monthly growth since September 2009. Concurrently, excess liquidity in the banking system is on the rise since October 2012, which pushed call money rate downwards in the recent months. Over the last eight months the excess liquidity increased by more than 50 per cent as it reached to Tk. 61,700 crore. As a matter of fact, 40 per cent of total liquid assets was excess liquidity. In March 2013 the call money rate was 7.5 per cent which was 10.6 per cent in July 2012. All these indicators signify the slowdown of private sector investment. The foreign direct investment (FDI) inflow (net) during July-February was USD 950 million (863 million in FY2011-12) which is on an average about USD 120 million in a month. However, in February net FDI inflow was only USD 75 million. Regrettably, foreign aid disbursement during the last two months has also declined. As a result, it may be apprehended that the pace of improvement in ADP implementation can face a setback in coming months.

Figure 2.4
Investment Outlook Related Indicators



Source: Calculated from the data of Bangladesh Bank and Economic Relations Division (ERD).

2.2.3 Current Political Instability will Aggravate the Situation Further[1]

In connection with a number of entrenched political conflicts, Bangladesh is currently experiencing political agitations in various forms which are transmitting serious shocks to the economy. Indeed, the political instability in Bangladesh, particularly in the run-up to the national parliamentary election is not uncommon. The latest CPD research[2] showed that continued political conflicts caused decline in domestic demand, lower investment, decelerated trade activities and escalated social costs. In addition to tangible economic costs, there are intangible losses including erosion of country's image. A major long-term impact arising from *hartals* is found to be the loss of capital stock. In connection to this, a Computable General Equilibrium (CGE) model exercise in the Bangladesh context shows that a 1 per cent decline in capital supply can reduce GDP by 0.9 per cent (Table 2.1). In fact, all major macroeconomic indicators would face adverse impacts. Having recognised a number of adjustment measures already deployed by both government and non-government agents, it is felt that the effectiveness of macroeconomic policy instruments towards protecting the economy will be weak as institutions remain paralysed due to political agitations. Hence, the budget implementation in FY2013-14 will critically hinge on the future political outcome.

[1]This section is benefited from the keynote paper presented at a CPD dialogue on the implications of ongoing political instability on Bangladesh economy, organised on 13 April 2013, in Dhaka.
[2]Bhattacharya *et al.* (2013).

Table 2.1
CGE Results

Macroeconomic Indicator	**Outcome (% Change from Base Year)**	**In Nominal Terms**
GDP	-0.9	-8,233 crore Taka (FY12) -1.0 billion USD (FY12)
Household Consumption	-0.8	-5,487 crore Taka (FY12) -694 million USD (FY12)
Exports	-2.4	-583 million USD (FY12)
Imports	-0.8	-284 million USD (FY12)
Government Revenue	-0.7	-796 crore Taka (FY12) -101 million USD (FY12)
Government Deficit	7.1	2,280 crore Taka (FY12) 288 million USD (FY12)
Investment	-0.1	-233 crore Taka (FY12) -29 million USD (FY12)
Employment	-0.9	-0.5 million (2010)

Source: Bhattacharya *et al.* (2013).

2.2.4 IMF-ECF Conditionalities: The Binding Constraint

In the backdrop of growing BOP pressure, the government sought the IMF-ECF support in March 2012 (USD 1 billion for three years) which is tied to a number of stringent conditionalities. In view of the above, the IMF released a new Bangladesh Country Report in March 2013 before releasing the second installment of the loan (USD 141 million). Among the 'quantitative performance criteria' two were not met by the government, namely tax revenue (floor) and social-related spending (floor). Most of the 'structural benchmarks' were also not met according to the IMF. The most notable one was "submit a new VAT (value added tax) law to the National Parliament consistent with tax modernisation plans and medium-term revenue targets" by June 2012. As is known, the new VAT law was submitted in July 2012 and had been passed in November 2012. The new VAT law is expected to be fully implemented from FY2015-16. Towards this end, the government needs to put together necessary infrastructure and adequate budgetary allocation.

The IMF seems to have agreed with the government stance to keep the petroleum subsidy within Tk. 10 per litre instead of "adopting an automatic adjustment mechanism for retail petroleum prices to ensure full pass-through of international prices." As per the IMF condition, the government was required to remove tax concessions and exemptions in the FY2012-13 Finance Bill equivalent to at least 0.5 per cent of GDP. According to IMF, an estimated tax concessions and exemptions equivalent to 0.3 per cent of GDP were removed. The IMF conditionalities also include monitoring of fertiliser subsidies and subsidies to state-owned enterprises (SoEs). Moreover six new conditions were added. The formulation of budget for FY2013-14 will need to be in line with all these conditionalities. However, one can argue that in the backdrop of present macroeconomic circumstances this loan is not necessary. Whatsoever, if the government would like to fulfill these conditionalities the policy space for them will remain limited in FY2013-14.

2.2.5 Economic Growth Outcome: Slowdown is Evident

The GDP growth target for FY2012-13 was set at 7.2 per cent following the medium-term target of SFYP (Table 2.2). The early projections from analysts explicitly agree that the GDP growth rate in FY2012-13 will not meet its target. The Finance Minister, however, is hopeful that it will be around 6.4 per cent

Table 2.2

GDP Growth: Target vs Projection

Reporter	Projected Growth (%)
Growth in FY2012	**6.3**
Target for FY2013	**7.2**
CPD, January 2013	<6.3
Bangladesh Bank, December 2012	6.1-6.4
World Bank, October 2012	<6.0
IMF, March 2013	5.8
ADB, April 2013	5.7
World Bank, April 2012	5.8

Source: Collected from various sources.
Note: ADB: Asian Development Bank.

though the latest independent projections suggest that it may not reach the 6 per cent threshold. More importantly, as the latest information are made available, the projection of the GDP growth rate for FY2012-13 has become more pessimistic. Nevertheless, the economic growth is expected to remain at a subdued level for both FY2012-13 and FY2013-14.

2.2.6 The Proposed Macroeconomic Stance for Budget FY2013-14

As was anticipated at the halfway through to FY2012-13, Bangladesh economy is settled for macroeconomic stability with moderated economic growth. Regrettably, even realisation of this 'second best' ambition critically hinges on the possibility of overcoming the enduring political uncertainties. In view of the discussed macroeconomic scenario, the budgetary framework for FY2013-14 requires to take a more pragmatic approach. Such a stance should be informed by a number of considerations.

First, the allocation for public expenditures needs to be consolidated as much as possible. Towards this, the Finance Minister will have to confront the political demand for a populist budgetary allocation in the run-up to the forthcoming national election. It will be unfortunate if the financing plan of the Padma Bridge project creates a detrimental impact on the resource availability for other development projects.

Second, the target for revenue mobilisation should also not be overambitious. If the economy continues to suffer, it will take toll on the revenue collection as well. Hence, efforts towards revenue mobilisation should get greater emphasis. No doubt that, the revenue collection in the form of telecom 3G license fee will be an important factor. In this connection, one may recall that, during the time of political transition in 2006 and 2007, Bangladesh economy faced significant illicit financial outflow (CPD 2013). In 2010, the amount of illicit financial outflow was estimated to be USD 2.4 billion which was only 0.7 billion in 2009. This outflow arose from transfer mispricing, trade mispricing and money laundering, and has a significant revenue implication. The recently established Transfer Pricing Cell under the NBR needs to be fully functional at the earliest. Bangladesh also requires a strong and well-equipped specialised institution to confront this issue in the near future where a number of public institutions (e.g. NBR, Bangladesh Bank and others) will need to act in a coordinated manner.

Third, containing fiscal deficit in FY2013-14 within a comfortable level will be necessary, but more importantly, it is the financing structure that demands close attention. Borrowing target from sales of National Savings Bond (NSD) certificate needs to be fixed at a more realistic level. Caution is also called for with regard to the issuance of sovereign bond. Given the importance of the issue, the incumbent government is better off to defer this initiative for the next government. In contrast, efforts towards greater utilisation of foreign aid should be the highest priority.

Fourth, as has been mentioned above, in the present circumstances it will be difficult to revitalise the private investment through pursuance of macroeconomic policy instruments. Nevertheless, the budget needs to consider providing greater access to credit and better infrastructure to prospective investors. Towards this end, priority should be given to the thrust sectors identified under the present industrial and export policies.

Fifth, ensuring adequate incentives (for both inputs and outputs) to farmers is essential from both economic and political perspectives. Close coordination and cooperation among various government agencies will be of critical importance in this context. This will also be helpful to stabilise the inflation.

Sixth, the successful implementation of the forthcoming budget will require a complementary monetary policy. It is now urgently required to stabilise the value of BDT and avoid its further appreciation. The present money supply situation is able to accommodate more accumulation of foreign exchange reserve. Indeed, the additional foreign exchange reserve may prove to be useful later if the Padma Bridge is decided to be constructed with the domestic resources only.

Seventh, in all likelihood the targets of the SFYP for macroeconomic correlates will become irrelevant in FY2013-14. For example, the targets for the GDP growth rate and gross investment as a share of GDP for FY2013-14 are 7.6 per cent and 31 per cent respectively. Under the present macroeconomic circumstances attaining these targets will not be possible. Surely, there is no economic sense to fix the macroeconomic targets at an overambitious level. In view of this, it is necessary to consolidate the macroeconomic targets for FY2013-14 accordingly and streamline the targets for the subsequent years.

2.3 DELIVERY OF THE BUDGET FY2012-13

2.3.1 Revenue Earnings

The revenue income structure in the budget for FY2012-13 was 80.3 per cent from NBR tax, 3.3 per cent from non-NBR tax and 16.4 per cent from non-tax revenue accumulating the target of Tk. 139,670 crore as total revenue earnings. NBR is playing the major role in realising the revenue earnings target set for FY2012-13. However, in the current fiscal year, NBR revenue growth may once again witness a shortfall, the first time since FY2008-09. This anxiety was already expressed by CPD in its review of the economy in January this year. During the first eight months of the current fiscal (July-February), the growth of NBR revenue was 15.4 per cent against the target of 18.8 per cent (Table 2.3). This will require a growth of

Table 2.3

NBR and Non-NBR Revenue Collection

(in Per cent)

Particular	Actual Growth FY12	Annual Growth Target FY13	Achieved Growth FY12 (Jul-Feb)	Achieved Growth FY13 (Jul-Feb)	Required Growth FY13 (Mar-Jun)
External Total	11.89	13.79	13.72	6.20	26.75
Import Duty	14.75	16.06	17.48	2.80	38.00
VAT Import	10.07	8.17	8.95	12.02	1.79
Supplementary Import	9.05	25.46	17.57	-0.76	78.92
Local Total	22.92	17.28	17.08	13.56	22.65
VAT Local	22.64	12.61	16.32	19.76	2.83
Supplementary Local	22.82	23.95	16.49	2.67	56.14
Total Direct Tax	22.65	26.23	26.65	30.79	21.84
Income Tax	22.79	24.95	27.17	30.85	19.34
Total	**18.96**	**18.85**	**18.13**	**15.36**	**23.53**

Source: National Board of Revenue (NBR).

about 23.5 per cent during the last four months (March-June) of the going fiscal. Supplementary import duty is one major concern for NBR revenue collection that not only failed to achieve growth target, but also registered a negative growth during the above mentioned period. Import was substantially low during the July-February period of FY2012-13 (-7 per cent growth of import payments) which has significantly affected the external revenue collection of the NBR. Among the components of NBR revenue collection, only the collection of direct tax is in the right track towards meeting the target. Non-NBR revenue collection is also lagging behind from its target set for FY2012-13. Despite the remarkable performance in achieving high targets in recent past, NBR may find it difficult to attain the targets set for FY2012-13 due to sluggish import as well as slowing down of economic activities.

2.3.2 Revenue Expenditures

Higher interest payments went beyond its budget allocation during FY2011-12 and continued during the first five months of FY2012-13 (July-November) with a growth rate of 41.1 per cent compared to the same period of previous fiscal (Table 2.4). During this period, augmented non-development revenue expenditure recorded 24 per cent growth compared to the matching period of the previous fiscal while the target growth for FY2012-13 was only 13 per cent. This implies that the growth of this component needs to be restricted to only 7.5 per cent during the rest of the months of FY2012-13. Total expenditure set in the budget for FY2012-13 was Tk. 191,731 crore in which Tk. 136,731 crore is allocated for non-development and other expenditures and the rest is for the ADP. The Finance Minister in his half yearly budget statement mentioned that the net expenditure up to December 2012 was 33.3 per cent of total allocation, and ADP expenditure is 23.3 per cent of its total allocation. Non-ADP expenditure during July-December 2012 registered a 0.6 per cent growth compared to the same period of FY2011-12. Based on the Finance Minister's speech, it is expected that the revenue expenditure will exceed the target set for FY2012-13.

Table 2.4

Non-Development Expenditure: FY2012-13 (July-November)

(in Per cent)

Component	**Actual Growth FY12**	**Growth Target FY13**	**Achieved Growth FY13 (Jul-Nov)**	**Required Growth FY13 (Dec-Jun)**
Pay and Allowances	4.8	9.9	11.0	9.0
Goods and Services	6.0	21.0	18.0	21.9
Interest Payments	28.9	15.7	41.1	3.7
Subsidies and Current Transfers	15.2	6.5	23.8	-1.9
Block Allocation	-38.0	815.6	-2.3	1172.5
Non-Development Revenue Expenditure	**13.9**	**12.8**	**23.2**	**7.5**
Acquisition of Assets and Works	7.4	16.9	56.1	8.0
Augmented Non-Development Revenue Expenditure	**13.6**	**13.0**	**24.0**	**7.5**

Source: Calculated from the Ministry of Finance (MoF) data.

2.3.3 Annual Development Programme (ADP)

Expenditure under the ADP has shown improvement during the first eight months (July-March) of FY2012-13 in contrast to the past few years. During the above mentioned period 49 per cent of total ADP allocation (Tk. 55,000 crore) has been utilised which is 3 percentage points higher than the comparable period of FY2012-13 (46 per cent). Better disbursement of project aid has helped to improve ADP expenditure in the current fiscal. During July-February of FY2012-13, 42 per cent of total project aid has been disbursed while this was only 33 per cent in the same period of FY2011-12. This has also helped to maintain a healthy BOP in the above mentioned period. The implementation status of the ADP of top ten ministries/divisions with large allocation (72 per cent of total ADP allocation) shows that about 56 per cent of allocation for those ten ministries/divisions has been spent during July-February of FY2012-13. Among these, implementation by M/O Health and Family Welfare, M/O Railway, and M/O Industries was, however, below par. Power Division, Roads Division and Local Government Division are the better performers in terms of ADP utilisation. The Power Division had allocation for concluding and carryover projects that may have helped it to utilise about 68 per cent of ADP allocation.

As past experiences suggest, it is too early to comment on the status of ADP utilisation which will be completed by the end of the current fiscal. In most cases, the utilisation of ADP allocation has failed to achieve the target. However, performance in FY2012-13 is expected to be better compared to FY2011-12 in terms of project aid disbursement. It may happen that the government would defer few projects at the end of the fiscal that may affect next fiscal's budget.

2.3.4 Budget Deficit

On the basis of data from the first six months of FY2012-13, it can be stated that budget deficit and its financing are in line with the traditional trend. The revenue collection may face shortfall in view of slow NBR revenue collection. However, if ADP allocation is not fully utilised, it may provide some cushion to the revenue collection shortfall. Domestic borrowing was a major concern throughout FY2011-12 as a result of poor project aid disbursement. This may not be a concern for the current fiscal since disbursement of project aid remained satisfactory up to December 2012. Concerns remain, however, as the net sale of NSD certificates is running below the expected level till date. Therefore, the government needs to pay more attention towards managing the deficit financing in the latter part of the fiscal.

2.4 CONTINUATION OF LOW INVESTMENT AND ITS IMPLICATION FOR GROWTH

Investment in the current fiscal year is experiencing a sluggish trend as was observed in the last year. A set of new issues and concerns along with a few of the last year are responsible for a weak investment scenario. Under such adverse situation, accelerating investment both in private and public sectors will be challenging for the government in the next fiscal.

2.4.1 State of Production in FY2012-13

Till November 2012, the Quantum Index of Production (QIP) of large and medium-scale manufacturing industries have maintained a double-digit growth, thanks to better performance of key industries such as food and beverage industry and jute, cotton and wearing apparel industry. But a number of domestic market-oriented industries could not attain that level of growth perhaps due to unfavourable business environment till that time (November 2012). This may have aggravated further in the following months due to political unrest. Low or negative growth rates of imports of industrial raw materials and intermediate products are reflections of weak demand of these products.

2.4.2 State of Domestic Credit in FY2012-13

Unlike last year's high growth of domestic credit particularly led by the public sector credit, the growth of domestic credit in the current fiscal year (July-January 2013) is below the targeted level. Slow growth of private sector credit (14.8 per cent), in the absence of public sector's 'crowd out' effect, indicates that there is a low level of demand for capital in the ongoing and new ventures. This is perhaps linked to weak business competitiveness emerged from the uncertainties caused by political unrest and economic adversities.

Private Sector Credit

A large part of private sector credit is disbursed to agriculture, off-farm, manufacturing and services-related activities including the small and medium enterprises (SMEs). Disbursement of working capital and term loan in the above mentioned sectors has registered a moderate level of growth during FY2012-13. In case of industrial term loan, high growth in disbursement of credit is related to significant rise in term loan in the large-scale enterprises. Term loan for small and medium industries could not maintain the high growth momentum observed during the last two years. On the other hand, the rate of repayment of industrial term loan has significantly dropped since FY2010-11 which caused a rise in overdue and even default loans. In this connection, about 30 per cent drop of SME credit in the state-owned commercial banks (SCBs) is partly because of their liquidity shortfall and high rate of default loans. Microcredit institutions, though maintained a double digit growth in credit disbursement this year, could not reach the higher level of previous years.

The structure of credit to the private sector appears to be changing over the years. The share of advances to major real sectors such as manufacturing, services and agriculture-related activities has been systemically decelerated while that of trade, construction, transport and other activities has increased. Advances to the agriculture sector have further concentrated on crop production followed by livestock and fisheries, but with reduced share of storage and marketing and others. Lower share of advances to the manufacturing sector has affected most of the related activities, except a few (including food and beverage and non-metallic products). Despite a small share of the services sector in overall advances, long-term financing particularly in hospital, information technology (IT), hotel and restaurant, and other services has maintained a stable trend. Credit for trade has concentrated on wholesale and partly retail and import financing.

Public Investment

Public investment in major ministries/divisions has registered a considerable rise during July-January FY2012-13. It is difficult to predict whether such pace of growth would sustain in the following months given the disruption of activities caused by the political unrest. Because of violence and political unrest, significant damages occurred in roads, power stations, railways and other services. Keeping these infrastructures intact has become one of the major challenges for the government.

Public sector projects, currently being implemented under the Ministries/Divisions of Power, Roads, Energy and Mineral Resources, and Industries have direct and immediate impact on facilitation and enhancement of private investment. However, the performance of a number of those projects during July-January FY2012-13 was mixed. Necessary allocations of fund for those projects as well as their timely implementation are critically important which should receive proper attention in the upcoming budget for FY2013-14.

2.4.3 FDI and Investment in the Capital Market

FDI inflow has showed an upturn in the current fiscal year (USD 950 million in July-February 2013 against USD 863 million in the corresponding period of FY2011-12) despite various uncertainties and challenges. If the current rate of growth continues in the remaining months of this year, FDI would cross the total inflow of last year (USD 1.1 billion). According to the Board of Investment (BoI), a number of constraints hinder more FDI flow in the country. These include poor infrastructure (lack of sufficient land, inadequate supply of gas and electricity), high taxes, port inefficiency and weak supply chain (Moazzem 2012). Given the scarcity of capital in the stock market, increasing portfolio investment could be a suitable source for raising funds. However, portfolio investment during July-February 2013 was 11 per cent lower compared to that in the same period of the previous year.

In the capital market, a total of seven companies have offloaded shares so far in the FY2012-13 to raise Tk. 340 crore for various kinds of manufacturing and services-related activities. This amount of investment in the primary market is almost half of what was at the same period of the previous year. However all initial public offerings (IPOs) in FY2012-13 received subscription request well over their initial offers.

2.4.4 Reasons for Slowdown of Investment

Investment slowdown in FY2012-13 is related to a number of economic and non-economic factors which include, among others, high rate for bank borrowing, moderately high rate of inflation, less private consumption due to deceleration in the growth of real income, appreciation of BDT against USD, and poor supply of energy and power in the industrial sector. Prolonged political unrest with destruction of capital goods, roads, rails, covered van and obstruction of movement of goods within and outside the country seriously damaged the supply chains which have detrimental impact on both domestic market and export market-oriented industries.

2.4.5 Proposals for the National Budget FY2013-14

Domestic Credit

- There is a scope for further rise in supply of domestic credit even beyond the MTBF target set forth for FY2013-14. Lower growth of credit due to weak demand will leave a huge amount of money unutilised in FY2012-13. As a result, the effective rate of growth for domestic sector credit for FY2013-14 would be as high as 25.5 per cent. Thus, the central bank should allow expansion of credit beyond the targeted level of growth of 17.2 per cent in FY2013-14 taking into account its inflationary impact and absorptive capacity of the economy.

- Disbursement of private sector credit to different economic activities should facilitate restructuring of the overall distribution of credit. More should be disbursed to agriculture sector particularly non-crop sectors, manufacturing particularly SMEs, and various kinds of services-related activities.

Public Sector

- In view of the slowdown in consumption demand and employment generation, investment in the public sector needs to be accelerated in the next fiscal year. Public investment, which has immediate impact on private investment and employment generation, should be facilitated. Thus the Asian Development Bank (ADB) projects currently under different phases of implementation under the Ministries/Divisions of Power, Roads, Energy and Mineral Resources, and Industries should be allocated funds as per their requirements.

- Implementation of a number of projects under the Ministry of Industries should be expedited given their importance for local and foreign investment. The government should allocate necessary funds for building special economic zones (SEZs) in selected areas, *garments palli* in Munshiganj, leather industrial park at Savar, IT park in Karwan Bazar and industrial park for light engineering sector.

- With a view to improve occupational health and safety in industries particularly in garment factories, revenue and ADP allocations for the Ministry of Labour should be significantly increased. This fund will be used for the development of the Directorate of Labour for factory inspection, and will be used for setting up regional inspection offices as per the Master Plan. Necessary allocation will be required for the improvement of monitoring operations of the factory inspectors which include improvement in logistic facilities and rise of their allowances.

Private Sector

- With a view to improve the competitiveness of small firms at domestic and international markets tax-free turnover limit should be increased from the current level of Tk. 24 lakh to Tk. 40 lakh. Considering the adverse business condition, truncated VAT system for SMEs should be continued in the next fiscal.

- The Public-Private Partnership (PPP) office has completed the Detailed Feasibility Study of seven out of 38 projects of which three are related to infrastructure development. To initiate the implementation of these projects, necessary allocation should be made available in the next budget particularly for *Dhaka-Ashulia Expressway* and *Two jetties at the Mongla Port*.

- Tax holiday facility should not be discontinued across the board without proper assessment of impact and implications, as these fiscal measures have 'strategic' importance for potential industries to enhance their competitiveness at domestic and international markets. In this connection, proposals placed by a number of industries for continuation of tax holiday should be taken into due consideration which include poultry, IT, light engineering, chemicals and pharmaceuticals, etc.

- In the previous budgets, in the guise of various investment-promoting measures, undisclosed income was allowed to be legalised. Considering the negligible success in mobilising additional resources in the past and the attendant moral hazard, the government should not provide any such special tax measure in any form in the budget of run-up to the national election.

- Potential domestic market-oriented industries which have strategic importance should get fiscal and budgetary support. Hence, duties (i.e. import duty, supplementary duty, advance income tax (AIT) and VAT) imposed on finished products and intermediate products in support of local industries should be continued in the next fiscal year. Similarly, exemption of VAT, currently provided to selected domestic market-oriented industries, should be extended after their expiration (e.g. motorcycle industry in June 2014).

- In order to retain export competitiveness under the weak global demand situation, the government should consider reviewing a number of support measures applicable for export-oriented industries. These include special allotment of gas connection to new projects and expansion of existing ones, subsidised credit (at a rate of less than 5 per cent) for building dormitories for workers, special allocation for workers' training, particularly for occupational health and safety issues, and extension of bond license for three years instead of two years. Similarly, 12 export-oriented industries which are currently enjoying cash incentives should continue receiving that facility in the next fiscal.

- In order to enhance industrial production, government should make special allotment of new gas and electricity connection for SMEs and gas-based industrial units.

- To promote long-term investment by institutional investors, government may announce preparation of a Code of Conduct for long-term investment.

- The ADB-funded project for capital market development should be implemented as per the project timeline. Activities include installation of advanced market monitoring software, setting up a separate tribunal, human resource development in the Securities and Exchange Commission (SEC), and finalising the Financial Reporting Act.

2.5 FINANCING OF PADMA BRIDGE PROJECT: IMPLICATIONS FOR ADP FY2013-14

With the demise of the prospect of restoration of the World Bank loan for the Padma Multipurpose Bridge Project (PMBP) on 29 June 2012, the government is largely left with two other costlier options to finance this single largest infrastructure project in Bangladesh: *first*, financing through commercial loans, and *second*, resorting to self-financing. However, one can also think of a mixed basket of finance including domestic resources and various types of financing from the external sources. Whatsoever, the government, till date, seems to have opted for self-financing by allocating substantial domestic funds in successive ADPs starting from FY2013-14.

The PMBP was brought into the purview of public finance through the revised ADP of FY2007-08. The total cost of the project was estimated to be Tk. 10,162 crore, with 68 per cent attributable to project aid. As the PMBP remained under negotiation with prospective external financiers, the allocations and expenditures in successive years were rather negligible. The allocations varied from as low as 0.16 per cent of the total ADP to 2.89 per cent in FY2010-11. In FY2011-12, the comparable allocation was only 1.5 per cent. These low figures are largely explained by the absence of operationalisation of the loan agreement with the development partners.

It may be observed from Table 2.5 that, although there has been allocation in the PMBP over the years, the expenditure pattern has been sluggish. By scrutinising the revised ADPs over the consecutive years, it can be observed that while 91 per cent of the allocated finance was utilised in FY2008-09, the proportion has come down in recent years – with 59 per cent of expenditure in FY2009-10, 30 per cent in FY2010-11 and 67 per cent in FY2011-12.

Having estimated the overall cost of PMBP at Tk. 10,162 crore in FY2007-08, this was revised upward in FY2011-12 to Tk. 20,507 crore, making the total cost almost double the original estimation. While foreign fund for the PMBP was yet to be released, an amount of Tk. 207 crore from foreign sources under ADP FY2011-12 was utilised. This foreign currency allocation, a loan provided by the World Bank, possibly underwrote the project preparatory cost.

The ADP for FY2013-14 is reportedly estimated to be Tk. 65,600 crore. With the cancellation of the World Bank loan and other related external financing, the Government of Bangladesh (GoB) has come to a

Table 2.5

Allocation and Expenditure on Padma Multipurpose Bridge Project: FY2008 RADP to FY2013 ADP

Year	ADP	Project Cost (Crore Tk.)			Allocation (Crore Tk.)			Expenditure (Crore Tk.)		
		Taka	Aid	Total	Taka	Aid	Total	Taka	Aid	Total
FY08	Revised ADP	3,281	6,881	10,162	36	0	36	0	0	0
FY09	Original ADP	3,281	6,881	10,162	65	0	65	287	0	287
	Revised ADP	3,281	6,881	10,162	317	0	317	287	0	287
FY10	Original ADP	3,281	6,881	10,162	700	0	700	200	0	200
	Revised ADP	3,281	6,881	10,162	338	0	338	200	0	200
FY11	Original ADP	3,281	6,881	10,162	300	908	1,208	316	0	316
	Revised ADP	3,281	6,881	10,162	318	720	1,038	316	0	316
FY12	Original ADP	4,258	16,250	20,507	480	1,707	2,187	202	207	409
	Revised ADP	4,258	16,250	20,507	162	453	615	202	207	409
FY13	Original ADP	4,258	16,250	20,507	572	232	804	9	34	43
	Revised ADP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Source: Calculated from the Implementation Monitoring and Evaluation Division (IMED) data.

decision, with the intention of self-financing the project, to allocate Tk. 6,852 crore in the next ADP, i.e. 33.4 per cent of the PMBP cost. The comparable foreign component is a paltry sum of Tk. 60.8 crore (0.3 per cent of the project cost). It has also been reported that Tk. 7,800 crore, Tk. 5,000 crore and Tk. 300 crore, i.e. 38.04 per cent, 24.38 per cent and 1.46 per cent respectively of the project cost have been planned to be allocated over the next three years (FY2014-15, FY2015-16 and FY2016-17).

The PMBP will account for more than 10 per cent of the total outlay in the next year's ADP. Indeed, the project will absorb around 57 per cent of the total incremental allocations. In other words, the non-PMBP incremental allocation is only Tk. 4,600 crore.

Enhanced allocations of domestic resources in the ADP for FY2013-14 will have significant implications for the allocative priorities under the next three to four ADPs. As a large share of the additional ADP resources has to be allocated to the PMBP (more than 50 per cent annually), very little will be left for other priority sectors in the areas of physical and social infrastructure. Furthermore, one will need to assess a fuller macroeconomic implication encompassing exchange rate, inflation and other aspects of the economy as the government converts the domestic currency or takes loan from the foreign currency reserve.

This may create serious resource constraints for expanding capacities of essential public services in the face of growing demand. Under the circumstances, the government will be well advised to do the following two. *First*, the GoB should strengthen domestic resource mobilisation to finance the other underresourced essential public priorities. *Second*, GoB should explore possibilities for concessional or low-cost foreign financing to substitute the earmarked domestic resources and release those for other competing demands.

2.5.1 Foreign Financing

As mentioned earlier, funding from mixed sources could be a possible option at any point in the implementation of the PMBP. With diminished prospect of foreign aid, the government is considering the floatation of Sovereign Bonds for 5-10 years at the rate of 5.5 per cent to raise USD 1 billion. The proposal might seem quite challenging as the experience of neighbouring countries would demonstrate. The third international Sovereign Bond offered by Sri Lanka in 2011 had a yield rate of 6.25 per cent. Sri Lanka's rating is B+ by Standard & Poor's Rating Services and B1 by Moody's – both give a positive outlook and both are lower than the rating of Bangladesh. On the other hand, interest rates on Indian and Pakistani government bonds are 9 and 12 per cent respectively. It may be noted that India has higher rating and Pakistan has lower rating than Bangladesh.[3] Thus, it is reasonable to assume that this is not only the credit ratings which are taken into account by the international investors, but also other macroeconomic attributes. Having said this, even if the floatation of Sovereign Bonds is possible at 5.5 per cent, the reflections on the country would be fatally undermined in the case of undersubscription of the bonds, given the violent transition the country is going through at present.

However, two other commercial borrowing options are currently on the table. One is the Malaysian proposal, with regard to which a Memorandum of Understanding (MoU) was signed in 2012. An amount of USD 2.3 billion is proposed as credit in the Malaysian proposal. With the payment period being 26 years, the payable amount against this credit will be equivalent to USD 5.2 billion. The other is the Chinese proposal, which offered USD 1.95 billion worth of loan with 20 years payback period and no interest obligation. As credible details are not available about these loan offers, one is constrained to make any comment, although on the face of it the Chinese offer seems more preferable.

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[3]The rating of Bangladesh, according to the Standard and Poor's Rating Services, is BB-
The rating of India, according to the Standard and Poor's Rating Services, is BBB-
The rating of Pakistan, according to the Standard and Poor's Rating Services, is B-

However, to the government's great relief, it was able to open its forex account for the PMBP with the USD 200 million grant offered by India.

The government indicates that it will float the request for proposal for the construction of main structure of the PMBP by June 2013. This request will be sent to the earlier short-listed contractors – although it is not clear whether they are still interested or not to undertake the task. Whatsoever, it is apprehended that reputed firms may not feel interested until a credible financing package has been put together.

2.6 CURRENT STATE OF POWER AND ENERGY SECTOR OF BANGLADESH

Power and energy sector has been under pressure for long to meet the growing demand for electricity and gas to undertake economic activities. During the last four years, both public and private sectors have made significant investment, but have been unable to increase the access to energy to significant level. In this context, a number of concerns arise in this sector regarding the quality of investment, timely completion of different projects and efficiency of the management of concerned authorities.

2.6.1 State of Supply of Electricity in FY2012-13

The power sector has witnessed a substantial investment over the last four years which improved the state of electricity supply in the country (from 3,267 mega watts (MW) in 2009 to 6,080 MW in 2012), but that was much less than the targeted level.[4] Actual generation (6,261 MW) is way below the total installed capacity (8,988 MW) resulting in a gap of about 2,600 MW.[5] Currently, power is generating through three different sources, namely the Bangladesh Power Development Board (BPDB), independent power producers (IPPs) and quick rental power plants (QRPPs). About half of the total share is generated by BPDB power plants and the rest half is generated by IPPs and rental power plants. Since the cost of power generation and the selling price are different among various sources (highest for QRPPs and lowest for BPDB), the use of particular source of electricity has an implication for government expenditure. In this context, there has been a negligible change in the sourcing pattern in the current fiscal year although the government has earlier announced to reduce the share of QRPPs in the overall supply of electricity. Despite effort to diversify the fuel use pattern (from gas to non-gas fuel) little change has occurred over the years, except a few in case of use of heavy fuel oil (HFO), furnace oil and coal-based power plants.[6]

With the expansion of operation during the last four years, management in the power sector has become complex and maintaining its efficiency is a challenging task. One of the major concerns is the failure to ensure timely implementation of new power plants under IPPs which affect the overall supply of electricity. As a result, existing sources, particularly high-cost QRPPs have been used more for additional supply of electricity. As per the contract, various punitive actions (e.g. monetary punishment as per the contract) against the IPPs/QRPPs for their failure to timely implementation of projects were not properly enforced.[7] Poor implementation of a number of IPPs is found to be associated with lack of capital, inexperience in business and inadequate supply of gas. A large number of households and industrial and commercial units have been waiting for long to get the electricity connection. This has happened initially due to lack of electricity supply and later High Court's stay order against providing new connections which has been withdrawn recently.

[4]At present a total of 98 power plants are in operation with a generation capacity of 8,988 MW which was 20 per cent higher compared to the corresponding period of the previous year (16 April 2012).
[5]Recently, this gap was reduced because of higher rate of growth of electricity supply (about 40 per cent between 16 April 2012 and 16 April 2013).
[6]Power generation is overly dependent on gas (more than 75 per cent).
[7]Under such circumstance, reduction of the burden of QRPPs is getting difficult. In contrast, some QRPPs despite all their limitations (short-lived, high operational cost and old machineries) have approached the BPDB to convert their plants as IPPs.

2.6.2 State of Supply of Gas in FY2012-13

The gas sector of the country is in crisis because of rising gap between supply and demand of gas for different economic activities. During FY2012-13 (till December 2012) total supply of gas was 11,345 million cubic metres (mmcm) which was 10.8 per cent higher compared to that in the previous year.[8] At present, 45 per cent of gas is supplied by Petrobangla and the rest by the international oil companies (IOCs).[9] In fact, the overall gas supply is dependent on two major sources – Bangladesh Gas Fields Company Limited (BGFCL) (35 per cent) and Chevron of IOCs (49 per cent) – accounting for 84 per cent of the total supply which indicates high concentration in the sources of supply. As part of exploring gas in offshore blocks, recently held tenders for bidding in five blocks were not so successful – three blocks did not get any bidder. The initiative for setting up a liquefied natural gas (LNG) terminal for imported LNG (about 4 million tonnes) has not advanced much due to the failure in getting a qualified contractor. It is evident that alternate options are not so promising at present.

The distribution of gas in different economic activities is directed by the government. As a result, a significant part of gas is supplied to power plants (about 55 per cent of total supply) with a view to meet the priority demand in the power sector. The supply of gas to other economic activities has to be adjusted accordingly. For example, the supply of gas to fertiliser plants has significantly declined, and at present all four fertiliser units have been shut down in order to divert their gas supply to power plants.

2.6.3 Pricing of Energy

Tariffs of electricity, gas and petroleum products have been revised several times under the tenure of the present government – petroleum products by five times and electricity by seven times. Adjustment of tariffs has been undertaken in order to reduce the pressure of huge subsidy provided for generating diesel-based power generation which is as high as 51 per cent of total subsidy. On the other hand, rising tariffs have adverse impact on firm and household incomes. According to CPD (2013), an increase in petroleum price by 7.8 per cent is likely to reduce households' income by 0.3 to 0.6 per cent, households' consumption by 0.6 to 0.9 per cent, and firm's income by 0.7 per cent.[10] Hence, increasing supply of electricity at higher generation cost has to be traded-off with higher tariffs resulting in burden on households' income and consumption. Pricing of energy is also tied with the IMF-ECF conditionalities (see Section 2.2.4).

2.6.4 Budget Proposals

- It is expected that the government will immediately allocate necessary funds for repairing, refurbishment and other works to restart the power stations which were damaged due to political violence in last few months. If necessary the government should make necessary allocation of fund in the next fiscal to undertake those urgent works.

- The government should stick to its Master Plan by putting more emphasis on timely implementation of BPDB and IPP projects (22 projects will be completed in FY2013-14: 10 BPDB and 12 IPPs) with a view to reduce the share of power supply from QRPPs which will reduce financial burden as well.[11]

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[8]The supply situation would deteriorate further when gas supply from Sangu offshore plant (share 0.11 per cent of total supply) would be stopped due to lack of sufficient extractable reserve. Supply from Sangu plant has dropped by 33.6 per cent within a week in April 2013 and is apprehended to be shut down shortly. This will adversely affect the supply of gas particularly in the Chittagong region.

[9]Growing dependence on IOCs has reduced the share of Petrobangla in the overall supply of gas (from 55 per cent in 2008 to 45 per cent in December 2012).

[10]However, rising fuel prices has contributed to government's savings (by 0.2 per cent to 0.3 per cent of GDP).

[11]The government has extended the contract period for seven QRPPs by a year.

Similarly, non-gas based power plants such as dual-fuel power plants and combined cycle power plants have to be implemented timely on a priority basis.

- The administration of the Ministry of Power, Energy and Mineral Resources and BPDB should be strengthened in order to ensure timely implementation of projects, collection of charges/fines, and putting pressure on IPPs/QRPPs for supply of electricity as per the contract.

- Considering the adverse consequences on income of households and firms due to rising petroleum prices as well as the stable condition in the global petroleum prices in recent months, the government should try to avoid upward revision of tariffs of petroleum products in the next fiscal.

- The government should put the highest effort to develop the gas sector according to the gas sector Master Plan. In this context, offshore blocks which are yet to get successful bidders or which are yet to advertise for public tender, should be immediately placed for bidding and expedite the process further. Petrobangla should put high importance on the implementation of fast-track gas field development projects with effective strategy and proper management.

- Like the Electricity Development and Maintenance Fund, the government may set up a separate fund titled Energy Development Fund for the development of the gas sector by using a portion of revenue earned from the sales of petroleum products. This fund can be utilised in enhancing refining capacity, facilitating transportation and supporting the emergency imports.

- As part of promoting alternate sources of energy, special incentives could be provided for setting up solar-based power plants at the household level.

- The government should reconsider its decision to temporarily suspend the operations of four fertiliser factories in order to divert the gas supply from those factories to the power plants, particularly in view of the fact that at least one factory (e.g. Ashuganj fertiliser factory) has been operating profitably.

2.7 SUPPORT TO RURAL ECONOMY

In order to improve the socio-economic and livelihood conditions of the rural poor, national budget makes financial allocations and proposes several mid-term budgetary and short-term stop-gap measures to minimise the gap between rural-urban economy. Sectoral and ministry-wise allocations are made in the form of support for social safety net programmes (SSNPs), input subsidy and price support programmes.

In FY2012-13, both SSNP and the agriculture sector received lower allocation. Allocation for SSNPs was Tk. 22,751 crore, which was 11.87 per cent of the total budget and 2.18 per cent of total GDP in FY2012-13. This allocation was lower than what was received in FY2011-12 (13.79 per cent of total budget and 2.51 per cent of GDP).[12] In addition, an amount of Tk. 14,457 crore was allocated in FY2012-13 for agriculture and allied sectors in the non-development and development budget, which was only 0.77 per cent higher than the Revised Budget of FY2011-12. The budget also allocated Tk. 6,000 crore as agricultural subsidy which was 7.7 per cent less than the allocation in the revised budget for FY2011-12. The implementation status of SSNPs during the current fiscal year could not be discussed here due to unavailability of data. However, official resource management and effective implementation of SSNPs are issues which need continuous attention of policymakers. In this regard re-nationalisation of SSNP rules and regulations would reduce the overlapping of programmes and waste of resources. There is also a need for a Social Protection Policy for ensuring support to a larger section of needy people.

[12] 13 new programmes have been added to the ongoing SSNPs for FY2012-13, while six previous SSNPs will be discontinued. 43 ongoing programmes will receive lower allocations compared to FY2011-12. For details, see CPD (2012).

While the progress of SSNPs in the FY2012-13 is yet to be known, information on the performance of the agriculture sector are unavailable. In FY2012-13, the Department of Agricultural Extension (DAE) has set Aus, Aman, Boro and wheat production targets at 2.37 million metric tonnes (MMT), 13.3 MMT, 19.03 MMT and 1.03 MMT respectively. Bangladesh Bureau of Statistics (BBS) has finalised the estimates of Aus production at 2.16 MMT which is 7 per cent lower compared to the production of last year. The government has also set a target to procure 1.6 MMT foodgrains during the current fiscal year. About 0.7 MMT rice was procured during the last Boro harvesting season in FY2012-13. Moreover, during the same period, 0.26 MMT of wheat was procured against the target of 0.3 MMT. In FY2012-13, the government has a plan to distribute 2.77 MMT foodgrains. As of March 2013, a total of 1.35 MMT has been distributed through the Public Food Distribution System (PFDS). During this period, 0.1 MMT was distributed, mainly through Test Relief (TR), Food for Work (FFW) and Open Market Sales (OMS).[13] At the same time, the public foodgrain stock stood at 1.15 MMT which is lower than the stock of the previous year (1.36 MMT in March 2012). In case of prices of foodgrain, it is observed that price is higher in March 2013 compared to the previous year. Proposals for the budget of FY2013-14 in the area of rural economy should be based on the above context.

2.7.1 Social Safety Net

- Consolidation of SSNPs is needed in terms of programme allocation and selection of target areas and groups. There should be coordination among concerned ministries for proper implementation of programmes. In this regard, resources should be allocated for a central online database to manage the overall integrity of ongoing, continued and new SSNPs.

- Geographic distribution of SSNP coverage areas is highly concentrated in the western regions of the country. Priority should be given to the more vulnerable areas and extreme poor, based on the report of the Household Income and Expenditure Survey (HIES) 2010. Special safety net allocation should also be made for the poor and marginalised *char* dwellers.

- In order to achieve a resource allocation for SSNPs to the tune of 3 per cent of GDP by 2015, as stipulated in the SFYP, higher allocations will be necessary in the next fiscal year. The required annual average growth in safety net allocations for the next two years (FY2013-14 and FY2014-15) will be around 32.47 per cent. Based on this estimate, a safety net budget of around Tk. 30,200 crore will be needed in the budget for FY2013-14.

2.7.2 Agriculture and Food Safety

- Input subsidy and price support programmes for farmers/growers should be continued in order to maintain the growth momentum of the agriculture sector. Given that such measures put pressure on government's fiscal expenses, the government should improve the allocation efficiency through close monitoring of the distribution mechanism.

- Improved marketing structure and practices are essential to ensure fair market prices at the consumer level and help farmers/growers in getting a minimum profit for their agricultural products. Hence, more funds should be allocated for the Department of Agricultural Marketing (DAM) to provide improved marketing services and ensure fair market practices. An Agriculture Price Commission should be set up which will monitor prices and set a floor price for agricultural commodities.

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[13] For details, http://www.nfpcsp.org/agridrupal/sites/default/files/fortoutlook120.pdf

- The GoB has planned to initiate crop insurance for farmers on a pilot basis in a number of upazilas to protect farmers from climatic shocks. This initiative should be broadened for other sub-sectors such as poultry, livestock and fisheries in FY2013-14.

- Construction of public and private cold storages for potato and potato seeds in the bumper producing areas should be given priority. Uninterrupted power supply should also be ensured in those areas. Moreover, fund should be allocated for providing training and technical assistance to farmers/growers on usage of alternative storage systems. Policy support should be given for the establishment of export-oriented potato-based industries, such as potato flex, chips, etc.

- More funds should be allocated for agricultural research towards improving flood and drought-tolerant varieties to increase the agricultural outputs, especially in the southern and northern districts.

- The National Agricultural Policy should be finalised with guidance on foreign investment in capital-intensive agro-based industries.

- In view of recent bird flu attack, exemption of 5 per cent income tax and extension of existing tax holiday facility for poultry and fisheries owners should be continued to achieve self-sufficiency of these sectors.

- Funds should be allocated for establishing Food Safety Authority/Commission to develop required food safety regulations and harmonise domestic practices with international standards.

2.8 GLOBAL ENVIRONMENT: IMPLICATIONS FOR BANGLADESH'S EXPORT

The world economy is still struggling to recover from the multiple crises despite the economic upturn visible in early 2013. The World Bank (2013) has estimated a lower growth rate for the global economy, at 2.4 per cent for 2013 and 3.1 per cent in 2014. The World Trade Organization (WTO) also downgraded trade forecast to 2.5 per cent from 3.7 per cent for 2012 and from 5.6 per cent to 4.5 per cent for 2013 (WTO 2012). Whilst the United States (US) economy is set to continue its recovery to grow at 2 per cent in 2013 and 3 per cent in 2014, the European Union (EU) zone is projected to post negative growth of 0.2 per cent in 2013. Since USA and EU remain two most important markets for Bangladesh, export demand for Bangladeshi goods is likely to be impacted by these projections with their consequent impact on import demands. Better growth projection for emerging countries for 2013, however, transmits good signal for Bangladesh.

After the initial slowdown, Bangladesh's export has picked up in recent months – export growth stood at 10.16 per cent during July-March; however, this was well below the 15.3 per cent growth target envisaged for FY2012-13. Whilst apparels exports have been showing robust growth, except leather and footwear, all other major items have seen negative growth in the first nine months of FY2012-13. In the US market export growth has been 5.3 per cent over the first nine months, whilst in the EU the growth was 7.9 per cent. The slow economic recovery in the developed countries is likely to have negative implications for Bangladesh's exports performance. It is interesting to note that Bangladesh's export growth in other markets (i.e. barring the USA and the EU) was a robust 18.57 per cent over the corresponding period of FY2012-13 mainly through South-South trade. In view of the growth projection for 2013 and 2014 in the USA and the EU, Bangladesh's major export markets, and the emerging opportunities of South-South trade, appropriate fiscal-budgetary measures will be needed in the budget for FY2013-14 to maintain robust export performance in the next fiscal year.

2.8.1 Proposed Budgetary Measures

- The three year Export Policy (July 2012 – June 2015) approved by the government has expanded thrust sectors to 10. The budget should have additional allocations in support of the new thrust sectors (e.g. tourism, furniture and plastic products, etc.).

- The three year Export Policy plans to set up a national databank containing detailed information on import, export, tariffs, etc. Adequate allocations should be made in the budget for setting up this data bank.

- Bangladesh's preferential market access under the Generalized System of Preferences (GSP) scheme has come under question in USA, also in EU and Canada, because of non-compliance with labour rights, lack of conducive work environment and weaknesses in ensuring workers' safety at work place. In view of this, there is a need to allocate adequate resources to oversight institutions, particularly the Labour Directorate, towards endowing it with the required human resources and raising its operational capacity. The incentive structure for the export-oriented enterprises may also be tuned to the compliance enforcement status of the particular enterprise.

- The 5 per cent cash incentive for the backward linkage industries in the textile sector should continue in FY2013-14.

- The government should take an initiative to set up a Technological Upgradation Fund for modernising the export industry. Such a fund, set up in India some years back, has been playing an important role in helping firms modernise, move up the value chain and raise productivity.

- SME apparel exporters are now given special incentives if they export to non-traditional markets. As per the earlier plan, this was supposed to continue in FY2013-14 at 2 per cent of free-on-board (f.o.b.) value. Allocations should be kept towards this in the budget.

- The government has taken the policy to create Export Development Fund to expand the export basket of Bangladesh. The fund should be endowed with adequate allocation in the upcoming budget.

- There is a need to realise the increasing opportunities of South-South trade for Bangladesh. In recent years the share of South-South trade in Bangladesh's total trade has seen some rise, but more comprehensive efforts are needed. It is proposed that a South-South Market Development Fund should be set up which will be dedicated to undertaking comprehensive plans to promote South-South trade; the fund may jointly be managed with private sector exporters. This fund can also be deployed to realise the potential opportunities emanating from the recent duty-free quota-free (DF-QF) market offer by India. This could also be merged with the proposed Export Development Fund.

- There is an urgent need to set up Bangladesh Standards and Testing Institution (BSTI) offices and laboratories at land ports, especially at Benapole, Hilli and Banglabandha Ports. Allocation of necessary funds for infrastructure, laboratory equipments and manpower are required towards these trade facilitation measures. This will also help implementation of the *Mutual Recognition Agreements* with India (and perhaps with Myanmar as well).

- Establishment of the Active Pharmaceutical Ingredient (API) Park has been inordinately delayed. Budget should make necessary allocation of funds towards implementation of this needed initiative.

- Given the growing importance of the information and communication technology (ICT) sector as an export-oriented sector and its identification as a Most Prioritized Sector in the Export Policy 2012-

2015, the sector needs to be accorded special attention under the Equity Entrepreneurship Fund (EEF). In this connection, completion of the Hi-Tech Park at Kaliakair, well behind schedule, should be given priority.

- Cash incentives, ranging from 2 to 20 per cent, are provided to selected potential sectors including textile, frozen fish, agricultural products, ship-building and light engineering. Some emerging sectors such as ICT-related export sectors may also be included in this scheme given its potential.
- In pursuance of the new Export Policy, a fund should be allocated to rejuvenate the traditional industries such as handloom industries. Since the new Export Policy has clustered these sectors as Special Developmental Sector, adequate budgetary allocation is needed for their support. It may be noted that, the Indian government has recently initiated the *Scheme of Fund for Regeneration of Traditional Industries* (SFURTI) under which 100 traditional industry clusters (of *khadi*, village industry and coir) would be taken up for comprehensive development over five years.
- The government, with a view to reducing the costs associated with overseas migration of workers, is currently in the process of signing government-to-government (G2G) contracts with a number of countries including Malaysia and Bahrain. To deal with this work appropriately, the Bureau of Manpower, Employment and Training (BMET) will need to be significantly strengthened. Adequate provision should be made towards this in the budget.

2.9 IMPLEMENTATION CHALLENGES OF THE UPCOMING BUDGET

The upcoming budget for FY2013-14 will be particularly constrained by the implementation challenges. Some of these challenges are structural in nature and may aggravate further over time. The erosion of the institutional capacity of the development administration is a case in point. At the same time, some of the challenges reflect contextual realities of the current time. For example, given that the duration of the budget is largely overlapping with electoral transition, a successor government would implement the fiscal programme designed by its predecessor.

In view of the above, one may group various implementation challenges of the budget for FY2013-14 under the following three broad heads.

a. Fiscal challenges
b. External challenges
c. Governance challenges

All these three risks will be underpinned by the unfolding political hostilities afflicting the country.

2.9.1 Fiscal Challenges

The fiscal challenges include risks relating to both revenue and expenditure sides.

a) *Resource Risk*. If a gap emerges between the projected revenue envelope and the actual expenditure, it may constitute a resource risk for the country. Such a risk would become real, if revenue intake decelerates and foreign aid disbursement slows down. This year the revenue collection has already been below target, while the foreign inflow improved reasonably (see Section 2.2). However, the resource risk will not be significant if the budgetary targets are not overambitious.

b) *Expenditure Risk*. There may be risks on the expenditure side if the revenue and ADP expenditures are too much frontloaded. This may happen, if the outgoing government resorts to profligacy during the early part of the next fiscal year in the wake of national elections. Such a trend will also entail deterioration of expenditure effectiveness.

2.9.2 External Challenges

A significant part of Bangladesh economy is integrated with the global economy. Thus, implementation success of the national budget also depends on the conduct of the external factors, such as foreign aid, FDI, exports, commodity prices and remittances.

Export remains conditional to global recovery, particularly that of the Eurozone. The recent slowdown in imports has resulted in low intake of import duties. FDI had also been slowing down in the recent months. While keeping up the improved official development assistance (ODA) will be important, continued robust remittance flow will also be critical.

2.9.3 Governance Challenges

While the impact of weak economic governance on budget implementation is an enduring issue, current tensions in the political arena could further aggravate the economic and development management. Indeed, in Bangladesh, governance challenges accentuate as the country approaches the national election. It has been historically observed that when the national elections approach, development administration enters into a state of paralysis as officials opt for fence sitting.

Furthermore, ongoing violent political agitations are adversely affecting the economic environment including the investment trend. CPD, in one of its recent research papers, has spelt out the negative implications of the ongoing political agitation. If such hostilities continue for a longer duration, if not intensify even further, they are seriously going to jeopardise the successful implementation of the upcoming budget.

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- Bangladesh Economy in FY2011-12: Third Interim Review of Macroeconomic Performance
- State of the Bangladesh Economy in FY2010-11 and Outlook for FY2011-12
- Bangladesh Economy in FY2010-11: Second Interim Review of Macroeconomic Performance
- State of the Bangladesh Economy in 2009-10 and Outlook for 2010-11
- বাংলাদেশের অর্থনীতি পর্যালোচনা ২০০৮-০৯
- Bangladesh Economy in FY2009-10: An Interim Review of Macroeconomic Performance
- State of the Bangladesh Economy in FY2008-09 and Outlook for FY2009-10
- Development of Bangladesh with Equity and Justice: Immediate Tasks for the New Government
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