Centre for Policy Dialogue (CPD)

State of the

BANGLADESH ECONOMY

in FY2011-12 and Outlook for FY2012-13

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CENTRE FOR POLICY DIALOGUE (CPD)
B A N G L A D E S H
a civil society think tank

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Mr Towfiqul Islam Khan was the Coordinator of the CPD IRBD 2012-13 Team.

PREFACE

Since 1995 the Independent Review of Bangladesh's Development (IRBD), the flagship publication series of the Centre for Policy Dialogue (CPD), has strived to service the growing demand of stakeholders in Bangladesh and also others interested to learn about developments taking place in the Bangladesh economy, to provide an in-depth analysis of the dynamics of major macroeconomic correlates and developments in Bangladesh. In the course of its journey the IRBD has undergone significant evolution in the way it is prepared and presented including selection of the themes and the focus and content. In recent years, the IRBDs have put more emphasis on blending thorough review with rigour of analysis, and the current volume reflects this ongoing change.

The present volume captures key developments in the Bangladesh economy in FY2011-12 and anticipates early signals of FY2012-13. The analyses presented in this volume have highlighted the positive developments and also flagged a number of emerging challenges facing the Bangladesh economy. The current volume includes three analytical chapters and one dialogue report as an annex. It may be noted that the volume has gained significantly from the feedbacks at the expert group meetings and from views of major stakeholder groups at the dialogue where some of the drafts were presented and discussed.

Chapter 1 puts forward an assessment of Bangladesh's macroeconomic performance in FY2011-12 by tracking the performance of key macroeconomic correlates. The analysis flags positive achievements and draws attention to disquieting trends which need to be corrected. The analysis also serves as a benchmark exercise for assessing the outlook for the upcoming fiscal year by reviewing the movements of major macroeconomic correlates over first few months of FY2012-13 for which latest data and information were available. Based on this the chapter attempts to anticipate the possible future direction of key indicators as the economy moves forward in FY2012-13 in the backdrop of current policy stance of the government. The chapter also picks up two thematic issues which are perceived to be critical to the macroeconomic management in the present juncture. Recognising the fact that FY2012-13 is a period when the Sixth Five Year Plan (SFYP) would cross its mid-point, the chapter presents a mid-term assessment of some of the key deliverables in the Plan by reviewing their progress in terms of implementation. The chapter also brings out a review of the performance of the manufacturing sector of Bangladesh.

An analysis of the various proposals in the National Budget for FY2012-13 has been presented in Chapter 2. As in earlier years, CPD has carried out a detailed examination of the various components of the Budget including fiscal framework that informs the budget proposals, tariff rate restructuring and investment incentives. Change in effective rates of protection has also been examined. An analysis of sectoral allocation was undertaken. The analysis makes an attempt to capture the possible impacts of various fiscal measures and budgetary allocations on macroeconomic performance. The Annual Development Programme (ADP) has been scrutinised to identify key trends and investment priorities and their rationale.

Chapter 3 focuses on the state of governance in the banking sector of Bangladesh. The issue of governance in banking sector has come under scrutiny in the backdrop of the Hall-Mark scam which has exposed serious malgovernance in the leading public sector bank of the country. The chapter discusses some of the challenges confronting the banking sector in Bangladesh, particularly focusing on the state-owned commercial banks. A number of policy recommendations have been made towards improvement of governance of the banking sector of the country with a view to avoiding recurrence of such malfeasance in future.

Annex 1 of the volume includes a report on the dialogue CPD had organised titled *Analysis of the National Budget FY2012-13*, held on 16 June 2012. The report includes a brief summary of the keynote presentation which was prepared based on CPD's analysis of the National Budget for FY2012-13 (which has been detailed out in Chapter 2) followed by a report that captures the critical views and perspectives of the stakeholders from the floor on a wide range of issues including various fiscal measures and incentives, budgetary allocations and implementational challenges.

Acknowledgement

The IRBD output is the result of a team work and a debt of gratitude is owed to all the involved team members, both collectively and individually. I would like to particularly thank *Dr Debapriya Bhattacharya*, Distinguished Fellow, CPD for his leadership in conceptualising the IRBD 2012. His intellectual guidance and advice have made it possible for my CPD colleagues to implement the assigned tasks in keeping with the high standard of the IRBD. *Dr Fahmida Khatun* has provided leadership and guidance to the IRBD Team members and was also one of the key contributors to the volume. I would like to particularly appreciate the dedication and hard work put in by *Mr Towfiqul Islam Khan*, Research Fellow, CPD who performed his responsibilities as coordinator of the IRBD programme with exceptional devotion and perseverance.

As on previous occasions, the present volume has benefitted greatly from peer reviews of earlier interim drafts. I will be remiss if I do not adequately recognise the contribution of the large number of individuals and institutions who have extended their cooperation to the CPD IRBD 2012 Team. They included researchers, members of the academia, leading policymakers, political leaders and Members of the Parliament, government officials, business leaders, and representatives from grassroots and civil society organisations. I would like to put on record our sincere gratitude to all the professionals who shared their views and comments at the expert group meeting held to discuss the IRBD work in progress. CPD IRBD Team gratefully acknowledges the important contributions of all the participants and experts who shared their views at the CPD dialogue held to discuss the IRBD outputs. Inputs of all these well-wishers of the CPD have enhanced the quality of the volume significantly.

Taking advantage of this opportunity, on behalf of the IRBD 2012 Team, I would like to put on record my sincere appreciation to the concerned officials of a number of institutions. They have extended valuable support to the CPD IRBD 2012 Team in the form of providing access to relevant reports, data and information. These included the Bangladesh Bank, Bangladesh Bureau of Statistics (BBS), Bangladesh Export Processing Zone Authority (BEPZA), Bangladesh Energy Regulatory Commission (BERC), Bureau of Manpower, Employment and Training (BMET), Board of Investment (BOI), Bangladesh Power Development Board (BPDB), Department of Agricultural Extension (DAE), Department of Agricultural Marketing (DAM), Dhaka Stock Exchange (DSE), Export Promotion Bureau (EPB), Ministry of Finance, Ministry of Food, National Board of Revenue (NBR), Petrobangla, and Planning Commission.

On behalf of the IRBD 2012 Team, I would like to most thankfully recall the support and cooperation of the print and electronic media of the country which has helped CPD to take the messages emanating from the IRBD exercise to the broader sections of the society, both in Bangladesh and beyond.

Special words of appreciation are due to colleagues at CPD's Dialogue and Communication Division headed by *Ms Anisatul Fatema Yousuf*, Director, CPD for the hard work in organising various dialogues and workshops on interim IRBD outputs, and for preparing the IRBD manuscript for publication. Contribution of the CPD Administration and Accounts

Division in facilitating the organisation of IRBD-related research and dialogue activities is also sincerely acknowledged. I would like to specially mention the hard work of *Ms Nazmatun Noor*, Deputy Director, Dialogue and Outreach, CPD who has worked tirelessly to copy edit all the chapters in this volume. *Mr Avra Bhattacharjee*, Deputy Director, Dialogue and Outreach, CPD has worked with devotion for the cover and graphic works in connection with publication of the volume, and was in overall supervision of the design work. *Mr Fazley Rabbi Shakil*, Publication and Print Associate, CPD and *Mr Md. Shaiful Hassan*, Programme Associate (DTP) have provided efficient assistance to prepare the pre-printing format of the volume. Contributions of *Mr A H M Ashrafuzzaman*, Senior System Analyst, CPD for his technical support, and *Mr Md Hamidul Hoque Mondal*, Senior Administrative Associate, CPD for his valuable secretarial support are also thankfully acknowledged.

Professor Rehman Sobhan has been the guiding light of CPD's IRBD exercise as the initiator of this pioneering programme. On behalf of the IRBD Team I would like to take this opportunity to register our deep gratitude to *Professor Sobhan* for his unfailing support and invaluable guidance in implementing the IRBD-related activities over all these years including the preparation of the present volume.

May 2013
Dhaka

Professor Mustafizur Rahman
Executive Director
Centre for Policy Dialogue (CPD)

CONTENTS

LIST OF TABLES, FIGURES AND BOXES

List of Tables

List of Annex Tables

List of Figures

List of Boxes

ACRONYMS

ADB	Asian Development Bank
ADP	Annual Development Programme
ADR	Alternative Dispute Resolution
AIT	Advance Income Tax
API	Active Pharmaceutical Ingredients
ASYCUDA	Automated System of Customs Data
ATM	Automated Teller Machine
BADC	Bangladesh Agricultural Development Corporation
BAPEX	Bangladesh Petroleum Exploration & Production Limited
BBBF	Bangladesh Better Business Forum
BBS	Bangladesh Bureau of Statistics
BCA	Banking Company Act
BCCRF	Bangladesh Climate Change Resilience Fund
BCCTF	Bangladesh Climate Change Trust Fund
BCIC	Bangladesh Chemical Industries Corporation
BDT	Bangladeshi Taka
BEPZA	Bangladesh Export Processing Zone Authority
BERC	Bangladesh Energy Regulatory Commission
BFIDC	Bangladesh Forest Industries Development Corporation
BGMEA	Bangladesh Garment Manufacturers and Exporters Association
BIFFL	Bangladesh Investment Facilitation Fund Limited
BJMC	Bangladesh Jute Mills Corporation
BKMEA	Bangladesh Knitwear Manufacturers & Exporters Association
BO	Beneficiary Owner
BOI	Board of Investment
BOP	Balance of Payments
BPC	Bangladesh Petroleum Corporation
BPDB	Bangladesh Power Development Board
BSCIC	Bangladesh Small and Cottage Industries Corporation
BSEC	Bangladesh Steel and Engineering Corporation
BSFIC	Bangladesh Sugar & Food Industries Corporation
BSTI	Bangladesh Standards and Testing Institution
BTMC	Bangladesh Textile Mills Corporation
BTRC	Bangladesh Telecommunication Regulatory Commission
BUET	Bangladesh University of Engineering and Technology
CAMELS	Capital Adequacy, Asset Quality, Management Quality, Earnings, Liquidity and Sensitivity to Market Risks

Acronyms

CBSP	Central Bank Strengthening Project
CDM	Clean Development Mechanism
CEO	Chief Executive Officer
CGE	Computable General Equilibrium
CHT	Chittagong Hill Tracts
CIB	Credit Information Bureau
CNG	Compressed Natural Gas
CNY	Chinese Yuan
CPD	Centre for Policy Dialogue
CPI	Consumer Price Index
CSE	Chittagong Stock Exchange
CY	Calendar Year
DAP	Diammonium Phosphate
DFI	Development Financial Institution
DGM	Deputy General Manager
DMD	Deputy Managing Director
DPI	Domestic Price Index
DSE	Dhaka Stock Exchange
DTA	Domestic Tariff Area
ECF	Extended Credit Facility
EEF	Equity and Entrepreneurship Fund
EGBMP	Enterprise Growth and Bank Modernization Programme
EGP	Employment Generation Programme
EPB	Export Promotion Bureau
EPZ	Export Processing Zone
ERD	Economic Relations Division
ETP	Effluent Treatment Plant
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FCB	Foreign Commercial Bank
FCMD	Foreign Currency Management Division
FDI	Foreign Direct Investment
FPMU	Food Planning and Monitoring Unit
FRA	Financial Reporting Act
FSAC	Financial Sector Adjustment Credit
FSRP	Financial Sector Reforms Programme
f.o.b.	Free-on-Board
GBP	British Pound
GCR	Global Competitiveness Report
GDP	Gross Domestic Product
GED	General Economics Division
GFI	Global Financial Integrity
GM	General Manager
GSP	Generalized System of Preferences
GoB	Government of Bangladesh
G-2-G	Government-to-Government
HR	Human Resource
HS	Harmonized Commodity Description and Coding System

HYV	High-Yielding Variety
IAD	Inspection and Audit Division
ICOR	Incremental Capital-Output Ratio
ICT	Information and Communication Technology
IDB	Islamic Development Bank
IDCOL	Infrastructure Development Company Limited
IFPRI	International Food Policy Research Institute
IMED	Implementation Monitoring and Evaluation Division
IMF	International Monetary Fund
INR	Indian Rupee
IPO	Initial Public Offering
IRBD	Independent Review of Bangladesh's Development
IT	Information Technology
ITFD	International Trade Finance Division
JICA	Japan International Cooperation Agency
KPI	Key Performance Indicator
LDC	Least Developed Country
LGRD	Local Government Rural Development
LMI	Large and Medium-scale Industries
LNG	Liquefied Natural Gas
L/C	Letter of Credit
MCR	Minimum Capital Requirement
MIS	Management Information System
MLT	Medium and Long Term (Loan)
MOVE	Modernization of VAT Environment
MPS	Monetary Policy Statement
MT	Metric Ton
MTBF	Medium Term Budgetary Framework
MTMF	Medium Term Macroeconomic Framework
MW	Mega Watt
MkWh	Million Kilowatt-Hour
MoF	Ministry of Finance
MoP	Muriate of Potash
mmcm	Million Cubic Metre
M2	Broad Money
NARI	Northern Areas Reduction-of-Poverty Initiative
NBFI	Non-Bank Financial Institution
NBR	National Board of Revenue
NCB	Nationalised Commercial Bank
NITTRAD	National Institute of Textile Training Research and Design
NPA	Non-Performing Asset
NPL	Non-Performing Loan
NSD	National Savings Bond
OMS	Open Market Sale
PCB	Private Commercial Bank
POL	Petroleum and Other Liquids
PPP	Public-Private Partnership
PRGF	Poverty Reduction and Growth Facility

PSC	Pre-Shipment Credit
PSI	Pre-Shipment Inspection
PTTI	Primary Teachers Training Institute
QIP	Quantum Index of Production
RADP	Revised Annual Development Programme
REB	Rural Electrification Board
REER	Real Effective Exchange Rate
RMG	Readymade Garments
RRC	Regulatory Reforms Commission
RWA	Risk Weighted Asset
RoO	Rules of Origin
SAM	Social Accounting Matrix
SARSO	South Asian Regional Standards Organisation
SBL	Sonali Bank Limited
SCB	State-owned Commercial Bank
SEC	Securities and Exchange Commission
SEZ	Special Economic Zone
SFYP	Sixth Five Year Plan
SME	Small and Medium Enterprise
SMI	Small-scale Industries
SREDA	Sustainable Renewable Energy Development Authority (Act)
SRO	Statutory Regulatory Order
SSNP	Social Safety Net Programme
SoE	State-owned Enterprise
TCB	Trading Corporation of Bangladesh
TIN	Tax Identification Number
TPP	Trans-Pacific Partnership
TR	Test Relief
TSMU	Textile Strategic Management Unit
TSP	Triple Super Phosphate
TTI	Total Tax Incidence
TUF	Technological Upgradation Fund
ToR	Terms of Reference
ToT	Terms of Trade
UAE	United Arab Emirates
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
US	United States
USD	United States Dollar
USITC	United States International Trade Commission
VAT	Value Added Tax
VGD	Vulnerable Group Development
VGF	Vulnerable Group Feeding
WDI	World Development Indicator
WEF	World Economic Forum

1 CHAPTER

State of the Economy in FY2011-12 and Early Signals of FY2012-13

This chapter was originally presented at a CPD press briefing titled *Analytical Review of Bangladesh's Macroeconomic Performance in FY2012-13 (First Reading)*, held at the CPD office on 5 January 2013. The presented paper has also been published as CPD Working Paper 101.

1.1

INTRODUCTION

The present interim review of macroeconomic performance of Bangladesh focuses particularly on the developments of the economy during the first few months of FY2012-13. This analysis takes developments in FY2011-12 and targets set for FY2012-13 by various policy documents as its benchmarks, and reviews the movements in major macroeconomic indicators for the period for which latest data and information are available. Simultaneously, the review also makes an attempt to project future direction of these indicators as the economy moves towards the end of FY2012-13 in the backdrop of current policy stance of the government. As is known, the increasingly globalised economy of Bangladesh is facing a number of challenges in recent times in view of the ongoing global economic stagnation. FY2012-13 is a period when the Sixth Five Year Plan (SFYP) will cross its mid-point. Additionally, for the present government, 2013 will be the final year of its regime and FY2012-13 will be a period when the government will implement its fiscal budget to the fullest for the last time. Indeed, the policy environment in this period will be impacted by the fall-outs of Padma Bridge financing debate and the Hall-Mark scam; and in addition, policy direction will be significantly influenced by the ongoing Extended Credit Facility (ECF) programme of the International Monetary Fund (IMF) in Bangladesh.

This review makes an attempt to project future direction of the major macroeconomic indicators as the economy moves towards the end of FY2012-13 in the backdrop of current policy stance of the government

In FY2011-12, the economy, after having passed through a period when major domestic and external sector indicators were under significant pressure, appears to have stabilised, albeit at somewhat of a lower level than was targeted. The weaknesses in the macroeconomic situation were manifested by high inflation, stagnation in private investment and economic growth. Indeed, lax macroeconomic management was greatly responsible for many of the economic woes, particularly during the first half of FY2011-12. The target for economic growth rate could not be achieved in FY2011-12, and the early trends in FY2012-13 indicate that there is a possibility that gross domestic product (GDP) growth target may not be achieved in this fiscal year as well. One has to appreciate the fact that, compared to previous fiscal year, macroeconomic situation has been more stabilised. The external balance is expected to be at a comfort zone. However, this low level outcome undermines the fiscal balance as overall revenue mobilisation including import duty has suffered from contraction in import payments. Government targets for fiscal framework was found to be far from on-track, as bank borrowing may again have to step forward to compensate for non-bank borrowing. The government has tried to maintain fiscal balance by containing subsidy requirement through adjustments of administered prices. However, it will keep the commodity price at a high level. Admittedly, policy stance of the government appears to be, by and large, stability-centric. However, this stability could come under pressure if the downside risks are not appropriately addressed through emphasis on enhancing domestic resource mobilisation, stimulating private sector investment, further improvement in public investment, both in quantitative and qualitative terms, and raising the quality of governance across all spheres of economic management.

No doubt, performance of the economy in FY2012-13, and also beyond, will critically hinge on how the political challenges facing Bangladesh at the moment are addressed in the coming months

No doubt, performance of the economy in FY2012-13, and also beyond, will critically hinge on how the political challenges facing Bangladesh at the moment are addressed in the coming months. Any prolonged uncertainty in this context will have serious implications for the performance of the economy.

The present review is prepared in two parts. In the first part, Section 1.2 recalls the performance of Bangladesh economy in FY2011-12 which sets the benchmarks for the following section. Section 1.3 presents the review of the initial months of FY2012-13 which indicates that the economy is moving towards a lower level equilibrium. The second part includes two thematic issues of interest in the present context of Bangladesh economy. Section 1.4 presents a brief interim review of the implementation of the SFYP with a specific focus on macroeconomic framework and a selected set of sectoral issues. A review of the performance of the manufacturing sector of Bangladesh is prepared under Section 1.5.

The provisional figure for GDP growth for the last fiscal year was to the tune of 6.3 per cent, i.e. 0.7 percentage points lower than the target

1.2

REVIEW OF FY2011-12: SETTING THE BENCHMARK

1.2.1 Economic Growth: Lower than Target

The provisional estimates made by the Bangladesh Bureau of Statistics (BBS) indicate that the Bangladesh economy was not able to meet its GDP growth target of 7 per cent set for FY2011-12. The provisional figure for GDP growth for the last fiscal year was to the tune of 6.3 per cent, i.e. 0.7 percentage points lower than the target. This is definitely a setback for the present government's plan to move the economy towards a higher growth trajectory as was envisaged in the SFYP. It may be recalled that in previous year (FY2010-11) the GDP growth target of 6.7 per cent was attained. According to the BBS estimates, a repeat of strong performance by the industry sector (9.5 per cent), particularly its manufacturing component (9.8 per cent) played the role of the key driver of the projected GDP growth rate in FY2011-12. Along with it, the construction sector surpassed its growth target for FY2011-12 (6.6 per cent) to attain a robust 8.5 per cent growth. On the other hand, agriculture sector, particularly the crop production component, failed to maintain its remarkable track record of the past two fiscal years (6.1 per cent against a target of 5.7 per cent). Services sector maintained its traditional 6-plus per cent growth rate, although this was somewhat lower than the target.

Decline in agriculture sector's contribution to the GDP was more than the overall decline in the GDP growth

A decomposition of the GDP growth rates in FY2010-11 and FY2011-12 bears out that in the overall growth in FY2011-12 (6.3 per cent) only 0.5 per cent was contributed by the agriculture sector; in contrast the figure was 1 per cent in FY2010-11 (Table 1.1). This decline in agriculture sector's contribution to the GDP was more than the overall decline in the GDP growth (0.4 per cent). Accordingly, it appears that the decline in GDP growth was mostly accounted for by the relatively depressed performance in the agriculture sector, more particularly, its crop component. In contrast, industry sector, backed up by its manufacturing and construction sub-sectors, improved their contribution to growth. Indeed, out of 6.3 per cent growth in FY2011-12, 2.8 per cent originated from the industry sector, the highest in recent history. Services sector's growth contribution was limited to about 2.9 per cent. FY2011-12 related to a period of sluggish economic performance in the developed economies with its knock-on effects on the export sector performance of Bangladesh. On the other hand, growing domestic demand sustained by robust remittance flows had positive impact on the performance of the economy.

Industry sector, backed up by its manufacturing and construction sub-sectors, improved their contribution to growth

Table 1.1
Contribution to Growth

(in Per cent)

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

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

1.2.2 Investment: Improved Public Sector Performance but Stagnation in Private Sector

Investment, as a share of GDP, failed to accelerate in line with expectations in the second year of the SFYP. Private investment as a share of GDP declined in FY2011-12 to 19.1 per cent from 19.5 per cent of the preceding year. Public investment rate was reported to be 6.3 per cent of the GDP; however, this estimate, in all probability, will perhaps need to be revised downwards because of the underachievement of the targets of the Revised Annual Development Programme (RADP). The current estimate of public investment is based on the allocations of the RADP. The final expenditure estimates of the Annual Development Programme (ADP) suggest that of the total RADP allocation for FY2011-12, about 7.8 per cent had remained unutilised. According to the mid-term plan, the investment target for FY2012-13 was 29.6 per cent of the GDP. This would require a rise in investment as a share of GDP to the extent of 4.2 percentage points. Private investment will need to rise significantly to reach 22.7 per cent of GDP from 19.1 per cent in FY2011-12. This would imply that in the absence of faster accumulation of investment, particularly on part of the private sector, and improved implementation of government investment plan (i.e. ADP), achievement of the targeted GDP growth in FY2012-13 (according to SFYP) is likely to remain a long shot.

Investment failed to accelerate in line with expectations in the second year of the SFYP

1.2.3 Revenue Collection: Impressive NBR

Revenue collection from the National Board of Revenue (NBR) proved to be a source of some comfort in view of the performance of key macroeconomic correlates in FY2011-12. Indeed, for the second consecutive year, NBR revenue target was adjusted upward; this time from 15.7 per cent to 16.3 per cent. Backed by strong revenue mobilisation, thanks to rising import duty, value added tax (VAT) (local) and income tax, NBR was able to surpass its annual revenue collection target by Tk. 2,587 crore. The stellar performance from NBR was somewhat moderated though by underachievement from non-tax sources. Indeed, the target for non-tax revenue collection had to be slashed by Tk. 4,000 crore, which resulted in the overall revenue collection to be at a level below the target.

NBR was able to surpass its annual revenue collection target by Tk. 2,587 crore

1.2.4 Revenue Expenditure: Surpassed the Target

In addition to revenue shortfall, significant rise in revenue expenditure put further pressure on the fiscal balance. Revenue expenditure (augmented) posted 14.7 per cent growth in FY2011-12, surpassing the original growth target of 12 per cent. Major rise in expenditure was observed on account of Acquisition of Assets and Works, Interest Payments, and Subsidies and Current Transfers. It is to be noted that, Subsidies and Current Transfers alone (excluding those to public institutions like Bangladesh Petroleum Corporation (BPC), Bangladesh Power Development Board (BPDB)) contributed to about 42.5 per cent of the incremental revenue expenditure during this period. Domestic interest payments contributed another 38.3 per cent, underwritten primarily by the high borrowing of the government from the banking system. The rising cost of public debt servicing and its attendant fiscal burden is transmitting worrying signs, and could emerge as a problem with long-term adverse consequence. However, as of now, the debt situation has not crossed the critical zone.

The rising cost of public debt servicing and its attendant fiscal burden is transmitting worrying signs

1.2.5 Subsidy Requirement: Growing Fast with Concomitant Fiscal Pressure

A major destabilising feature of the fiscal management in FY2011-12 was the unforeseen growth in subsidy requirements. Original allocation for subsidy was about Tk. 20,447 crore in FY2011-12. As the year progressed, this allocation proved to be way off the mark. Until FY2010-11, agriculture sector was the single-largest recipient of subsidies incurred in the form of fertiliser and irrigation price support (around 42 per cent in FY2009-10). During the last couple of fiscal years, fuel and electricity sectors had received about half of the total allocation for subsidies. Mounting fuel demand from the rental power plants proved to be too costly to bear, forcing the government to maintain a large part of the installed capacity unutilised by restraining the flow of fuel to the plants. At the same time, several upward adjustments in prices of fuel and electricity had to be made to reduce the subsidy demand. However, these measures proved to be insufficient in limiting the demand on subsidy payments – total subsidy demand for the year approached to 3.3 per cent of the GDP. This was a significant rise compared to the figure of 2.4 per cent in FY2010-11. The government went one step further and decided to transfer Tk. 10,000 crore of subsidy payments from the FY2011-12 to FY2012-13. According to the statement of profit (loss) of the BPC, the organisation incurred a loss to the tune of around Tk. 10,000 crore in FY2011-12. Indeed, the subsidy portfolio of the government undermined the efficacy of overall macroeconomic management in FY2011-12.

Subsidy portfolio of the government undermined the efficacy of overall macroeconomic management in FY2011-12

1.2.6 ADP: Underutilisation of Project Aid Undermined Overall Utilisation

ADP implementation during FY2011-12 stood at Tk. 37,871 crore, which was Tk. 8,129 crore less than the original target, implying an implementation rate of 82.3 per cent (of the original budget). This was about 3 percentage points lower than that of the last year (85.3 per cent). As a result, ADP-GDP ratio in FY2011-12 was same as that of the previous year (4.1 per cent). An added concern as regards the ADP had been the higher share of local financing in the absence of envisaged foreign financing. Of the implemented ADP of FY2011-12, about 66 per cent had to be financed from local sources; while the figure stood at 59 per cent in the original allocation. Indeed, only 68 per cent of the total project aid allocation was utilised in FY2011-12. This led to increased government borrowing from the banking system, putting pressure on availability of credit for the private sector.

An added concern had been the higher share of local financing in the absence of envisaged foreign financing

1.2.7 Deficit Financing: Riding on Bank Borrowing

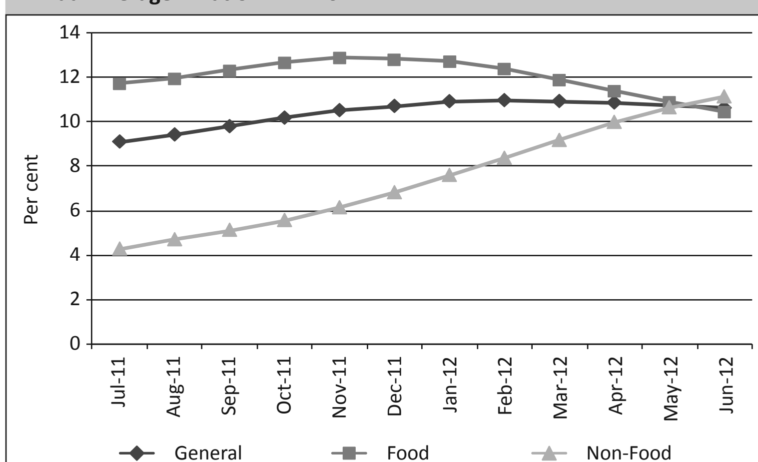
With financing pressure emanating from the overshooting of the revenue expenditures, overall budget deficit (excluding grants) stood at Tk. 36,025 crore in FY2011-12, which was 3.6 per cent of GDP. Modest level of net foreign financing and low contribution of financing from the non-banking sources made financing the deficit a major macroeconomic challenge in FY2011-12. From the very onset of the current fiscal year, the government had to resort to borrowing from the banking sources which turned up to be alarmingly high, and had already exceeded the annual budgetary target of Tk. 18,957 crore by the end of February (Tk. 19,483 crore). As a result, the government revised the target for bank borrowing by Tk. 10,158 crore (to Tk. 29,115 crore). Eventually, the government managed to restrain overall bank borrowing to Tk. 27,188 crore at the end of fiscal year which was Tk. 1,927 crore less than the revised budget target. The underutilisation of domestic financing part of the ADP (by Tk. 949 crore) helped the cause of curtailing bank borrowing to a large extent. However, the government was not able to accumulate the targeted domestic financing from selling of National Savings Bond (NSD) certificates. While the revised target for financing from NSD was Tk. 6,000 crore, only Tk. 271 crore could be mobilised at the end of FY2011-12. Hence, the government had to seek financing from other non-bank borrowing sources. During the last quarter of FY2011-12, the government borrowed Tk. 12,342 crore from such sources as provident funds of government employees. As past experience suggests, this borrowing was short-term in nature and had put pressure on deficit financing in FY2011-12.

From the very onset of the current fiscal year, the government had to resort to borrowing from the banking sources which turned up to be alarmingly high, and had already exceeded the annual budgetary target

1.2.8 Inflation: Non-Food Inflation Elevated Price Level

As is known, inflation rate has been on the rise over the past three years. In the backdrop of high level of commodity prices, the annual average inflation target for FY2011-12 was set at 7.5 per cent. However, general inflation (annual average) rate reached 10.6 per cent in FY2011-12 which was 8.8 per cent in FY2010-11 (Figure 1.1). Since the mid-2000s price level of food items became the dominant contributor to inflation in Bangladesh. However, food inflation started to somewhat slow down since January 2012 after the Aman harvest, and indeed inflation rate of non-food items had a greater influence on the final outcome in FY2011-12. Non-food inflation was on the rise since July 2011 mainly due to the upward adjustment in the administered prices of fuel and electricity, and falling value of Bangladeshi Taka (BDT) against the United States Dollar (USD), leading to imported inflation. At the end of the fiscal year, annual average non-food inflation reached as high as 11.2 per cent and exceeded the annual average food inflation (10.5 per cent). Within non-food commodities, prices of clothing and footwear, gross rent, fuel and lighting, and transport and communication experienced notable rise in FY2011-12.

Figure 1.1
Annual Average Inflation in FY2011-12



Source: Bangladesh Bureau of Statistics (BBS).

1.2.9 Monetary Policy: Contractionary Policy Pursued with Limited Success

A major focus of the Monetary Policy Statement (MPS) for first half of FY2011-12 which was released in July 2012, was to restrain broad money (M2) supply. However, at the end of first half of the fiscal year (December 2011), the overall growth of M2 was close to the target (19.1 per cent against the target 18.5 per cent), and well below the benchmark growth rate (21.3 per cent at the end of

Table 1.2
Growth of Monetary Aggregates

(in Per cent)

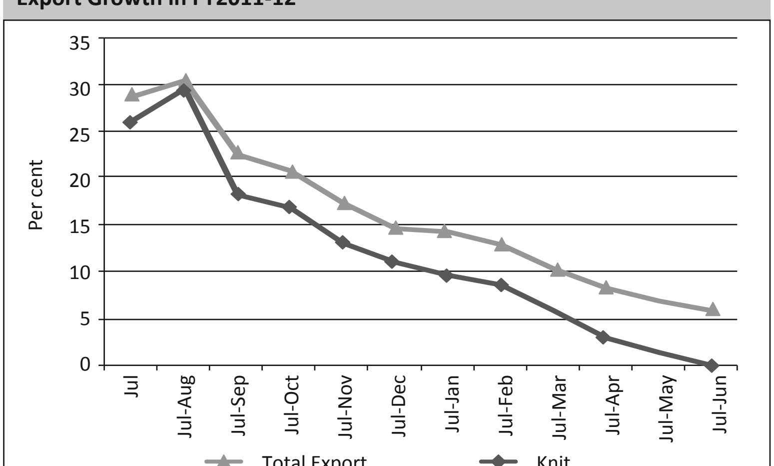
Monetary Aggregate	Target Jun 2011	Actual Jun 2011	Target Jun 2012 (MPS Jul 2011)	Target Jun 2012 (MPS Jan 2012)	Actual Dec 2012	Actual Jun 2012
Broad Money (M2)	15.2	21.3	18.5	17.0	19.1	17.4
Domestic Credit	17.9	27.4	20.0	19.1	25.9	19.5
Credit to Public Sector	25.3	33.6	28.1	31.0	54.4	18.9
Net Credit to Government Sector	NA	35.0	NA	NA	73.5	25.2
Credit to Other Public Sectors	NA	28.7	NA	NA	1.7	-5.0
Credit to Private Sector	16.0	25.8	18.0	16.0	19.4	19.7

Source: Bangladesh Bank data.

Effectiveness of monetary contraction in controlling overall inflation as well as its non-food component was rather limited

FY2010-11) (Table 1.2). Admittedly, the growth of money supply was beyond the target, primarily due to excessive government borrowing from the banking sources. Growth of government bank borrowing was 73.5 per cent at the end of December 2011. In view of the above, the second MPS of the Bangladesh Bank (in January 2012) had reduced the target for growth of credit flow to the private sector and raised government borrowing targets. The monetary policy for the second half of FY2011-12 set growth targets for private and public sector credit at 16 per cent and 31 per cent respectively, whereas the target for growth of M2 was brought down to 17 per cent. At the end of fiscal year, the growth of government borrowing was reduced to 25.2 per cent. Thanks to negative growth of other public sectors credit, overall public sector credit growth was limited to 18.9 per cent. In contrast, private sector credit remained 19.7 per cent and had exceeded the target. The overall money supply growth remained at 17.4 per cent towards the end of FY2011-12. Indeed, restraining credit growth, particularly growth of government borrowing, had helped to restore macroeconomic balance to a certain extent. Regrettably, the effectiveness of monetary contraction in controlling overall inflation as well as its non-food component was rather limited. As mentioned earlier, non-food inflation continued to soar throughout the fiscal year as a result of upward adjustment of administered prices of fuel and electricity. In the end, demand side management was outplayed by cost-push inflation.

Figure 1.2
Export Growth in FY2011-12



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

1.2.10 Export: Target Missed and by a Large Margin

Robust performance of export was one of the major achievements in FY2010-11. Growth target of export for FY2011-12 was set at 15.6 per cent. Regrettably, at the end of the fiscal year, overall export earnings growth stood at 5.9 per cent; this was only 86.5 per cent of the target (USD 26,500 million). Indeed, since September 2011, export growth experienced a secular fall (Figure 1.2). As a result, during the last ten months of FY2011-12 (September-June), export earnings increased by only 1.3 per cent compared to the same period of FY2010-11. Of the exported items, knit readymade garments (RMG) had underperformed significantly, registering zero growth during FY2011-12. The fall in export earnings might perhaps be partially attributed to the fall in cotton prices. During September 2011 to June 2012, average international price of cotton declined by (-) 44.7 per cent compared to the matching period of the previous fiscal. Thus, there was perhaps some 'price effect' in the decline in the earning from the RMG sectors in contrast with the 'volume effect'. Export to the United States (US) market had been rather weak, failing to register positive growth ((-) 0.1 per cent) in FY2011-12. Additionally, export earnings from the European Union (EU) have also started to decline in the second half of FY2011-12, since January 2012. Export earnings from non-traditional markets were impressive, but inadequate to sustain the overall export growth.

There was perhaps some 'price effect' in the decline in the earning from the RMG sectors

1.2.11 Import: Petroleum Products Defined Overall Import Direction

Contrary to the export agenda, imports did not see a significant reduction until last quarter of the fiscal year, leading to heightened pressure on the balance of payments (BOP) situation of the country. At the end of the third quarter, growth of import payments was about 12 per cent. This came down to 5.7 per cent at the end of FY2011-12. Growth of import payments in the current fiscal year originated mainly from the higher import demand for liquid fuel as about 44 per cent of the incremental import payments generated from these products. Import of petroleum products registered a whopping 39.1 per cent growth in the July-March period of FY2011-12 which later came down to 19.5 per cent at the end of FY2011-12. In contrast, import payments for other commodities registered only 3.7 per cent growth. Indeed, in the backdrop of import pressure (along with subsidy requirement), the government was not able to utilise the full capacity of liquid fuel-run quick rental power plants. According to BPC statistics, import payments for petroleum products increased by 33.5 per cent in FY2011-12 (in BDT terms). A division of the increase was attributed to higher prices of petroleum products, which increased by 21.3 per cent in USD terms. Slowdown in export also helped to reduce pressure of import payments as a significant proportion of import is directly related to export performance. At the same time, stringent policies of Bangladesh Bank to restrict financing of import have also contributed to slowdown imports.

Growth of import payments in the current fiscal year originated mainly from the higher import demand for liquid fuel

1.2.12 Balance of Payments: Pressure Somewhat Released

In the face of a widening trade balance during the first ten months of FY2011-12, the BOP continued to remain under severe pressure. At the end of April, the overall balance was in the negative terrain ((-) USD 106 million) (Table 1.3). However,

Table 1.3
Balance of Payments in FY2011-12

(Million USD)

Indicator	Jul-Apr	May-Jun	Jul-Jun
Trade Balance	-7345	-650	-7995
Export f.o.b. (including EPZ)	19543	4449	23992
Import f.o.b. (including EPZ)	26888	5099	31987
Current Account Balance	509	1121	1630
Capital Account	429	40	469
Financial Account	-934	-21	-955
FDI (net)	580	415	995
Portfolio Investment (net)	142	56	198
Errors and Omissions	-110	-540	-650
Overall Balance	**-106**	**600**	**494**

Source: Bangladesh Bank.
Note: f.o.b: Free-on-board; EPZ: Export processing zone; FDI: Foreign direct investment.

during the last two months of the fiscal year (May-June), when trade balance remained under control due to falling import payments, the BOP situation began to see some positive turn. At the same time, impressive growth of remittance inflow (22.4 per cent in FY2011-12), played an important and impressive role in improving the BOP scenario. Foreign aid inflow, which remained below par during the major part of the fiscal year, also showed signs of improvement during this time. In FY2011-12 net inflow of foreign aid was about USD 1.2 billion in comparison to USD 1 billion in FY2010-11. The BOP, and consequently the value of BDT against foreign currencies, remained on shaky grounds until January 2012, and started to improve thereafter.

As FY2011-12 drew to a close, the economy had started to recover some of the early weaknesses with reduced reliance on bank borrowing for financing of budget deficit, improved foreign aid disbursement, somewhat slowdown in the pace of (food) inflation, restrained excessive import payments, improved balance of payments position and stabilised exchange rate

Thus, as FY2011-12 drew to a close, the economy had started to recover some of the early weaknesses with reduced reliance on bank borrowing for financing of budget deficit, improved foreign aid disbursement, somewhat slowdown in the pace of (food) inflation, restrained excessive import payments, improved BOP position and stabilised exchange rate (of BDT against USD). The resilience of the economy, in terms of attaining positive export earnings and remittance inflow in the face of the global economic slowdown gave hope. Revenue collection by the NBR turned out to be the only consistent performer throughout the fiscal year. At the same time, no tangible breakthrough was visible in terms of investment, productivity growth, quality of macroeconomic governance, and putting in place the needed infrastructure that would propel the economy to a higher trajectory of economic growth.

1.3

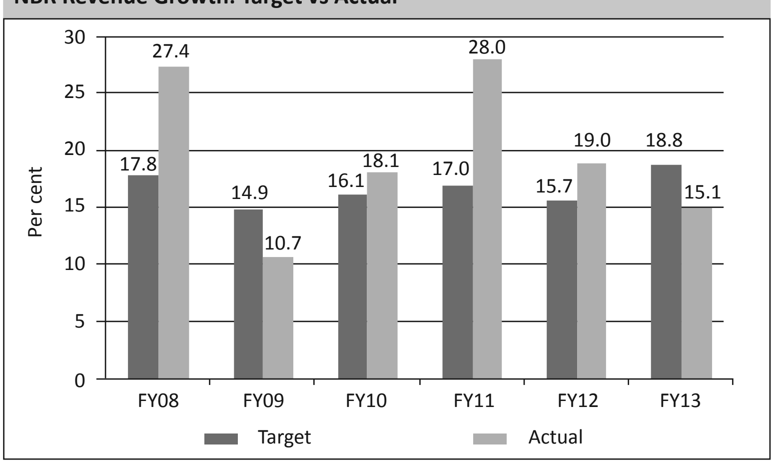
EARLY SIGNALS FROM FY2012-13: ECONOMY APPROACHING TOWARDS A LOWER LEVEL EQUILIBRIUM

1.3.1 Public Finance

Revenue Receipts: Lagging Behind

NBR's performance record showed revenue mobilisation to be a reliable performer among key macroeconomic correlates in recent years (FY2007-08 to FY2011-12). In the past five years, NBR had comfortably surpassed the respective targets four times. The only exception was FY2008-09, a period when Bangladesh economy was confronted with the lagged impact of the global economic crises, when revenue growth rates suffered in the backdrop of lower collection from import duties due to falling global commodity prices, and slowdown in economic activities. Indeed, the GDP growth rate in FY2008-09 was only 5.7 per cent, the lowest in last nine years (FY2003-04 to FY2011-12). In FY2012-13, NBR revenue growth may once again witness a shortfall when compared with the targets set in the budget. Over the first five months, during July-November period, growth of NBR revenue was 15.1 per cent against the target of 18.8 per cent for FY2012-13 (Figure 1.3).

Figure 1.3
NBR Revenue Growth: Target vs Actual



Source: Calculated from the National Board of Revenue (NBR) data.
Note: Actual growth figure of FY2012-13 is for July-November period.

This would imply that to achieve the growth target during the last seven months of the fiscal year about 20.8 per cent growth will be required. In view of the present economic prospects, this appears to be unlikely.

Within the NBR, revenue collection in the form of income tax and VAT are generally in line with the respective targets. Indeed, VAT collection (from both import and domestic) may surpass the target at the end of the year. However, it is apprehended that collection of income tax may face a setback over the coming months. Banking sector, traditionally the largest income tax paying sector of the economy, had faced a decline in profit during the first quarter of FY2012-13. In fact, seven large commercial banks experienced net loss during this period. Inability of some borrowers to repay bank loans has dented the profit making prospects of the commercial banks. This is also evident from the rising *doubtful* and *classified* loans in recent quarters. The slowdown in trading business (import) arising out of some of the recently enforced restrictive policies (towards controlling import payments) has also resulted in relatively low profit performance of the banking sector. Income tax collection from banks in the first five months was largely accounted for by advance income tax AIT payments under Article 64 of Income Tax Ordinance (along with withholding income tax). It is expected that the AIT payments will be adjusted in the last quarter of the fiscal year and hence the lower projections. Slowdown in import has also had adverse impact on import duty collection by NBR. During July-November period, import duty collection increased by only 7 per cent against the target of 16.1 per cent (Table 1.4).

It is apprehended that collection of income tax may face a setback over the coming months

Table 1.4

NBR Revenue: Growth Targets and Achievements

(in Per cent)

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

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

Although NBR has in recent times intensified its effort to mobilise domestic resources, with commendable success in terms of achieving the high targets, it is apprehended that in FY2012-13 it will be difficult to attain the target set in the budget.

Information on non-NBR tax[1] and non-tax revenue[2] is available only for the July-September period of FY2012-13. Data shows that collection of non-NBR tax revenue earnings had slowed down quite considerably during the first quarter. Against a target growth of 25.6 per cent for FY2012-13, this revenue head recorded only 16.2 per cent increase during the reported period (Table 1.5).

[1] Non-NBR tax is expected to contribute about 3.3 per cent to total revenue.

[2] Non-tax revenue is projected to augment about 16.4 per cent of total revenue intake.

Table 1.5
Growth in Non-NBR Tax and Non-Tax Revenue Collection

(in Per cent)

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

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

On the other hand, the remarkable 89.9 per cent growth in non-tax revenue was primarily due to Tk. 4,664 crore received from Bangladesh Telecommunication Regulatory Commission (BTRC). It is expected that the auction for 3G license will be opened in mid-January. If any part of this license fee is collected within next June, this could play an important role in augmenting non-tax revenue and compensate the expected revenue gap originating from NBR collection in FY2012-13.[3]

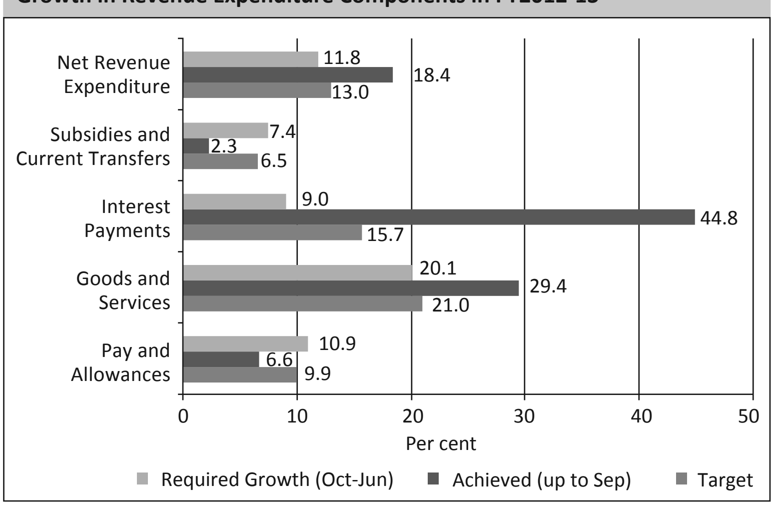
The most visible deviation from the net revenue expenditure targets were recorded for interest payments

Public Expenditure

Revenue Expenditure: Interest Payments may Surpass the Planned Allocation

In FY2011-12 revenue expenditure was higher compared to their programmed levels (budget allocation) primarily due to higher interest payments. During the first quarter of FY2012-13 this trend had continued. Overall, net revenue expenditure recorded 18.4 per cent growth during the first three months compared to the matching period of the previous year, while target growth for FY2012-13 was only 13 per cent. This would mean that during the last three quarters, growth of net revenue expenditure requires to be limited within only 11.8 per cent which will be a difficult task (Figure 1.4).

Figure 1.4
Growth in Revenue Expenditure Components in FY2012-13



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

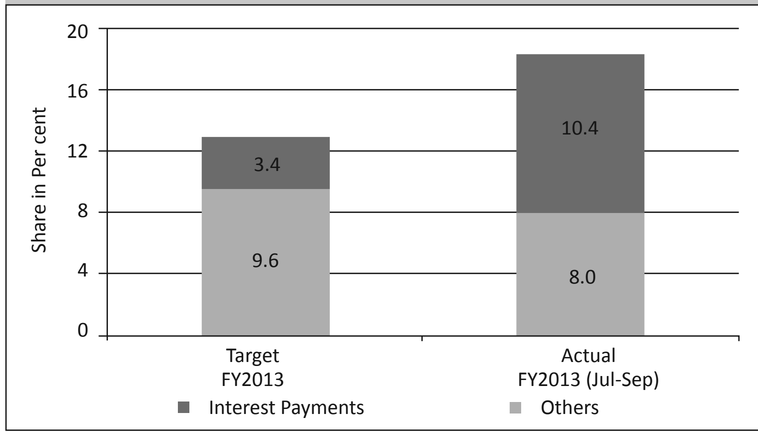
The most visible deviation from the net revenue expenditure targets were recorded for interest payments. Interest payments increased by 44.8 per cent during the first quarter of FY2012-13 against its target of 15.7 per cent, a consequence of the high borrowing of the government during FY2011-12. Indeed, of the 18.4 per cent of net revenue expenditure growth, contribution of interest payments was about 10.4 percentage points. The Budget for FY2012-13 envisaged this contribution

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

to be limited to only 3.4 per cent by the end of fiscal year (Figure 1.5). As the fiscal year will move towards its end the requirement of government borrowing is likely to be higher, and hence it will be difficult for the government to bring down this expenditure pressure to the programmed level. From the vantage point of first quarter of FY2012-13, it appears that revenue expenditure may once again surpass the budgetary target.

Figure 1.5

Contribution to Growth in Revenue Expenditure



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

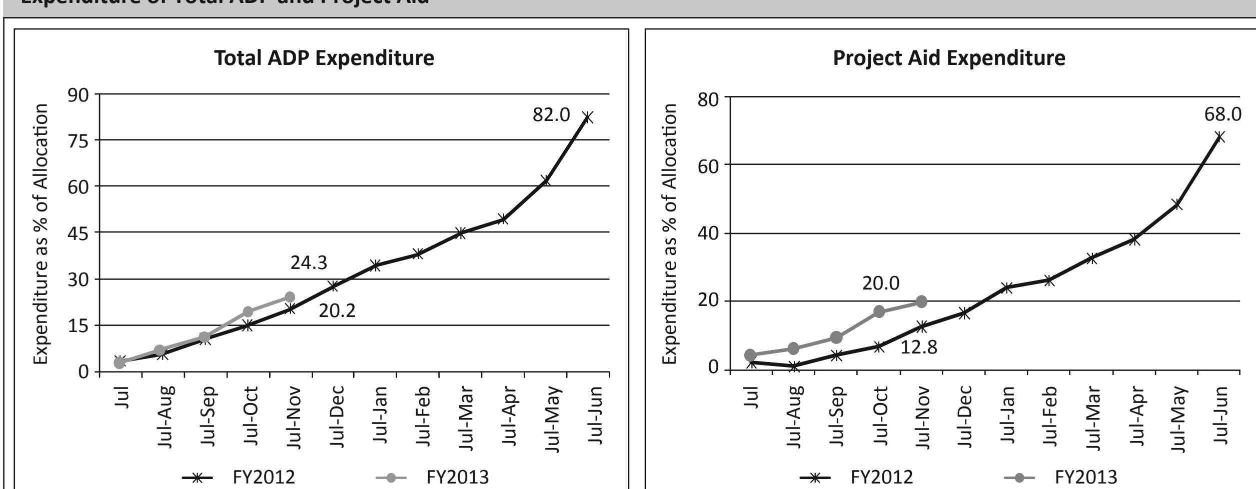
Annual Development Programme (ADP): Project Aid Utilisation has Improved

In contrast to the last couple of years (FY2010-11 and FY2011-12), expenditure under the ADP has improved in the early months of FY2012-13. During the first five months, 24.3 per cent of the ADP allocation has been utilised, which was 20.2 per cent for the comparable period of the previous year (Figure 1.6). On a positive note, this improvement has largely been attributed to higher spending on account of project aid; about 20 per cent of the total project aid allocation was spent in this time (12.8 per cent in FY2011-12). Better spending of project aid has also helped maintain healthy BOP during this period. Thus far, October turned out to be the most successful month in terms of ADP spending when about 7.9 per cent of total ADP allocation and 7.4 per cent of project aid were spent. Regrettably, this positive trend could not be sustained in the next month. In November, only 4.8 per cent of ADP (and 3 per cent of project aid) allocation could be utilised.

Expenditure under the ADP has improved in the early months of FY2012-13

Figure 1.6

Expenditure of Total ADP and Project Aid



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

A sectoral decomposition indicates that ADP implementation by the ministries/divisions with largest allocations was observed to be better than others. If considered together, the top 10 ministries/divisions (in terms of largest ADP allocations) spent 30.2 per cent of their total allocation as distinct from the other ministries/divisions which could spend only 10 per cent (Table 1.6). The

Table 1.6

Expenditure of Total ADP and Project Aid in FY2012-13 (July-November)

(in Per cent)

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

Source: Calculated from the Implementation Monitoring and Evaluation Division (IMED) data.
Note: M/O refers to Ministry of.

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

Utilisation rate of Power Division has been the most impressive

Overall, as it appears from the early signals, despite some progress, in FY2012-13 it is unlikely that there will be any significant improvement in ADP implementation. However, one may expect some improvement in financing composition of the ADP in the form of better project aid utilisation when compared to FY2011-12.

One may expect some improvement in financing composition of the ADP in the form of better project aid utilisation

One may recall that in its June 2012 review of macroeconomic performance analysis, CPD identified that the implementation performance of larger projects in the ADP, which were initiated by the present government, were found to be at a slow pace. In a welcome note, average expenditure of these projects during July to October FY2012-13 was marginally better (20.9 per cent of allocation) than the overall ADP expenditure (19.5 per cent of allocation) (Annex Table 1.1).[4] Regrettably, average expenditure of aid component of these projects (15.3 per cent) lagged behind compared to the average expenditure of total project aid allocation (17.1 per cent). One may note that, among these projects, three were carried over to ADP for FY2012-13. Six projects are expected to be completed by 2013. The cumulative expenditure status of these projects suggests that many of them will also fall under 'carryover' criterion in future.

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

Budget Deficit: In Safe Zone So Far

As would be recalled, FY2011-12 was a year of turbulence as far as budget deficit and its financing perspectives were concerned. FY2012-13 appeared to be in line with the usual trend. Traditionally, during the first quarter of the fiscal year, budget deficit remains within the safe zone. Government budget in the first quarter of FY2012-13 recorded a surplus to the tune of Tk. 5,672 crore. As a result, low off-take of foreign grants (Tk. 123 crore) and net foreign borrowing (Tk. 200 crore) did not put any serious pressure on the budget deficit financing thus far (up to the first quarter) (Table 1.7). The large revenue surplus was in fact used to repay government borrowing from non-bank sources (sources outside borrowing from sale of NSD certificates). Borrowing from the banking system was only Tk. 14 crore. However, less than expected net sale of NSD certificates may give rise to some concerns with regard to managing deficit financing in the latter half of the fiscal year.

Less than expected net sale of NSD certificates may give rise to some concerns

Table 1.7
Financing of Budget Deficit

(Crore Tk.)

Description	**Budget FY12**	**Actual FY12**	**Budget FY13**	**Actual FY12 (Jul-Sep)**	**Actual FY13 (Jul-Sep)**
Foreign Grants	4938	4097	6044	72	123
Foreign Borrowing (Net)	13058	1886	12541	-1074	200
Foreign Loan	18685	7775	20398	364	1877
Amortisation	-5627	-5888	-7858	-1437	-1677
Domestic Borrowing	27208	30939	33484	3457	-5995
Bank Borrowing (Net)	18957	27187	23000	7668	14
Non-Bank Borrowing (Net)	8251	3752	10484	-4211	-6009
National Savings Schemes (Net)	6000	271	7400	414	472
Others	2251	3481	3084	-4626	-6481
Total Financing (excl. Grants)	**45204**	**36923**	**52069**	**2455**	**-5672**

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

Outlook for Fiscal Balance: Difficult Times Ahead?

At present complete information on most government income and expenditure related variables are available for only three to five months. As was found, in the first quarter of the fiscal year the government's fiscal balance was in a comfort zone. However, as the year will progress towards the finishing line, one may expect growing pressure on the fiscal balance. Unlike the past three years, the government's revenue earnings may fall short of the target in FY2012-13, given the present trends. In absence of any bulk amount received in the form of non-tax revenue (such as 3G license fee), revenue collection by the government may fall short of Tk. 3,500 crore.[5] In contrast, non-development expenditure may require an additional amount equivalent to Tk. 1,025 crore considering the trend of the first three months (Table 1.8). Indeed, underutilisation of ADP has systematically helped the government, in an undesirable way, in reducing the fiscal burden. If we expect that this year's ADP implementation will duplicate a scenario similar to that of FY2009-10 (the best performance in recent years), 86 per cent of the original ADP allocation will be spent. If the other expenditures remain in line with the

The government's revenue earnings may fall short of the target in FY2012-13, given the present trends

[5]The projection considers revenue collection trend of NBR during the first five months. It is also assumed that foreign grants will be equal to the figure received in FY2011-12.

Table 1.8

Projection of Budget Structure for FY2012-13

(Crore Tk.)

Particular	Actual FY12	Budget FY13	Projection FY13
Revenues	113779	139670	136170
Foreign Grants	3558	6044	3558
Revenue and Foreign Grants	**117337**	**145714**	**139728**
Non-Development Expenditure	95186	111675	112700
Annual Development Programme	36269	55000	47053
Other Expenditures	18462	25063	25063
Total Expenditure	**149918**	**191738**	**184816**
Financing	**32826**	**46024**	**45088**
Foreign Borrowing (Net)	1886	12540	6950
Domestic Borrowing	30939	33484	38138
Bank Borrowing	27187	23000	33054
Non-Bank Borrowing	3752	10484	5084
National Saving Schemes (Net)	271	7400	2000
Others	3481	3084	3084

Source: Ministry of Finance (MoF) data and CPD projections.

budget allocation, overall deficit may turn out to be lower than the original limit, by about Tk. 1,000 crore. However, for this to be the case the subsidy requirement for FY2012-13 will need to be within the limit set in the budget.

On the financing side of the deficit, it is understandable that the underutilisation of ADP will also mean lower availability of foreign resources for the deficit financing. As a result, the incremental burden from lower revenue intake and higher non-development expenditure will need to be borne by the domestic sources. Recent experience suggests that deficit financing from sale of NSD certificates has not been impressive. The target for net sale of NSD was set at Tk. 7,400 crore. During July-November of FY2012-13 only Tk. 385.3 crore could be generated on this account (to recall, the amount was Tk. 570.3 crore in the corresponding period of FY2011-12). It is to be noted that the last time when the interest rate was increased in FY2011-12 (in March 2012), it net with limited success (net sale in FY2011-12 was only Tk. 271 crore). In all likelihood, the net sale of NSD certificates may not surpass Tk. 2,000 crore in FY2012-13. Considering all these possible scenarios, if we residually calculate the requirement of bank borrowing of the government for FY2012-13, it is found that an additional amount to the tune of about Tk. 10,000 crore will be needed over the planned figure. Hence, even though the budgetary structure appears to be within the government plan at the moment, serious revisiting of the targets may be needed in the latter half of the fiscal year.

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1.3.2 Monetary Policy

Falling Rice Price Pushed Down Overall Inflation

FY2011-12 had ended with record highest inflation rate of 10.6 per cent (Table 1.9). In the backdrop of high price levels, the Budget for FY2012-13 (and the MPS of Bangladesh Bank for the first half of FY2012-13) had set the lower inflation target at 7.5 per cent. The latest available figure from BBS suggests that in November, annual average inflation was 9 per cent. In November 2012, food inflation came down to 7.7 per cent (from 10.5 per cent in June 2012), while non-food inflation had

Table 1.9

Category-wise Annual Average Inflation

(in Per cent)

Commodity Group	FY2012 (Jun)	FY2013 (Nov)
General	10.6	9.0
Food, beverage and tobacco	10.5	7.7
Non-Food	11.1	11.7
Clothing and footwear	17.6	15.7
Gross rent, fuel and lighting	10.3	13.5
Furniture, furnishing, household	11.8	11.6
Medical care and health expenses	5.9	7.3
Transport and communication	11.3	8.7
Recreation, entertainment	2.3	2.2
Miscellaneous goods and services	13.5	11.7

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

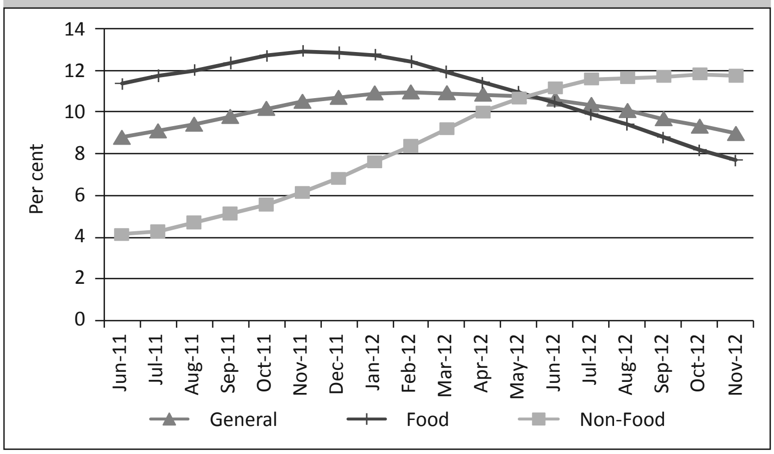
reached a high 11.7 per cent (from 11.1 per cent in June 2012).[6] As may be recalled, since the mid-2000s price level of food items became the dominant contributor to inflation in Bangladesh. In contrast, point-to-point food inflation had started to slow down since July 2011. Indeed, non-food inflation had exceeded food inflation in December 2011. Within non-food commodities, prices of 'clothing and footwear', 'gross rent, fuel and lighting', and 'furniture, furnishing, household' experienced double-digit inflation. As a matter of fact, average inflation of 'gross rent, fuel and lighting' increased in November 2012 compared to June 2012 – thanks to upward adjustments of electricity tariff by the Bangladesh Energy Regulatory Commission (BERC). If the current falling trend in inflation continues, the annual average inflation at the end of FY2012-13 may come down to about 7.7 per cent.

Non-food inflation had exceeded food inflation

Apparently, the inflationary pressure has been declining steadily since March 2012 (Figure 1.7). The recent decline in general inflation was largely attributed to decline in food inflation. Indeed, food inflation had started to decline since December 2011, whereas, non-food inflation figure had somewhat stagnated in FY2012-13, at about 11.6-11.7 per cent.

Figure 1.7

Annual Average Inflation (July 2011 - November 2012)



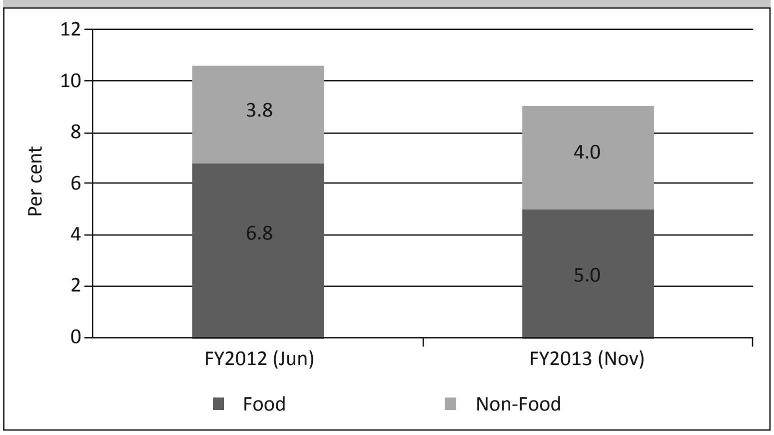
Source: Estimated from the Bangladesh Bureau of Statistics (BBS) data.

A decomposition of inflation figures as of June 2012 and November 2012, indicates that, of the 10.6 per cent inflation in June 2012, only 6.8 per cent came from food inflation, while the rest 3.8 per cent came from non-food inflation. Of the 9 per cent inflation in November 2012, 5 per cent was contributed by food inflation and 4 per cent was on account of non-food inflation

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

Figure 1.8

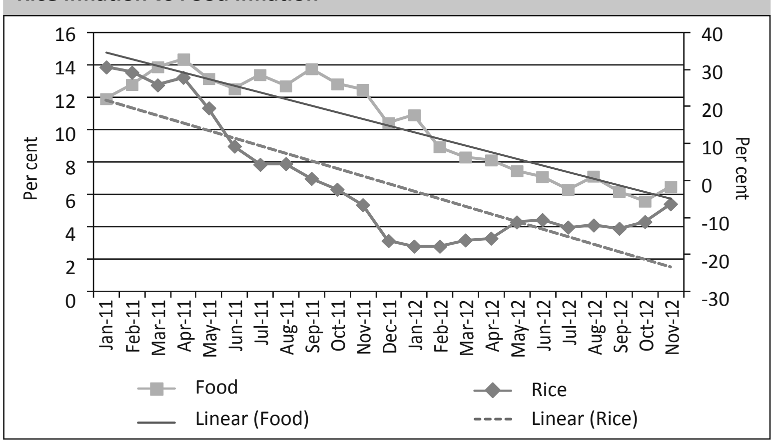
Sources of Annual Average Inflation



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

Figure 1.9

Rice Inflation vs Food Inflation



Source: Estimated from the Food and Agriculture Organization (FAO) and Bangladesh Bureau of Statistics (BBS) data.

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

(Figure 1.8). This would imply that the food inflation declined (by 1.8 percentage points) more than the total decline in the inflation between the two periods, i.e. 1.6 percentage points, while contribution from the rise in non-food commodity prices increased by 0.2 percentage points. Indeed this incremental contribution originated from the rise in gross rent, fuel and lighting, contribution of which increased by 0.4 percentage points. Indeed, the adjustment of administered tariff of electricity made a mark on price level of non-food items. However, one needs to be mindful that food inflation still remains higher than its non-food counterparts.

As is noted earlier, the recent fall in inflation has largely originated from the fall in food inflation. The price of coarse rice in domestic market stabilised at around Tk. 28-29 per kg and remained stable for the most part of FY2012-13 (July-November). It may be concluded that this fall in food inflation is largely attributed to the fall in prices of rice in the domestic market. Figure 1.9 reveals that rice inflation in domestic market and food inflation are following similar trends in recent times. It has been found that in the Bangladesh context, price of rice controls about one-fourth of the overall price index. Thus, there is little surprise that falling rice price made an impact in food inflation and overall inflation. Indeed, annual average rice price (according to the Food and Agriculture Organization (FAO) data) in November 2012 declined by (-) 13.6 per cent. Rice price was expected to remain stable in the global market in the near future as FAO has recently raised its forecast of global paddy production in 2012 by 4.2 million tonnes to 729 million tonnes (486 million tonnes, milled). FAO Rice Price Index averaged 244 points in October 2012, nine points lower than in October 2011. Food Planning and Monitoring Unit (FPMU) indicate that in the week ending 14 December 2012, rice prices including Thai 5 per cent broken (545 USD/MT), Vietnam 5 per cent white (405 USD/MT), and Kolkata wholesale price (329 USD/MT) declined by 1.8 per cent, 5.8 per cent and 10.5 per cent respectively. During the same period, Dhaka city wholesale rice price stood at 293 USD/MT.

Comfortable food stock of the government also transmitted positive signals to the market which helped to stabilise the foodgrain prices

Comfortable food stock of the government also transmitted positive signals to the market which helped to stabilise the foodgrain prices. As of 13 December 2012, the public foodgrain stock stood at 1.4 million MT (of which 1.1 million is rice) and is expected to remain at a comfortable zone in the near future. The government set the Aman procurement target at minimum 0.3 million MT rice (0.25 million MT parboiled and 0.05 million MT white) to be procured with a price of 26 Tk./kg for parboiled rice and at 25 Tk./kg for white rice from the domestic market. The procurement drive began on 9 December 2012 and will continue until the end of February 2013. However, the present minimum price set by the government appears to be inadequate to provide price incentive to the farmers in view of the currently experienced continued fall in prices of rice. Keeping rice prices within reasonable limits and ensuring producer incentives in terms of rice price will be a major policy challenge for the government in FY2012-13 and also beyond.

Favourable global commodity price level has also helped to contain domestic inflation in Bangladesh. According to IMF data, global commodity price level has declined by (-) 3.3 per cent during July-November period of 2012 compared to July-November of 2011. Among the other contributors, stable exchange rate of BDT (against USD) has helped restrain further elevation of price level. One could also argue that the contractionary monetary policy pursued by the central bank has also played a role in bringing down inflationary pressure. At the same time, in course of the last one year, the government did not raise administered prices of petroleum products. As a result, the negative impact of last year's raise has somewhat reduced. The government has recently made an upward revision of the petroleum prices, and one may expect in coming days the price of electricity will also need to be increased as a consequence. This will create further pressure on price level, both directly and indirectly. As a result, the inflation rate in FY2012-13 is likely to remain higher than the target of 7.5 per cent.

Inflation rate in FY2012-13 is likely to remain higher than the target of 7.5 per cent

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

The central bank was reasonably successful in containing the monetary aggregates to their respective targets by the end of June 2012. Monetary policy for the first half of FY2012-13 aimed to contain the growth of M2 and its components further. At the end of October 2012, net domestic asset and its components were well within their respective targets. Growth of private sector credit was 18.4 per cent as of October 2012 – down from 19.7 per cent as of June 2012 (Table 1.10). Weak bank borrowing requirement on part of the government helped reduce the growth of net credit to government to 13.4 per cent. However, robust inflow of remittances pushed the growth of net foreign asset beyond its programmed limit. Growth target for this was set at 7.2 per cent by the end of December 2012. At the end of October 2012, the growth figure turned out to be 37.2 per cent. As a consequence, M2 supply recorded a growth of 19.5 per cent at the end of October 2012 against the target of 16 per cent (as of December 2012). It appears that, despite considerable credit tightening, the growth of M2 may surpass its target and may remain well above of the figure of June 2012.

Despite considerable credit tightening, the growth of M2 may surpass its target and may remain well above of the figure of June 2012

Table 1.10
Growth of Monetary Aggregates: Target vs Actual

(in Per cent)

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

Source: Bangladesh Bank data.

Monetary Policy Stance for the Second Half of FY2012-13: Improved Governance Warranted

Over the years successive monetary policies of the Bangladesh Bank were designed to accommodate concurrently the targets set for economic growth and inflation. The last two MPSs have tried to move towards, primarily, containment of the inflationary expectation and took a rather contractionary stance. The MPS for first half of FY2012-13 had come up with two major objectives: "(i) maintaining inflation at moderate levels and (ii) supporting inclusive growth objectives of the Government." However, it appears that containing inflation remained the "core focus of the announced monetary program."

The last two MPSs have tried to move towards, primarily, containment of the inflationary expectation and took a rather contractionary stance

The MPS also announced four major policy objectives. The first one was about maintaining close coordination with the Ministry of Finance (MoF) to limit government borrowing from the banking sector. The MPS has aimed to accommodate the budgetary target of bank borrowing by the government (Tk. 23,000 crore). However, CPD estimates (mentioned earlier) suggest that the credit requirement of the government from the banking sector may surpass the budgetary target by a considerable margin at the end of the fiscal year. It will be interesting to see if the central bank would prepare its next MPS (for second half of FY2012-13) to accommodate this.

Secondly, Bangladesh Bank expressed its intention to "focus on the quality/ composition of private sector credit." At present it is difficult to assess how this quality control of bank lending has been maintained. One may expect a more comprehensive assessment from the Bangladesh Bank itself which would use beyond the bank advances data. Issues have been raised periodically about the mismatch between the documented purpose of bank loan and its actual use. The incident with regard to the Hall-Mark scandal (more of this in Chapter 3) and some of the other developments of similar disquieting nature reinforce these apprehensions. The next MPS will hopefully come up with more credible data on the distribution of private sector credit.

The next MPS will hopefully come up with more credible data on the distribution of private sector credit

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

Thirdly, the central bank recognised the need to strengthen the financial sector for "effective transmission of monetary policy." The central bank has put in place new provisioning and rescheduling procedures for bank loan as of January 2013 in line with international practice, in face of significant resistance from banking and private sector actors. In view of the urgent need to improve financial sector governance, the steps taken by the central bank are welcome. It may be noted that, during the period under the present MPS, classified loans had indeed showed considerable rise. As of the first quarter of FY2012-13, percentage share of classified loan to total outstanding loan has increased to 8.8 per cent (from 7.2 per cent as of June 2012). This is the second successive quarter in which classified loan had increased as a share of total outstanding loan. Indeed, the overall governance of the banking sector has come under scrutiny in recent months. The aforesaid biggest banking sector scam in the history of Bangladesh (Hall-Mark scam), lax supervision of the banking sector, both internal and external, and the delayed appointment of directors of the state-owned commercial banks (SCBs) – all these have undermined financial sector management in FY2012-13, and have had an adverse impact on overall financial sector performance.

During the period under the present MPS, classified loans had indeed showed considerable rise

Fourthly, the MPS for first half of FY2012-13 also aimed "to preserve the country's external sector stability." Certainly, the external sector balance is more stable compared to the corresponding period of FY2011-12. However, this has come at the expense of the slowdown of both export and import growth. This low level of external sector activities will surely have adverse implications for the economic growth prospect in FY2012-13. Moreover, it appears that commercial banks also faced considerable decline in their profit in the first quarter of FY2012-13. It is expected that new commercial banks will come into operation some time in the second half of FY2012-13. At a time when the commercial banks are struggling to operate profitably, new banks will also bring more competition. Under such circumstances, the central bank will need to remain vigilant to maintain the health of the banking sector in the coming days.

Low level of external sector activities will surely have adverse implications for the economic growth prospect in FY2012-13

Overall, the forthcoming MPS will need to present an assessment of the outgoing MPS (July-December, 2012); along with this the MPS should also examine the overall implications of the stated measures for economic growth, employment and inflation. On the one hand, the central bank is expected to examine the contribution of monetary policy to the decline in inflation. On the other hand, the monetary policy should also estimate its impacts on economic growth and investment. Indeed, according to the new estimates of Bangladesh Bank, economic growth in FY2012-13 will be around 6.1-6.4 per cent. However, this will also imply that the growth rate in FY2012-13 may fall short of its target (7.2 per cent) by about 1 percentage point. 6.2 per cent as an economic growth outcome perhaps will be considered respectable. This will be a further setback for the government when compared with the medium term development targets as set out in the SFYP. It is more likely that the central bank will continue to pursue a contractionary monetary policy stance for the coming half of FY2012-13; however, this will surely entail a trade-off with growth prospects of the Bangladesh economy.

A contractionary monetary policy stance will surely entail a trade-off with growth prospects of the Bangladesh economy

1.3.3 External Sector

Export Earnings: Lower than Expected Growth

Export earnings stood at USD 24.31 billion in FY2011-12, registering a moderate growth of 6 per cent. This modest growth rate was a significant departure from the impressive growth rate of 41.5 per cent posted in FY2010-11. The slowdown experienced in FY2011-12 has continued into the early months of FY2012-13. As can be seen from the Table 1.11, in the first five months of FY2012-13, during

Table 1.11
Export Growth of Major Products: FY2012-13 (July-November)

(in Per cent)

Product	Target FY13	Growth FY12 (Jul-Nov)	Growth FY13 (Jul-Nov)	Required Growth for Rest of the Year to Attain Export Target
RMG	12.80	17.90	5.70	17.50
Knit	11.90	13.10	1.70	19.20
Woven	13.80	23.60	10.20	15.90
Non-RMG	24.30	15.20	-9.60	31.00
Raw Jute	13.40	-21.60	-13.10	33.10
Leather	21.20	19.00	-0.60	35.40
Home Textiles	26.90	37.30	0.60	40.50
Frozen Food	17.00	15.10	-22.50	58.40
Total	**15.28**	**17.60**	**4.10**	**21.20**

Source: Export Promotion Bureau (EPB) data.

the July-November period, export earnings registered a growth rate of 4.1 per cent as opposed to the robust growth rate of 17.6 per cent in FY2011-12. Sectoral composition for this period shows that RMG sector posted a modest growth rate of 5.7 per cent, whereas non-RMG exports experienced a negative growth rate of 9.6 per cent compared to the matched period of FY2011-12. To attain the export target for FY2012-13 which has been set at 15.3 per cent, growth rate in the coming months of FY2012-13 will need to be significantly high: 17.5 per cent and 31 per cent for RMG and non-RMG respectively. It is projected that growth in export earnings in FY2012-13 will approximate that of the previous fiscal (about 6 per cent in FY2011-12).

The ongoing economic slowdown in the Eurozone and sluggish recovery and lower economic growth in many developed countries will likely to have adverse implications for Bangladesh's overall export performance in FY2012-13

The ongoing economic slowdown in the Eurozone and sluggish recovery and lower economic growth in many developed countries will likely to have adverse implications for Bangladesh's overall export performance in FY2012-13. IMF (2012b) found that emerging markets are being affected by the lower growth and uncertainty in developed countries; according to their projections, growth in world trade volume will slump to 3.2 per cent in 2012 from 5.8 per cent in 2011 and 12.6 per cent in 2010.

Market decomposition of Bangladesh's export performance for the RMG sector depicts a mixed scenario. Export performance of Bangladesh in the US market clearly illustrates that export of RMG products failed to maintain the earlier momentum and has remained stagnant in value terms posting a growth rate of only about 0.33 per cent in FY2011-12. Other competitors of Bangladesh in the US market have managed to register higher growth in FY2011-12: e.g. Vietnam (7.9 per cent), Indonesia (4.1 per cent), China (1 per cent), Cambodia (6.4 per cent), Mexico (4 per cent) and Turkey (20.8 per cent).

Competitors of Bangladesh in the US market have managed to register higher growth

Total RMG imports of US declined by 3.2 per cent during the July-October period of FY2012-13. Export of RMG from Bangladesh to US decreased by 4.2 per cent over the corresponding period (Table 1.12). China also witnessed a negative growth rate ((-) 3.4 per cent); however, export from Vietnam and Cambodia have continued to grow, by 7 per cent and 5.9 per cent respectively over the matched period. Over this period when Bangladesh's export earnings from both knit and woven wear declined by 3.2 per cent and 5.6 per cent respectively, export earnings for Vietnam posted a rise of 8.9 per cent and 4.5 per cent respectively for these two items.[7]

In contrast to the US market, the EU market fares somewhat better. Total exports to the EU countries had registered a 10 per cent growth rate in FY2011-12 with the

Table 1.12

Comparison of Growth Performance between Bangladesh and Vietnam in the US Market: 2013 over 2012 (July-October)

(in Per cent)

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

Source: Estimated from the United States International Trade Commission (USITC) data.

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

RMG earnings posting a 13.9 per cent rise in 2012. Despite the Eurozone crises, Bangladesh's apparel export growth in the EU has sustained in view of the relatively better economic situation of its major destination backers. Germany (9.6 per cent), UK (20.9 per cent), Italy (15.6 per cent) had been good with the exception of France ((-) 4.9 per cent). Of heightened interest here is to note is the export record of Vietnam in FY2011-12 in major destination countries: Germany (36.3 per cent), France (47.6 per cent), UK (43.8 per cent), and Italy (42.8 per cent).

Average price per unit for woven products has registered some increase over time in spite of the volatility in the cotton market

Bangladesh's export growth for RMG items in the Eurozone came down further during July-November, 2013 posting a growth rate of 6.5 per cent compared to the corresponding period of FY2011-12. Whilst export earnings from woven sector were impressive, with a 23.1 per cent growth, it is notable that export of knitwear actually declined by 1.2 per cent.[8] Indeed, total global import of RMG by the EU had declined by 15.1 per cent over the corresponding period. World Bank (2012) also concluded that commodity export-dependent countries are most at risk in the event of a renewed global slowdown.

As can be seen from the Table 1.13, in recent years average price per unit for woven products has registered some increase over time in spite of the volatility in the cotton market. Average price for RMG remained stable (and somewhat rising) in spite of the recent fall in cotton prices (Figure 1.10).[9]

Table 1.13

Average Price for Top Five Woven Items: FY2009-10 to FY2011-12

RMG Item	Total Export FY12 (Million USD)	As % of Total Knit	Average Price per Unit (USD) FY10	Average Price per Unit (USD) FY11	Average Price per Unit (USD) FY12
Woven Garments					
620342: Mens/boys trousers and shorts, of cotton, not knitted	3664.08	38.30	10.72	12.65	14.88
620462: Womens/girls trousers and shorts, of cotton, not knitted	1433.02	15.00	12.67	14.70	16.51
620520: Mens/boys shirts, of cotton, not knitted	1109.86	11.60	13.76	16.18	18.86
620590: Mens/boys shirts, of other textile materials, not knitted	598.85	6.30	11.83	14.12	17.00
620349: Mens/boys trousers and shorts, of other textile materials, not knitted	312.54	3.30	10.51	12.76	14.39
Knit Garments					
610910: T-shirts, singlets and other vests, of cotton, knitted	4490.12	47.33	9.40	11.94	12.73
611090: Pullovers, cardigans and similar articles of other textile materials, knitted	1494.20	15.75	12.59	14.48	15.93
611020: Pullovers, cardigans and similar articles of cotton, knitted	665.96	7.02	13.89	16.12	17.51
610510: Mens/boys shirts, of cotton, knitted	624.23	6.58	10.28	13.16	14.03
610990: T-shirts, singlets and other vests, of other textile materials, knitted	222.99	2.35	10.78	14.52	16.00

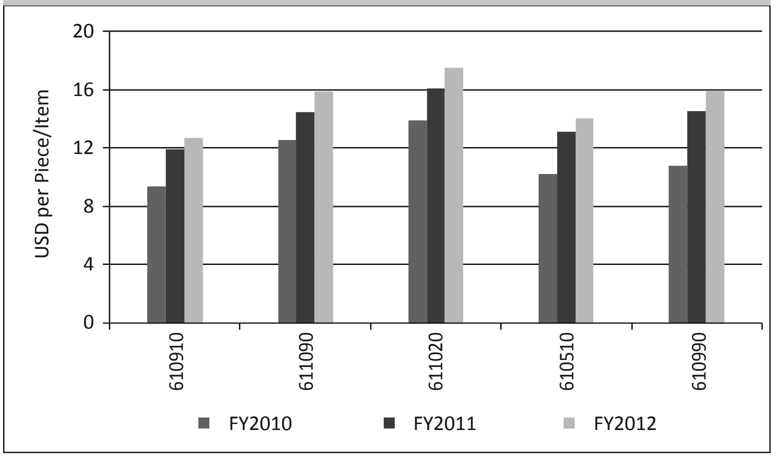
Source: Estimated from the Export Promotion Bureau (EPB) data.

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

[9]The average price for top woven items increased from USD 10.72 to USD 14.88 during the period of 2010 to 2012, while the price of the knit item ranked first (T-shirts, singlets and other vests, of cotton, knitted) increased from USD 9.40 to USD 12.73 over the same period. However, the total volume of export has decreased for top five knit items in FY2011-12 compared to FY2010-11.

Figure 1.10

Average Price (per Unit) for Top Five Knit Items: FY2009-10 to FY2011-12



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

Note: 610910: T-shirts, singlets and other vests, of cotton, knitted; 611090: Pullovers, cardigans and similar articles of other textile materials, knitted; 611020: Pullovers, cardigans and similar articles of cotton, knitted; 610510: Mens/boys shirts, of cotton, knitted; 610990: T-shirts, singlets and other vests, of other textile materials, knitted.

Apart from the country's principal export items, the RMG, encouraging growth rates were posted in FY2011-12 in the EU market for footwear and shrimp, 21.3 per cent and 7.4 per cent respectively. On the other hand, in the US market, export earnings from footwear remained almost unchanged (0.81 per cent) whereas shrimp export declined by a significant 40.5 per cent.

Whilst Bangladesh's exports have been experiencing fluctuating fortunes in the North American and EU markets, its South-South trade has been on the rise.[10] In FY2011-12, Bangladesh experienced robust export growth in China (25.7 per cent), Malaysia (27.9 per cent), Korea (28.1 per cent), Myanmar (39.4 per cent), Thailand (55.8 per cent), Singapore (58 per cent), Brazil (40.9 per cent) and South Africa (16.9 per cent). Export basket in these countries mostly concentrated on non-RMG products which speak of the significant opportunities for export diversification, and Bangladesh should put more emphasis on this emerging opportunity for market and product diversification.

Bangladesh export to India has experienced a robust growth in recent years and stood at USD 498 million in FY2011-12. During the July-November period of FY2012-13, export earnings reached USD 221 million, registering 3.8 per cent growth over the corresponding period of FY2011-12. The recent duty-free market offer to Bangladesh from India have created favourable window of opportunity to enter the fast growing Indian market.[11] To take advantage of the duty-free offer of India, a dedicated strategy should be developed including in areas such as attracting Indian and other investments targetting the Indian market, developing bilateral/regional supply networks and value chains, development of physical infrastructure and connectivity, ensuring better investment environment, capacity to address non-tariff barriers, simplification of custom procedures, and improved trade facilitation.

Recent devastating fire incident in Tazreen Garments Factory in Ashulia has once again drawn attention to the need for ensuring safety and security of RMG workers

Along with the external factors some of the internal disquieting developments also did not augur well for Bangladesh's RMG export. Recent devastating fire incident in Tazreen Garments Factory in Ashulia has once again drawn attention to the need for ensuring safety and security of RMG workers.[12] Besides, this is likely to have adverse implications for Bangladesh's credibility as a supplier when Bangladesh is trying to consolidate its foothold as the second-largest RMG exporter in the world, and major buyers are showing keen interest in Bangladesh as part of their 'China Plus One' strategy for sourcing. Whilst RMG is not covered under US-GSP (Generalized System of Preferences) scheme, US-GSP hearings and likely adverse decision could also impair Bangladesh's overall export interest in the US market. The issue of allowing RMG workers on their trade union rights has

[10] This is a general trend for the least developed countries (LDCs), and indeed according to Anderson and Strutt (2011) the volume of South-South trade is projected to double by 2030.

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

[12] CPD has presented its findings on the issue of compliance and safety at factory level at a recent dialogue; the presentation is available at: http://www.cpd.org.bd/downloads/rmg26012012.pdf

also been highlighted by the CPD. If the Government of Bangladesh (GoB) and concerned institutions fail to take adequate measures in the above regard, the adverse implications will seriously undermine Bangladesh's export potentials in the near future. Additionally, the increasing number of bilateral and regional trade agreements is likely lead to preference erosion for Bangladesh, as will unilateral tariff reductions by developed countries. Bangladesh should strategise in view of the above if it is to realise its potential to match China's track record. Thus, Bangladesh will need to give adequate attention to both software (regulatory regime, trade union rights, compliance, etc.) and hardware (infrastructure development, trade facilitation, supply-side capacity building) related measures on an urgent basis.

Bangladesh should strategise in view of the ongoing developments in the global trade scenario if it is to realise its potential to match China's track record

Import Payments: Contraction Contributed to Improved External Balance

Performance of the import sector had been rather sluggish in FY2011-12. Registering a growth rate of 5.3 per cent, total imports amounted to USD 35,442.30 million in FY2011-12. Growth in import payments in the first quarter of FY2012-13 was 2 per cent compared to the corresponding period of FY2011-12 (Table 1.14). Fall in some of the key commodity prices and the overall contractionary policy pursued by the central bank played its role. Statistics with regard to global commodity prices shows a fall in prices of foodgrains and fuel and a number of other items in the global market. It needs to be noted that there was also a drastic reduction in the import of rice ((-) 97.6 per cent) which also contributed to containing total import payments.

Table 1.14

Import Payments for Selected Commodities

Item	FY12 (Jul-Sep)	FY13 (Jul-Sep)	Change FY13 (Jul-Sep)	Change FY13 (Jul-Oct)
	(Million USD)		(%)	
A. Foodgrains	195.3	62.0	-68.3	56.2
Rice	143.2	3.5	-97.6	NA
Wheat	52.1	58.5	12.3	NA
B. Consumer goods	1385.9	1272.6	-8.2	NA
Edible oil	840.5	824.9	-1.9	17.4
Pulses	71.1	103.1	45.0	NA
Sugar	403.4	271.4	-32.7	NA
C. Intermediate goods	4466.1	5161.6	15.6	NA
Crude petroleum	104.7	15.2	-85.5	31.4
Petroleum and other liquids	453.0	680.0	50.1	
Pharmaceutical products	47.1	61.0	29.5	NA
Fertiliser	452.0	508.1	12.4	NA
Raw cotton	415.5	618.3	48.8	10.5
Yarn	419.8	395.8	-5.7	
Textile and articles thereof	991.5	992.9	0.1	-0.3
D. Capital Goods	2171.7	1958.9	-9.8	NA
Capital machineries	632.2	546.5	-13.6	-7.5
Others	1539.5	1412.4	-8.3	NA
E. Others n.i.e.	673.8	619.2	-8.1	NA
Grand Total	**8892.8**	**9074.3**	**2.0**	**-4.0**

Source: Bangladesh Bank data; and National Board of Revenue (NBR) and Bangladesh Export Processing Zone Authority (BEPZA) data provided by the Bangladesh Bank.

Among other import items, petroleum and other liquids (POL) recorded a robust growth of 50.1 per cent in the first quarter in 2013. In contrast, import of machineries, an important import item having significance for investment, faced a negative growth rate both in FY2011-12 ((-) 14 per cent) and in the first quarter of FY2012-13 ((-) 13.6 per cent) with attendant adverse implications for investment. However, fertiliser growth was high (12.4 per cent) and import of raw cotton was also high (48.8 per cent). The latter was likely to have positive impact on performance of export-oriented RMG sector in the near term. However, data for import of textile-related machineries, collected from NBR, gives a mixed picture (Table 1.15).

Table 1.15
Dynamics of Import of Textile-related Machineries

Four Digit Code	Type of Machinery	FY12 (Jul-Nov)	FY13 (Jul-Nov)	Growth Rate (%)
		(Million USD)		
8445	Machine for preparing textile fibre	130.55	73.36	-39.09
8446	Weaving machine (looms)	47.19	39.65	-8.91
8447	Knitting machine (Stitch-Bonding)	58.86	69.34	27.70
8448	Auxiliary machine for extrude-draw machine (text)	28.77	30.76	15.88

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

It is to be noted that import payments indeed has experienced a negative growth of (-) 6.9 per cent over the July-November period of FY2012-13.

The declining tendency of overall import was likely to continue in the coming months of FY2012-13 in view of the restrained monetary policy pursued by the central bank in order to maintain external balance stability

Letter of credit (L/C) opening and settlement declined by (-) 9.7 per cent and (-) 13.2 per cent respectively during the first five months of FY2012-13. It is important to note that L/C opening for petroleum decreased by (-) 16.7 per cent during the same period. Anecdotal information suggests that commercial banks are also showing reluctance in opening L/Cs in general, although Bangladesh has gone for moral persuasion in discouraging import of particularly consumer and luxury goods only. The declining tendency of overall import was likely to continue in the coming months of FY2012-13 in view of the restrained monetary policy pursued by the central bank in order to maintain external balance stability.

Remittances: Stellar Performance

The flow of inward remittances to Bangladesh stood at USD 5.01 billion during July to November of the current fiscal year, marking 24.9 per cent impressive growth over the comparable months of the previous fiscal year. This is a remarkable achievement also because remittance earning in FY2011-12 (USD 12.84 billion) was a significant 10.3 per cent higher compared to FY2010-11 (Table 1.16). In

Table 1.16
Yearly Trend of Inward Remittance Flow: FY2004-05 to FY2011-12

Year	Remittance (Million USD)	Growth (%)
FY2005	3848.29	14.13
FY2006	4802.41	24.79
FY2007	5998.47	24.91
FY2008	7914.78	31.95
FY2009	9689.26	22.42
FY2010	10987.40	13.40
FY2011	11650.32	6.03
FY2012	12843.43	10.24

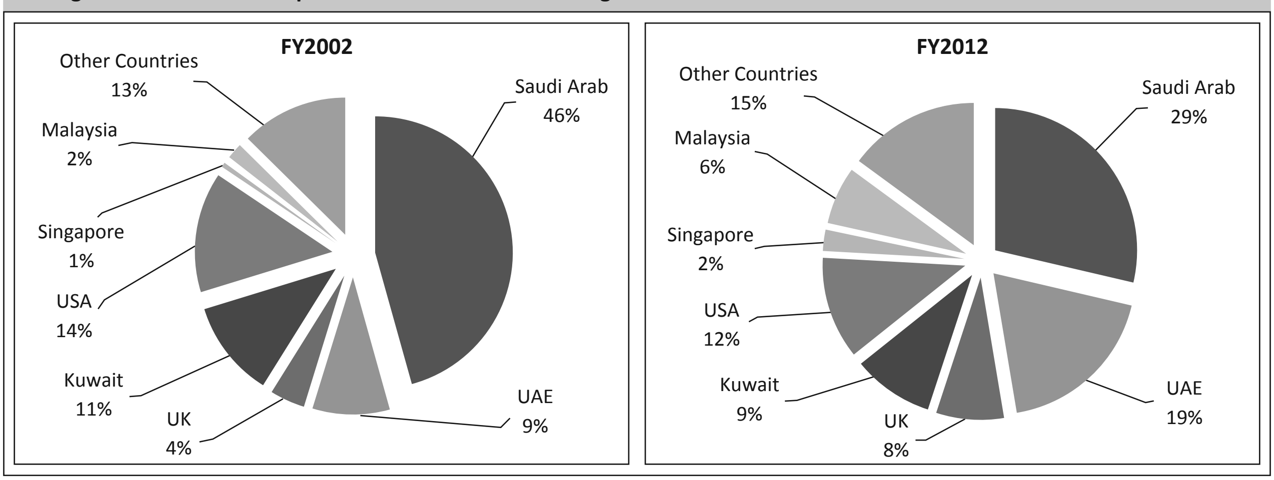
Source: Bangladesh Bank.

part, significant depreciation of exchange rate has helped to achieve this higher growth. Celebration of Eid-ul-Azha and Durga Puja in the first quarter in FY2012-13 may have also contributed to this higher growth.

Despite the recent diversification of remittance sources, Middle East countries continue to be the major sources of remittance inflow in Bangladesh. Saudi Arab was the largest source of remittance with total amount of remittance stood at USD 3.68 billion in 2012 with 28.7 per cent growth. According to the Bangladesh Bank's official figure for remittances inflow in FY2011-12, other important sources for remittances were United Arab Emirates (UAE) (18.7 per cent), USA (11.7 per cent), Kuwait (9.8 per cent), United Kingdom (UK) (9 per cent) and Malaysia (6.6 per cent) (Figure 1.11).

Figure 1.11

Changes in the Market Composition for Remittance Earnings: FY2001-02 and FY2011-12



Source: Calculated from the Bangladesh Bank data.

During FY2011-12, the total number of migrant workers going abroad stood at about 0.69 million, registering a robust growth of 57.4 per cent compared to the previous fiscal year. It is of interest to note that impressive growth has occurred after a significant deceleration of migrant workers in 2009 and 2010, (-) 50.9 per cent and (-) 34.3 per cent respectively. Though the growth rate of the number of migrant workers was negative ((-) 6.7 per cent) in the first quarter, the number of workers was likely to increase in the coming months of FY2012-13 as Malaysia has indicated its interest to recruit a significant number of workers from Bangladesh under the government-to-government (G-2-G) arrangement. This could reduce the cost of migration, but will require significant strengthening of the capacity of all involved institution of the GoB.

First four months of the current fiscal year observed surplus in the balance of payments mainly because of higher inward remittance flow and lower import growth

Balance of Payments: Safe Terrain

In the backdrop of the volatility observed in FY2011-12, the first four months of the current fiscal year observed a BOP surplus mainly because of higher inward remittance flow and lower import growth. The overall balance reached USD 1,923 million in July-October period of FY2012-13 from a negative balance of USD (-) 384 million for comparable months in FY2011-12. Trade deficit started to come down, and current account registered surplus of USD 464 million over the same period in of FY2012-13 (Table 1.17).

Table 1.17
Balance of Payments

(Million USD)

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

Source: Compiled from the Bangladesh Bank data.

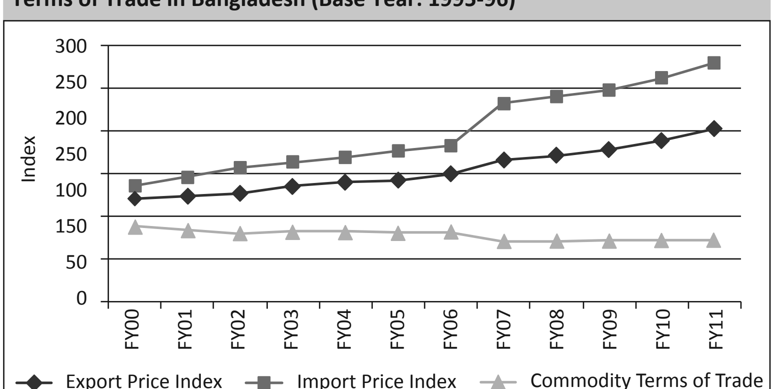
According to Bangladesh Bank, over July-October period in FY2012-13, foreign direct investment (FDI) inflow increased to USD 588 million from USD 466 million over the corresponding months in FY2011-12, registering a growth of 26.3 per cent. Medium and long term (MLT) loans stood at 579 million in 2013 with a significant growth rate (185 per cent) in July-October period of FY2012-13.

Due caution will need to be exercised in dealing with the possible attendant risks emanating from 'sovereign bond' form of government borrowing

Gross foreign exchange reserves stood at USD 12.8 billion as of 1 January FY2012-13, equivalent to more than four months of imports bills, which was about 32.3 per cent higher than the same period in 2012. Despite the rising reserves in recent times, Bangladesh Bank projects a modest growth in FY2012-13 in light of the subdued forecast for global trade in the coming year.

After two years of uncertainty, the government has now decided to participate in the 'sovereign bond' market. Sovereign bonds, worth of USD 500 million, will be issued during March-April, 2013. The government expects that the interest rate to be in the range of 5.0-5.5 per cent. Bangladesh's stable credit rating has perhaps played a role in this expectation although due caution will need to be exercised in dealing with the possible attendant risks emanating from this form of government borrowing.

Figure 1.12
Terms of Trade in Bangladesh (Base Year: 1995-96)



Source: Bangladesh Bank.

It is important to mention here that Bangladesh's terms of trade (ToT) has been following a declining trend in recent years. Whilst reliable up to date data is lacking, according to Bangladesh Bank information, ToT has improved marginally, by 0.5 per cent, in FY2010-11 compared to FY2009-10 (Figure 1.12). In view of volatility of commodity prices in the global market, a renewed effort to move up the value chain in exportables, away from basic manufactured items where price movements are slow, is required to change the situation in Bangladesh's favour.

Foreign Aid: Improved – Thanks to Better Project Aid Implementation

Foreign aid inflow in July-November period, FY2012-13 stood at USD 906.6 million, posting an impressive growth of 107.4 per cent compared to the corresponding months of FY2011-12. Net foreign aid inflow during the first five months (USD 568.4 million) was significantly higher compared to the same period of FY2011-12 (USD 97.1 million). This significant improvement in aid inflow mainly originated from disbursement by Japan (USD 150 million), World Bank (USD 285 million) and Asian Development Bank (ADB) (USD 136 million). Close monitoring and better coordination have perhaps helped. In the current fiscal year, government has set a gross foreign aid target of USD 3.2 billion. Developments related to the Padma Bridge financing by the World Bank has cast a dark shadow on the management of large development projects, transparency and overall economic governance, and appropriate lessons will need to be drawn from this experience. The IMF also delayed the disbursement of second part of the ECF which was due in November, 2012. Though the country is gradually moving out from aid dependency, the aid inflow has its own significance to meet the country's increasing development needs.

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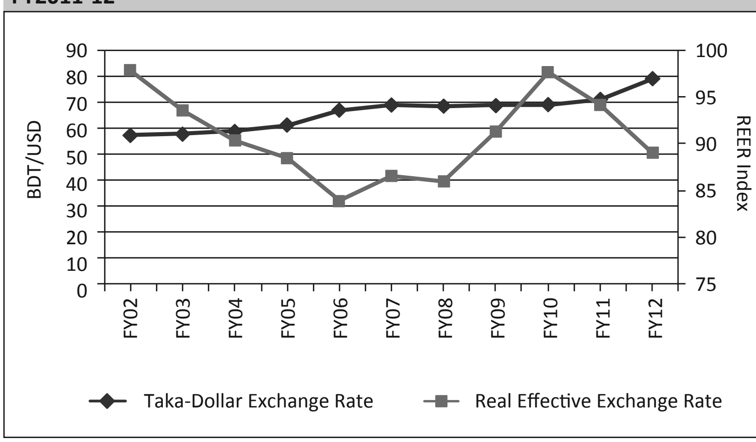
Exchange Rate Movements: Towards Appreciation of Taka

During July-October period of FY2012-13, BDT had appreciated against all the major currencies including USD, Euro, British Pound (GBP) and Chinese Yuan (CNY), except the Indian Rupee (INR). This trend was a reversal of the trends experienced during the comparable months of FY2011-12. The underlying causes for this are higher inward remittances, lower import demand and the resultant replenishment of the foreign exchange reserves. Figure 1.13 shows the BDT-USD exchange rate and real effective exchange rate (REER) over the last ten years.

Whilst export sector and remittances flow were incentivised by the large scale depreciation experienced in FY2011-12, recent strengthening of the BDT changes the scenario in a significant way; however, this is likely to have some positive impact on the price of imported commodities in the domestic market.

Figure 1.13

Taka-Dollar Exchange Rate and Real Effective Exchange Rate: FY2001-02 to FY2011-12



Source: Adopted from the Bangladesh Bank data.

1.3.4 Growth and Economic Outlook

Bangladesh economy had passed through a difficult period in FY2011-12 from the perspective of macroeconomic management. The defensive adjustments adopted by the government, in the course of FY2011-12 (particularly during the latter half), were manifested in various policy actions including those related to fiscal and monetary policies. On the one hand, the policy package had contributed to the restoration of macroeconomic stability to some extent; however, this entailed a cost in terms of the realised economic growth. As the halfway mark of FY2012-13 approached, economic policy of the government had continued to maintain a similar cautious approach. In the backdrop of unattainment of growth target in FY2011-12 and its likely repetition in FY2012-13, the gap between SFYP growth target and actual performance will widen. There may be a need to revisit the SFYP targets in view of this. The signals emanating from the first

The fiscal and monetary policy package had contributed to the restoration of macroeconomic stability to some extent; however, this entailed a cost in terms of the realised economic growth

few months of FY2012-13 indicate that, the policymakers will have to confront a more challenging phase in the coming months.

Challenges for Macroeconomic Management

To avoid revenue shortfall from collection of supplementary duties (domestic), NBR will need to put up a heroic effort in the remaining months of the fiscal year

Macroeconomic stability may come under considerable pressure if heavy borrowing from banks remains 'the preferred source' for the government to finance its deficit

The present government, for the first time in its tenure, may have to deal with an NBR revenue shortfall during FY2012-13.[13] Over the last three fiscal years the NBR was able to surpass the targets set for in the budget. If the current trend in FY2012-13 continues, it is apprehended that there will be some shortfall (about 1.8 per cent of the total budget for FY2012-13). A significant part of this is likely to be on account of shortfall in import duty collection. While restrictive policies pursued by the government were partly successful in limiting import payments to maintain external BOP, the underside of this had been manifested in adverse impact on revenue collection. Moreover to avoid revenue shortfall from collection of supplementary duties (domestic), NBR will need to put up a heroic effort in the remaining months of the fiscal year. NBR has taken up initiatives to realise additional revenues through Alternative Dispute Resolution (ADR), particularly in view of the significant amount, estimated to be about Tk. 27,000 crore, which remained unrealised because of disputes with the taxpayers. Surprisingly, NBR has been (verbally) instructed to collect an additional amount to the tune of Tk. 8,000 crore, which perhaps indicates that the government itself is also expecting some pressure in terms of fiscal management. If this be the case, overall revenue collection growth target in FY2012-13 will rise to 27.3 per cent. To meet this target, attaining a growth rate of 33.5 per cent in revenue collection will be required over the remaining seven months of FY2012-13. In all likelihood, this appears to be an impossible task. However, the fact remains that there is a need to intensify NBR mobilisation effort and there is a significant scope to raise more revenue. As discussed earlier, CPD estimates indicate that an additional Tk. 10,000 crore may be required in FY2012-13 in the form of bank borrowing to replenish budgetary allocation. Subsidy pressure may once again steal the limelight, as BPC has already sought Tk. 11,700 crore from the government to pay its debt to commercial banks. The government has a slim chance to receive another lump amount from the telecommunication sector in the form of 3G license fee. Recently, the government has decided to float sovereign bond to augment USD 500 million (about Tk. 4,000 crore) from abroad. It is speculated that the government wants to make use of this fund to finance large projects, including the Padma Bridge. This decision of the government requires further consideration given its adverse long-term impact on the Bangladesh economy. Under the circumstances, it appears that macroeconomic stability may come under considerable pressure if heavy borrowing from banks remains 'the preferred source' for the government to finance its deficit. As is the case, bank borrowing has already been on the rise. According to the Bangladesh Bank data, up to 13 December 2012 net borrowing of the government from the banking sources increased sharply to Tk. 10,400 crore (about 45 per cent of the budget limit).

Money supply is expected to remain higher than the programmed limit

It is expected that monetary policy for the second half of FY2012-13 will continue to remain contractionary. The decline in inflation in recent times may primarily be attributed to price stabilisation in the rice market and hence food inflation. However, non-food inflation will continue to hurt the purchasing power of the people as administered prices of fuel and electricity have received yet another set of upward revisions. Money supply is expected to remain higher than the programmed limit. Robust remittance inflow is expected to continue during the rest of the months in FY2012-13. As a consequence, net foreign assets will be well above the target, and hence, will pull the M2 supply with it. Moreover, as

[13] One may recall that, the last time the NBR failed to meet to its revenue target was in FY2008-09.

discussed earlier, it will be the central bank which will have to accommodate the higher government borrowing from the banking system. The targeted growth rates of monetary aggregates will require a revisit with a view to setting these at a more realistic level. Besides, the central bank will immediately need to restore good governance in the banking system which has been afflicted by high profile malfeasance. The role of the central bank in managing the financial sector will remain under spotlight in the coming period. With regard to this, a better coordination between the two policy institutions, the government (MoF) and the central bank (Bangladesh Bank) will be called for. The role of financial sector as supportive ally to promote higher investment and economic growth will also be tested in the second half of FY2012-13. The high interest rate on lending is making business uncompetitive; loan default is rising.

The role of financial sector as supportive ally to promote higher investment and economic growth will also be tested in the second half of FY2012-13

The external sector stability appears to be more secured for the rest of FY2012-13. Regrettably, this is largely aided by falling import payments. Besides, one needs to take cognisance of the fact that, for a developing country like Bangladesh, slowdown in trade deficit may not be always helpful when the interests of economic growth are kept in the perspective. Economic growth requires higher levels of investment, which in Bangladesh case is highly dependent on imported capital machineries and intermediate goods. Decline in import payments for capital goods is certainly a major setback. As is known, the government has planned for higher growth of 7.2 per cent in FY2012-13 which will need to be underwritten by higher investment. It appears that, the government is looking for more foreign resources, even if this entails higher financial and economic cost. The central bank has recently allowed a number of companies to borrow from the foreign sources (USD 293 million). Indeed, the IMF-ECF loan needs to be mentioned in this context. In the backdrop of growing BOP pressure the government sought IMF-ECF support (USD 1 billion for three years) which is tied to a number stringent conditionalities. The second installment of the loan was due on November 2012, which is now expected to be released in January 2013 if the government undertakes the necessary policy initiatives advised by the IMF. However, one can argue that the impact of an amount equivalent to USD 141 million (only 1.8 per cent of trade deficit in FY2011-12) will be rather insignificant.[14]

The policymakers in Bangladesh should give serious attention to the issue of illicit financial outflow

The policymakers in Bangladesh should give serious attention to the issue of illicit financial outflow. A number of international studies have identified that a significant amount of resource capital outflow has taken place over the last decade. The United Nations Development Programme (UNDP) study (Kar 2011) estimated this illicit flow to be, USD 3.1 billion on an average, between 2001 and 2008 to have been taken outside from Bangladesh each year (Table 1.18). This was the highest among all the LDCs. A recent study initiated from the Global

Table 1.18

Illicit Financial Outflow from Bangladesh

(Million USD)

Estimate	Time Period	Cumulative	Average per Year
GFI (2012)[a]	2001-2010	14059	1406
Christian Aid (2009) (only in US and EU)[b]	2006-2008	1190	397
UNDP (2011)[c]	2001-2008	24514	3064

Source: [a]Kar and Freitas (2012); [b]Christian Aid (2009); [c]Kar (2011).

[14]It may be recalled that the seventh installment of IMF-PRGF (Poverty Reduction and Growth Facility) loan for Bangladesh (in 2007), which was not released, was equivalent to 3.6 per cent of trade deficit in FY2006-07 (USD 123 million).

Financial Integrity (GFI), which has chosen a rather conservative estimation approach, showed that the annual average (illicit) capital flight from Bangladesh was USD 1.4 billion (between 2001 and 2010). This outflow, arising from transfer mispricing, trade mispricing and money laundering, has tended to be more visible in recent years. For example, at a time, when RMG export growth is at low level (particularly knit products), a robust growth in cotton import payments (48.8 per cent in July-September FY2012-13) is difficult to explain. It needs to be noted that the government has recently set up a Transfer Pricing Cell under the NBR. This is a welcome move, but the cell needs to be fully functional at the earliest. Surely Bangladesh requires a strong and well-equipped specialised institution to confront this issue in near future where a number of public institutions (e.g. NBR, Bangladesh Bank and others) will need to act in a coordinated manner.

The government at present is busy with maintaining macroeconomic stability, even at the expense of investment and economic growth prospect

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

As a result of fuel price adjustment, a part of the subsidy requirement will now be transferred to the BPDB

The government has revised administered prices of petroleum products at higher levels on 4 January 2012. The prices of diesel and kerosene have been raised by Tk. 7 per litre (11.5 per cent), while the prices of petrol and octane increased by Tk. 5 per litre (5.5 per cent and 5.3 per cent respectively). According to the government, even after this revision of prices, the BPC will incur a loss equivalent to Tk. 11.8 from selling per litre of diesel and Tk. 12.2 from selling per litre of kerosene. According to the CPD estimates, BPC can now reduce its loss by about Tk. 2,900 crore every year (the government has however indicated that the BPC loss will be reduced by Tk. 2,500 crore). According to media report, the government has already spent Tk. 2,700 crore during the first half of the ongoing fiscal year in the form of fuel subsidy. As is known, as a result of fuel price adjustment, a part of the subsidy requirement will now be transferred to the BPDB. Hence, unless the electricity price is revised upward, the reduction of government subsidy will be lower than the reduction of loss on the part of the BPC. Regrettably, the government did not make its position clear about the consequences of this price hike for the farmers. Diesel subsidy to the farmers for irrigation needs to be increased to prevent the rise in cost of production of agricultural commodities including Boro paddy. In the backdrop of falling rice prices, the government will need to incentivise paddy farmers to ensure food security in the country.

Due to the government's inability to implement the Master Plan in accordance with the programmed activities, contracts with the quick rental power plants are expected to be renewed

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

CPD, as part of the present study, has undertaken a Computable General Equilibrium (CGE) exercise to estimate the economy-wide impacts of increase in oil prices. The estimates have considered two different scenarios under three assumptions (closures): (i) Capital is fully employed and mobile (Simulation 1) and (ii) Capital is fully employed and activity-specific (Simulation 2).[15] The simulations examined the impact of rise in the petroleum prices by 11.5 per cent. The results show that the rise in petroleum prices will be helpful for restoring macroeconomic balance in terms of improving government deficit. However, adverse impacts are observed in the areas of GDP (in the range of (-) 0.2 per cent to (-) 0.3 per cent), exports (in the range of (-) 0.4 per cent to (-) 1.8 per cent), and imports ((-) 0.8 per cent) (Table 1.19).

Table 1.19
Impact of Raising Petroleum Price on National Accounts

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

Source: CPD estimates from CGE Model.

Among the economic sectors clothing manufacturing will be the most affected as its value addition loss could be in the range of (-) 0.4 per cent to (-) 2.4 per cent (Table 1.20).

Table 1.20
Impact of Raising Petroleum Price on Sectoral GDP (% Change)

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

Source: CPD estimates from CGE Model.

The loss of GDP for clothing manufacturing originates primarily from decline in exports of RMG sector. The estimated decline in quantity of RMG exports will be around (-) 0.4 per cent to (-) 2.6 per cent (Table 1.21).

The decline in GDP is manifested by the decline in employment for unskilled labour by about (-) 0.5 per cent and for skilled labour in the range of (-) 0.5 per cent to (-) 0.7 per cent (Table 1.22).

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

Table 1.21
Impact of Raising Petroleum Price on Quantity of Exports (% Change)

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

Source: CPD estimates from CGE Model.

Table 1.22
Impact of Raising Petroleum Price on Quantity of Factor Supply/Demand (% Change)

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

Source: CPD estimates from CGE Model.

It is also estimated that, households across the economy will suffer losses in both income and consumptions (in the range of (-) 0.5 per cent to (-) 0.9 per cent). As a result, welfare impact of such increase in petroleum prices is likely to be adverse (Table 1.23).

Table 1.23
Impact of Raising Petroleum Price on Household Consumption (% Change)

Household	Simulation 1	Simulation 2
Landless farmer	-0.8	-0.7
Marginal farmer	-0.8	-0.7
Small farmer	-0.8	-0.7
Large farmer	-0.8	-0.7
Rural non-farm poor	-0.8	-0.6
Rural non-farm non-poor	-0.9	-0.8
Low education	-0.6	-0.5
High education	-0.7	-0.5
Total	**-0.8**	**-0.7**

Source: CPD estimates from CGE Model.

Firms will also face a negative impact on their income due to the slowdown in aggregate demand ((-) 0.7 per cent) (Table 1.24). The CGE results also confirm that the government's future actions in the form of rise in fuel prices will undermine economic growth and overall welfare of the households.

Table 1.24
Impact of Raising Petroleum Price on Income of Households and Enterprises (% Change)

Agent	Simulation 1	Simulation 2
Landless farmer	-0.3	-0.5
Marginal farmer	-0.4	-0.5
Small farmer	-0.6	-0.5
Large farmer	-0.6	-0.6
Rural non-farm poor	-0.5	-0.5

(Table 1.24 contd.)

(Table 1.24 contd.)

Agent	Simulation 1	Simulation 2
Rural non-farm non-poor	-0.6	-0.6
Low education	-0.5	-0.4
High education	-0.6	-0.5
Enterprises	-0.7	-0.7

Source: CPD estimates from CGE Model.

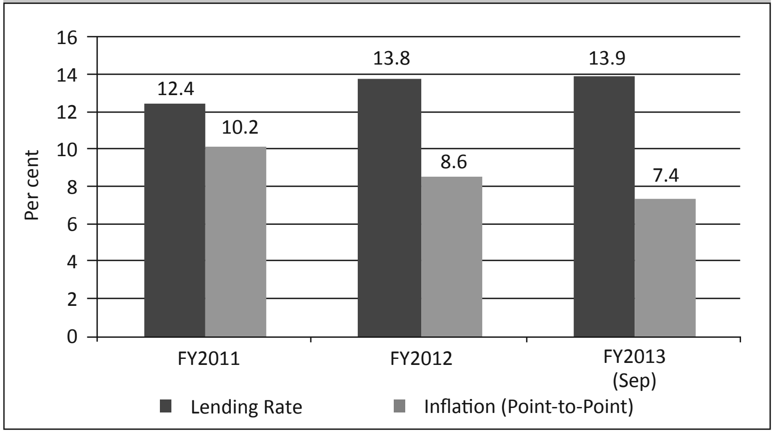
Moreover, it needs to be mentioned that an increase in administered prices of fuel will eventually transfer a part of the subsidy from BPC to BPDB. This implies that another raise in electricity prices will be on cards.

An increase in administered prices of fuel will eventually transfer a part of the subsidy from BPC to BPDB

Growth and Investment Outlook

Higher level of investment is a binding constraint for higher economic growth. According to the SFYP target, share of total investment to GDP needs to be 29.6 per cent of GDP in FY2012-13 (i.e. 4.6 percentage points over FY2011-12). In other words, it will need an additional Tk. 75,460 crore of investment; of which more than 81 per cent should come from the private sector. Certainly this will be an impossible target to chase. Additionally, an overwhelming part of the investment has to go to manufacturing sector to acquire the incremental 1 per cent GDP growth in FY2012-13 over FY2011-12. Signs of slowdown in investment trend are becoming increasingly visible. A combination of a number of factors, including weakening of global demand, inadequate infrastructural facilities, constricted access to finance, increasingly dysfunctional development administration and institutions, unsatisfactory industrial relation have depressed the investment outlook further. High cost of borrowing has been repeatedly mentioned by the business community as an impediment for private investment. In this connection, high level of inflation is often blamed for high interest rate. Interestingly, at a time when inflation is coming down, interest rate is creeping up (Figure 1.14). The real interest rate (both nominal and real) in FY2010-11 was 2.2 per cent which is now increased to 6.5 per cent in September FY2012-13.

Figure 1.14
Lending Rate vs Inflation Rate



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

The depressing sign of investment scenario is visible from the decline in import of capital machineries. In contrast, term loan disbursement in the first quarter of FY2012-13 has been impressive compared to the corresponding quarter of the previous fiscal year. However, this disbursement was ((-) 4.9 per cent) lower than last quarter (April-June, FY2011-12). It is, however, found that overall private sector credit growth was at a moderately high level. At a time when investment in terms of importing capital machineries is declining and economic activity including trade-related activities are slowing down, such a growth in private sector credit and term loan is somewhat perplexing. The Hall-Mark scam has put forward an important lesson to the economy that loans acquired from the commercial banks may not always be destined for the intended purpose (as is evidenced in the bank documents). In view of the disquieting signs in the financial sector, it is proposed that a high-powered taskforce is set up by the central bank to investigate the mismatch between credit and investment-related data.

The Hall-Mark scam has put forward an important lesson to the economy that loans acquired from the commercial banks may not always be destined for the intended purpose

The above analysis of the macroeconomic performance in current fiscal, based on early data, transmits the signal that a growth target of 7.2 per cent for FY2012-13 is unlikely to be achieved. The GDP growth projections made by the multilateral donors (i.e. the World Bank, IMF and ADB) corroborate that GDP growth rate in FY2012-13 would be around 6 per cent. A more recent projection by the Bangladesh Bank has also estimated that the GDP growth rate in FY2012-13 will be in the range of 6.1-6.4 per cent (Table 1.25). At this point in time, the available data on real sector's performance are not adequate to estimate the final outcome for the GDP growth in FY2012-13. The crop production data (on Aus and Aman) is yet to be finalised; however, anecdotal information suggests that, the production figure could be better in FY2012-13 compared to the previous fiscal year. On the other hand, Quantum Index of Production (QIP) for large and medium industries for the first two months of FY2012-13 shows that manufacturing production growth in large and medium industries was only 4.9 per cent. The relatively slow pace of growth in export will also likely have a dampening impact on industrial sector performance in FY2012-13. In all likelihood, given the current scenario, the economic growth rate in FY2012-13 is unlikely to surpass the growth record of FY2011-12.

Relatively slow pace of growth in export will also likely have a dampening impact on industrial sector performance

Table 1.25

Growth Projections by Sixth Five Year Plan and Bangladesh Bank for FY2012-13

(in Per cent)

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

Source: Sixth Five Year Plan (SFYP) and Bangladesh Bank data.

Compared to previous fiscal year, at the halfway mark of FY2012-13, macroeconomic situation is more stabilised. The analyses of macroeconomic performance in this section indicate that apparently this stability is underpinned by a number of risks. It appears that, the government has settled for a 'second best' option by holding on to macroeconomic stability with moderated economic growth, investment and employment prospects. Regrettably, even this modest ambition could come under serious challenge in view of the looming uncertainties in the political front.

The government has settled for a 'second best' option by holding on to macroeconomic stability with moderated economic growth, investment and employment prospects. Regrettably, even this modest ambition could come under serious challenge in view of the looming uncertainties in the political front

1.4

A BRIEF INTERIM REVIEW OF THE IMPLEMENTATION OF THE SFYP: MACROECONOMIC FRAMEWORK AND SECTORAL ISSUES

The Sixth Five Year Plan (SFYP: FY2010-11 to FY2014-15) started its journey of implementation beginning from FY2010-11 with the goals of "accelerating growth and reducing poverty." It has passed the half way mark in this journey, in 2012. SFYP is informed by political commitment on the part of the government which sees the plan as key strategic intervention to reach the middle-income country status by 2021. Time has come to take a close look at where the SFYP targets stand, and how feasible are the possibility of their attainment at the end of 2015. One should also note that the implementation of SFYP so far has to be exercised at a period of adverse global environment which accentuated the domestic problems that implementation had to face in the past three years.

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

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1.4.1 Methodological Framework for Assessment of the SFYP Implementation

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

Drives for undertaking institutional reforms as per the strategies set forth for different sectors should have been highlighted in the assessment exercise

In this backdrop, the present review has put focus on both measurable indicators and sectoral strategies set forth in the Plan for attaining the set targets. The macroeconomic framework has been assessed through two kinds of variables – core and associate variables. Core variables include: public and private investment, production of agriculture, industry and services, exports, revenue and savings, while associate variables include credit to public and private sector, government subsidy to different sectors, inflation, interest rate, exchange rate and imports. These variables are shown in Table 1.26.

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

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

Table 1.26

Core and Associate Variables for Assessment of the Macro and Sectoral Targets

Core Variables	Associate Variables
Public investment	Credit to public sector
Private investment	Credit to private sector
Production of agriculture, industry and services sectors	Subsidy
Exports	Inflation
Revenue	Interest rate
Savings	Exchange rate
	Imports

Source: Compiled by the authors.

1.4.2 Accounting Exercise: Performance Assessment (Targets vs Achievements)

The macroeconomic performance was better in the first year of the Plan period as most of the targets were achieved (Table 1.27). These include GDP growth, gross investment, growth in production of agriculture and industry, exports, national savings, current account balance and fiscal balance. However, performance record

Table 1.27

Summary of Key Economic Indicators

Component	FY11		FY12		FY13 Target	FY14 Target	FY15 Target
	Target	Actual	Target	Actual			
Real GDP (Billion Taka)	3850.16 (6.7)	3851.00 (6.7)	4119.67 (7.0)	4093.80 (6.3)	4416.00 (7.2)	4752.00 (7.6)	5132.10 (8.0)
Gross Investment (Billion Taka)	1947.90 (24.7)	1947.90 (24.7)	2411.73 (28.8)	2327.80 (25.4)	3032.50 (29.6)	3622.40 (31.0)	4339.08 (32.5)
Private (Billion Taka)	1535.60 (19.5)	1532.10 (19.5)	1997.70 (22.2)	1751.00 (19.1)	2325.60 (22.7)	2781.00 (23.8)	3337.70 (25.0)
Public (Billion Taka)	417.30 (5.3)	415.80 (5.3)	593.90 (6.6)	576.70 (6.3)	706.91 (6.9)	841.32 (7.2)	1001.30 (7.5)
National Savings (Billion Taka)	2236.50 (28.4)	2236.50 (28.8)	2402.70 (26.7)	2689.60 (29.4)	3012.00 (29.4)	2587.30 (30.7)	4285.60 (32.1)
Production Growth (Percentage of GDP)							
Agriculture	5.0	5.1	4.5	2.5	4.4	4.3	4.3
Manufacturing	9.5	9.4	9.8	9.8	10.1	10.7	11.7
Services	6.6	6.2	6.8	6.1	7.1	7.3	7.8
External Sector (Million USD)							
Exports	22405.70 (20.3)	23008.00 (20.6)	25654.50 (21.2)	16006.00 (13.6)	29374.40 (22.1)	33780.60 (23.0)	38847.70 (23.9)
Imports	-31012.60 (28.2)	-30336.00 (27.1)	-35354.40 (29.2)	-21707.00 (18.4)	-40304.00 (30.3)	-46148.10 (31.4)	-52839.50 (32.5)
Current Account Balance	-349.90	995.00	-192.10	681.00	-229.40	-438.50	-648.50
Fiscal Balance (excl. Grants)	-346.50 (-4.4)	-348.20 (-4.4)	-449.90 (-5.0)	-452.00 (-4.9)	-512.20 (-5.0)	-584.30 (-5.0)	-667.55 (-5.0)
Others							
CPI Inflation (Avg. %)	8.0	8.8	7.5	11.0	7.0	6.5	6.0
Exchange Rate (BDT/USD)	71.51	71.17	74.29	77.72	76.97	79.6	82.17
Subsidy (Billion Taka)	310.00	366.00	352.00	366.00	410.00	479.00	561.00

Source: Bangladesh Economic Review 2012.
Note: Figures in parentheses indicate the percentage of GDP.

achieved in the first year could not be continued in the second year; most of the variables were behind the targets except that of national savings. As a result, overall GDP growth in FY2011-12 was lower compared to that in FY2010-11 (gap: 0.7 per cent). However, given the adverse global economic environment, Bangladesh has performed better than many other developing countries in terms of GDP score including Indonesia (6.5 per cent in 2011), Pakistan (2.9 per cent) and Vietnam (5.9 per cent).[18]

The poor performance in the second year of the Plan period (FY2011-12) is mainly attributed to a number of internal and external shocks. However, these shocks were not exogenous in nature. Weak fiscal and financial management and lack of good governance accentuated the problems. Poor performance in FY2011-12 has widened the gap with Plan targets. If the targets for the end period are to be achieved, many indicators will need to be reset at higher levels. Most of the macroeconomic and sectoral variables have to attain a significant growth over the rest of the Plan period if the desired level of growth and development are to be attained. This would be difficult to attain perhaps because of the lingering global economic slowdown in 2013 (IMF 2012a), particularly in USA and EU, possible rise of petroleum price in the global market, and possible adverse impact of 'Fiscal Cliff' on US economy. A major factor which will influence the performance in 2013, with its implications for attaining Plan target, relates to domestic political environment. If in the coming days political uncertainties rise, this will adversely affect investment and business, with serious implications for macroeconomic performance in 2013, and also beyond.

Most of the macroeconomic and sectoral variables have to attain a significant growth over the rest of the Plan period if the desired level of growth and development are to be attained

1.4.3 Gap Analysis

Since the macroeconomic performance of the economy in FY2011-12 is far behind the target, huge gaps are observed in all major indicators (Table 1.28). Thus growth in all those indicators needs to be significantly high in the rest of the Plan period, FY2012-13 to FY2014-15. Although government has set the target of GDP growth of 7.2 per cent for FY2012-13 keeping in line with the target set forth in the SFYP, because of low level of GDP growth in FY2011-12 (gap: (-) 0.7 per cent) the required rate of GDP growth for FY2012-13 ought to be much higher (7.9 per cent). Achieving that level of economic growth would require a significant rise in investment; for example, gross investment will need to be at a rate of 30.3 per cent in FY2012-13 of which private and public investment to be increased at a rate of 33 per cent and

Table 1.28

Key Economic Indicators: Target and Gap

(Billion Tk.)

Component	GDP in Constant Term	Investment			ADP (PPP+ Public Entities)	FDI	Portfolio Investment	National Savings
		Gross	Private	Public				
Gap after FY2012	**-25.9**	**-83.9**	**-246.8**	**-17.2**	**-93.0**	**-55.0**	**248.0**	**286.9**
Target for FY2013	4416.0	3032.5	2325.6	706.9	545.0	1250.0	-50.0	3012.0
Required rate of growth in FY2013 (%)	**7.90**	**30.30**	**32.80**	**22.60**	**25.51**	**25.60**	**-125.30**	**11.90**
Average growth rate between FY2009 and FY2012 (%)	6.50	17.20	14.00	28.80	24.89	30.00	5.70	13.60
Target for FY2014	4752.0	3622.4	2781.0	841.3	669.0	1350.0	-50.0	3587.3
Target for FY2015	5132.1	4339.1	3337.8	1001.3	808.0	1590.0	-50.0	4285.7

Source: Based on the Sixth Five Year Plan (SFYP).

Note: PPP denotes public-private partnership.

[18] According to the World Development Indicators (WDI).

23 per cent respectively.[19] Under the existing contractionary monetary policy (MPS July-December, 2012), such a high level of growth of investment to be largely driven by credit to the public and private sector, would be difficult to attain. Besides, a major challenge for raising private credit is the prevailing high rate of interest on term loan and working capital which makes the investment costlier.

Government has already shifted its focus and has put more emphasis on mobilising domestic resources for deficit financing

Financing public expenditure with limited domestic resources is always a challenging enterprise. After the end of FY2011-12, total revenue has fallen short of Tk. 4,814 crore which needs to be adjusted in the following year by attaining a growth of 12 per cent (Table 1.29). Attaining this target appears to be manageable though. Government has been successful in revenue generation, particularly in case of NBR tax and non-tax revenue. Various measures undertaken by the NBR have contributed towards attaining the target. A major challenge for the government would be to meet the huge gap in case of deficit financing which was as high as Tk. 12,374 crore. Reaching the targeted level by external resources would be difficult. Instead government has already shifted its focus and has put more emphasis on mobilising domestic resources for deficit financing as mentioned in the revised Medium Term Budgetary Framework (MTBF) for FY2012-13 to FY2016-17. Besides there should also be a strategy to make use of the huge foreign aid in the pipeline amounting to USD 17 billion at present.

Table 1.29

Total Expenditures and Financing of Budget Deficit: Gap and Target

(Billion Tk.)

Component	National Savings	Total Revenue	Tax	Total Expenditure	Deficit Financing			
					Overall	External	Domestic	Banks
Gap FY2012	286.90	-48.14	-5.69	-139.82	-123.74	-162.14	38.39	70.87
Target FY2013	3012.00	1372.80	1147.40	1885.10	509.00	195.00	309.00	229.00
Required growth rate in FY2013 (%)	11.99	20.70	20.40	25.50	55.06	933.03	-0.13	-15.77
Target FY2014	3587.30	1635.90	1378.80	2220.20	581.00	230.00	351.00	260.00
Target FY2015	4285.67	1949.25	1655.50	2616.80	664.00	261.00	403.00	299.00

Source: Based on the Sixth Five Year Plan (SFYP).

The huge gap in net aid loans is mainly related with failure to realise the part of USD 3 billion loan to be disbursed for the 'Padma Bridge' project

There were gaps in a number of variables related to the BOP such as export, export earnings from services, FDI, net aid disbursement and other short-term loans, although a number of other variables have attained the targeted level such as import and workers' remittances (Table 1.30). The high export growth in FY2010-11 did not sustain in FY2011-12 mainly because of EU's debt crisis and slow growth of US economy. This may also happen due to low level of growth of gross export earnings caused by decline in the price of raw materials (e.g. cotton, cotton yarn) and products (e.g. cotton textiles). The significant rise in import in FY2011-12 is mainly related with rise in import cost for high-priced petroleum at a substantial amount and import of essential food products at a high price. However, high import was not continued in FY2012-13; it has slowed down due to decelaration in import of raw materials for export-oriented industries, and reduced expenditure for import of petroleum and food due to their low price in the international market. The contractionary monetary policy implemented since January 2012, has partly restrained the growth of import during the second half of the FY2011-12. The huge gap in net aid loans is mainly related with failure to realise the part of USD 3 billion loan to be disbursed for the 'Padma Bridge' project.

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

Table 1.30
Balance of Payments: Gap and Target

(Million USD)

Component	Export	Import	Services	Workers' Remittances	Current Account Balance	Foreign Investment		Financial Account				
						FDI	Portfolio Investment	Net Aid Loans	Debt Amortisation	Other Long Term Loans (Net)	Other Short Term Loans (Net)	Trade Credit (Net)
Gap 2012	-1662.5	3367.4	-180.4	153.4	1822.1	-55.0	248.0	-342.6	-47.5	143.0	-105.6	-200.0
Required growth rate (%)	22.4	26.0	-2.8	10.7	-114.1	25.6	-125.3	36.2	14.8	-12.3	68.2	-13.8
Target for FY2013	29374.0	-40304.0	-2493.0	14213.0	-229.4	1250.0	-50.0	1989.0	-906.0	-50.0	407.0	-1250.0
Target for FY2014	33781.0	-46148.0	-2609.0	15918.0	-438.5	1350.0	-50.0	2379.0	-1056.0	-120.0	513.3	-1350.0
Target for FY2015	38848.0	-52840.0	-2744.0	17829.0	-648.5	1590.0	-50.0	2681.0	-1200.0	-170.0	520.0	-1450.0

Source: Based on the Sixth Five Year Plan (SFYP).

1.4.4 Shortfall in Major Strategies Set Forth in the SFYP

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

Macroeconomic Framework

Taking into account of the macroeconomic targets set forth in the SFYP, the government has prepared an MTBF for the period of FY2010-11 to FY2014-15. However, this was effective only for two years, as a revised MTBF was adopted in FY2012-13 for the period of FY2012-13 to FY2016-17 taking into cognisance of the poor performance of the first two years of the Plan period (Table 1.31). Although

Table 1.31
Comparison between SFYP, MTBF (FY2011-FY2015) and MTBF (FY2013-FY2017)

(Billion Tk.)

Component	FY2012-13			FY2013-14			FY2014-15		
	Target in SFYP	Projection in MTBF FY11-FY15	Projection in MTBF FY13-FY17	Target in SFYP	Projection in MTBF FY11-15	Projection in MTBF FY13-17	Target in SFYP	Projection in MTBF FY11-15	Projection in MTBF FY13-17
Total Revenue	1373.0	1313.9	1396.7	1636.0	1551.3	1667.3	1953.0	1824.8	1986.2
Tax Revenue	1147.0	1083.2	1168.2	1379.0	1239.0	1406.0	1953.0	1427.1	1687.7
Non-Tax Revenue	225.0	230.7	228.5	257.0	262.4	261.3	294.0	297.7	298.5
Total Revenue as % of GDP	13.4	13.1	13.4	14.0	13.6	14.0	14.6	14.1	14.6
Total Expenditure	1882.0	1745.2	1917.4	2217.0	2030.4	2227.8	2617.0	2342.4	2613.0
Programme Expenditure	NA	1499.6	NA	NA	1761.9	NA	NA	2037.2	NA

(Table 1.31 contd.)

(Table 1.31 contd.)

Component	FY2012-13			FY2013-14			FY2014-15		
	Target in SFYP	Projection in MTBF FY11-FY15	Projection in MTBF FY13-FY17	Target in SFYP	Projection in MTBF FY11-15	Projection in MTBF FY13-17	Target in SFYP	Projection in MTBF FY11-15	Projection in MTBF FY13-17
Interest Payments	234.0	220.7	233.0	234.0	239.5	273.1	267.0	271.8	312.0
Other Expenditures	NA	24.9	NA	NA	29.0	NA	NA	33.5	NA
Total Expenditure as % of GDP	18.4	17.4	18.4	19.0	17.8	18.8	19.6	18.1	19.3
Budget Deficit as % of GDP	NA	-4.3	-5.0	NA	-4.2	-4.7	NA	-4.0	-4.6
Financing Operations	NA	431.3	520.7	NA	479.1	560.5	NA	517.7	626.8
External Borrowing (Net)	NA	201.6	185.8	NA	229.3	210.2	NA	247.2	241.9
Loans	NA	200.6	204.0	NA	228.1	237.5	NA	245.9	271.3
Grants	NA	66.2	60.4	NA	75.3	61.4	NA	85.4	69.9
Amortisation	NA	65.2	78.6	NA	71.1	88.7	NA	84.1	99.3
Domestic Borrowing	NA	229.7	334.8	NA	249.8	350.3	NA	270.5	384.9
Bank Borrowing	NA	170.5	230.0	NA	193.9	243.4	NA	220.1	262.8
Non-Bank Borrowing	NA	59.2	104.8	NA	55.9	106.9	NA	50.5	122.1

Source: Bangladesh Economic Review 2012.

overall growth target remains at 8 per cent of GDP in FY2014-15 keeping a number of targets same such as revenue generation, total expenditures, but a number of targets have been revised upward such as export and import, as well as some have been revised downward such as gross investment and gross savings. Overall, such revision in the MTBF in effective sense indicates government's downward adjustment of the macro framework for the rest of the Plan period. This reflects government's conservative position with regard to implementation of the SFYP.

Revised targets for deficit financing through higher domestic financing would not be a desired policy choice given its implications on growth of private sector credit and inflation

Taking into cognisance of the performance in revenue generation and deficit financing, the revised MTBF for FY2012-13 to FY2016-17 in most related variables have made necessary revisions of the targets. There is an upward revision in the target for tax revenue given the better performance of the NBR in revenue generation. Revised targets for deficit financing through higher domestic financing would not be a desired policy choice given its implications on growth of private sector credit and inflation. Rise in interest payments as set in the MTBF because of possible high bank borrowing is another issue of concern. Thus future path in implementation of macroeconomic framework of the SFYP seems to be less smooth which may cause continuity in less stable macroeconomic framework.

Investment

Public Investment

SFYP has put emphasis on efficient implementation of the ADP in order to increase its share in GDP to 7.5 per cent by FY2014-15. In this context major strategic focus has been put in place to take all ministries under the MTBF, building capacity for project implementation by different ministries/agencies, and strengthening of the monitoring and evaluation processes.

Although ADP utilisation has marginally improved during this period, majority of ministries are still struggling with traditional challenges such as lengthy procurement procedure, inadequate capacity of implementing agencies, land procurement and lack of proper monitoring of implementing agencies. Failure to disburse funds for approved projects (e.g. under the Ministry of Communication) and reduced budgetary allocation for social sectors against the targeted level of SFYP because of poor subsidy during FY2011-12 (particularly for the power and energy sector), are a reflection of mismanagement in the budgetary process.

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

Reduced budgetary allocation for social sectors against the targeted level of SFYP because of poor subsidy during FY2011-12 is a reflection of mismanagement in the budgetary process

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

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

Because of incomplete institutional set up of the PPP, the Bangladesh Investment Faciliation Fund Limited (BIFFL) was not able to attract external resources for PPP projects

Private Investment: Local and FDI

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

Government's excess borrowing from commercial banks has partially caused 'crowd out' effect to the private sector

Private investment based on debt financing has largely been constrained by shortages of fund in banks, particularly in FY2011-12. Government's excess borrowing from commercial banks has partially caused 'crowd out' effect to the private sector (CPD 2012). The contractionary monetary policy undertaken in the second half of FY2011-12 and the first half of FY2012-13 has slowed down the growth of credit both in private and public sectors. Because of high inflation, real expenditure in manufacturing industries (as against in nominal terms) has suffered a setback. An added pressure for the investors is the high rate of interest, particularly after the ban on the interest rate was lifted with a view to broaden the market-based operation in deposit collection and loan disbursement. These measures instead of incentivising the growth of private sector credit, have contributed towards slowdown of the credit growth. The central bank has undertaken a number of initiatives as part of broadening the financial inclusion within the country.

Banking sector has faced a number of incidences of malgovernance including bank's investment in the capital market for short-term profit, violating rules and regulations (largest fraud in banking sector by six companies mainly by a textile and apparels manufacturing group called Hall-Mark which siphoned off a total of about Tk. 2,900 crore), illegal banking operation and fraudulent practices by multi-level marketing companies, particularly by companies like Unipay 2 and Destiny

While banking sector has undertaken necessary measures to be complied with the Basel II requirements during this period, a number of incidences raised doubt as regards the preparedness towards that direction. Banking sector has faced a number of incidences of malgovernance including bank's investment in the capital market for short-term profit, violating rules and regulations (largest fraud in banking sector by six companies mainly by a textile and apparels manufacturing group called Hall-Mark which siphoned off a total of about Tk. 2,900 crore), illegal banking operation and fraudulent practices by multi-level marketing companies, particularly by companies like Unipay 2 and Destiny. Lack of proper monitoring by the commercial banks as well as by the central bank is considered to be a major weakness in these regards. A number of post-facto measures have been undertaken by concerned authorities including banks, the central bank, relevant ministries and departments which ought to be taken much earlier. In view of rising bad loans in recent year, the loan classification policy has been tightened. In general, banking sector has faced a number of institutional challenges.

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

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

Analysis of investment performance does not indicate visible change with regard to volume of investment and efficiency and productivity of investment

Analysis of investment performance does not indicate visible change with regard to volume of investment and efficiency and productivity of investment. Growth of private sector credit has slowed down, and more importantly, share of disbursed credit for large industries has decelerated while that of medium-scale industries has significantly increased. Because of high rate of interest, growth of advances for working capital has slowed down. The efficiency of capital which is measured by the incremental capital-output ratio (ICOR) was found to be higher than the targeted level in the first two years of the Plan period, and is likely to be much higher in FY2012-13, which indicates rise in inefficiency in capital use (Table 1.32).

Table 1.32

Efficiency in Capital Use

Component	FY2010	FY2011	FY2012	FY2013
ICOR Target	4.00	3.69	3.83	4.10
ICOR Actual	4.29	3.71	4.03	NA
Gap	+0.29	+0.02	+0.20	NA

Source: CPD estimates based on the Sixth Five Year Plan (SFYP).

Revenue Mobilisation

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

Institutional reforms are in line with the targets set forth in the strategies which have contributed to improve the mobilisation of resources

1.4.5 Sectoral Issues

Agriculture and Food Security

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

Diesel facility through Agricultural Card was initiated along with a project undertaken for technological upgradation of agriculture

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

No effort has been observed to develop a professional agricultural marketing channel

Manufacturing Sector

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

RMG and Textiles

Diversification of product and market destination, vertical integration, improving supply of skilled and unskilled workers are the medium-term goals set for the RMG sector. The strategies for the development of this sector also include signing bilateral agreements with potential partners, investment in training facilities by Bangladesh Garment Manufacturers and Exporters Association (BGMEA) and Bangladesh Knitwear Manufacturers & Exporters Association (BKMEA), improve capacity of owners of RMG on the value chain, and greater use of information technology (IT). For making the RMG sector competitive in the global market and sustain in view of external shocks, various supportive measures have been adopted for the sector. A number of stimulus packages have been given during the period of global financial crisis. The various measures adopted for the development of the textile sector include compilation of Economic Survey on Textile and Jute Sector 2011, Five Year Plan for Textile and Jute Sector (2010-2015), Textile Act 2011 and draft of Jute Act 2011. Technical Project Planning for strengthening National Institute

Diversification of product and market destination, vertical integration, improving supply of skilled and unskilled workers are the medium-term goals set for the RMG sector of Textile Training Research and Design (NITTRAD), textile colleges and Textile Strategic Management Unit (TSMU) for the development of the sector has been completed. There are no measures regarding product diversification or to create facilities for developing skilled human resources as per the SFYP medium-term goal for the sector. Progress with regard to market diversification has been slow.

Small and Medium Enterprises

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

The need for strengthening SME Foundation is also required according to the Plan

Various measures adopted during the SFYP period include: initiative for upgradation of *Bangladesh Small and Cottage Industry Act 1957*; supporting SME Foundation; organisation of 'Financial Fair' by SME Foundation with commercial banks in divisional, commercial and economic cities; development of SME Foundation webportal; provision of refinancing by Bangladesh Bank fund, Enterprise Growth and Bank Modernization Programme (EGBMP) fund and ADB fund to 31,855 enterprises under the SME sector. The crucial problem that obstructs in assessing the SME performance in the economy and their requirement is the lack of database on SMEs. There are a large number of SMEs which remain unregistered even though they contribute to the economy and generate income opportunity to a large segment of rural population. If not properly brought under a systematic database, these SMEs will not be able to reap the benefits from the government's support programmes and remain vulnerable.

Government has decided to extend the operation of Bangladesh Small and Cottage Industries Corporation (BSCIC)

To support the development of SMEs, government has decided to extend the operation of Bangladesh Small and Cottage Industries Corporation (BSCIC). As part to this, initiatives have been undertaken for simplification of the allotment process of industrial plots, plan for establishing BSCIC industrial area, and also establishment of industrial units at Gopalganj, Comilla, Barguna and Kushtia. The progress of establishment of Active Pharmaceutical Ingredients (API) Park for pharmaceutical industry and Leather Industry Park has advanced in a snail pace.

Export

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

To prevent the adverse impact of the global financial crisis, the SFYP included measures for backward and forward linkage expansion, meeting compliance standards, product and market diversification, and product and process upgradation to sustain global opportunities

Taking into cognisance the adverse impact of the global economic crisis, the government had come up with two fiscal and financial packages (Tk. 5,035 crore and Tk. 2,000 crore) particularly targeting the export-oriented manufacturing sectors. These measures included additional cash incentive for the selected sectors, support for exporting to the non-traditional markets, and relaxing the rules and regulations related to repayment of export credit for a short period of time. Those initiatives have contributed to reduce the pressure created by low level export growth in traditional markets. Besides, exporters got the benefit of depreciation of local currency against USD (about 15 per cent devaluation) during January-June, 2012. Given the wide gap existed earlier between REER with nominal exchange rate, such revision of the exchange rate has been considered as 'required'.

Exporters got the benefit of depreciation of local currency against USD

Power and Energy Sector

The core targets of the SFYP include generation of electricity to increase to 15,457 mega watts (MW) by FY2014-15. It also aims to ensure electricity coverage to be increased to 68 per cent and to increase energy efficiency by 10 per cent. Considering the energy crisis as the major bottleneck in hampering investment and development of the economy, the SFYP has emphasised on the development of the energy sector with a number of strategies such as ensuring proper pricing of power, establishing private electricity distribution companies, taking efforts to exploit all possible sources of primary energy (hydropower, gas, coal and solar energy), and energy trade with neighbouring countries. This will be pursued in combination with public investment, PPP, as well as pure private investment for power and energy sector projects. The Plan realises the needs for primary fuel to be balanced through cross-subsidies and budgetary transfers, with a view to reconcile the incentives for private investment, and efficient use of resources for ensuring access for the poor.

The Plan realises the needs for primary fuel to be balanced through cross-subsidies and budgetary transfers, with a view to reconcile the incentives for private investment, and efficient use of resources for ensuring access for the poor

Despite the fact that total installed capacity as well as actual generation of electricity has increased during the Plan period, full capacity is yet to be realised, and the gap between installed capacity and actual generation has widened in each successive year (Table 1.33). Initially government decided to establish diesel-based quick rental power plants by the private sector which costs high tariff for electricity. As a result government had to provide huge subsidy against import of diesel for power generation as well as high charges for generation of electricity. The government had to take the burden of excess subsidy beyond the budgetary limit, which created mismanagement in fiscal and financial issues. Budget for a number projects including for social sector had to be cut down in order to meet the subsidy requirement. Although government announced a medium to long-term plan to reduce the burden over diesel-based quick rental power plants to shift to coal-based power plants, little progress has been achieved so far. Instead government has renewed contracts with a number of quick rental power plant companies.

Table 1.33

Electricity Generation

(MW)

Date	Installed Capacity	Actual Generation (Evening Peak)	Gap between Installed Capacity and Usable Load
30 June 2008	5272	3386	1886
30 June 2009	5710	3735	1975
30 June 2010	5927	3183	2744
30 June 2011	7574	4852	3351
30 June 2012	8871	5518	3889
20 December 2012	8931	4622	4693

Source: Bangladesh Power Development Board (BPDB).

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

1.4.6 Implementation Challenges

Although most of the required changes will be made by the private sector through increasing investment, it is still far below the targeted level

The core targets of SFYP included reduction of the headcount poverty ratio by about 10 per cent. This was to be achieved, inter alia, among others by creating good jobs for underemployed and new labour force entrants by increasing the share of employment in the industrial sector and increasing the social security spending to 3 per cent of GDP. This will contribute to reduce the level of poverty to 22 per cent in FY2014-15. Although most of the required changes will be made by the private sector through increasing investment, it is still far below the targeted level. Government's role to facilitate the private investment has been questioned because of weak institutional capacity, mismanagement, and most importantly, malgovernance.

The political commitment of the government to implement the SFYP in order to become a middle-income country by 2021 was not adequately reflected in the functioning of the various concerned ministries and departments

The political commitment of the government to implement the SFYP in order to become a middle-income country by 2021 was not adequately reflected in the functioning of the various concerned ministries and departments. More importantly, the process was seriously disrupted because of mismanagement and malgovernance, particularly in case of fiscal and financial issues, which has made the macroeconomic framework vulnerable during the Plan period. Government has spent most of its time to reduce the damage of the macroeconomic and budgetary framework, except for few areas where fresh efforts have been made such as revenue generation by the NBR. Global economic downturn in 2010 and 2011 was a big blow towards ensuring a sustained export-oriented growth in the country, which is likely to be continued in 2013 due to Europe's debt crisis, slow growth of US economy and high unemployment and likely adverse impact of 'Fiscal Cliff'. Various projections on Bangladesh's economic growth has expected a moderate level of growth in FY2012-13 between 6-6.5 per cent instead of 7.2 per cent which is targeted in the National Budget of FY2012-13 (even though the required GDP growth for FY2012-13 to catch up the SFYP target is 7.9 per cent). Thus the targets set in the SFYP have become almost unreachable. In fact, Bangladesh has still performed better compared to those of other competing countries. But the performance would be much better if the mismanagement and malgovernance issues had been handled properly which could contribute to narrow down the gap with the targets set forth in the SFYP.

Taking cognisance of the situation, government has already made downward revision in the revised Medium Term Macroeconomic Framework (MTMF) and MTBF during the time of National Budget FY2012-13. It may happen that further downward revision in those frameworks would be required given the expected slow growth in FY2012-13. This would ultimately affect the broader objective of poverty reduction in the country at the targeted level. Government should strengthen its social support measures by allocating more resources for safety net programmes.[20] The government according to the Plan should launch a comprehensive social protection strategy. Given the slow progress in implementation of different strategies and specific activities, most of the ministries and departments should be proactive in order to implement the stated activities. An 'as usual' pace of work by the concerned ministries would not help much to achieve the broader goals of the SFYP.

Government should revisit the targets set forth in the SFYP with regard to the macroeconomic framework and sectoral targets and make the necessary revisions accordingly

Finally, government should revisit the targets set forth in the SFYP with regard to the macroeconomic framework and sectoral targets and make the necessary revisions accordingly. The challenge for the government is to determine when is an appropriate time to undertake this exercise. Is it now, or is at the end of FY2012-13? Or should it be left to the newly elected government after the elections are over? Considering the adequate time needed for effective implementation, it will perhaps be better to go for a mid-term correction without delay.

1.5

REVIEW OF THE PERFORMANCE OF THE MANUFACTURING SECTOR OF BANGLADESH

Excepting a few sub-sectors of the manufacturing sector, major components of the sector are yet to attain the strength to compete globally in equal footing, or in the domestic market without tariff and incentive support

Over the past decades manufacturing sector of Bangladesh was able to maintain and sustain a relatively high level of growth, surpassing that of the GDP, which contributed to a rise in its share in the GDP (from 10 per cent in 1989 to about 19 per cent in 2012). In the course of particularly the last five years (FY2007-08 to FY2011-12) manufacturing sector was confronted with a number of challenges which had important implications both for its domestic market-oriented components as well as the export-oriented ones. Despite these challenges manufacturing sector has been able to post at 7-10 per cent growth which was led particularly by the large and medium-scale enterprises (Table 1.34). Over this same period small-scale enterprises have also experienced a modest level of growth. Nonetheless there is an increasing concentration towards large and medium industries. Excepting a few sub-sectors of the manufacturing sector, major components of the sector are yet to attain the strength to compete globally in equal footing, or in the domestic market without tariff and incentive support. This had been mainly due to a number of structural and operational constraints/ weaknesses including narrow production base, lack of well-developed value chains, low productivity of capital (e.g. high ICOR), lack of access to adequate infrastructure facilities, and in recent years, high interest rates on bank loan. In this backdrop, a detailed analysis of the recent performance of the manufacturing sector is perceived to be important in view of the key role of the sector in ensuring structural transformation of the economy.

[20]The project of Northern Areas Reduction-of-Poverty Initiative (NARI) has been adopted in various northern areas for building dormitories and providing training facilities for women. The safety net programmes adopted by the government mostly have been taking place within the budgetary framework. Allocation in social safety net in the National Budget for FY2012-13 has been reduced to 2.2 per cent of GDP which was 2.51 per cent in FY2011-12. The various programmes include the ones related to food security, Vulnerable Group Feeding (VGF), Test Relief (TR), Employment for Ultra Poor in Northern Region, etc. However, considering the prevailing high level of poverty, allocation for this head needs to be raised. Moreover, most of the social safety net programmes are related to food-based programmes, whereas little emphasis is given on cash transfer programmes.

Table 1.34

Share and Growth in Production of Manufacturing Enterprises: FY2007-08 to FY2011-12

(in Per cent)

Component	FY2008	FY2009	FY2010	FY2011	FY2012
Share in GDP					
Manufacturing	17.8	17.9	17.9	18.4	19.0
Large and medium-scale	*12.6*	*12.7*	*12.7*	*13.2*	*13.8*
Small-scale	*5.2*	*5.2*	*5.2*	*5.2*	*5.2*
Share in Manufacturing GDP					
Large and medium-scale	*70.8*	*70.9*	*70.9*	*71.7*	*72.6*
Small-scale	*29.2*	*29.1*	*29.1*	*28.3*	*27.4*
Growth					
Manufacturing	7.2	6.7	6.5	9.4	9.8
Large and medium-scale	*7.3*	*6.6*	*6.0*	*10.9*	*10.8*
Small-scale	*7.1*	*6.9*	*7.8*	*5.8*	*7.2*

Source: Bangladesh Economic Review (various issues).

1.5.1 Structure of the Manufacturing Sector and Its Performance

According to the *Survey of Manufacturing Industries 2005-06* by BBS, there were a total of about 35,000 establishments in the country of which small-scale manufacturing units (employing 20-99 workers) were about 41 per cent, and large and medium-scale manufacturing units were about 15 per cent (Table 1.35).[21] Between 1998 and 2006, share of small-scale enterprises has increased while that of large and medium-scale enterprises has reduced.[22] Over 99 per cent of the manufacturing units were privately-owned with the share of foreign-owned companies remaining insignificant (e.g. share of joint venture enterprises was 0.6 per cent).

Table 1.35

Distribution of Manufacturing Enterprises

Component	1997-98	1999-2000	2001-2002	2005-06
No. of establishments	29573	24752	28065	34710
Share of total establishments (%)				
10-99 workers	*63.8*	*79.9*	*81.0*	*85.0*
100-999 workers	*17.1*	*19.1*	*17.8*	*13.3*
1000 and above workers	*0.5*	*1.0*	*1.2*	*1.7*
Average fixed assets per establishment (Lakh Tk.)	73.0	98.0	119.0	267.0

Source: Bangladesh Bureau of Statistics (BBS).

Performance of large and medium-scale manufacturing industries (LMIs) and small-scale manufacturing industries (SMIs) varies for different sub-sectors (Table 1.36). Despite the global economic slowdown, Bangladesh was able to maintain moderately high level of growth in export of jute, cotton, wearing apparels and leather industries during FY2008-09 to FY2011-12 in the backdrop of higher production of LMIs (average growth rate of 15.7 per cent). SMI sub-sectors which attained high growth rates were basic metal products (19.8 per cent) and

[21]On the other hand, there were over 50 per cent establishments which were micro and cottage industries (employed 1-19 workers).

[22]However the share of very large enterprises (above 1000 workers) has increased during this period.

Table 1.36

Growth of Production of Large, Medium and Small Enterprises: FY2008-09 to FY2012-13

(in Per cent)

Item	Enterprise	FY2009	FY2010	FY2011	FY2012	FY2013 (Jul-Aug)	Average Growth Rate
General Index	LMI	7.4	6.9	17.7	9.6	4.9	10.4
	SMI	7.8	10.7	3.3	5.1	-	6.7
Food, beverage & tobacco	LMI	0.8	8.7	21.9	-6.9	15.1	6.1
	SMI	6.3	38.8	0.5	10.8	-	14.1
Jute, cotton, w. apparel, leather	LMI	10.6	3.2	30.1	18.9	-1.1	15.7
	SMI	6.2	4.3	-1.7	0.5	-	2.3
Wood prod./furniture	LMI	4.1	3.5	3.0	-4.2	-5.7	1.6
	SMI	10.3	-0.4	4.0	-20.8	-	-1.7
Paper & paper prod.	LMI	4.2	1.6	-0.7	3.6	10.2	2.2
	SMI	5.1	4.6	-1.7	8.6	-	4.1
Chemical, petroleum & rubber	LMI	4.4	22.3	-5.6	-0.9	13.3	5.1
	SMI	2.5	0.8	5.7	3.1	-	3.0
Non-metallic product	LMI	12.1	2.4	3.1	2.5	3.5	5.0
	SMI	10.7	5.0	1.9	-3.7	-	3.5
Basic metal product	LMI	15.6	-41.3	32.3	-1.2	6.9	1.3
	SMI	21.0	1.4	3.1	53.7	-	19.8
Fabricated metal product	LMI	6.1	8.6	1.8	8.6	30.0	6.3
	SMI	-2.3	4.2	17.0	8.4	-	6.8
Other manufacturing	LMI	-	-	-	-	-	-
	SMI	3.3	-19.9	-0.5	55.7	-	9.7

Source: Estimated based on the Quantum Index of Production (QIP) Advance Release (various years), Bangladesh Bureau of Statistics (BBS).

food, beverage and tobacco (14.1 per cent) mainly driven by higher demand in the local market. Other industries including non-metallic, fabricated products, wooden furnitures, etc., which largely cater to the domestic market did not show a significant variation in the performance of LMIs and SMIs. Compared to the corresponding period of the previous year, growth of LMIs in the first two months of FY2012-13 (July-August) has slowed down mainly due to negative growth of jute, cotton, apparels and leather ((-) 1.1 per cent) industries which catered largely to the global market and had to confront slowdown in demand.

There was a high concentration in the value addition of the manufacturing sector

There was a high concentration in the value addition of the manufacturing sector (Table 1.37). Top 10 manufacturing industries accounted for almost 62 per cent of total value addition in FY2005-06, which was, however, somewhat higher in FY2000-01 (67 per cent). Apart from the traditional manufacturing industries (such as woven, knit, textiles and pharmaceuticals) a number of non-traditional domestic market-oriented industries made significant contribution in the value addition in the manufacturing sector – these included bricks and tiles, cigarettes, iron steel and re-rolling mills (Table 1.37). To some extent, this relatively lower concentration in value added in the top 10 industries in 2006 reflects some diversification in the manufacturing base.

Table 1.37

Comparison of Top 10 Manufacturing Industries in terms of Value Added Share in 2001-02 and 2005-06

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

Source: Census of Manufacturing Industries 2001-02 and Survey of Manufacturing Industries 2005-06 by the Bangladesh Bureau of Statistics (BBS).

1.5.2 Changes in Financing of the Manufacturing Sector

Debt financing is the major form of resource mobilisation on part of the manufacturing sector of Bangladesh. About 30 per cent of the required capital is raised through loans from banks and other financial institutions. However, share of loans and advances to the manufacturing sector (share in M2) has declined over the years (from 27 per cent in FY2007-08 to 23 per cent in FY2011-12) indicating higher flow of money for non-manufacturing related activities.[23] Whilst between FY2008-09 and September of FY2012-13 disbursement of industrial term loan in nominal term has doubled, growth rate has experienced significant deceleration (from 30 per cent in FY2009-10 to 10 per cent in FY2011-12) (Table 1.38).

Table 1.38

Disbursement and Recovery of Credit: Value, Share and Growth

Period	Disbursement				Recovery			
	LSI	MSI	SSI	Total (Crore Tk.)	LSI	MSI	SSI	Total (Crore Tk.)
Share (%)								
FY2008-09	73.0	23.0	4.0	19973	74.0	20.0	5.0	16302
FY2009-10	73.0	21.0	5.0	25876	68.0	26.0	6.0	18983
FY2010-11	68.0	25.0	7.0	32163	71.0	22.0	7.0	25016
FY2011-12	62.0	31.0	7.0	35278	59.0	33.0	8.0	30237
FY2012-13 (Jul-Sep)	64.0	30.0	6.0	9720	64.0	29.0	7.0	8191
Growth (%)								
FY2009-10	30.0	22.0	76.0	30.0	6.0	51.0	25.0	16.0
FY2010-11	16.0	45.0	63.0	24.0	37.0	12.0	62.0	32.0
FY2011-12	-0.2	38.0	7.0	10.0	2.0	77.0	33.0	21.0

Source: Estimated based on the Bangladesh Bank data.
Note: LSI: Large-scale industry; MSI: Medium-scale industry; SSI: Small-scale industry.

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

Although large and small-scale industries have seen a decline in growth in terms of disbursement of term loan, medium-scale industries have seen a consistent rise in this period which resulted in a higher share for medium-scale industries in the total disbursement of credit (from 23 per cent in FY2008-09 to 30 per cent in July-September, FY2012-13), whilst large-scale enterprises experienced a decline in share. During the first quarter of FY2012-13, all categories of industries have experienced lower growth particularly due to tightening of credit growth as a result of the contractionary monetary policy pursued by the central bank to contain inflation (MPS, January-June 2012 and July-December 2012).

Rate of recovery of loan disbursed, particularly to large-scale enterprises was found to be low

Rate of recovery of loan disbursed, particularly to large-scale enterprises was found to be low. The amount of non-performing loan (NPL), particularly the doubtful loan component has been on the rise in recent years (Table 1.39). Moreover, net disbursement of term loan and working capital tends to vary widely in relation to net advances (between FY2008-09 and FY2011-12). This could be due to rise in classified loan in this period or for some other reason. Several incidences of frauds and forgeries reported in the national dailies have given rise to concern about diversion of fund from specified activities. Thus, it is important to examine the issue of classified loan in some detail.

Table 1.39
State of Classified Loan

(Crore Tk.)

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

Source: Bangladesh Bank.
Note: *Data taken as of September.

A number of sub-sectors have higher shares in the increasing amount of advances; this indicates that these sub-sectors have received significant amount of credit

Trends in the share of bank advances to various manufacturing activities should help to appreciate performance of the related manufacturing sub-sectors (Annex Table 1.2). It is assumed here that any significant changes in advances in a particular period will be reflected in changes in the share of advances. It is found that a number of sub-sectors have higher shares in the increasing amount of advances; this indicates that these sub-sectors have received significant amount of credit during the corresponding period. Among the LMIs, major rise in the share of advances was observed in case of rice and flour milling, milk and food processing, jute yarn, printing and publications, plastic products, bricks and tiles, electrical equipments, automobiles (including compressed natural gas (CNG) conversion), etc. A number of these activities involve medium-scale operation that target the domestic market.[24] Among the SMIs, major changes in terms of advances were observed in case of rice mills, leather, paper, wood products, cosmetics, livestock and poultry feed, etc.

A large part of bank advances (other than working capital) was used for accumulating fixed assets particularly for procuring capital machineries. According

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

to the Survey of Manufacturing Industries 2005, this constituted about one-third of total fixed assets of manufacturing enterprises. Share of capital machineries in fixed assets, however, has declined over time, while that of transport and other related equipments has registered significant rise (from about 8 per cent in 1997 to as high as 50 per cent in 2005). Because of limited domestic capacity, most of the manufacturing enterprises are overwhelmingly dependent on imported machineries.[25] In line with expected growth in demand for manufactured products, industries have added to their productive capacities by installing the needed capital machineries in this period. However, the growth of import of machineries has slowed in FY2011-12 and was even negative in the first quarter of FY2012-13 (Table 1.40). This could be perhaps because of slow pace of export growth as is evident in case of textiles and apparels industries which accounted for about 30 per cent of total import of machineries. Import of various kinds of other capital machineries such as motor vehicles and parts, iron and steel products, motor vehicle and motorcycle products, and computer and accessories has significantly increased in recent years. Rise in investment for machineries and other equipments have contributed to capital deepening in the manufacturing sector; however it is also important to examine the overall productivity and contribution of capital towards this. According to the Survey of Manufacturing Industries 2005, productivity of capital (measured in terms of ratio of gross value added with fixed assets, machinery, transport and other equipments) has improved over the previous years.

Rise in investment for machineries and other equipments have contributed to capital deepening in the manufacturing sector

Table 1.40
Import of Machineries

Component	**FY2010**	**FY2011**	**FY2012**	**FY2013 (Jul-Sep)**
Capital Goods (Million USD)	5085.7	6563.6	7029.1	1958.9
Capital machinery	1594.5	2324.6	1997.7	546.5
Other capital goods	3491.2	4239.0	5031.4	1412.4
Growth (%)				
Capital Goods	NA	29.1	7.1	-9.8
Capital machinery	NA	45.8	-14.1	-13.6
Other capital goods	NA	21.4	18.7	-8.3
Share (%)				
Capital Goods	100.0	100.0	100.0	100.0
Capital machinery	31.3	35.4	28.4	27.9
Other capital goods	68.7	64.6	71.6	72.1

Source: Estimated based on the Bangladesh Bank data.

1.5.3 Foreign Direct Investment (FDI) in the Manufacturing Sector

Contribution of FDI in private sector gross capital formation has not been significant in Bangladesh (only 5.5. per cent) as well as in GDP (1 per cent). In recent years, contribution of FDI has marginally improved in terms of both the indicators (Table 1.41). Despite the large number of FDI proposals registered with BOI in recent years (USD 3.5 billion in FY2011-12), only a small share of these proposals was finally realised on the ground (USD 1.1 billion in 2011). For most sectors, amount of local

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

Table 1.41

Domestic Private Investment in Bangladesh (2001-2011): Share of FDI

Component	2001	2005	2008	2009	2010	2011
GCF, private sector (Million USD)[a]	7170.00	10557.80	15319.30	17517.60	19338.20	20704.00
GCF, private sector (% of GDP)[a]	16.00	18.30	19.30	19.70	19.40	19.00
FDI (Million USD)[b]	354.50	845.00	1086.00	700.00	913.00	1136.40
FDI (% of GFC private sector)	4.90	8.00	7.10	4.00	4.70	5.50
FDI (% of GDP)[b]	0.78	1.40	1.37	0.78	0.91	1.05

Source: [a]World Development Indicator (WDI); [b]United Nations Conference on Trade and Development (UNCTAD).
Note: GCF refers to Gross Capital Formation.

Table 1.42

Registration for Investment: Local Investment vs FDI

Sector	FY2008-09			FY2009-10			FY2010-11		
	Total (Million USD)	Local (%)	Foreign (%)	Total (Million USD)	Local (%)	Foreign (%)	Total (Million USD)	Local (%)	Foreign (%)
Agriculture	322.5	93	7	896.7	97	3	280.2	44	56
Food	27.7	93	7	247.5	100	0	87.6	15	85
Clothing	799.2	95	5	923.7	92	8	425.7	38	62
Printing, packaging and publication	11.5	100	0	34.4	92	8	0.6	0	100
Leather and rubber	4.2	49	51	40.8	64	36	83.4	6	94
Chemical	299.8	98	2	732.9	92	8	226.3	31	69
Engineering	349.9	65	35	261.1	93	7	3726.1	35	65
Services	2210.6	16	84	1125.6	42	58	3743.2	92	8
Glass and ceramic	90.2	80	20	29.2	100	0	36.4	72	28
Miscellaneous	2.2	100		0.2	51	49	0.9	85	15
Total	**4117.6**			**4292.1**			**8610.3**		

Source: Board of Investment (BOI).

investment registered with the BOI are significantly high compared to that of FDI except in services sectors such as banking, telecommunication, etc. (Table 1.42). In case of manufacturing sector, foreign investment proposals generally tend to be associated with export-oriented industries such as leather and rubber, textile and clothing and engineering. According to BOI, more than 200 FDI proposals were registered in FY2011-12, and the majority of these are related to small-scale investment (with an amount between USD 1-125 million).

FDI inflow is still lower compared to Bangladesh's major competing countries including India

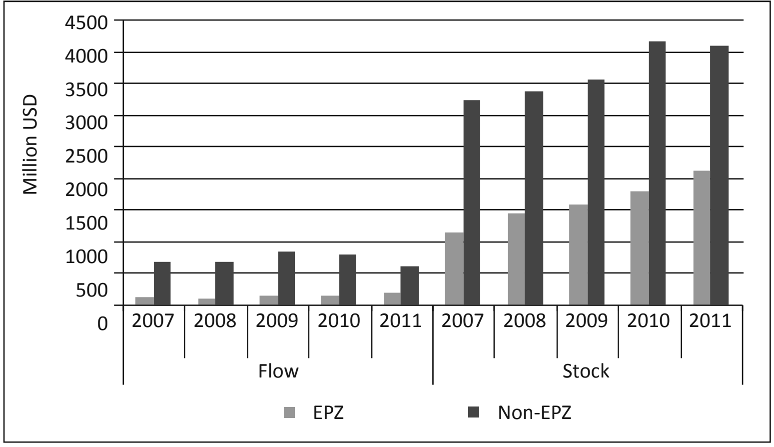
Despite the fact that FDI inflow has increased in recent years and has crossed the USD 1 billion mark in FY2011-12, its flow is still lower compared to Bangladesh's major competing countries including India (USD 32 billion), Indonesia (USD 19 billion), Vietnam (USD 7 billion), and even the war-torn Pakistan (USD 1.3 billion).[26]

About one-third of these investments generally tend to be in different manufacturing industries which are mostly located in the export processing zones (EPZs) (Figure

[26]Average FDI flow during FY2005-06 to FY2010-11 was USD 860 million compared to USD 470 million in FY2000-01 to FY2004-05. In 2011, Bangladesh received USD 1.1 billion worth of FDI which was highest ever.

1.15).[27] In other words, foreign investors usually look for a secure area such as EPZs to avoid risks and uncertainties. A large part of investment in EPZs is in the form of reinvested earnings and intra-company loans of existing companies. This is indicative of their preference for continuing investment in safe locations. Thus expansion of specialised, secured areas such as EPZs/SEZs is important to attract existing and new investors for investment.

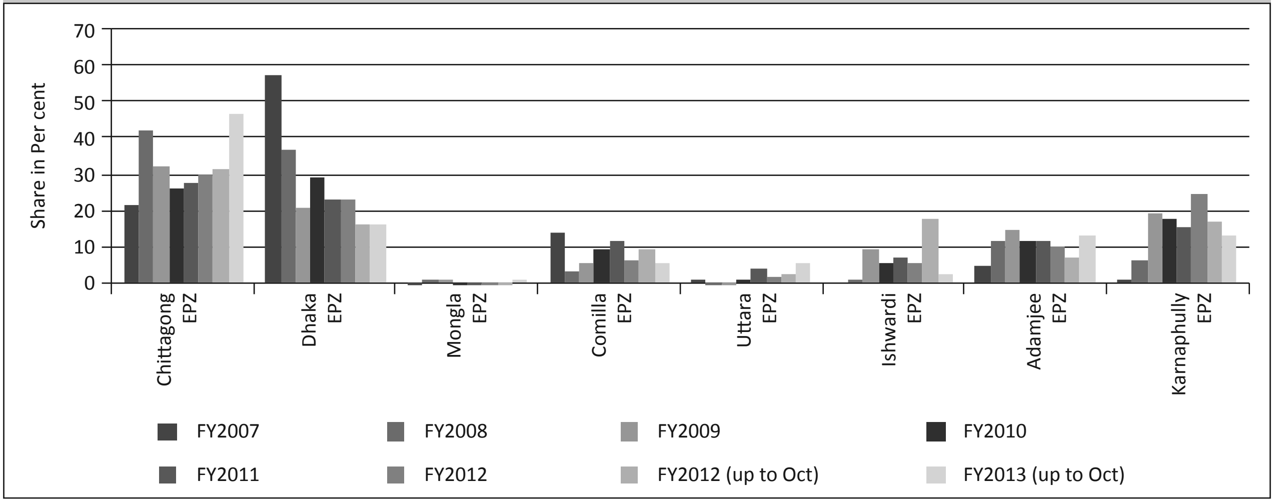
Figure 1.15
Share of EPZ and Non-EPZ in FDI Inflow



Source: Bangladesh Bank and Bangladesh Export Processing Zone Authority (BEPZA).

The overwhelming share of investment in EPZs is usually on account of two main EPZs of the country – Dhaka EPZ and Chittagong EPZ (Figure 1.16). These two EPZs accounted for USD 1.8 billion worth of FDI stock till October 2012. This is mainly because of their advantages in terms of location, infrastructure and logistics.[28] Since the capacity to absorb new investment has been exhausted both in Dhaka and Chittagong EPZs, new foreign investment has to be attracted to other EPZs which have available plots. However, infrastructure, logistics, housing for workers and other facilities have to be developed if FDI is to come to these locations.

Figure 1.16
Distribution of Investment in Different EPZs



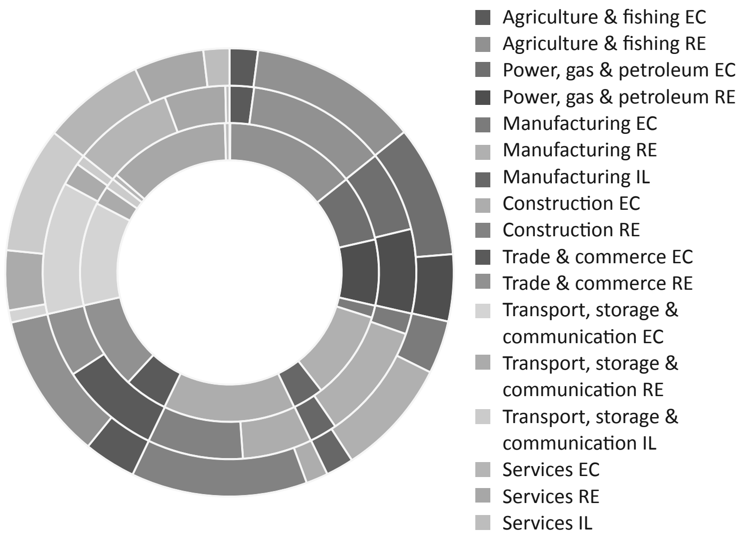
Source: Bangladesh Export Processing Zone Authority (BEPZA).

Of the total FDI inflow of USD 1.13 billion in 2011, only 14 per cent was in the manufacturing sector. There is a rising trend in FDI flow in the manufacturing sector both in absolute amount and relative share. Major share of FDI in the manufacturing sector comprised of reinvested earnings of existing companies. This is somewhat different compared to what is observed in other sectors. For example,

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

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

Figure 1.17
Component-wise Distribution of FDI in Different Sectors



Source: Bangladesh Bank.
Note: EC: Equity capital; RE: Reinvested earnings; IL: Intra-company loan.

FDI in power and energy sector is largely in the form of equity capital and reinvested earnings (Figure 1.17); in telecommunication sector this is largely equity capital or intra-company loan; in banking sector this comes in the form of equity capital and reinvested earnings. In view of this scenario, it is important to encourage new investment in the manufacturing sector in the form of equity capital, particularly in the DTAs, by addressing the difficulties concerning such investment.

Major home countries for FDI in the manufacturing sector in Bangladesh are both developed and developing countries (Table 1.43). Developing countries were found to invest relatively large share of their respective FDI in manufacturing activities. The pattern of investment generally tends to follow their specialisation. The investment coming from developing countries to the manufacturing sector generally tends to be in the form of reinvested earnings and intra-company loans.

Table 1.43
Sources of FDI in Bangladesh

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

Source: Bangladesh Bank.

1.5.4 Raising Equity from the Capital Market for Manufacturing Enterprises

Raising financial resources from the equity market faced a number of challenges in 2012. The artificial bubble created in the capital market in 2009 and 2010 came to an end in December 2010 (the boom and bust story). Manufacturing sector initial public offerings (IPOs) were rather few till FY2010-11.[29] After the collapse of the market, a number of reform measures were undertaken to raise market efficiency, particularly focusing on the primary market. As a result, number of IPOs for setting up manufacturing enterprises has increased significantly in FY2011-12 (Table 1.44). New IPOs included engineering, textiles and food and allied products which accounted for about 18 per cent of total IPOs in FY2011-12. However, number of IPOs for mutual funds in FY2011-12 and the amount to be raised by these through public offers were still high. In view of allegations about market manipulation, to ensure transparency and reduce malpractices, operations of the concerned companies should be properly audited.[30] To address some of the attendant concerns, it is important to implement the Financial Reporting Act on an urgent basis.

New IPOs included engineering, textiles and food and allied products which accounted for about 18 per cent of total IPOs

Table 1.44

IPOs in the Capital Market

Sector	FY2009		FY2010		FY2011		FY2012		FY2013 (Jul-Dec)	
	No.	Public Offer (Million Tk.)	No.	Public Offer (Million Tk.)	No.	Public Offer (Million Tk.)	No.	Public Offer (Million Tk.)	No.	Public Offer (Million Tk.)
Pharmaceuticals & chemicals	-	-	2	834	-	-	-	-	-	-
Engineering	1	200	2	185	4	780	2	700	-	-
Textiles	1	80	2	700	-	-	1	475	2	600
Food & allied	-	-	-	-	-	-	1	294	-	-
Fuel & power	-	-	-	-	-	-	1	205	-	-
Financial institutions	3	1905	-	-	-	-	1	200	-	-
Insurance	6	3735	3	288	-	-	1	120	-	-
Corporate Bond	-	-	-	-	1	300	-	-	-	-
IT	-	-	-	-	-	-	2	526	-	-
Services	1	100	2	4961	-	-	1	260	-	-
Mutual Fund	2	300	9	9225	10	6775	5	5508	-	-
Total	**14**	**6320**	**20**	**16193**	**15**	**7855**	**15**	**8287**	**2**	**600**

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

1.5.5 State-owned Manufacturing Enterprises

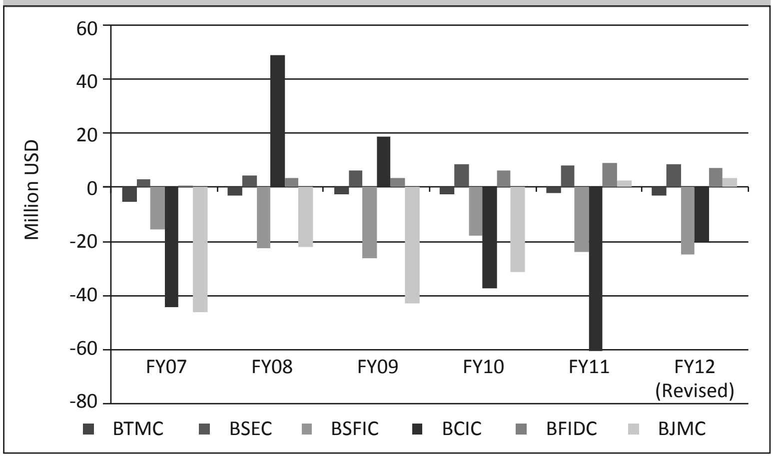
Despite the various initiatives taken to revitalise the state-owned manufacturing enterprises, particularly in light of the new Industrial Policy 2010, performance of most of the corporations did not improve significantly (Figure 1.18). This is observed from net profit/loss of various corporations and the amount of outstanding and classified loans. The majority of the corporations operated either at low levels

[29]Before the collapse of the market, even primary market was used by opening IPOs for mutual funds, particularly for increasing transaction in the secondary market – there were as many as nine new mutual funds introduced in FY2009-10 with a public offer of Tk. 9,225 million which constituted more than 60 per cent of the total public offer in that year.

[30]Auditing company should be equally responsible for any irregularity or misrepresentation in the audited report.

Figure 1.18

Net Loss and Profit of the State-owned Manufacturing Enterprises



Source: Ministry of Finance (MoF).

of profit or at loss (e.g. Bangladesh Textile Mills Corporation (BTMC), Bangladesh Forest Industries Development Corporation (BFIDC)); indeed, some suffered significant losses (e.g. Bangladesh Chemical Industries Corporation (BCIC), Bangladesh Sugar & Food Industries Corporation (BSFIC)). Few enterprises were able to make profit in recent years, thanks primarily to freezing of their respective classified loan. BJMC is a case in point where huge public debt was partly responsible for making losses over the years (CPD 2009). Outstanding and classified loans tend to vary across corporations. A number of corporations have very high outstanding loans – these include BCIC and BSFIC. Some of the others have reasonable amount of classified loan (e.g. BTMC). A number of corporations were able to reduce the amount of classified loan (e.g. Bangladesh Steel and Engineering Corporation (BSEC), BSFIC and BJMC). Despite the support measures of the government, the majority of the manufacturing corporations could not operate profitably.

In addition to running public sector corporations, government also provided support in the form of infrastructure and utility facilities to attract investment in BSCIC Industrial Estates (Table 1.45). Out of the over 10,000 plots belonging to BSCIC, 9,700 plots have already been allotted, where 5,700 industrial units have been established or are at different phases of establishment. Whilst some of the industrial estates were functioning well, thanks to adequate infrastructural facilities and market linkages, many others were not found to be in good shape because of lack of required facilities.

Table 1.45

BSCIC Industrial Estates

Division	Land Area (Acre)	Allocable Plots	Allotted Plots	Particulars of Allotted Plots					Plots Waiting for Allotment
				Total	On Production	Under Implementation	Construction Not Started	Sick/ Inactive	
Dhaka	713.63	3738	3645	2752	1894	403	369	86	93
Chittagong	440.72	2440	2231	1270	920	143	126	81	209
Rajshahi	456.26	2378	2298	974	808	85	46	35	80
Khulna	358.60	1791	1583	692	415	76	129	72	208
Total	**1969.21**	**10347**	**9757**	**5688**	**4037**	**707**	**670**	**274**	**590**

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

1.5.6 Changes in the Business Enabling Environment

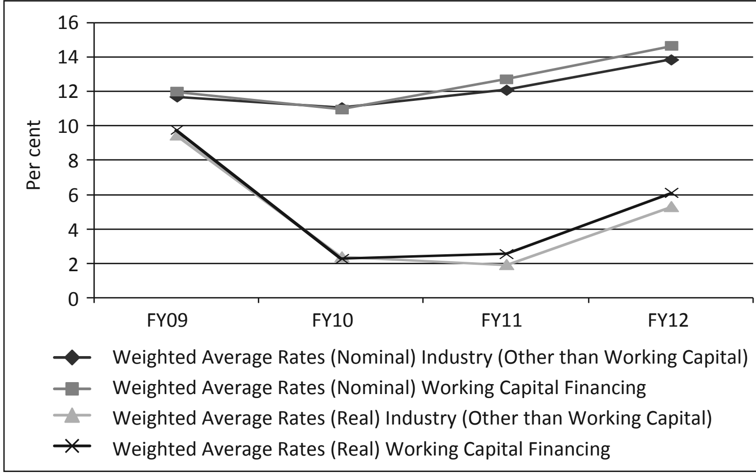
Growth of manufacturing sector in recent years was adversely affected because of absence of appropriate business enabling environment in the country. Rising interest rate for bank loans, lack of adequate supply of gas and electricity, weak infrastructure support, changes in effective rates of protection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

Rise in Interest Rate for Bank Loan

High rate of interest for bank loan is a key concern for entrepreneurs operating in the manufacturing sector. Since FY2009-10, interest rate has significantly gone up both in nominal and real terms (Figure 1.19). Weighted average interest rates applied for term loan and working capital has significantly increased since June 2010; this was relatively high in case of working capital (compared to that in term loan). Besides, removal of cap over interest rate in June 2012, ostensibly to infuse competitiveness in the market, has contributed to the rise in interest rates both for deposit collection as well as for advances and loans. This has adversely affected the growth of working capital, both for LMIs and SMIs.

Figure 1.19

Rise in Interest Rates: Nominal and Real



Source: Estimated based on the Bangladesh Bank data.

Lack of Adequate Supply of Energy and Power

Despite the rise in generation and supply of electricity and gas over the last three years, industrial sector still faces significantly high unmet demand for these. While the second highest recipient of electricity was industrial sector, after the household sector with increased share between FY2009-10 and FY2011-12 (till March) (Table 1.46) the supply has not been able to match the required need of the sector. There is a large gap between installed capacity for generation of electricity and usable load available for consumption; this has widened over the years. The supply of electricity could be much higher if the existing power plants could generate electricity as per their installed capacity. On the other hand, industrial sector was deprived of adequate supply of gas since a large part of the gas resources had to be used for electricity generation (Table 1.47). As a result, gas supply for industrial usages has significantly declined both in amount and share over the recent years (from 12 per cent in FY2007-08 to 2 per cent in August 2012).[31] Unless gas supply can be increased for industrial usage, growth prospects for gas-based industries (e.g. knitwear industries, textiles, etc.) will continue to suffer.

The supply of electricity could be much higher if the existing power plants could generate electricity as per their installed capacity

Table 1.46

Sector-wise Electricity Consumption

Sector	FY2010	FY2011	FY2012 (up to March)
Domestic (MkWh)	11628	12760	11598
Share (% of Total Electricity Consumption)			
Domestic	48.2	46.1	51.8
Commercial	9.7	9.3	8.9
Irrigation	5.1	4.6	5.5
Industrial	27.1	34.4	32.2
Others	9.9	5.6	1.6
Total	**100.0**	**100.0**	**100.0**

Source: Bangladesh Power Development Board (BPDB).
Note: MkWh: Million kilowatt-hour.

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

Table 1.47

Sector-wise Gas Distribution

(in Per cent)

Year	Total (mmcm)	Sector-wise Distribution						
		Electricity	Fertiliser Industry	Captive Power	Industry	Commercial	Domestic	CNG
FY2008	2827	20.6	34.2	10.2	11.9	1.9	16.4	4.9
FY2009	2881	15.2	33.1	11.8	13.1	2.0	17.2	7.6
FY2010	3035	21.3	22.6	12.9	14.4	2.1	18.3	8.6
FY2011	664	26.2	1.0	11.7	6.5	4.8	29.9	19.9
FY2012	2999	70.0	12.1	2.5	1.7	1.2	7.7	4.9
FY2013 (up to August)	536	76.1	6.7	2.6	1.7	1.2	7.2	4.5

Source: Petrobangla Management Information System (MIS) Report.

Changes in Effective Tariff Rates

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

Lack of Developed Value Chain

Most of the value chains relating to local manufacturing industries are underdeveloped

Most of the value chains relating to local manufacturing industries are underdeveloped. This undermines their competitiveness in the global and local markets. However, in recent years a gradual rise in the quality of various indicators related to the supply chain is becoming visible. According to the Global Competitiveness Report (GCR), positive changes have been observed (in terms of higher score in recent years) in case of quality of local suppliers, state of cluster development, control of international distribution and production process sophistication (Table 1.48). On the other hand, changes in terms of other indicators were either negative or insignificant – these included sophistication of buyer, availability of local suppliers, value chain breadth and extent of marketing, etc. Overall, most of the attributes related to value chain need significant improvement for raising the competitiveness of Bangladesh's manufacturing sector in local and global markets.

Table 1.48

Score of Selected Indicators of the Value Chain (Out of 7)

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

Source: Global Competitiveness Report (GCR) by the World Economic Forum (WEF), various Issues.

1.5.7 Concluding Remarks

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

Low capital and labour productivity can only be addressed through capital infusion, technology adoption and skill development

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Annex Table 1.1

Status of a Number of Large Projects in ADP

(in Per cent)

Project	Duration	Project Cost		Cumulative Expenditure up to Nov 2011	Cumulative Expenditure up to Oct 2012	FY13 Allocation (Lakh Tk.)	FY13 (Jul-Oct) Expenditure % of Allocation
		Total (Lakh Tk.)	Aid Share				
Construction of Padma Multipurpose Bridge (rev)	2009-2015	2050720.0	79.0	4.3	6.1	80400.0	5.3
Bheramara combined cycle plant (360 MW) development	2010-2014	414048.0	78.0	1.1	1.7	2800.0	12.2
Revitalisation of community healthcare initiatives in Bangladesh	2009-2014	267749.0	19.0	0.0	11.5	32500.0	17.8
Construction of Shiddhirganj 335 MW peaking combined cycle power plant (rev)	2009-2015	423947.0	43.0	0.0	6.4	14500.0	0.1
3G network technology establishment and extension of 2.5G network	2011-2012	190099.0	78.0	0.0	47.4	101779.0	12.6
Construction of meter gauge line at Dohajari-Cox's Bazar and Ramu-Gungdum	2010-2013	185235.0	64.0	0.5	0.6	100.0	0.0
Feasibility study and railway construction from Khulna to Mongla Port	2010-2013	172139.0	70.0	0.0	0.0	4800.0	0.0
Bibiana-Kaliakoir 400 KV and Fenchuganj-Bibiana 230 KV transmission line	2010-2013	171435.0	37.0	9.0	13.6	9400.0	13.3
South-West rural infrastructure development	2010-2013	148072.0	72.0	3.9	20.4	25000.0	24.9
Rural electrification upgradation project (Rajshahi, Rangpur, Khulna, Barisal divisions)	2010-2015	132218.0	75.0	0.1	18.4	46195.0	24.8
Construction of 820 MW peaking power plant (rev)	2009-2012	695986.0	0.0	52.5	67.8	105400.0	5.0
Priority based important rural infrastructure development project	2010-2013	469113.0	0.0	11.9	30.7	119823.0	49.8
Development of physical infrastructure of selected non-government high schools	2011-2014	211480.0	0.0	0.0	13.0	21200.0	49.3
Ekti bari, ekti khamar project (rev)	2009-2013	149292.0	0.0	14.9	49.8	47000.0	24.3
Dredger and related machinery procurement for capital dredging of rivers of Bangladesh	2010-2012	130988.0	0.0	0.0	1.1	7000.0	19.0
Asrayan-2	2010-2015	116918.0	0.0	0.0	13.7	18000.0	9.7
Important urban infrastructure development project	2011-2014	115099.0	0.0	0.7	5.8	4500.0	46.9
Total 17 Largest Projects		6044538.0	47.0	9.3	18.2	640397.0 (11.6)	20.9
ADP FY2013						5500000.0	19.5

Source: Implementation Monitoring and Evaluation Division (IMED).

Note: Figure in parentheses denotes share of total ADP.

Annex Table 1.2

Status of Advance for Selected Manufacturing Enterprises: FY2007-08 to FY2011-12

Industry	Advance as of June 2008		Advance as of June 2012		Change in Share between 2008 and 2012
	Amount (Lakh Tk.)	% of Total Advance	Amount (Lakh Tk.)	% of Total Advance	
A. Other Than Working Capital Financing					
Large and Medium Manufacturing					
Rice, Flour, Oil & Pulse Mills	69932	0.39	262975	0.68	Increased
Milk & Milk Foods Processing	5907	0.03	28481	0.07	Increased
Jute (Pressing, Baling & Yarn)	14624	0.08	81419	0.21	Increased
Jute Mills (Carpet, Bags & Textiles)	56374	0.31	74092	0.19	Decreased
Printing, Publishing & Allied	9411	0.05	49182	0.13	Increased
Newspapers & Periodical Publishers	2309	0.01	17156	0.04	Increased
Fertiliser Factories	17154	0.09	24170	0.06	Decreased
Drugs & Pharmaceuticals	121665	0.67	211501	0.55	Decreased
Plastic & Plastic Products	34827	0.19	101535	0.26	Increased
Soaps & Detergents	13284	0.07	2211	0.01	Decreased
Other Chemicals & Chemical Products	64752	0.36	72089	0.19	Decreased
Cement & Asbestos	91841	0.51	155174	0.40	Decreased
Bricks & Tiles	22491	0.12	95721	0.25	Increased
Others	42269	0.23	22157	0.06	Decreased
Electrical Equipments & Spares	30776	0.17	115002	0.30	Increased
Automobiles	12553	0.07	41586	0.11	Increased
Electricity	72436	0.40	287504	0.74	Increased
Petroleum (Refine & Supply)	4164	0.02	24008	0.06	Increased
Gas (Elevation, Supply & Distribution)	19095	0.11	16830	0.04	Decreased
Oxygen Gas	7	0.00	3462	0.01	Increased
Others	12856	0.07	36228	0.09	Increased
Small Scale Manufacturing and Cottage Industries					
Rice, Flour, Oil & Pulse Mills	18540	0.10	83769	0.22	Increased
Leather & Leather Products	541	0.00	58852	0.15	Increased
Paper & Paper Products	5486	0.03	22069	0.06	Increased
Wood & Wood Products	2548	0.01	16572	0.04	Increased
Saw Mills	652	0.00	5852	0.02	Increased
Cosmetics	471	0.00	4147	0.01	Increased
Jute & Jute Goods	565	0.00	18372	0.05	Increased
Livestock & Poultry Feed	4631	0.03	19080	0.05	Increased
Other Industries	55641	0.31	86131	0.22	Decreased
Cottage Industries	7723	0.04	8658	0.02	Decreased
B. Working Capital Financing					
Large and Medium Scale Industries	3084644	16.99	4513305	11.69	Decreased
Small Scale and Cottage Industries	129169	0.71	214888	0.56	Decreased
Small Scale Industries	115241	0.63	195597	0.51	Decreased
Cottage Industries	13928	0.08	19291	0.05	Decreased

Source: Bangladesh Bank.

2 CHAPTER

Analysis of the National Budget for FY2012-13

This chapter is based on the immediate reactions on the National Budget for FY2011-12 presented by the Centre for Policy Dialogue (CPD) at a media briefing which was telecast live on 8 June 2012, the day after the budget was placed before the national parliament. Later an earlier version of the paper was presented at a CPD organised dialogue titled *Analysis of the National Budget for FY2012-13*, on 16 June 2012 at the Lakeshore Hotel, Dhaka. The report of this dialogue is included in this volume as Annex 1.

2.1

THE CONTEXT: SETTING THE BENCHMARKS

2.1.1 Setting the Benchmarks

One of the distinctive features of FY2012-13 Budget is that this particular one is set to be the last budget to be fully implemented during the tenure of the present government. The budget for the upcoming fiscal year had to be prepared in the backdrop of diverse and opposing signals emanating from the economy as it approached the finishing line of FY2011-12. On the one hand, there was the encouraging performance of the National Board of Revenue (NBR), steady growth demonstrated by the country's agriculture sector and the robust inflow of remittances; on the other hand, the outgoing fiscal year experienced serious strains in terms of fiscal management, inflationary trends, public and private sector investment performance (including foreign direct investment (FDI)), balance of payments situation, and slowdown of economic growth.

FY2012-13 will need to address the daunting tasks of fiscal consolidation, reversal in investment downturn (both public and private), restraining inflation, and revitalising the lost momentum of economic growth

In view of the emergent challenges, macroeconomic and budgetary management in FY2012-13 will need to address the daunting tasks of fiscal consolidation, reversal in investment downturn (both public and private), restraining inflation, and revitalising the lost momentum of economic growth.

2.1.2 Outlook for GDP Growth for FY2012-13

As is known, the gross domestic product (GDP) growth target for FY2012-13 has been set at 7.2 per cent. This will demand a significant improvement on this year's provisional growth performance (6.3 per cent) – a rise of almost one percentage point. Of the 7.2 per cent overall growth in FY2012-13 – agriculture is to contribute 0.8 per cent (0.5 per cent in FY2011-12), industry sector's contribution is projected to be 3 per cent (2.8 per cent in FY2011-12), and that of the services sector is planned to be 3.4 per cent (2.9 per cent in FY2011-12)[1] (Table 2.1). As may be recalled, over the period of the past ten years, average addition to the GDP growth rate was to the tune of 0.2 percentage point per annum. In view of this, rise of almost one percentage point in one year will be a challenge that will call for significant improvement in many key performance indicators.

A crucially important contributing factor in attaining GDP growth target will have to be investment

A crucially important contributing factor will have to be investment, share of which in the GDP will need to rise by 4.6 percentage points – from 25 per cent of GDP in

Table 2.1
Growth Rates and Contribution to Growth

Sector	Growth (%)			Contribution to Growth (%)		
	FY2011	FY2012	FY2013	FY2011	FY2012	FY2013
Agriculture	5.1	2.5	4.4	1.0	0.5	0.8
Industry	8.2	9.5	9.9	2.4	2.8	3.0
Services	6.2	6.1	7.1	3.0	2.9	3.4
GDP	**6.7**	**6.3**	**7.2**	**6.7**	**6.3**	**7.2**

Source: Estimated from the Bangladesh Bureau of Statistics (BBS) data and the Sixth Five Year Plan (SFYP).

[1] The projection is based on the growth targets set at Sixth Five Year Plan (SFYP).

FY2011-12 to 29.6 per cent of GDP in FY2012-13.[2] This would imply that a 32.4 per cent growth in investment will be required in nominal terms (by Tk. 75,460 crore in one year). Private investment will also need to be increased by 3.6 percentage points: from 19.1 per cent in FY2011-12 to 22.7 per cent in FY2012-13, requiring an increase in investment, in nominal terms, by about 35 per cent (Tk. 61,280 crore). Over the last ten years, average increase in private investment as a share of GDP was only about 0.2 percentage points per annum. If the public sector's investment share in GDP is to rise from about 5.9 per cent to about 6.9 per cent, then a full implementation of the envisaged Annual Development Programme (ADP) (Tk. 55,000 crore) will be required. Over the last three years (FY2008-09 to FY2011-12) share of public investment in GDP rose from 4.7 per cent to 5.9 per cent. This formidable jump in public, private and overall investment performance in one single year appears to be a daunting task, particularly in view of the targets for private sector credit growth mentioned in the budget and the demonstrated capacity of the development administration (Table 2.2).

The formidable jump in public, private and overall investment performance in one single year appears to be a daunting task

Table 2.2
Monetary Sector Targets

(in Per cent)

Monetary Aggregates	FY2012 (B)	FY2012 (RB)	FY2013	FY2014	FY2015
Broad Money (M2)	16.0	17.0	16.0	15.5	15.5
Domestic credit	21.1	19.5	17.7	17.2	16.8
Credit to private sector	20.0	16.0	16.0	16.0	16.0
Public sector credit	25.1	31.8	23.0	20.7	19.0

Source: Budget documents.
Note: Throughout the chapter, B denotes budget and RB denotes revised budget.

2.1.3 Inflation Outlook for FY2012-13

The rate of inflation in FY2012-13 is planned to be contained within 7.5 per cent, similar to the target that was set for FY2011-12. However, throughout FY2011-12 inflation continued to remain a major concern for the policymakers and the levels turned out to be significantly higher, to reach double-digit. As per the budgetary targets, inflation rate will need to be reduced by 3.8 percentage points in FY2012-13 to attain the target of 7.5 per cent. Whilst thanks to good Boro harvest and downward swing in the global food prices, food inflation may be somewhat moderated in FY2012-13, the prospect of this moderation is likely to be affected by the fact of the non-food (core) inflation being sticky downwards and also the likely upward revision of the administered prices of power, fuel and gas.

Thanks to good Boro harvest and downward swing in the global food prices, food inflation may be somewhat moderated in FY2012-13

2.2

PUBLIC FINANCE FRAMEWORK

The National Budget for FY2012-13 has envisaged an expenditure package of Tk. 191,738 crore which is 18.9 per cent or Tk. 30,525 crore higher than the Revised Budget for FY2011-12. As a share of GDP, the proposed public expenditure (18.4 per cent of GDP) in FY2012-13 is about 0.8 percentage points higher than that of FY2011-12 (17.6 per cent in the Revised Budget). The estimated growth target of

[2]According to CPD estimates, public investment is likely to be lower at 5.9 per cent of GDP. Provisional estimate of investment as a share of GDP is 25.4 per cent which may also come down to 25 per cent of GDP.

21.6 per cent for revenue mobilisation indicates a faster growth on the earnings side when compared with the expenditure side. At the same time, development expenditure is expected to grow faster (31.7 per cent) than non-development revenue expenditure (8.4 per cent). The proposed ADP, to the tune of Tk. 55,000 crore, is equivalent to 28.7 per cent of total public expenditure; this is 25.5 per cent in the Revised Budget for FY2011-12. According to a CPD projection, at the end of the year (FY2011-12) it may be limited to 23.4 per cent.

Overall budget deficit has been projected at 5 per cent of GDP for FY2012-13 which is estimated to be around 5.1 per cent in the Revised Budget for FY2011-12. As would be recalled, for financing of the deficit, the government relied on borrowing from the banking system in FY2011-12. In FY2012-13, an attempt has been made to restore the balance in financing the budget deficit. High foreign financing target (56.7 per cent growth over the Revised Budget for FY2011-12) has been set with anticipated gross foreign aid flow of USD 3.2 billion. Borrowing from non-banking sector will also be almost double. In contrast, government's net bank borrowing is planned to decrease by (-) 21 per cent. As it appears, the programmed fiscal framework has been prepared in a manner that has followed ideal principles of public finance.

As it appears, the programmed fiscal framework has been prepared in a manner that has followed ideal principles of public finance

2.2.1 Revenue Earnings

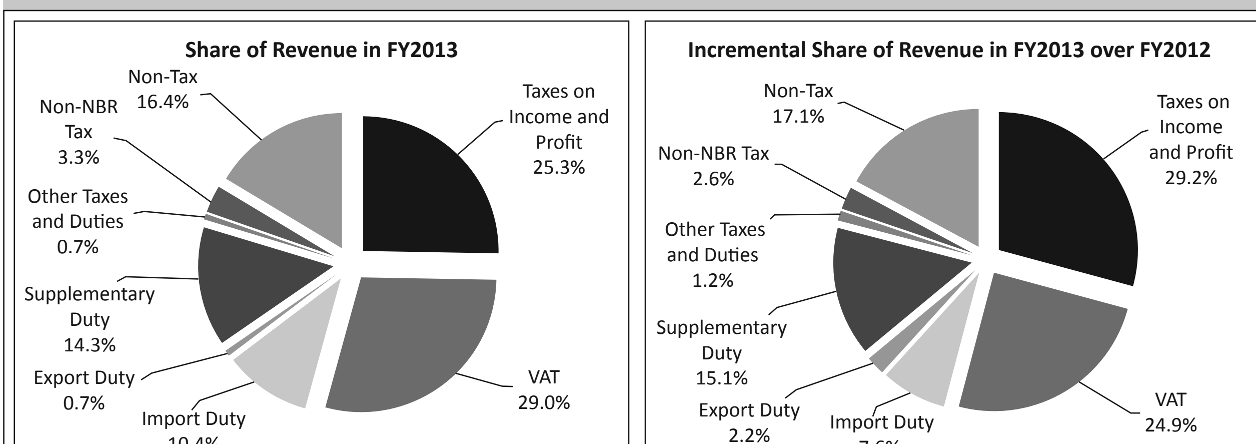
Budget for FY2012-13 has targeted a revenue earning of Tk. 139,670 crore which implies that an additional Tk. 24,785 crore will need to be mobilised in FY2012-13 when compared to the revised budget target of FY2011-12. As a result, revenue-GDP ratio and tax-GDP ratio are expected to increase to 13.4 per cent and 11.2 per cent respectively in FY2012-13 from previous year's revised matched figures of 12.6 per cent and 10.5 per cent. The planned revenue collection structure is prepared with almost unchanged revenue income structure (100 per cent) among the three heads – NBR tax (80.3 per cent), non-NBR tax (3.3 per cent) and non-tax revenue (16.4 per cent).

29.2 per cent of incremental revenue will come from income tax – the highest in the last four years!

NBR Components

As it stands, in order to achieve the revenue earning targets set for FY2012-13, NBR will have to play the key role and contribute the largest share (80.2 per cent) of the additional revenue. 29.2 per cent of incremental revenue will come from income tax – the highest in the last four years (Figure 2.1)! Overall, the NBR growth

Figure 2.1
Projected Share and Incremental Contribution of Sources in Revenue Growth: FY2012-13



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

target for FY2012-13 has been set at 21.5 per cent higher than the revised budget figure of FY2011-12. The growth rate was 21.1 per cent in FY2011-12 (revised).

Within the NBR component, tax collection efforts from value added tax (VAT) and supplementary duty will need to be intensified to attain the targets of 18 per cent and 23.1 per cent respectively. In view of the proposed fiscal measures, expected improvement in revenue collection efforts, and high price levels, it would appear that these targets should be within the reach. In the backdrop of falling import payments, the target for customs duty in FY2012-13 has been set at a somewhat conservative level (15 per cent) against the Revised Budget for FY2011-12.

Non-NBR Components

Within the NBR component, tax collection efforts from VAT and supplementary duty will need to be intensified to attain the targets

The growth targets for non-NBR tax and non-tax revenue are set at 16.6 per cent and 22.8 per cent respectively, which are lower than their benchmarks figures of FY2011-12 (18.7 per cent and 38.4 per cent). Within Tk. 22,846 crore of revenue earnings targeted from non-tax sources, 38 per cent is expected to come from Other Non-Tax Revenue and Receipts. The likelihood of reaching this target will hinge on receiving the expected telecom spectrum fee. The current trend of revenue collection by non-NBR and non-tax components could result in a shortfall in the ongoing FY2011-12. Shortfall in benchmark (FY2011-12) would mean higher than stipulated growth targets for FY2012-13. Revenue collection from a number of heads under non-tax revenue (e.g. Rents, Leases and Recoveries; Tolls and Levies) need to improve in order to attain the target.

2.2.2 Public Expenditure

A sector-wise analysis of total expenditure (development and non-development) reveals that the highest growth in terms of resource allocation has taken place in the Public Services sector over the revised allocations of FY2011-12. Total allocation for Public Services is set to increase by 38.5 per cent, driven partly by subsidies (including for export), allocation for public-private partnership (PPP) and lump allocation for development programmes financed from the revenue budget (Table 2.3). In contrast, allocation for Agriculture has remained almost

Table 2.3

Sector-wise Distribution of Total Expenditure

Sector	Share in FY2013 (B)	Share in FY2012 (RB)	Change in FY2013 (B) over FY2012 (RB)	
	%		Crore Tk.	%
Public Services	12.6	10.8	6704.0	38.5
Fuel and Energy	5.0	4.9	1587.0	19.9
Transport and Communication	6.9	6.5	2856.0	27.3
Interest Payments	12.2	12.3	3506.0	17.7
Social Security and Welfare	5.7	6.4	652.0	6.3
Local Government Rural Development (LGRD)	7.4	7.4	2207.0	18.4
Education and Technology	11.5	11.6	3392.0	18.1
Health	4.9	5.1	1183.0	14.5
Public Order and Safety	4.8	5.3	626.0	7.3
Defence Services	6.7	7.6	662.0	5.4
Industrial and Economic Services	1.4	1.0	1208.0	77.4

(Table 2.3 contd.)

(Table 2.3 contd.)

Sector	Share in FY2013 (B)	Share in FY2012 (RB)	Change in FY2013 (B) over FY2012 (RB)	
	%		Crore Tk.	%
Housing	0.8	0.8	89.0	6.5
Recreation, Culture and Religious Affairs	0.8	1.0	63.0	4.1
Agriculture	7.5	8.9	110.0	0.8
Others (Memorandum Items)	11.7	10.4	5680.0	34.0
Total Expenditure	**100.0**	**100.0**	**30525.0**	**18.9**

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

unchanged compared to the Revised Budget of FY2011-12. Interest Payments remains the sector with second highest allocation, which is also likely to post significant rise (by 17.7 per cent). The allocation of Defence increased by 5.4 per cent in Taka terms, but its share has fallen from 7.6 per cent (Revised Budget FY2011-12) to 6.7 per cent (FY2012-13).

Allocation for Agriculture has remained almost unchanged compared to the Revised Budget of FY2011-12

Revenue Expenditure

Non-Development Revenue Expenditure (augmented) in FY2012-13 is set to rise by only 8.5 per cent compared to the Revised Budget of FY2011-12 (Table 2.4). Accordingly, as a share of GDP it will decline to 10 per cent from 10.5 per cent in the Revised Budget of FY2011-12. Share of three major heads under Revenue Expenditure (i.e. Interest Payments, Pay and Allowances, Subsidies and Current Transfers) declined to 81.4 per cent in FY2012-13 (82.1 per cent in Revised Budget FY2011-12).

Pay and Allowances and Subsidies and Current Transfers are set at a lower level, and may require an upward revision at the end of the year

About 43.1 per cent of total incremental revenue expenditure will be on account of the envisaged rise in Interest Payments, particularly from domestic interest payments (42.6 per cent). Interest Payments is expected to increase by 17.7 per cent in FY2012-13 over the Revised Budget target. Interest Payments for domestic borrowings is expected to make a significant growth of 19.1 per cent, while foreign interest payments will increase by 2.8 per cent. In contrast, Pay and Allowances and Subsidies and Current Transfers are expected to grow by only 6.6 per cent and 2.6 per cent – both are set at a lower level, and may require an upward revision at the end of the year.

Table 2.4

Economic Classification of Revenue Expenditures

Expenditure Category	Growth FY13 (B) over FY12 (RB) (%)	Share FY13 (B) (%)	Share FY12 (RB) (%)	Incremental Share FY13 (B) (%)	Change FY13 (B) over FY12 (RB) (Crore Tk.)
Pay and Allowances	6.6	22.0	22.4	17.4	1418.0
Goods and Services	11.8	12.5	12.1	17.0	1380.0
Interest Payments	17.7	22.3	20.6	43.1	3506.0
Domestic	19.1	20.7	18.9	42.6	3459.0
Foreign	2.8	1.6	1.7	0.6	47.0
Subsidies and Current Transfers	2.6	37.0	39.2	12.0	974.0
Block Allocation	32.9	1.5	1.2	4.9	395.0
Acquisition of Assets and Works	10.5	4.6	4.5	5.6	454.0
Total Augmented Non-Development Revenue Expenditure	8.5	100.0	100.0	100.0	8127.0

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

Subsidy

Transfer of this year's subsidy payments to the next year is in conflict with the plan of much lower subsidy expenditure projected for the coming year

Allocation for, and the expenditure on, subsidies for various sectors of the economy were under the spotlight throughout FY2011-12. It is important to note that, 'Subsidies and Current Transfers' reported in economic analysis of non-development revenue expenditure does not include all subsidy expenditures. Regrettably, budget documents also do not provide a detailed account of subsidy expenditures and contingent liabilities for FY2012-13. Total revised subsidy in FY2011-12 has been mentioned as Tk. 30,154 crore, which is 47 per cent higher than the proposed subsidy of Tk. 20,477 crore. Clearly, subsidy projection for FY2011-12 was not synchronised with the government's plan for the power sector. It was mentioned earlier that at least Tk. 10,000 crore subsidy payments would be transferred from the current fiscal year to FY2012-13. Accordingly, total subsidy demand for FY2011-12 is estimated to be about Tk. 40,000 crore. However, no clear specification on transferring subsidy burden is provided in the Budget Speech. The transfer of this year's subsidy payments to the next year is in conflict with the plan of much lower subsidy expenditure projected for the coming year. This implies that the government will have to undertake energy price adjustments, as agreed with the International Monetary Fund (IMF) (as a part of the Extended Credit Facility (ECF) conditionalities), to allow 'full pass-through' of international prices for petroleum products in the domestic market by December 2012.

Annual Development Programme (ADP)

ADP for FY2012-13 has been targeted at Tk. 55,000 crore (5.3 per cent of the projected GDP)

The ADP for FY2012-13 has been targeted at Tk. 55,000 crore (5.3 per cent of the projected GDP). The new ADP will be 34.1 per cent higher than the revised ADP (RADP), and 19.6 per cent higher than the original ADP of FY2011-12. According to CPD estimates, the proposed ADP for FY2012-13 could turn out to be 1.5 times of this year's actual ADP expenditure.

Project aid component of the new ADP is targeted at 39.1 per cent (which was 36.6 per cent in the RADP and 40.6 per cent in the original ADP of FY2011-12). Five priority sectors in the ADP for FY2012-13 have received 63.5 per cent of the total allocation (Table 2.5). Transport sector has received the highest allocation (14.8 per cent) for the highest number of projects (222).

In the ADP for FY2012-13, only 35 new projects are included with an allocation equivalent to 1.3 per cent of the total ADP (Figure 2.2). 192 carryover projects

Table 2.5

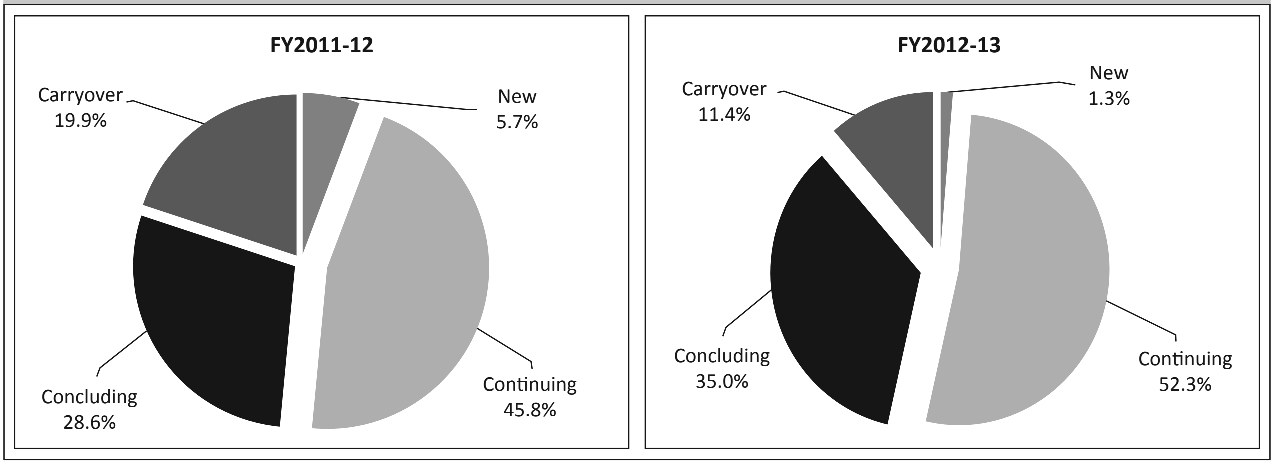
Allocation for Top Five Sectors in ADP for FY2011-12

(in Per cent)

Sector	No. of Projects	Share FY12 (ADP)	Share FY12 (RADP)	Share FY13 (ADP)	Growth FY13 (ADP) over FY12 (RADP)
Transport	222	16.8	15.1	14.8	31.1
Power	54	15.6	17.6	14.4	9.6
Education and Religious Affairs	109	13.3	11.8	13.4	52.9
Rural Development and Institutions	76	9.6	12.3	11.4	24.2
Physical Planning, Water Supply and Housing	126	12.6	10.2	9.6	26.1
Top Five Sectors	**587**	**67.9**	**67.0**	**63.5**	**27.3**
Total ADP	**1037**	**100.0**	**100.0**	**100.0**	**34.1**

Source: Estimated from the Planning Commission data.

Figure 2.2
Structure of ADP: FY2011-12 and FY2012-13



Source: Based on the Planning Commission data.

account for 11.4 per cent of the total allocation (19.9 per cent in FY2011-12), while 454 projects with 35 per cent of total allocation will need to be concluded in FY2012-13. Combining these two categories, about 646 projects are expected to be completed by 30 June 2013. In all possibility, many of these projects will not be able to meet with their respective deadlines. Allocation for these is also not adequate for completion by 30 June 2013. According to Planning Commission, 330 of these projects will be completed within the stipulated time. It appears that even attaining this target will be challenging.

The fate of Padma Bridge project continues to remain uncertain

An examination of the seven priority sectors in ADP shows that, Power (22.4 per cent), Oil, Gas and Natural Resources (19 per cent), and Transport (15.4 per cent) sectors are carrying over a significant amount of their past allocations (Table 2.6). No doubt, slow progress in the implementation of infrastructure-related sectors is hurting the investment environment. About 99 per cent of allocation for Oil, Gas & Natural Resources has gone to the 28 projects that need to be completed by FY2012-13. However, Planning Commission expects only 16 of these will be completed by 30 June 2013.

The fate of Padma Bridge project continues to remain uncertain. The total project cost was estimated to be Tk. 20,507 crore, of which Tk. 16,249 crore (79.2 per

Table 2.6
Share of Allocation in Priority Sectors

(in Per cent)

Project Category	Total ADP FY2012	Total ADP FY2013	Power	Oil, Gas and Natural Resources	Transport	Education	Physical Planning, Water Supply and Housing	Health	LGRD
New	5.7	1.3	1.5	0.6	0.0	0.2	0.4	0.3	4.1
Continuing	45.8	52.3	27.8	0.3	47.9	67.0	55.5	90.1	67.4
Concluding	28.6	35.0	48.3	80.0	36.6	28.7	37.7	6.2	26.8
Carryover	19.9	11.4	22.4	19.0	15.4	4.1	6.4	3.5	1.7

Source: Based on the Planning Commission data.

cent) was expected to come from project aid. The cost of the project is escalating with passing time. In FY2011-12, Tk. 2,187 crore was allocated for the project (Tk. 1,707 crore under project aid). The allocation was slashed to Tk. 614.9 crore (Tk. 162.1 crore under project aid) in the RADP for FY2011-12. In FY2012-13, Tk. 804 crore (3.9 per cent of total project cost) has been allocated for Padma Bridge; of which Tk. 232 crore is allocated under project aid (1.4 per cent of total for the project). World Bank, Islamic Development Bank (IDB), Asian Development Bank (ADB) and Japan International Cooperation Agency (JICA) are still mentioned as the sources of foreign funding.

A large number of 'to-be-completed' projects are likely to miss their deadlines

ADP for FY2012-13 managed to reduce the 'carryover' part. However, a large number of 'to-be-completed' projects are likely to miss their deadlines. As it would appear, ADP for FY2013-14 could come with a large burden of carryover projects if major changes in allocation and utilisation do not take place. 83 projects in FY2012-13 have allocation of less than Tk. 1 crore. 720 projects have been listed in ADP without allocation or approval; some of these will be included in the course of the year. The Finance Minister has recently expressed his interest to form a high-powered committee to bring down the number of projects in ADP (a similar initiative was taken in FY1982-83).

Some 327 development projects, worth Tk. 258,000 crore, are listed in the ADP document for FY2012-13 to attract foreign financing without any allocation. Of these 91 belongs to Transport sector. About 61 per cent of the estimated cost of these projects is expected to be financed by foreign resources. Till date, only four project proposals, under the Department of Environment, have been sent to Economic Relations Division (ERD). Of the 327 identified projects, 13 electricity generation projects (for 4,250 MW (mega watts)) are included, of which five are newly included. From last year's similar list, only one project (Ashuganj 450 MW) has been included in the ADP with allocation. In the present context, it is important to start these projects with foreign financing as early as possible.

For FY2012-13, a deficit of Tk. 52,068 crore has been projected which is expected to be within 5 per cent of the GDP

2.2.3 Budget Deficit and Financing

The Revised Budget for FY2011-12 projects an overall deficit (excluding grants) of Tk. 46,328 crore (5.1 per cent of GDP) for the fiscal year. With the possibility of ADP not attaining its revised target, the final budget deficit figure for FY2011-12 is likely to be lower than the revised targets. For FY2012-13, a deficit of Tk. 52,068 crore has been projected which is expected to be within 5 per cent of the GDP (Table 2.7). However, in view of the growing subsidy requirement and increased demand for investment on account of infrastructure, a deficit equivalent to 5 per cent of GDP does not appear to be high.

Table 2.7
Fiscal Framework in the Budget

Description	FY13 (B)		FY12 (RB)		Growth FY13 (B) over FY12 (RB) (%)
	Crore Tk.	% of GDP	Crore Tk.	% of GDP	
Revenue Collection	139670	13.4	114885	12.6	21.6
Total Expenditure	191738	18.4	161213	17.6	18.9
ADP	55000	5.3	41080	4.5	33.9
Non-ADP	136738	13.1	120133	13.1	13.8
Overall Deficit (excl. Grants)	52068	5.0	46328	5.1	12.4

(Table 2.7 contd.)

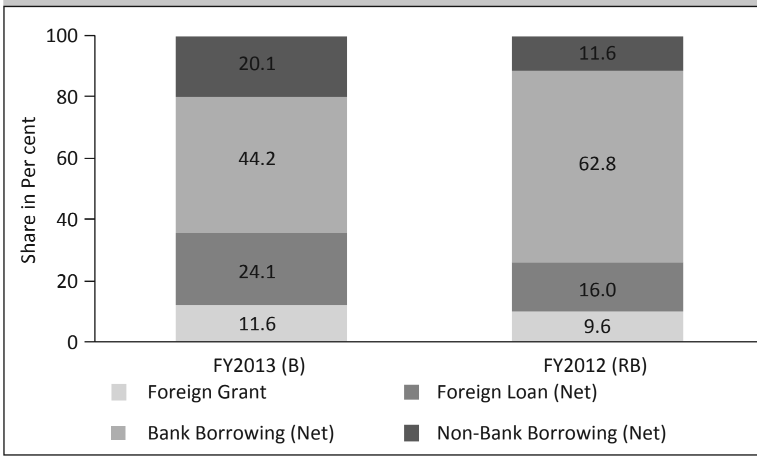
(Table 2.7 contd.)

Description	FY13 (B)		FY12 (RB)		Growth FY13 (B) over FY12 (RB) (%)
	Crore Tk.	% of GDP	Crore Tk.	% of GDP	
Financing					
Foreign Grants	6044	0.6	4460	0.5	35.5
Foreign Loan (Net)	12540	1.2	7399	0.8	69.5
Foreign Loan	20398	2.0	14036	1.5	45.3
Amortisation	7858	0.8	6637	0.7	18.4
Domestic Borrowing	33484	3.2	34469	3.8	-2.9
Bank Borrowing (Net)	23000	2.2	29115	3.2	-21.0
Non-Bank Borrowing (Net)	10484	1.0	5354	0.6	95.8
Total Aid Requirement (Net)	18584	1.8	11859	1.3	56.7
Total Aid Requirement (Net, bln USD)	2.2	-	1.5	-	52.9
Total Aid Requirement (Gross)	26442	2.5	18496	2.0	43.0
Total Aid Requirement (Gross, bln USD)	3.2	-	2.3	-	39.5

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

With regard to financing of the deficit, as projected in the Budget for FY2012-13, it may be noted that about 64.3 per cent of total deficit (Tk. 33,484 crore) is earmarked to be financed through domestic borrowing (from bank and non-bank sources), of which Tk. 23,000 crore (44.2 per cent of total deficit) is expected to come from the banking system (62.8 per cent in the Revised Budget for FY2011-12) and Tk. 10,484 crore (20.1 per cent) to be mobilised through non-bank instruments (11.6 per cent in Revised Budget for FY2011-12) (Figure 2.3). Considering the fact that during July-March FY2011-12 net sale of the National Savings Bond (NSD) certificates stood at only Tk. 21 crore, achievement of this target will be a testing task for the government.

Figure 2.3
Sources of Financing Deficit



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

The remainder 35.7 per cent is supposed to come from foreign sources that included foreign loans and grants. Gross foreign aid requirement was envisaged to be about USD 3.2 billion (USD 2.3 billion in the Revised Budget FY2011-12) which will be a challenging target, particularly in view of the fact that only USD 1.6 billion was received during July-April, FY2011-12.

The financing structure of budget deficit suggests that the government will try its best to reduce reliance on bank borrowing for the financing of the budget deficit. Attaining target for foreign financing will largely hinge on utilisation of project aid under the ADP. For non-bank borrowing targets, much will depend on whether the government will be able to increase net sale of NSD certificates.

Experience suggests, particularly of FY2011-12, that the delivery of the envisaged plan had been quite often severely wanting

The proposed public finance framework suggests that an effort has been made to tighten the fiscal management. Experience suggests, particularly of FY2011-12, that the delivery of the envisaged plan had been quite often severely wanting. The final outcome of the fiscal framework at the end of FY2012-13 will depend on a number of key questions:

- Will the revenue income targets be fulfilled?
- Have the revenue expenditure estimates been correctly derived?
- Can ADP implementation capacity be enhanced significantly?
- Can the foreign aid awaiting in the pipeline be utilised?
- Will it be possible to attract people to invest in non-bank borrowing instruments?

Some of the tax proposals may need further scrutiny

The prospect of the key indicators and targets mentioned in the Budget for FY2012-13, will in all possibility, depend on favourable answers to the aforesaid questions.

2.3

OVERVIEW OF FISCAL MEASURES

2.3.1 Direct Tax Measures

A number of direct tax measures have been proposed in the budget with a view to broadening the base of direct tax and raising higher taxes. The tax proposals in FY2012-13 Budget are expected to increase the share of direct taxes in total tax. Whilst this is expected to play a progressive role with respect to distributional impact, some of the tax proposals may need further scrutiny.

The budget has proposed to maintain the existing threshold for personal income tax

Personal Income Tax

The budget has proposed to maintain the existing threshold for personal income tax, which was set at Tk. 180,000 in the budget for the previous years. On the other hand, minimum tax has been raised from Tk. 2,000 to Tk. 3,000. It has been mentioned in the Budget Speech that the earlier threshold remains in view of the income growth that has taken place alongside inflation. However, even after acknowledging the fact that per capita income has indeed increased, one also needs to keep in mind that, if this is a threshold income level below which one is assumed not to be in a position to pay taxes, those who belong to this group despite the income growth will effectively have a lower real threshold limit due to the high inflation experienced in the past year.

Because of inflation, real income of those who will cross the threshold this year will be below the inflation adjusted threshold limit (average annual inflation rate in FY2011-12 remained 10.8 per cent), but they will need to pay the higher minimum tax. Indeed this measure will not have significant revenue impact, but will be against social justice.

A proposal has been placed to tax the life insurance income after maturity of the policies; this may not be the right moment for this proposal

Tax on Income from Life Insurance

A proposal has been placed to tax the insurance income after maturity of the policies (however, in the event of death of a policyholder before the maturity of the policy, the tax will not be applicable). This measure is expected to create a level playing field for banks and insurance companies. However, considering the poor coverage of life insurance in the country and the need to improve long-term domestic savings, this may not be the right moment for this proposal.

Corporate Tax

Two mentionable changes have been brought in the existing corporate tax structure. First, corporate tax rate has been increased for listed cigarette companies from 27.5 per cent to 35 per cent. Corporate tax rate for non-listed cigarette companies will remain at 42.5 per cent. Although this is perhaps primarily guided by revenue mobilisation concerns, it is also a socially desirable step if the interest of discourage smoking is kept in mind. Second, reduced tax rate has been maintained for non-listed merchant banks (37.5 per cent instead of 42.5 per cent as with other banks). This measure has been mentioned in the Budget Speech as an incentive to the capital market although the rate matches with the existing applicable rate. However, it is difficult to relate this measure with the Bangladesh Bank's declared aim of reducing merchant banks' exposure to the capital market.

Two mentionable changes have been brought in the existing corporate tax structure

Advance Income Tax (AIT) on Export

Uniform tax rate of 1.2 per cent (to be deducted at source) has been proposed on earnings from exports against the existing rates of 0.6 per cent and 0.7 per cent. Considering the rough estimates about profit margin for the exporters in general, this amounts to about 17 per cent tax on profit, a significant increase from the existing level (8-9 per cent). This rate may be considered for downward revision, to say 1 per cent, particularly in view of the depressing global market situation and the negative growth rates in export earnings in recent months.

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Land Tax

It has been proposed that depending on the location of the property, 3-5 per cent tax to be deducted at source for sale of land by developers. This could lead to increase in land price for the consumers, as the tax incidence is most likely to fall on the buyers as the burden will be shifted on to them.

2.3.2 Indirect Tax Measures

A number of indirect tax measures have been proposed in the budget whose primary objective appears to be to raise taxes. However, in the process, the effective rate of protection and the state of anti-export bias in the economy have also changed for a number of industries. Indeed, one would expect that proposals for new indirect taxes would have considered the trade-offs here with a view to finding optimum solutions.

Value Added Tax (VAT)

Uniform trade VAT of 4 per cent has been proposed to be imposed at all levels of wholesale and retail sales, including advance VAT, abolishing the existing multiple rates of VAT. However, provision has been kept for traders willing to pay VAT on actual value addition, who may opt to pay 15 per cent. Doubts remain as to whether this could act as a regressive measure falling back to the earlier abolished 'sales tax'.

Uniform trade VAT of 4 per cent has been proposed to be imposed at all levels of wholesale and retail sales

Import and Supplementary Duties

A number of positive changes have been proposed in the budget for FY2012-13 with regard to import and supplementary duties. For example, total tax burden (including import duty and VAT) on edible oil has been reduced from 38 per cent to 16 per cent, which is likely to have positive impact on prices. Total tax burden (including import duty and VAT) on nutritional supplement for pregnant women and lactating mothers is reduced from 90 per cent to 59 per cent, which is a welcome measure. Total tax burden (including import duty and VAT) on air conditioners has been increased from 152 per cent to 213 per cent; a positive move both from the considerations of the current balance of payments and the power situation. On the other hand, larger increase in supplementary duty for importers of parts (from 45 per cent to 60 per cent) compared to imports by VAT-registered manufacturers (from 20 per cent to 3 per cent) will provide support to local assemblers.

Total tax burden (including import duty and VAT) on air conditioners has been increased from 152 per cent to 213 per cent; a positive move both from the considerations of the current balance of payments and the power situation

Budget for FY2012-13 has proposed one more slab of 150 per cent supplementary duty (along with the existing eight). However, the move does not corroborate to NBR's effort to simplify the existing duty structure. At the same time, 20 per cent regulatory duty has been withdrawn from the imported refrigerators and motorcycles, which could negatively impact on the flourishing local manufacturers.

The budget proposals indicate that for 112 product lines, duties (customs duty/specific duty/supplementary duty/VAT) have been changed (Table 2.8). In general, duties on imported food items and imported clothing have been increased whilst for some of the other items the customs duties have been reduced.

Table 2.8
Number of Product Lines with Duties Adjusted

Type of Duty	Raised	Reduced	Waived
Customs duty	10	43	0
Supplementary duty	37	0	10
Specific duty	3	0	0
Concessionary benefits by Statutory Regulatory Order (SRO)	0	9	0
VAT	1	1	3

Source: Budget documents.

Motor Vehicles

No major changes have been proposed in the existing duty structure for motor vehicles. However, for motor vehicles with cylinder capacity of up to 1000 cc, supplementary duty has been increased from 30 per cent to 45 per cent. At the same time, the existing depreciation facility (of 25 per cent) will be applicable for five years old vehicles, instead of existing three years. These measures will increase the price of smaller vehicles, instead of the gas guzzling ones, which could be discriminatory for the middle-income group.

These measures will increase the price of smaller vehicles, instead of the gas guzzling ones, which could be discriminatory for the middle-income group

2.3.3 Tax Incidence at the Import Stage

At the import stage, collection of revenue (import duty, VAT, supplementary duty and regulatory duty) during July-April FY2011-12 was to the tune of Tk. 24,741.3 crore. This was about 34.8 per cent of NBR's total collection. CPD has examined the impact of proposed changes in customs duty, supplementary duty, regulatory duty and VAT (import) on import-related revenues. CPD's estimate shows that the changes may increase import-related revenues by 20.5 per cent in FY2012-13.[3] Consequently, the changes proposed in the existing duty structure appear to be

[3]Based on the import data for FY2010-11 and changes applied in existing tariff schedule of FY2011-12. The basis of the assumption is 15 per cent growth of import in both FY2011-12 and FY2012-13 as predicted in the Medium Term Budgetary Framework (MTBF). Estimated revenue collection may differ if the structure of FY2011-12 import changes significantly.

consistent with the programmed targets for NBR revenue growth at the import stage in FY2012-13.

2.3.4 Other Miscellaneous Measures

Mobile Bill

One of the noticeable proposals in the Budget for FY2012-13 has been the additional tax to be imposed on mobile phone usage. According to the proposal, 2 per cent tax was to be levied at source on both post-paid bills and pre-paid recharge, along with a surcharge at the rate of Tk. 0.15 to 0.20 per call. The latter is aimed at creating a dedicated energy fund. This will imply additional cost for mobile users across the board, including those not in the tax net. As is known, mobile phone usage is now almost universal, cutting across income groups. Thus, this is most likely to have a regressive impact. If the government is keen to raise taxes, it should go for 'ability to pay' method and find ways to impose taxes on use of various services by more resource-endowed people.

One of the noticeable proposals in the Budget for FY2012-13 has been the additional tax to be imposed on mobile phone usage; this is most likely to have a regressive impact

Tax on Bank Interest and Personal Loan

Deduction of tax at source at the rate of 15 per cent has been proposed, instead of 10 per cent at the time of paying interest by banks in case the taxpayers do not have Tax Identification Number (TIN). This measure would induce people to obtain TIN. At the same time, any loan or gift exceeding Tk. 5 lakh has been proposed to be treated as taxable income of the recipient if not received through banking channel. This is a measure to bring transactions under the purview of tax authorities and it should contribute to improved tax collection.

Deduction of tax at source at the rate of 15 per cent has been proposed, instead of 10 per cent at the time of paying interest by banks in case the taxpayers do not have Tax Identification Number (TIN)

Vehicle Registration

It has been proposed that "the rate of tax on privately owned car, jeep and microbus will be increased and this will be deducted at source at the time of renewal of its registration and fitness." It is not clear whether the 'tax' refers to registration and fitness fees. It is also not clear how this will be done through 'deduction at source'. Neither is it mentioned what will be the new rates.

2.3.5 Special Tax Measures

The budget kept the provision for voluntary disclosure of untaxed income with a penalty of 10 per cent in addition to the applicable tax on such income. At the same time, capital market investment is supposed to get the 'same' facilities as FY2011-12. This could imply that the previously maintained investment opportunity for undisclosed income at a tax rate of 10 per cent in the capital market may continue; however, this is yet another proposal that has not been clarified. It is to be noted that, in the past, such provisions failed to receive any significant response; since 1975, only Tk. 12,996 crore has been disclosed, with NBR collecting only Tk. 1,368 crore as taxes.

Investment opportunity for undisclosed income at a tax rate of 10 per cent in the capital market may continue; however, this is yet another proposal that has not been clarified

2.3.6 Tax Administration

A number of continuing and new measures have been mentioned in the Budget Speech for FY2012-13, in order to strengthen the tax administration. Some important ones are mentioned below:

- Universal Self-Assessment will be implemented allowing taxpayers to assess their own income tax and submit returns. This will facilitate submission, and is likely to increase submission of returns, and increase revenue collection.

- Process of strengthening the audit system and preparing a 'Revenue Audit Manual' is underway to prevent abusing of the system. This initiative will increase transparency through a system of check and balance and accelerate the tax collection process.
- Measures to facilitate effective issuance of tax refunds has been proposed. This will give greater incentives to pay taxes.
- Online submission of tax returns has been introduced in two tax zones, with plans to cover the entire country by the end of the current fiscal year. Together with the recently introduced online payment system at the NBR website, this is expected to increase taxpayers' convenience and likely to increase the rate of tax submissions.

Taxpayers will be able to submit TIN applications online

- Taxpayers will be able to submit TIN applications online. This will make the payment process convenient for the potential taxpayers.
- Digitisation of bonded warehouses of export-oriented industries has been proposed. This will allow them to submit and receive approval of customs-related applications online, and is expected to expedite the processes involved.
- Pre-shipment inspection (PSI) is finally to be abolished by December this year and to be replaced with the Automated System of Customs Data (ASYCUDA) World software developed by the United Nations Conference on Trade and Development (UNCTAD). This is now under progress in five custom houses and ten land customs stations. This software allows all customs formalities to be completed online, reducing costs of trade and other barriers significantly. The mentioned target is to expand the system to all the major custom houses and stations by 2013.
- Recruitment of 800 Assistant Revenue Officers is underway. This will hopefully help ease the existing acute human resource shortage in the NBR.

NBR is continuing with its impressive reform plans which it had been gradually implementing over the recent years

As the above mentioned measures towards strengthening tax administration reveal, NBR is continuing with its impressive reform plans which it had been gradually implementing over the recent years. It needs to be acknowledged that the past measures have indeed resulted in significant revenue dividends for the public exchequer. However, there still remains many untapped opportunities and sources for the NBR to tap resources and further increase the tax-GDP ratio, in line with the SFYP targets.

2.4

SECTORAL MEASURES

2.4.1 Agriculture

Agriculture Subsidy

Budget FY2012-13 earmarks Tk. 6,000 crore as agricultural subsidy

Budget FY2012-13 earmarks Tk. 6,000 crore as agricultural subsidy. The total amount is 7.7 per cent less than the allocation in the Revised Budget for FY2011-12, and 33.3 per cent higher than the proposed Budget for FY2011-12. The Revised Budget for FY2011-12 is 44.4 per cent higher than the proposed budget for the same year. It is to be noted here that subsidy pressure is likely to increase further in the coming year in the backdrop of the upward trend in prices of urea and muriate of potash (MoP) in the international market. Due to price changes in international market, per unit cost of the imported urea and MoP increased by 55 per cent and 25 per cent between April 2011 to April 2012. Given that the total demand for fertiliser is about 4.67 million metric tonnes (MT), as estimated by the Ministry of Agriculture, an amount of Tk. 8,225 crore will be required in FY2012-13 on account of fertiliser subsidy, assuming that the stock will remain the same. This is 37 per cent higher than the total annual subsidy allocation for the agriculture sector. Assuming that, the total subsidy allocation for agriculture is Tk. 6,000 crore in FY2012-13, of which Tk. 4,000 crore is for fertiliser, a price adjustment of urea and MoP by 60 per cent, and diammonium phosphate (DAP) and triple super phosphate (TSP) by 15 per cent will be necessary (Table 2.9). The needed price adjustments will have adverse impact on the rate of returns for the farmers.

The needed price adjustments will have adverse impact on the rate of returns for the farmers

Table 2.9
Estimation of Subsidy Requirement for Fertilisers in FY2012-13

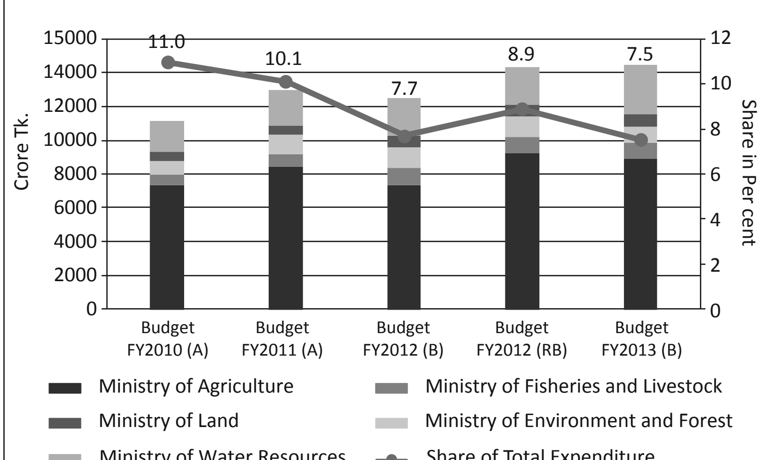
Fertiliser	Source	Price in April 2012 (USD/ Ton)	Insurance and Freight Charge (USD/ Ton)	Imported Cost (USD/ Ton)	Cost (Tk./ kg)	Administered Price (Tk./kg)	Demand for FY13 (Million Ton)	Subsidy (Crore Tk.)	Price Projection (Tk./kg)	Change in Price (%)
DAP	China	518	50	568	46.5	27	0.60	1171	31	15
Urea	China	493	60	553	45.3	20	1.50	3794	32	60
	Bangladesh				9.5	20	1.00	-1050	32	60
TSP	Tunisia	441	100	541	44.3	22	0.70	1562	25	15
MoP	Belarus	469	100	569	46.6	15	0.87	2749	24	60
Total							**4.67**	**8226**		

Source: CPD estimation based on the World Bank Pink Sheet data and Ministry of Agriculture.

Allocation for Agriculture and Allied Sectors

Tk. 14,457 crore has been allocated for agriculture and allied sectors in FY2012-13 National Budget (non-development and development), which is only 0.77 per cent higher than the Revised Budget of FY2011-12 and 15 per cent higher than that of the proposed Budget of FY2011-12. The overall agricultural allocation as a percentage of the total budget is 7.5 per cent in FY2012-13, while the figure stands at 8.9 per cent in the Revised Budget of FY2011-12, and was 7.7 per cent in the proposed Budget of FY2011-12. Experience of the past few years indicate that the share of agricultural expenditure in the total budget has been on a declining trend since FY2009-10. In FY2009-10, allocation for the agriculture sector was 11 per cent of the total budget; this has now come down to 7.5 per cent in the proposed Budget for FY2012-13 (Figure 2.4). A number of specific measures for the agriculture sector in FY2012-13 have been reviewed below.

Figure 2.4
Development and Non-Development Expenditure in Agriculture and Allied Sectors



Source: Budget documents.
Note: A denotes actual.

Agriculture Promotion

Proposal for the exemption on income tax by 50 per cent in relation to the production of maize and sugar beet will benefit the cause of production diversification in agriculture. However, as a follow up of *Agricultural Policy 2011*, diversification of agriculture through promotion of water-efficient crops and pulses in the drought-prone regions has not been mentioned in the Budget. Measures that could benefit farmers include expansion of maize cultivation, production of quality seeds through Bangladesh Agricultural Development Corporation (BADC), supply of high-yielding variety (HYV) seeds in coastal areas, etc. Special projects for rapid expansion of submergence-tolerant rice varieties such as BRRI Dhan 51 and BRRI Dhan 52 would have contributed to reduction in production risks, and would have induced adaptation to climate change.

No measures have been proposed in the FY2012-13 Budget for promoting agricultural exports

No measures have been proposed in the FY2012-13 Budget for promoting agricultural exports. Measures to encourage export of potato and vegetables through promotion of contract farming and linking with cash incentives (direct procurement from farmers and having farmers' identity numbers aligned with Input Subsidy Card) would have had positive impact.

Agriculture credit disbursement has been on a declining trend in recent years. The target for agriculture credit disbursement in FY2012-13 has been set at Tk. 14,143 crore while in FY2011-12, this was Tk. 13,800 crore, of which 73.9 per cent has been realised until April. In this backdrop, it is essential to identify the causes of slow delivery of agriculture credit with a view to taking corrective measures.

Farmers' Incentives

The budget has not articulated any measure in support of farmers getting appropriate prices for their products

The budget has not articulated any measure in support of farmers getting appropriate prices for their products. Introduction of 'crop insurance' on pilot basis in one upazila in Habiganj is a commendable measure; however, no specific allocation and modalities have been mentioned. In the area of agriculture marketing, government has a plan to form 800 'Farmers Clubs' and construct eight assemble centres in FY2012-13 in addition to the existing 18,000 Farmers Club. But, no new 'Farmers Marketing Group' and agro-products processing centres have been added in FY2012-13 Budget; the earlier set target of reaching 22,877 Farmers Club in FY2011-12 has not seen much success. More important than the quantitative targets, it is important to identify the institutional modalities under which the Farmers Club and Marketing Group can work as corporate ventures.

Storage Capacity

In order to ensure food security, the government has targeted to increase food storage capacity up to the level of 2.2 million MT by 2015 by raising the storage capacities. In the last three years a total capacity of 0.2 million MT has been added to the previous capacity of 1.45 million MT. In FY2012-13, two projects with capacity of 0.22 million MT will be implemented to the existing 1.65 million MT; the plan is to add another 0.16 million MT capacities by FY2013-14. In this backdrop, more new projects will have to be undertaken to attain the proposed storage capacity target.

New projects will have to be undertaken to attain the proposed storage capacity target

Fisheries and Livestock

Prospects of marine fishing have increased, thanks to establishment of the legal rights in the sea. However, no specific allocation has been outlined to exploit the marine fisheries and tap the potential resources in the Bay of Bengal.

On a priority basis, government is implementing a project titled *Modernization of Vaccine Production Technology and Extension of Laboratories*. Poultry farmers will need further support, on a short-term basis, to address the losses arising from bird flu disease. Tax holiday for poultry industry may also be extended considering current volatility in the sector.

Fish, meat and milk production could increase significantly if these sectors were provided with proper research, legal framework and incentives. However, no new inducement has been given in FY2012-13 Budget in support of these sectors.

Tax holiday for poultry industry may also be extended considering current volatility in the sector

2.4.2 Agro-Based Industries

VAT exemption from agriculture machineries used in applying granular urea, organic fertiliser, rice and wheat crushing machines and rice bran oil, will hopefully facilitate and promote the local small and medium enterprises (SMEs). A recent innovation with regard to producing cholesterol-free rice bran oil from husk of paddy has received boost through tax holiday for 5-7 years, depending on locations. Special allocation is needed to develop agro-processing industries, in adequate number, to process seasonal surpluses of perishable items. This is necessary to reduce post-harvest losses and also to ensure profitable return for the farmers.

2.4.3 Industrial Sector

Investment by the Private Sector

The efficacy of public expenditure which has critical implications for promoting private investment in the industrial sector, needs to be examined with regard to the timeliness, appropriateness, effectiveness, and ability to deliver the outputs

Given the ongoing challenges that are confronting the private sector, the Budget for FY2012-13 was expected to address a number of critical issues. These included acceleration of private investment, establishing better business enabling environment, and support to export-oriented and domestic market-oriented industries. However, acceleration of private investment, as is projected in the National Budget for FY2012-13, would be rather difficult to attain in view of the projected growth of private sector credit remaining the same as in FY2011-12 (i.e. 16 per cent). This appears to be inadequate for attaining the targeted level of investment to the tune of 22.7 per cent in FY2012-13 (from 19.1 per cent in FY2011-12). Although imposition and exemption of duties in a targeted manner would improve competitiveness status of some domestic market-oriented industries, their market power will eventually hinge on host of other factors. These include the direction of changes in the bank interest rate, exchange rate movements and rate of inflation in the upcoming fiscal year. In addition, the efficacy of public expenditure which has critical implications for promoting private investment in the industrial sector, needs to be examined with regard to the timeliness, appropriateness, effectiveness, and ability to deliver the outputs.

In FY2012-13, proposed ADP allocation for the industrial sector is Tk. 2,066.7 crore, which is 113.3 per cent higher compared to that in the RADP FY2011-12. A significant rise in the ADP allocation in FY2012-13 is mainly attributed to fresh allocation for the *Shahjalal Fertilizer Factory Project* which covers 70.2 per cent of total allocation for the industrial sector. In view of the need to shift a proportion of the gas supply from the existing fertiliser factories to meet the urgent needs of various economic activities, establishment of a new fertiliser factory could remain unfeasible if the required supply of gas cannot be ensured.

Slow implementation of ADP projects under the Ministry of Industries remains a major concern

Slow implementation of ADP projects under the Ministry of Industries remains a major concern. Among the 18 projects in the industrial sector listed as 'projects to be completed within FY2012-13', 15 projects are not likely to be completed on time, as the rate of implementation of these projects, till June 2013, varied between

18-89 per cent. For example, four projects on strengthening and modernisation of the Bangladesh Standards and Testing Institution (BSTI) as well as establishment of South Asian Regional Standards Organisation (SARSO) will not be concluded in due time (only 10 per cent of the total cost of the four projects to be spent by the end of FY2012-13). Putting special focus on strengthening the National Database maintained by the Bangladesh Bureau of Statistics (BBS) through implementation of several projects is a commendable initiative. The proposed projects include conducting economic census, development of industrial sector database and digital information system. Updating the national database on a regular basis and maintaining real time information should be a major focus of BBS's activities. Furthermore, a number of trade support programmes is currently underway with the Ministry of Commerce which will be continued in FY2012-13. As part of these initiatives, a comprehensive trade policy, with an aligned industrial policy, should be adopted soon.

Putting special focus on strengthening the National Database maintained by the BBS through implementation of several projects is a commendable initiative

Export-oriented Industries: Pharmaceuticals, Leather and Jute Goods, and Export Processing Zones (EPZs)

Export-oriented sectors, particularly pharmaceuticals, leather and readymade garments (RMG) have been denied the needed higher quality infrastructural facility support due to slow implementation of a number of critically important projects. For example, *Active Pharmaceutical Ingredients (API) Industrial Park Project* is far behind the targeted completion schedule (set for 31 December 2011), only about 40 per cent of the work has been completed till date; even at the end of June 2013 a large part of work will remain incomplete (only 64 per cent of the total work is expected to be completed by then). Similarly, *Leather Estate Project* is far behind the targeted completion date, and only about 43.1 per cent of total project would be completed at the end of June 2013. The long awaited project in the RMG sector, i.e. establishment of the *Garment Industry Park* was included as unfunded project in the ADPs of the last two years. This has now been included in the ADP of FY2012-13 as a PPP project under the Ministry of Industries. Given the importance of the project, the role to be played by the Ministry and the PPP Office under the Prime Minister's Office needs to be sorted out on an urgent basis. Necessary administrative work, particularly selection of investors and modalities regarding sharing of responsibilities, risks and profits should be finalised so that interested investors could initiate the work in order to complete it as per the timeline (June 2015). As far as tax holiday incentive is concerned, following a lengthy pause, enterprises in the private EPZs have been accorded the same treatment as those in the government EPZs. This will hopefully encourage more FDI flow to the private EPZs (e.g. Karnaphuli EPZ).

The long awaited project in the RMG sector, i.e. establishment of the Garment Industry Park was included as unfunded project in the ADPs of the last two years

In view of the export potentials of the raw jute and jute goods, the proposed project regarding development of HYV jute and production of seed holds much promise. The project needs to be implemented with due urgency so that it is completed on time (allocation in ADP FY2012-13 is Tk. 30 crore, which was Tk. 20.3 crore in RADP of FY2011-12). Budget FY2012-13 states that government has decided to take the past bank liabilities of the Bangladesh Jute Mills Corporation (BJMC) mills under its own responsibility (Tk. 2,827 crore) with a view to make the BJMC mills profitable. In other words, this would imply that the government has moved away from its earlier plan of privatisation of BJMC-owned mills. It should be noted, however, that the mere initiative of undertaking bank liabilities will not solve the formidable problems facing the BJMC mills. A major technological restructuring will need to be undertaken. The idea of putting in place, a Technology Upgradation Fund (TUF), in support of both public and private sector jute mills needs serious consideration. Such a fund is in place in India and it has given rich dividends to the entrepreneurs.

The government has moved away from its earlier plan of privatisation of BJMC-owned mills

Small and Medium Enterprises (SMEs)

Modernisation of the existing Bangladesh Small and Cottage Industries Corporation (BSCIC) industrial estates and development of new ones has been an important policy focus in successive budgets with a view to promoting SME interest. However, there is a need to examine the performance of BSCIC industrial estates before allocating more fund for setting up new BSCIC estates. According to CPD (2012)[4], of the total allotted plots numbering 9,699 (till March 2012), only 40 per cent were made use of by operational enterprises. Besides, slow progress in implementing the existing BSCIC industrial estate projects has been another weak point. One of the big-funded projects currently being implemented is the Sirajganj BSCIC industrial estate, for which only 21.4 per cent will be completed by FY2012-13.

There is a need to examine the performance of BSCIC industrial estates before allocating more fund for setting up new BSCIC estates

Despite the increasing demand for expansion of sectoral coverage, Equity and Entrepreneurship Fund (EEF) has remained narrow in its focus. EEF's coverage should be further widened to include other potential sectors, such as light engineering, plastic, melamine and electronics. Better access to credit facility at favourable interest rate will continue to be a major demand of the SMEs in FY2012-13, particularly in the backdrop of the difficulties they have faced in FY2011-12. The proposed reduction of turnover tax, in a staggered manner, is thus a welcome initiative, as this will reduce the tax burden of the SMEs. According to the Budget for FY2012-13, turnover up to Tk. 7 lakh will enjoy full tax waiver; this is followed by tax of 2 per cent for turnover between Tk. 7-24 lakh, and tax of 3 per cent for turnover between Tk. 24-60 lakh. This will be applicable for producers and traders operating in industries such as shoes and sandal, coconut oil, laundry soap, jam, jelly, PVC pipe, etc. Development of women entrepreneurship will be facilitated through the earmarked allocation of Tk. 100 crore. It is important that this fund is used at the district level. Moreover, disbursement of 15 per cent of SME loans to the women entrepreneurs will hopefully contribute towards development of women entrepreneurship in Bangladesh.

EEF's coverage should be further widened to include other potential sectors, such as light engineering, plastic, melamine and electronics

The proposed changes in the duty structure including supplementary duties and other taxes is a debated issue in the context of their implications for revenue generation in one hand, and support and protection of domestic industries on the other. Some of the proposed reduction in the customs duty and supplementary duty for raw materials, intermediate products and capital machineries are likely to have positive impact for domestic industries, and also for some of the export-oriented industries. Changes in Total Tax Incidence (TTI) in case of reduction duties will be (-) 92 per cent, and in case of increase in duties will be as high as 94 per cent.

Some of the proposed reduction in the customs duty and supplementary duty for raw materials, intermediate products and capital machineries are likely to have positive impact for domestic industries, and also for some of the export-oriented industries

Information and Communication Technology (ICT)

In order to expedite the development of the ICT sector, timely implementation of a number of important projects will be critically important. These include establishment of *SASEC Information Highway*, *Hi-tech Park* and *Software Park*. The proposed reduction of customs duty and supplementary duty on a number of computer-related accessories, such as multimedia projector, server rack, flash drives, etc. will positively contribute to the development of the ICT sector. Similar reduction in the customs duty is required in case of some of the other related items such as cables, webcams, CD/DVDs, etc. In order to ensure wider accessibility, VAT charges with regard to the use of internet service (i.e. 15 per cent) should have been reduced.

[4]CPD. 2012. *Bangladesh Economy in FY2011-12: Third Interim Review*. Dhaka: Centre for Policy Dialogue (CPD).

Capital Market

There are concerns arising from the slow implementation of the ADB-financed project relating to the development of monitoring and surveillance system for the Securities and Exchange Commission (SEC)

Given the weak institutional and operational structure in the capital market, a number of ongoing reform measures need to be completed with due urgency. There are concerns arising from the slow implementation of the ADB-financed project relating to the development of monitoring and surveillance system for the Securities and Exchange Commission (SEC). The project was supposed to be completed in April 2012. The date of completion has now been extended to the end of June 2013, which will definitely lead to cost escalation. Speedy enactment of the *Financial Reporting Act* is also necessary to improve the state of governance and transparency in the country's bourse. The long awaited demutualisation of stock exchanges has been further deferred, till FY2013-14. This, however, is a deviation from the 21-point measures that were to be undertaken as per the directive of the Prime Minister in October 2011. In order to ensure transparency involving transactions in the capital market, and also to ensure their reflection in the tax submission of individuals, submission of TIN for all Beneficiary Owner (BO) accountholders should be made mandatory. According to the National Budget FY2012-13, newly listed company will enjoy tax rebate of 10 per cent in the first year for offloading of 20 per cent share of paid up capital, and dividend income amounting Tk. 5,000 will be exempted from tax. However, without addressing the institutional and operational weaknesses, such measures are unlikely to generate the expected results.

Skill Development and Support to Industrial Workers

Allowance of Tk. 350 per month for an additional 78,000 mothers under the scheme of Poor Lactating Mothers' Allowance in the RMG sector is appreciable

The National Budget for FY2012-13 has proposed a significant rise in the ADP allocation for the development of human resources – from Tk. 34,150 crore in FY2011-12 to Tk. 39,390 crore in FY2012-13. This is an initiative in the right direction for development of human resources. The enactment of *National Skill Development Policy 2011* is also a commendable initiative in this direction. Two projects for female migrant workers related to their protection against workplace violence and also for their economic empowerment (Tk. 18.5 crore) are expected to be completed by FY2012-13. These projects will hopefully contribute to the improvement of livelihood condition of this target group. However, a number of projects are being implemented at a rather slow pace (e.g. establishment of technical training centres where only 2-18 per cent of the work will be completed by June 2013). Nevertheless, allowance of Tk. 350 per month for an additional 78,000 mothers under the scheme of *Poor Lactating Mothers' Allowance* in the RMG sector is appreciable. Support under this scheme should be extended beyond Dhaka and the nearby regions. Taking into account the high food inflation, government may consider reintroducing of the operation of food rationing facilities for industrial workers. Support to the industrial workers can be further extended through allocation of fund for setting up dormitories in major industrial clusters. Given the pressure of high inflation, initiatives should be taken to renegotiate the minimum wage for industrial workers.

Government is also planning to retire a number of diesel-based plants with a generation capacity of 657 MW by 2016; however, at the same time, a number of furnace oil-based new plants will be established where fiscal burden will remain high

2.4.4 Power and Energy

Despite the significant investment under public and private sectors, access to electricity and the availability-demand gap remain a nagging concern. During the last three years, net addition of electricity was 3,745 MW although the Budget mentions the figure of 5,000 MW for the period 2009-2012. According to the *Power Sector Road Map: Second Update* – most of the new power plants will be non-diesel based which is what it should be in view of the huge fiscal burden arising from the diesel-based power plants. Government is also planning to retire a number of diesel-based plants with a generation capacity of 657 MW by 2016.

However, at the same time, a number of furnace oil-based new plants will be established where fiscal burden will remain high. Accordingly, the dependence on diesel or furnace oil-based power plants will be continued for few more years with the resultant implications in terms of fiscal burden.

In the Budget FY2012-13, total allocation for the power sector is to the tune of Tk. 7,901.3 crore, which was 9.6 per cent and 10.2 per cent higher compared to that of RADP FY2011-12 and ADP FY2011-12 respectively. Six new projects have been announced with an allocation of Tk. 3,290.9 crore; however, there are 33 other projects which have been included in the ADP without any allocation; these are earmarked for financing through foreign funds (total project cost is to be Tk. 46,664.2 crore). As far as the ongoing projects are concerned, the rate of implementation of the projects varied widely. For example, *Rehabilitation and Modernisation of Ghorasal Thermal Power Station* and *Construction of Chandpur 150 MW* are to be completed in due time; but the *820 MW Peaking Power Plant* and *Bheramara Combined Cycle Plant (360 MW)* have fallen behind the timeline.

In the Budget FY2012-13, total allocation for the power sector is to the tune of Tk. 7,901.3 crore, which was 9.6 per cent and 10.2 per cent higher compared to that of RADP FY2011-12 and ADP FY2011-12 respectively

Proposed allocation for the oil, gas and natural resources sector in FY2012-13 is Tk. 1,608.4 crore, which is 117.7 per cent and 44.4 per cent higher compared to that of RADP FY2011-12 and ADP FY2011-12. Only one new project (Tk. 40.1 crore) has been included with budgetary allocation, while six other projects are listed without allocation, and five projects are earmarked for financing through foreign investment (total project cost is Tk. 7,384.5 core). A majority of the projects listed as 'projected to be completed' in FY2012-13 are unlikely to maintain the planned timeline. Out of the 13 projects listed as 'projected to be completed' in FY2012-13, only one project is likely to be completed in due time, two projects will be completed to the tune of 90 per cent, four projects to the tune of 75 per cent, and the rest of the six projects have been able to spend less than 50 per cent of total project cost. Sluggish progress has been observed in other projects too – less than 1 per cent of the work on the *2D Seismic Survey* has been completed till December 2011; eight well drilling projects will be only 60 per cent completed by the targeted timeline while the *Gas Transmission Pipeline & Compressor Station Establishment* project will be completed only to the tune of 9.6 per cent in FY2012-13. Exploration and production capacity building of Bangladesh Petroleum Exploration & Production Company Limited (BAPEX) and *Bheramara-Khulna* and *Bonpara-Rajshahi Gas Transmission Pipeline* projects are likely to be completed as per deadline. Completion of these projects would improve generation, transmission and distribution of gas supply. Analysis of the project completion status indicates that closing the supply-demand gap in the power sector will critically hinge on the capacity of the concerned authorities to complete the ongoing projects in time. In view of the priority that the sector deserves, there is much room for improvement in this regard.

Analysis of the project completion status indicates that closing the supply-demand gap in the power sector will critically hinge on the capacity of the concerned authorities to complete the ongoing projects in time

2.4.5 Environment, Climate Change and Disaster Management

The proposed allocation of local fund of Tk. 400 crore for Bangladesh Climate Change Trust Fund (BCCTF) is well appreciated, but its decreasing utilisation remains a concern. The number of additional projects as well as allocation under the fund has declined in subsequent fiscal years. In the last three fiscal years, the government allocated annually an amount of Tk. 700 crore for BCCTF, whereas for FY2012-13 only Tk. 400 crore has been allocated. In FY2011-12, only 20 new projects were completed (against 62 projects in the two preceding years), and only Tk. 719.6 crore out of Tk. 1,400 crore was actually utilised.

The proposed allocation of local fund of Tk. 400 crore for BCCTF is well appreciated, but its decreasing utilisation remains a concern

The government has proposed an amount of USD 113.5 million for Bangladesh Climate Change Resilience Fund (BCCRF) with financial support from a number of development partners. However, allocation for the development of a local authority on climate change is still to be there. Progress with regard to construction of flood rehabilitation and cyclone centres has been rather slow, but the pace of rehabilitation for stranded families has been moderate. Government of Bangladesh (GoB) has delivered on its promise to install incinerators at 10 medical institutions for medical waste management and there are plans to bring another 31 institutions under waste management system in next two years.

Several new environmental regulation policies were mentioned in the FY2011-12 Budget; follow-up of those initiatives were expected in this year's Budget. However, the proposed Budget for FY2012-13 does not mention about new steps in terms of regulation

Considering environmental implications of the initiative, upgrading of 500 brick fields and establishment of 11 Air Quality Monitoring Centres is commendable. However, allocation for mitigating emission from slow moving vehicles or steps toward a *Clean Air Act* is still not visible.

Several new environmental regulation policies were mentioned in the FY2011-12 Budget; follow-up of those initiatives were expected in this year's Budget. However, the proposed Budget for FY2012-13 does not mention about new steps in terms of regulation. Policy initiative is absent with regard to Bangladesh taking advantage of the Clean Development Mechanism (CDM) as in contrast to countries such as China and India. Moreover, no initiative to establish a zone-wise climate change adaptation policy for farmers is discernible. Installation of effluent treatment plants (ETPs) in 280 industries and decision to provide soft loans to factory owners to facilitate ETP installation are praiseworthy. However, management of *Leather Industrial City* in Savar has been slow and should be expedited on a priority basis.

Development of a waste disposal management system with 64 city authorities under the BCCTF is laudable, but little action has been taken to address the drainage problems. This will require active involvement of citizens in the design process, supported by aggressive awareness campaigns to ensure compliance. An integrated master plan encompassing all environment-related projects from different ministries is praiseworthy. In this regard, a strong governing body and monitoring unit as well as setting up monitorable targets are to be recommended. Moreover, implementation of the *Bangladesh National Building Code* is a positive move towards taking precautions against to natural disasters, such as earthquakes.

Management of Leather Industrial City in Savar has been slow and should be expedited on a priority basis

2.4.6 Rural Development

Tk. 13,549 crore has been allocated for the Local Government Division and the Rural Development and Cooperatives Division in FY2012-13. This is 24 per cent of the development expenditure for this fiscal, which remains similar to the one proposed in FY2011-12 Budget. This allocation involves 66 ongoing projects with four new projects, which are yet to be approved. With the aim of addressing the problem of providing safe drinking water to all, a timeline was earlier fixed for 2011. However, only 88 per cent of the population has been brought under the coverage of safe drinking water up to FY2011-12. The Budget for FY2012-13 proposes setting up 42,000 safe water sources in the coming fiscal. However, it has not been mentioned what additional measures will be taken towards this. It is to be noted that Bangladesh has made notable progress in sanitation coverage, and is now ahead of other South Asian countries with coverage of 91 per cent.

The Budget for FY2012-13 proposes setting up 42,000 safe water sources in the coming fiscal

In line with *Vision 2021*, rural electrification has been declared as one of the priority areas for the government. Although 48,711 (65 per cent) villages have been brought under the programme with 4.5 crore beneficiaries, there are still areas where electricity cannot be supplied from the grid. In relation to this, 15,000 biogas plants and 1.12 million solar home systems have been established with support from the Rural Electrification Board (REB) and Infrastructure Development Company Limited. (IDCOL). Further, work is under progress to set up 190 irrigation pumps and 200 biogas power plants. With assistance from IDCOL, steps have been taken to produce electricity from the paddy husk. Since the FY2012-13 Budget does not mention any detailed programme to enhance electrification, it will be necessary to take further actions, on an urgent basis, to realise the ambition concerning electrification towards *Digital Bangladesh* by 2021.

2.4.7 Local Government

Government has rightly recognised that there is no alternative to strengthening the local government system for successful public service delivery. The Budget for FY2012-13 talks of steps that were taken to make the union parishad and the upazila parishad system effective with the enactment of the *Upazila Parishad Act 2011*. However, the government has not been able to make much headway with respect to implementing these reforms. FY2012-13 Budget did not come up with a more transparent system for inter-governmental budgetary transfers. Additionally, budget for the upcoming fiscal year does not deal with property tax base reforms in order to strengthen the financial autonomy of city corporations and municipalities. FY2012-13 Budget should have proposed a timeline and institutional framework for designing modalities with the objective of moving towards District Budget, which the government had earlier announced that it would do.

The government has not been able to make much headway with respect to implementing reforms in the local government system

2.5

SOCIAL SECTOR

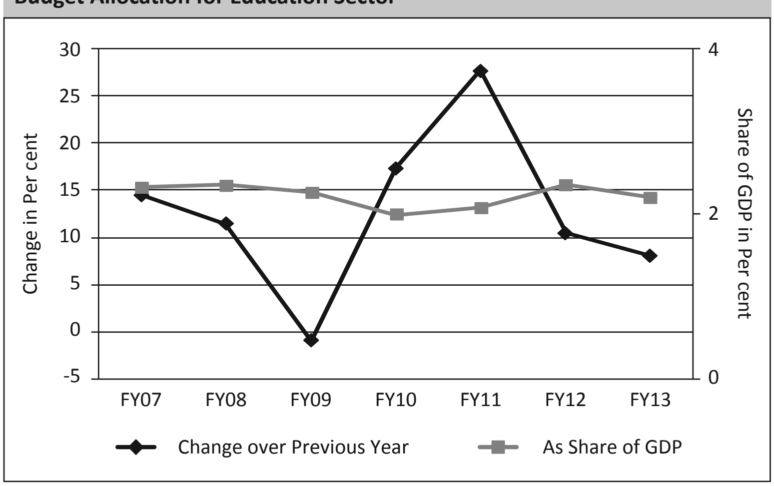
Social sector (Education and Health) is already bearing the brunt of increased subsidy pressure on the economy. Allocation for this sector is experiencing some slowdown and some stagnation. Indeed, as a share of GDP, it is falling. The case with gender-related allocation and allocation for children is not much different.

Social sector is already bearing the brunt of increased subsidy pressure on the economy

2.5.1 Education

In FY2012-13, 11.2 per cent (Tk. 21,408 crore) of total budget is allocated for education sector; this is lower than previous year's share in total public expenditure (Tk. 19,806 crore or 12.1 per cent of total budget). Allocation for education as a share of GDP has also decreased to 2.1 per cent in FY2012-13 from 2.2 per cent in FY2011-12 (Figure 2.5). In the current ADP, 13.4 per cent of total allocation has been proposed for education and religious affairs sector.

Figure 2.5
Budget Allocation for Education Sector



Source: Budget documents (various year).

Male-female student ratio in Bangladesh currently stands at 47:53, and this is the second highest in South Asia. Moreover, 40 per cent of female undergraduate students are at present being provided with stipends. Remarkably, in areas like *beels*, *haors* and other remote parts of the country, stipend coverage is almost 100 per cent. While the female stipend initiative is a commendable achievement, full stipend for female students should be extended up to graduate level. The *Creative Talent Hunt Policy*

2012 is a good follow-up of the previous year's Talent Hunt Programme, but implementation needs to be further strengthened.

ICT labs have been installed in 3,172 secondary and higher secondary institutions. At present, 306 model high schools have been established with multimedia facilities and 164 schools are under construction to remove the rural-urban educational disparity. In addition, multimedia classrooms will be installed in 20,500 educational institutions across the country by June 2013. It will require significant amount of fund, manpower and logistic support for proper functioning. There is also a plan to introduce e-learning in the educational institutions in the proposed budget.

Installation of multimedia classrooms in 20,500 educational institutions across the country by June 2013 will require significant amount of fund, manpower and logistic support for proper functioning

The Prime Minister's Education Assistance Foundation has also been continued in the Budget for FY2012-13. Additionally, *Prime Minister's Education Assistance Trust Act 2011* has been enacted to support education of the poor and the underprivileged meritorious students. A provision of waiving tax for those contributing to this fund, on any contributions up to a ceiling amount, has been proposed. The initiative is noble, but the challenge will be to build adequate fund bases and spread coverage in rural areas.

Shishu Bikash Kendra (child development centres) has been established in six large districts to rehabilitate street children. In the proposed budget, a pre-primary education programme and a standard primary examination system have been mentioned.

Allocation for health sector in FY2012-13 is 4.9 per cent of the total budget (Tk. 9,333 crore), whereas the allocation was 5.4 per cent of the total budget (Tk. 8,869 crore) in FY2011-12

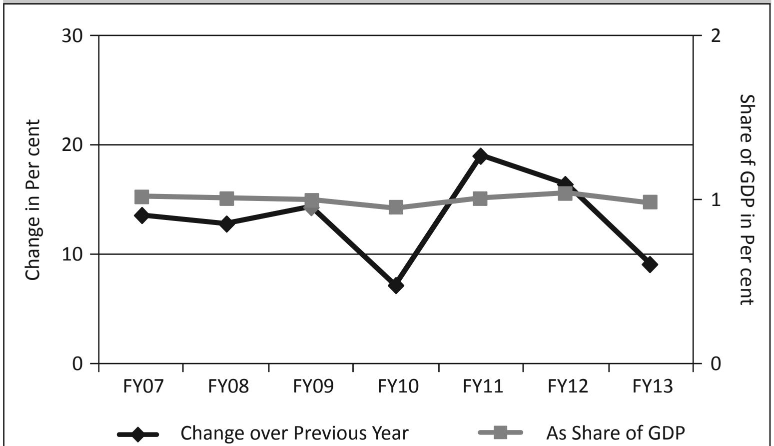
In addition to the above mentioned initiatives, a number of other programmes related to education have been kept in this Budget. Primary Teachers Training Institutes (PTTI) in 12 district headquarters have been established. A stipend programme, at a cost of Tk. 4,000 crore, to reduce and prevent drop-out of students on account of poverty will continue. In addition, the *School Feeding Programme* has also been continued. Free books have been distributed among the secondary level students.

National Child Labor Elimination Policy 2010 and *National Child Policy 2011* have been adopted, under which 166,000 children have been taken out of hazardous professions, and enrolled into primary education programme.

There is a proposal to establish child-friendly learning centres in *char*, *haor*, tea garden and other remote areas. In addition, computer and vocational education will be made compulsory at secondary level by 2013 and at primary level by 2021.

Figure 2.6

Budget Allocation for Health Sector



Source: Budget documents (various year).

2.5.2 Health

Allocation for health sector in FY2012-13 is 4.9 per cent of the total budget (Tk. 9,333 crore), whereas the allocation was 5.4 per cent of the total budget (Tk. 8,869 crore) in FY2011-12 (Figure 2.6). The GDP share of this year's allocation (0.9 per cent) is somewhat lower than that of the previous year (1 per cent). In the current ADP, 7.5 per cent of total allocation has been proposed for the health, nutrition, population and family welfare sector.

To improve health and well-being of poor city dwellers, 27 urban maternity clinics, 167 urban health centres and 656 satellite clinics have been providing primary healthcare services. Moreover, 30 per cent of these services were delivered free-of-cost. The coverage of *Maternal Health Voucher Scheme* has not increased beyond 46 upazilas though there was a plan to increase its coverage in last year's budget. In this budget, it is expected that 2,091 clinics will be set up and made operational by FY2012-13. This is a positive move, but implementation will require significant amount of fund, manpower, etc. Moreover, in order to improve the physician-population ratio, 3,551 physicians have been recruited, and five new medical colleges have been established. Furthermore, steps have been taken to increase the number of nurses and paramedics to improve the doctor-nurse-paramedic ratio to internationally accepted 1:3:5. However, concerted effort will need to be taken to attain this ratio, particularly in the rural areas.

A number of projects such as mobile and satellite health clinics will be implemented for the inhabitants of the remote hill tracts

In FY2012-13, more initiatives will be taken to introduce an e-health programme in the form of mobile phone service, internet connectivity and telemedicine facilities in hospitals at the district and upazila level. This is a progressive initiative, but making the skilled human resources available and providing the needed logistical support will be the major challenges in implementing these programmes.

The *National Nutrition Service Programme* has been expanded to 123 upazilas to address malnutrition by improving the rate of local participation, food support to pregnant mothers and infants, and through higher rates of immunisation. Moreover, a number of projects such as mobile and satellite health clinics will be implemented for the inhabitants of the remote hill tracts. *Bangladesh Medical and Dental Council Act 2010* has been enacted, while the *National Health Policy 2011* and *Patients Welfare Fund Policy* have also been formulated.

2.5.3 Gender Dimension

FY2012-13 Budget has come up with a number of initiatives in support of women entrepreneurs

In FY2012-13, the gender-related allocation (Tk. 50,344 crore) is about 26.3 per cent of the total budget. This allocation is lower than the previous year's allocation, which was 26.4 per cent of the total budget. This year's share for Ministry of Women and Child Affairs is 0.68 per cent of the total expenditure, which is lower than that of last year (0.78 per cent). In the proposed Budget for FY2012-13, gender budget is presented for 25 ministries; last year, it was for 20 ministries.

FY2012-13 Budget has come up with a number of initiatives in support of women entrepreneurs. Under the Women-friendly SME Programme, all the banks and non-bank financial institutions will continue to provide special desk service to support women entrepreneurs. At least 15 per cent of the SME refinancing scheme is to be allocated for women entrepreneurs, and a collateral-free loan programme amounting to Tk. 25 lakh has been introduced for their advancement. Furthermore, a lump sum allocation of Tk. 100 crore for women entrepreneurs has been proposed in the current budget.

Besides the above supportive measures, some general initiatives have also been proposed for women. Tk. 331.2 crore has been allocated to finance the allowances for 0.92 million widows and divorced/abandoned women (Tk. 300/month). The Vulnerable Group Development (VGD) progarmme for women (monthly 30 kg of foodgrains) has been maintained in this proposed budget. The tax-free threshold of income tax for women has been maintained at Tk. 200,000 against the general threshold of Tk. 180,000. In addition, the Budget mentions about a draft *Hindu Marriage Registration Act 2012* which is likely to be finalised soon.

In the proposed Budget for FY2012-13, the share for children has suffered some decline

2.5.4 Children Orientation

In the proposed Budget for FY2012-13, the share for children has suffered some decline; the allocation was 3.6 per cent of the total budget. A CPD-UNICEF study estimated that the share was 4.1 per cent in FY2010-11 and 4.6 per cent in FY2005-06.[5] As percentage of GDP, it has remained at around 0.7 per cent this year.

Budget allocation in the form of financial support for education of the children with disability will continue to be made against the Ministry of Social Welfare. Nevertheless, responsibility of programme administration is given to the Ministry of Education. Allocating resources and responsibility to two different ministries may create functional confusion. Both monetary allocations and responsibilities of education for children with disability should remain with the Ministry of Education.

2.6

SOCIAL SAFETY NET PROGRAMMES

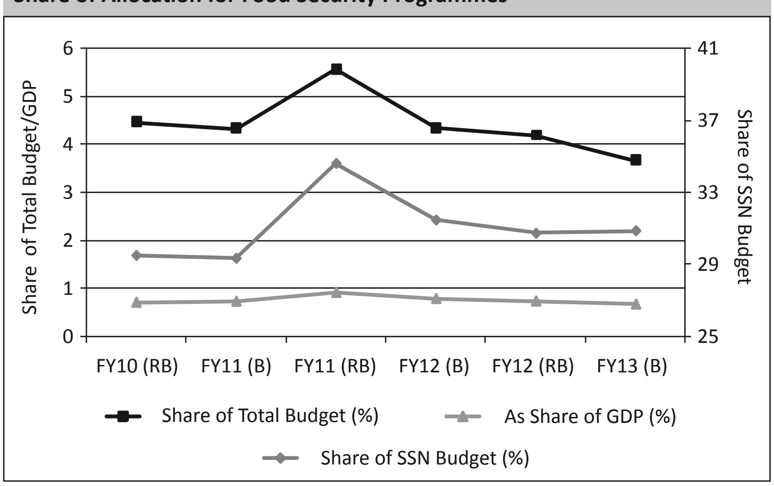
The objective of strengthening social safety net programmes, as seen in past two budgets, appears to have fallen victim to fiscal compulsions which gathered momentum in the budgetary framework

The objective of strengthening social safety net programmes (SSNPs), as seen in past two budgets, appears to have fallen victim to fiscal compulsions which gathered momentum in the budgetary framework. In FY2012-13, allocation for SSNPs is Tk. 22,751 crore, which is 11.87 per cent of total budget and 2.18 per cent of GDP. This allocation was lower than FY2011-12 (13.79 per cent of total budget and 2.51 per cent of GDP). 13 new programmes have been added to the ongoing SSNPs, while six of the previous programmes will be discontinued in FY2012-13. 43 ongoing programmes will receive lower allocations compared to FY2011-12. At this time of high inflation, there was a need for more effective SSNPs through reduction in wastage and leakage, and by raising the efficiency of the delivery system. Bangladesh should also gradually move from the concept of social safety net to social security. This will need putting in place a comprehensive strategy for social security.

2.6.1 Food Security in SSNP

Allocation for food security programmes in SSNP in FY2012-13 is 3.67 per cent of the total budget, which is 30.89 per cent of the total SSNP budget, and 0.67 per cent of the GDP (Figure 2.7). The percentage share of food security in SSNPs (based on the share of total budget and GDP) is lower than FY2011-12 (both provisional and revised). Moreover, allocation for VGD and Vulnerable Group Feeding (VGF) is set to decline by (-) 15.86 per cent and (-) 14.89 per cent respectively. In addition, allocation for Test Relief (TR) will also decline by (-) 2.44 per cent in FY2012-13 compared to that of FY2011-12 Budget.

Figure 2.7
Share of Allocation for Food Security Programmes



Source: Budget documents (various year).

2.6.2 Employment Generation Programmes in SSNP

Budget allocation for 10 major employment generation programmes (EGPs) in FY2012-13 is Tk. 1,818.3 crore, which is less

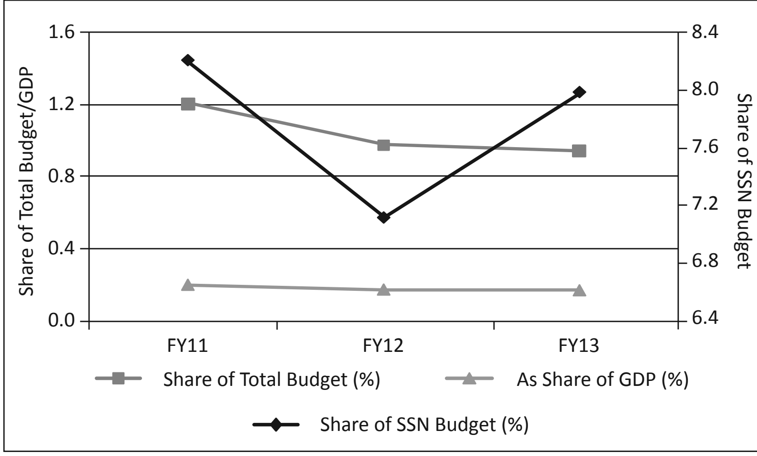
[5] Allocations in the child budget include both development projects and safety net programmes from the non-development budget. Moreover, projects concerning children directly and indirectly are included in the calculation. For example, projects for maternal health are included as these can indirectly affect the child's health.

than 1 per cent of total budget (Figure 2.8). This allocation is 0.17 per cent of the GDP in FY2012-13. The allocation for *National Service* is to be reduced from 305 crore in FY2011-12 to 228.3 crore in FY2012-13. In all possibility, the government has somewhat moved away from its earlier stance of rapid expansion of this programme.

Allocation for *Employment for Ultra-Poor in Northern Region* in FY2012-13 will reduce from Tk. 8 crore in FY2011-12 to Tk. 7 crore. However, allocation for this head needs to be raised considering the high level of poverty in the northern regions of Bangladesh. Among the ongoing employment generation programmes, *Rural Employment Opportunity for Public Asset* will be discontinued in FY2012-13.

Figure 2.8

Share of Allocation for Employment Generation Programmes



Source: Budget documents (various year).

2.7

REFORMS AND POLICY INITIATIVES

The FY2012-13 Budget Statement does evince a recognition about the need for undertaking second generation reforms if the growth rate is to be accelerated and the envisaged developmental outcomes are to be achieved. It may be recalled here that the CPD, in its *Analytical Review of Bangladesh's Macroeconomic Performance* report released on 4 June 2012 had drawn attention to the need for undertaking institutional reforms and policy measures as a necessary pre-condition for accelerating growth prospects and raising the quality of developmental outcomes. Indeed, the CPD report also undertook a review of the reform measures as espoused in various policy documents of the government.

In a welcome departure from the traditional budget speeches, the Finance Minister dedicated a separate section to the government's record on reforms and policy initiatives

In a welcome departure from the traditional budget speeches, the Finance Minister dedicated a separate section to the government's record on reforms and policy initiatives. The Budget Statement identified a total of 351 policy reforms and programmes which were categorised under three heads: (a) successfully implemented policies (203); (b) priority policies and programmes in progress (131); and (c) programmes yet to be completed (17). To monitor the progress with regard to reforms and as a sign of political commitment to pursue the agendas, it would have been better if a timeline was also mentioned for their completion. Some of the policy initiatives referred to the budget tends to evince contradictory signals though. For example, on the one hand, the government has passed the *Anti-Money Laundering Act 2012* to discourage illegal amassing of fortunes and capital flight, and on the other hand, it has allowed 'whitening of the black money' which goes against the cause of financial transparency and the spirit of good governance. The *Upazila Parishad (Amendment) Act 2011* that has been enacted is a good initiative; however, conflicts of interest among the various tiers of the government persist which deter the prospects of decentralisation and real devolution of administrative and fiscal powers. Another example relates to the initiative to establish the Bangladesh Investment Facilitation Fund Limited (BIFFL) as part of FY2011-12 budgetary proposal to attract foreign investors. However, in view of the inordinate delay in setting up the institutional framework of the PPP, this new outfit is yet to generate tangible results.

Since the government took over power in January 2009, a number of new initiatives were mentioned in various policy documents. It is not clear whether these will be pursued further

In the course of time since the government took over power in January 2009, a number of new initiatives were mentioned in various policy documents. It is not clear whether these will be pursued further. For example: formation of an Independent Vision 2021 Council was mentioned in the Perspective Plan. The first Budget Speech mentioned that the Regulatory Reforms Commission (RRC) will be reconstituted and the Bangladesh Better Business Forum (BBBF) will continue to function. Tax Ombudsman office was abolished but the institution Ombudsman as envisaged by the Constitution is yet to be put in place. The Perspective Plan mentioned that Pay, Services and Regulatory Reforms Commission will be set up to bring dynamism in the development administration.

The delay in finalising the Coal Policy remains a perplexing surprise in view of the urgency to design medium to long-term energy strategy for the country

All ministries have now come under the Medium Term Budgetary Framework (MTBF); however, for this initiative to generate the expected results, the capacity of line ministries to design, implement and monitor respective development activities will need to be significantly strengthened. Only now, the FY2012-13 Budget Statement mentions about establishment of budget management wings or branches in all the ministries and divisions. Sluggish progress with regard to PPP projects (only two infrastructure projects) has been a big letdown in spite of the significant dedicated allocations in successive budgets. The Budget mentions that the VAT law will come into effect by 2015. However, concerns remain whether the needed preparatory works can be completed before the law comes into effect in 2015. The Budget does not mention about reforming the state-owned enterprises (SoEs); it only talks about reorganising the Trading Corporation of Bangladesh (TCB). The delay in finalising the Coal Policy remains a perplexing surprise in view of the urgency to design medium to long-term energy strategy for the country. The Budget FY2012-13 mentions that a draft Audit Act has been prepared; however, it is to be noted that such an Act was submitted to the Ministry of Finance in 2008, and till date, no headway has been made in finalising the draft. The Budget talks of reforms and policy initiatives concerning the capital market. However, it fails to mention what measures were taken in view of the report of the investigation committee that was constituted by the government itself following the stock market debacle in 2010. Although demutualisation of the stock exchanges has been agreed upon, the progress towards this has been rather slow. The *Financial Reporting Act*, a key instrument for promoting transparency and accountability, has been drafted, but it will be placed before the Parliament for approval only in the next fiscal year.

It is good that the Budget FY2012-13 recognises the need for a more focused attention to institutional and policy reforms. However, success in this regard will critically hinge on the government's appetite and ability to pursue the follow-up actions

The Budget Statement also concedes that the *Civil Service Act* could not be finalised but that efforts to frame this law were continuing. Although introduction of Performance Based Evaluation System is a key to incentivising the development administration, the move towards the changed system has been slow. By any reckoning, success of government's developmental and investment plans will depend on its ability to raise the level and quality of performance of the development administration. It is good that the Budget FY2012-13 recognises the need for a more focused attention to institutional and policy reforms. However, success here will critically hinge on the government's appetite and ability to pursue the follow-up actions.

2.8

CONCLUDING REMARKS

The ongoing fiscal year's experience has put FY2011-12 in a league of its own from the perspective of challenges of macroeconomic management in the context of developing economies. It would have been good if Budget FY2012-13 undertook a close examination of the causes of the tensions emerging in the economy in FY2011-12 and put up a clear strategy to avoid those in FY2012-13. It would be good if the assumptions that inform the fiscal framework were spelt out in a more clear manner, the subsidy (other than agriculture) scenario was presented in a more transparent manner, the issue of legalisation of undisclosed money was dealt with more clarity, adjustment policy with regard to administered prices was detailed out, plans for transit-related investments and possible income from transit fees were shared, implications of conditionalities emanating from IMF-ECF were analysed, privatisation and reforms of SoEs were given importance.

It would have been good if the Budget FY2012-13 undertook a close examination of the causes of the tensions emerging in the economy in FY2011-12 and put up a clear strategy to avoid those in FY2012-13

The credibility of the Budget for FY2012-13 will largely depend on its implementation. It is critically important that there is a concrete implementation plan which is commensurate with the ideal fiscal framework that has been presented. A number of factors will be key to determining the outcome of Budget FY2012-13. The first relates to the soundness of the fiscal targets which sounds too good to be true, and will require exceptional efforts to achieve. Whilst NBR has been able to post stellar success in resource mobilisation, meeting non-tax revenue targets may be difficult. The targets for non-ADP expenditure, particularly subsidy requirement, may not match the price adjustments that the government will be agreeable to undertake. Whilst access to fund for implementing the ADP may not be a problem, its utilisation, as recent records validate, remains a serious concern. Attaining investment and growth targets will depend on the government's ability to deliver on the development budget, particularly also because achieving private sector investment targets will depend on this. Besides, delivery of credit from non-bank sources at a time of stagnating domestic savings, will also not be easy. The lower target set for private sector credit growth will likely to have negative impact on private sector investment unless there is significant rise in capital utilisation efficiency. It will be a challenge to gear up the development administration which is prone to lose momentum as elections near. The global economic scenario is also transmitting worrying signals with exports experiencing negative growth now for three months running. All the above factors will necessitate significant rise in resource utilisation efficiency, qualitative change in coordination among various ministries, alignment of fiscal and monetary policies, and undertaking the needed reforms and policy initiatives. Maintaining a conducive socio-political environment at a time of approaching elections will also be key to attaining the targets set out in the FY2012-13 Budget.

Maintaining a conducive socio-political environment at a time of approaching elections will also be key to attaining the targets set out in the FY2012-13 Budget

3 CHAPTER

State of Governance in the Banking Sector

Dealing with the Recent Shocks

Fahmida Khatun

This chapter was prepared as the keynote paper of the dialogue on *State of the Governance in the Banking Sector: Dealing with the Recent Shocks*, organised by the Centre for Policy Dialogue (CPD), on 5 November 2012, at the BRAC Centre Inn Auditorium, Dhaka.

Dr Fahmida Khatun is the Research Director of CPD.

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3.1

INTRODUCTION

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

Crisis, volatility and corruption in the banking sector have been found to have negative implications for the growth of the banking industry

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

The issue of governance in the banking sector has currently been under the spotlight in the context of the Hall-Mark scam

This chapter will discuss some of the challenges confronting the banking industry of Bangladesh, particularly focusing on the state-owned commercial banks (SCBs) in view of the Hall-Mark case. Hence the major objective of the study is to examine how far the exposed performance indicators of the SCBs are credible, and whether the SCBs have been able to meet the emerging domestic and global demands in terms of better services and newer products. The chapter also makes a number of recommendations for a healthy banking sector and to prepare for the emerging challenges.

The present study will discuss some of the challenges confronting the banking industry of Bangladesh, particularly focusing on the state-owned commercial banks in view of the Hall-Mark case

The chapter is structured in the following manner. The introductory section is followed by an overview of the performance of the banking sector in Section 3.2. This section also includes a brief discussion on the major reforms in the banking sector of the country since independence. Section 3.3 discusses the challenges of the sector in view of the recently exposed fraudulent practices of the Hall-Mark group. The chapter presents a set of key recommendations in Section 3.4 based on the lessons learnt from the Hall-Mark case. These suggestions are made with a view to ensuring a healthy and sustainable growth of the banking sector in the country. Finally, some concluding remarks have been made in Section 3.5.

3.2

OVERVIEW OF THE BANKING SECTOR

The pace of development for the banking industry has been significant over the past decades

3.2.1 Performance and Progress

The pace of development for the banking industry has been significant over the past decades. In calendar year (CY) 2011 total asset of 47 commercial banks stood at Tk. 58,749 crore and deposit at Tk. 45,098 crore. During the last ten years (2001-2011) total asset has grown by 324.2 per cent while deposit has increased by 326.9 per cent (Bangladesh Bank 2012). Total deposit is currently 51 per cent of GDP of the country. The ratios of money supply to GDP, total deposits to GDP and total domestic credit to GDP have shown steady increase over the years indicating an increased financial depth. In comparison to other South Asian countries Bangladesh stands behind India and Nepal (Table 3.1).

Table 3.1

Financial Depth in South Asian Countries

Indicator	Bangladesh				India	Pakistan	Nepal	Sri Lanka
	2000	2005	2010	2011	2011	2011	2011	2011
Money Supply-GDP	0.32	0.41	0.52	0.55	0.79	0.38	0.76	0.34
Deposit-GDP	0.29	0.38	0.49	0.51	0.57	0.36*	0.51	0.31
Credit-GDP	0.25	0.32	0.39	0.55	0.75	0.44	0.67	0.42

Source: Annual Reports of the central banks of Bangladesh, India, Nepal, Sri Lanka; World Development Indicator (WDI), available at: http://data.worldbank.org/country/bangladesh; accessed on 24 October 2012.
Note: *denotes data of 2010.

Financial inclusion, though still low compared to developing countries[1], have increased significantly since independence. Population per bank branch has reduced from 57,700 in 1972 to 17,660 in June 2011, indicating the wider coverage of banking services, and increase in the number of people included in the formal financial sector. However, there is still a large untapped market for the banking industry as a large number of people remain outside the banking services. Sarma (2008) developed an index of financial inclusion using data on three dimensions of financial inclusion and compared it among 55 countries. Bangladesh ranked 43, while India ranked 29 as per this index.

In line with Basel II requirement, to measure capital adequacy banks have now adopted the Basel minimum capital requirement in a phased manner

Soundness of the banking sector, which basically reflects on the quality of performance of the sector, is measured by indicators such as Capital Adequacy, Asset Quality, Management Quality, Earnings, Liquidity, and Sensitivity to Market Risks (CAMELS). In 1996, Bangladesh Bank adopted Basel I replacing the liability-to-capital approach with the risk-based capital approach which was adopted in 1991. Minimum capital requirement (MCR) was 8 per cent of risk weighted asset (RWA) with 4 per cent core capital. In 2002, MCR was raised to 9 per cent of RWA with 4.5 per cent of core capital. In line with Basel II requirement, to measure capital adequacy banks have now adopted the Basel minimum capital requirement in a phased manner. Accordingly, during January to June 2010 the minimum capital of banks was 8 per cent of RWA with core capital equal to 4 per cent of RWA; for the July 2010 to June 2011 period these rates were 9 per cent and 4.5 per cent respectively. Since July 2011 the minimum capital of banks should be 10 per cent of RWA with core capital equivalent to 5 per cent of RWA.

[1] In India, for example, population per bank branch was 13,466 in FY2010-11 (Reserve Bank of India; available at: http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?id=669; accessed on 2 November 2012).

Over the last few years the banking sector of Bangladesh has made significant progress with regard to these indicators. As shown in Table 3.2, in the recent past the situation of banks in terms of capital adequacy has improved and they have been able to maintain adequate RWA capital. The percentage share of non-performing loans (NPLs) to total loans has reduced dramatically during 1997 to 2011. Similarly there were improvements in the case of bank management, profitability and liquidity. However, a disaggregated performance of these indicators for different categories of banks shows that the performance of the SCBs has been weaker than other categories of banks (Table 3.3).

Performance of the SCBs has been weaker than other categories of banks

Table 3.2
Soundness of Banking Sector Performance

Indicator	CY2004	CY2006	CY2008	CY2010	CY2011	CY2012 (June)
Capital to Risk Weighted Asset (%)	8.70	6.70	10.10	9.30	11.30	11.31
Non-Performing Loan to Total Loans (%)	17.60	13.20	10.80	7.30	6.20	7.17
Expenditure-Income Ratio (%)	90.90	91.40	87.90	70.90	NA	NA
Return on Asset (%)	0.70	0.80	1.20	1.80	1.30	1.16
Return on Equity (%)	13.00	14.10	15.60	21.00	14.30	13.49
Liquid Asset (%)	23.40	21.50	24.80	23.00	21.00	27.19
Excess Liquidity (%)	8.70	5.10	8.40	6.00	9.21	18.20
Sensitivity to Risks	20.30	31.50	9.90	NA	NA	NA

Source: Bangladesh Bank.
Note: NA denotes not available.

Table 3.3
Performance of Various Types of Banks

Indicator	Bank Type	2004	2006	2008	2010	2011 (June)	2012 (June)
Capital Adequacy	**Capital to Risk Weighted Asset (%)**						
	SCBs	4.10	1.10	6.90	8.90	9.50	11.16
	DFIs	9.10	-6.70	-5.30	-7.30	-7.00	-7.05
	PCBs	10.30	9.80	11.40	10.10	10.40	10.41
	FCBs	24.20	22.70	24.00	15.60	17.10	17.08
Asset Quality	**NPL to Total Loans (%)**						
	SCBs	25.30	22.90	25.40	15.70	14.10	12.80
	DFIs	42.90	33.70	25.50	24.20	21.80	23.94
	PCBs	8.50	5.50	4.40	3.20	3.50	3.64
	FCBs	1.50	0.80	1.90	3.00	3.10	3.18
Management	**Expenditure-Income Ratio (%)**						
	SCBs	102.30	100.00	89.60	80.70	65.90	NA
	DFIs	104.00	103.50	103.70	87.80	101.70	NA
	PCBs	87.10	90.20	88.40	67.60	69.10	NA
	FCBs	76.30	71.10	75.80	64.70	45.40	NA
Profitability	**Return on Asset (%)**						
	SCBs	-0.10	0.00	0.70	1.10	0.60	0.75
	DFIs	-0.20	-0.20	-0.60	0.20	-0.30	-0.04
	PCBs	1.20	1.10	1.40	2.10	1.60	1.19
	FCBs	3.20	2.20	2.90	2.90	3.60	3.78

(Table 3.3 contd.)

(Table 3.3 contd.)

Indicator	Bank Type	2004	2006	2008	2010	2011 (June)	2012 (June)
	Return on Equity (%)						
	SCBs	-5.30	0.00	22.50	18.40	10.00	11.72
	DFIs	-2.10	-2.00	-6.90	-3.20	-5.20	1.39
	PCBs	19.50	15.20	16.40	20.90	15.60	12.39
	FCBs	22.50	21.50	17.80	17.00	20.20	19.43
Liquidity	**Liquid Asset (%)**						
	SCBs	22.80	20.10	32.90	27.20	27.00	NA
	DFIs	11.20	11.90	13.70	21.30	22.10	NA
	PCBs	23.10	21.40	20.70	21.50	24.50	NA
	FCBs	37.80	34.40	31.30	32.10	31.10	NA
	Excess Liquidity (%)						
	SCBs	6.80	2.10	14.90	8.20	8.10	NA
	DFIs	4.70	3.80	4.90	2.30	3.10	NA
	PCBs	8.80	5.60	4.70	4.60	8.00	NA
	FCBs	21.90	16.40	13.30	13.20	12.20	NA

Source: Bangladesh Bank.
Note: DFI: Development Financial Institution; PCB: Private Commercial Bank; FCB: Foreign Commercial Bank.
NA denotes not available.

Even though there have been improved performance, the SCBs continue to be grappled with problems of inefficiency and solvency. Thus the seemingly good performance does not capture the reality which raises elements of doubts as regards to the real health of SCBs.

3.2.2 Reforms in the Banking Sector

Even though there have been improved performance, the SCBs continue to be grappled with problems of inefficiency and solvency

The Government of Bangladesh (GoB) played an active role in functioning of the economy as it envisaged a socialist economy after independence in 1971. As a result the government had a greater involvement in various sectors of the economy including in banking and finance. The commercial and specialised banks were under the control of the government.

The government embarked on a policy of liberalisation, through denationalising the nationalised commercial banks (NCBs) in the 1980s. In view of the deteriorated performance and inefficient resource management, the government decided to open up the banking sector and adopt a number of reforms for the sector. As part of the reform process two of the six NCBs were denationalised, and a few commercial banks were given license to operate in the private sector to create competition in the banking sector. The reform process accelerated towards the end of 1980s and the beginning of the 1990s under the directions of the World Bank and the International Monetary Fund (IMF). The National Commission on Money, Banking and Credit was constituted in 1986 to look into the problems of the banking sector and suggest ways to overcome those under the direction of the World Bank. The Commission pointed out, among others, problems relating to the supervisory task of Bangladesh Bank, overall structure of the banking sector, and pointed out that non-performing assets (NPAs) required improvement. The consequent Financial Sector Reforms Programme (FSRP) and Financial Sector Adjustment Credit (FSAC) carried out in the 1990s were geared towards implementation of various reform measures in the financial sector. The objectives of these measures were to liberalise interest rate, enhance the capacity of loan classification and provisioning, capital restructuring and risk analysis, strengthening the central bank, and improving the legal system and framework for loan recovery.

The consequent Financial Sector Reforms Programme and Financial Sector Adjustment Credit carried out in the 1990s were geared towards implementation of various reform measures in the financial sector

Following the phase out of the FSRP in 1996, subsequent governments continued to undertake reform measures in the financial sector. The Commission on Banking and the Banking Reform Committee were formed in 1998 and 2002 respectively to make recommendations for the improvement of the performance of banks. A bill was passed in the National Parliament in 2003 to bring more reforms in the banking sector. Most important of the relevant initiatives was the *Bangladesh Bank Amendment Bill 2003* through which Bangladesh Bank received the autonomy to operate on its own and also to formulate the monetary policy. The World Bank and the GoB undertook a reform initiative called the Central Bank Strengthening Project (CBSP) to put in place a strong and effective regulatory and supervisory system for the banking sector of the country. The focus of this project was on three broad areas, such as (i) strengthening the legal framework; (ii) reorganisation and modernisation of Bangladesh Bank; and (iii) capacity building of Bangladesh Bank.

A bill was passed in the National Parliament in 2003 to bring more reforms in the banking sector

Another major reform attempt was the corporatisation of four SCBs into limited companies, and restructuring of three SCBs in 2007 to operate as more of a commercial entity. Supported by the World Bank and monitored by Bangladesh Bank, the reform initiative included measures such as selection of the Chief Executive Officer (CEO), Deputy Managing Director (DMD) and four General Managers (GMs) of the SCBs through a competitive process, and fixation of the compensation package that was commensurate with the private sector and in accordance with respective performance records. Monitorable goals were set for cash recovery of NPLs, limits on new NPLs, operations, computerisation, income and profitability, increased net worth and disclosure.

As can be seen from Table 3.3, since the corporatisation of the SCBs there have been some improvements in terms of achievement of the goals that were set out. The SCBs, for the first time, did earn profit in 2008, which they also continued afterwards. The NPL has reduced and the management performance has also increased which is reflected through lower expenditure-income ratio.

The reform initiatives for the banking sector in Bangladesh have not been able to deliver the expected results

However, the reform initiatives for the banking sector in Bangladesh have not been able to deliver the expected results. Achievements in terms of efficient resource allocation through disbursement of credit to productive sectors, prudent risk analysis, supervisory and management quality have not been encouraging in many banks even after so many reforms since independence. Moreover, lack of governance has been featured prominently in the recent years in several banks including the SCBs. This only suggests that reform is still an unfinished agenda in the banking sector of Bangladesh.

3.3

ANATOMY OF THE HALL-MARK INCIDENCE

Higher credit expansion, increased profitability, lower NPAs and increased financial inclusion have contributed to an improved banking system during the past decade

As is revealed from the previous section, higher credit expansion, increased profitability, lower NPAs and increased financial inclusion have contributed to an improved banking system during the past decade. The regulatory framework has supported this growth to a large extent. It may be worth to note that at a time when major economies of the world are under tremendous pressure due to the second wave of financial crisis and bankruptcy of financial institutions and sovereign debt crisis, the banking sector of Bangladesh has been navigating through in a resilient manner.

However, recent shocks in the banking sector have exposed the vulnerability of the seemingly resilient financial systems in the country. Despite some positive results initially after the reform in 2007, the SCBs unfortunately could not sustain the momentum due to poor supervisory capacity and weak institutional framework. As a result, not only these banks are suffering from shortages of capital but their profitability has also started to decline (Table 3.3). Additionally, incidences of irregularities have weakened the overall performance and threatened the stability of the banking industry. The recently detected Hall-Mark case of forgery through inland bills trade involving the largest SCB of the country, the Sonali Bank Limited (SBL), is a testimony to poor management, weak internal control and risk management, and above all, total lack of governance on the part of the bank. Shocks in the banking sector of such nature and extent will not only hamper the growth of the banking industry, but can also risk the economic growth of the country. Information provided in Box 3.1 support such claim. This is the most despicable financial forgery in the banking history of Bangladesh which has surpassed all the earlier cases of misappropriation of resources from banks.[2]

The recently detected Hall-Mark case of forgery through inland bills trade involving the largest SCB of the country, the Sonali Bank Limited, is a testimony to poor management, weak internal control and risk management, and above all, total lack of governance on the part of the bank

Box 3.1: Unauthorised Loans and Advances:
A Record of Sonali Bank – Ruposhi Bangla Branch

The recently unearthed incidence of financial irregularities at the Ruposhi Bangla branch of Sonali Bank Limited reveals that as on 31 May 2012 total outstanding loans and advances related to international trade was Tk. 3,699.53 crore, of which funded and non-funded unauthorised loans and advances was Tk. 3,606.48 crore. These unauthorised bank loan facilities were given by the General Manager and Assistant Manager of the branch to Hall-Mark Group (Tk. 2,667.45 crore), T and Brothers Group (Tk. 685.63 crore), Paragon Group (Tk. 144.44 crore), DN Sports Group (Tk. 28.54 crore), Nakshi Knit Group (Tk. 65.3 crore), and others (Tk. 15.12 crore).

A significant fund was misappropriated through the inland bills trading

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

The branch transferred the money to the accounts of the three companies which after a few days advised the bank to transfer the money to the account of Hall-Mark Group

The Branch Manager resorted to a number of unauthorised ways to disburse huge amount of money to Hall-Mark Group and other customers. Some of these are as follows:

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

(Box 3.1 contd.)

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

(Box 3.1 contd.)

- Created unauthorised fresh loans to adjust unauthorised overdue loans;
- Provided loan against fake export documents of Hall-Mark Group, T and Brothers Group, Paragon Knit Composite Ltd. and Nakshi Knit Composite Ltd.;
- Provided excess pre-shipment credits (PSC) over approved limit;
- Allowed PSC without L/Cs;
- Allowed PSC after shipment date;
- Opened cash L/Cs without customer's existing liabilities and limits;
- Opened cash L/Cs for capital machinery at zero margin without the approval of the Head Office of the bank;
- Foreign Currency Management Division (FCMD) debited Head Office NOSTRO account without obtaining reimbursement from the branch;
- Reported irregular Payment Against Documents loans as regular in classified loan report;
- Opened foreign back-to-back L/Cs without office note and realising commission;
- Transferred fund illegally by debiting sundry deposit accounts;
- Purchased export bills before completion of exports;
- Applied incorrect exchange rates for purchasing deferred payment export bills;
- Overdue export bills were not reported to the central bank; and
- Allowed temporary overdraft illegally against cash incentives.

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

In a resource-constraint country such as Bangladesh where the government has to struggle for allocating resources among competing priorities, Tk. 3,606.48 crore have significant implications for public investment

3.3.1 Magnitude of the Hall-Mark Scam

In a resource-constraint country such as Bangladesh where the government has to struggle for allocating resources among competing priorities, Tk. 3,606.48 crore have significant implications for public investment. Box 3.2 reveals why this scam is too important to be ignored exclusively on economic grounds. One may also wonder why does the country bows down to stringent conditionalities of donors for the construction of infrastructural projects when domestic resources are being plundered in this manner.

Tk. 3,606.48 crore is equivalent to 6.6 per cent of ADP of FY2012-13

Box 3.2: What is the Value of Tk. 3,606.48 Crore?

Tk. 3,606.48 crore is equivalent to:

- 320.6 per cent of Sonali Bank's paid up capital!
- 6.6 per cent of Annual Development Programme (ADP) of FY2012-13
- 15.9 per cent of allocation for social safety net programme in FY2012-13
- 38.6 per cent of allocation for health in FY2012-13
- 16.8 per cent of allocation for education in FY2012-13
- 0.3 per cent of projected GDP of FY2012-13
- 15.0 per cent of the finance requirement of the Padma Bridge
- 42.9 per cent of the envisaged support by the World Bank for the Padma Bridge

Source: Compiled by the author.

It is also alarming to observe that SBL disbursed an amount equivalent to almost 237 per cent of the paid up capital of SBL only to Hall-Mark Group; this is an utter violation of the 'Single Party Exposure Limit'

It is also alarming to observe that SBL disbursed an amount equivalent to almost 237 per cent of the paid up capital of SBL[3] only to Hall-Mark Group (Tk. 2,667.45 crore). This is an utter violation of the 'Single Party Exposure Limit'. Bangladesh Bank has determined that banks cannot give loan more than 35 per cent of its

[3]As on 31 December 2011, SBL had a paid up capital of Tk. 1,125 crore (http://www.sonalibank.com.bd/PDF_file/fs2011.pdf; accessed on 24 October 2012).

capital to any individual, enterprise or group, of which funded loan should not exceed 15 per cent of bank's capital. In case of the export sector, a client can be granted a loan up to 50 per cent of bank's capital, of which funded loan has to be kept within 15 per cent of bank's capital.

3.3.2 Fault Lines of the Hall-Mark Episode

A number of reasons have been identified by the audit team which helped this forgery to happen

It is more or less clear now that weak risk management, pressure exerted by powerful sections, connivance and unholy alliance between senior managers of the bank and the client, lack of supervision from the Head Office of the bank, oversight of the Board and lack of regulatory hindsight had been the reasons behind the embezzlement of this huge amount of money from a small branch of SBL. As is shown in Box 3.1, irregularities were of various natures and at a large scale. This cannot be performed by a sole manager of a small branch. A number of reasons have been identified by the audit team which helped this forgery to happen. These are summarised below:

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

No steps were taken by the ITFD to regularise the irregularities of the said branch of the bank

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

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

Inspection and Audit Division (IAD)-2 of the Head Office graded the branch as 'Low Risk' branch in February 2011

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

e. The irregularities were easy to be carried out by the branch due to the absence of an automated transaction system with central control and monitoring facilities.

3.4

LESSONS LEARNT AND RECOMMENDATIONS

The recent financial scam is an eye-opening incident for all associated with banking sector as well as the policymakers exposing the inherent weaknesses of the banking sector of the country. In view of the recent irregularities, appropriate measures ought to be undertaken in the short to the medium-term towards improved performance of the sector. This should range from proper investigation and punishment of involved persons to improvement of the monitoring and governance of the SCBs. Specific recommendations are the followings:

Absence of a comprehensive risk management policy in many banks makes it difficult to handle fraud and other extraordinary cases

3.4.1 Absence of Risk Management Policy

Absence of a comprehensive risk management policy in many banks makes it difficult to handle fraud and other extraordinary cases. Bangladesh Bank has identified six core risks and asked banks to formulate and implement appropriate guidelines on those. These core risks include the following: (i) Credit Risk Management; (ii) Foreign Exchange Risk Management; (iii) Asset-Liability Risk Management; (iv) Internal Control and Compliance Risk Management; (v) Money Laundering Prevention Risk Management; and (vi) Guidelines on Information and Communication Technology. Needless to say, these guidelines are hardly followed by most of the banks, especially the SCBs. The manual for loans and advances containing policies, procedures, processing and reporting transactions, review of security and collateral and responsibilities at different levels is not followed by many banks due to which it becomes difficult for them to handle and manage clients with various levels of exposures.

The Internal Control Department which ought to be the most critically important department of any bank is weak in the SCBs

3.4.2 Lack of Internal Control

The Internal Control Department which ought to be the most critically important department of any bank is weak in the SCBs. This is mainly due to incentive failure which prevents hiring of qualified persons for this department. As the nature of the job involves patient scrutiny of compliance, people are reluctant to work here, and those who do, are often in a way dumped in this department. Absence of information technology (IT) makes their work even more boring. Bangladesh Bank guidelines on internal control require that if there is any incidence of a loss equivalent to Tk. 1 crore the Board of Directors of Banks should be informed immediately. Besides, any major irregularities, fraud and embezzlement have to be presented through a report during the monthly assessment of banks. In the case of Hall-Mark scam it seems that the bank management was hiding the illegal activities in the said branch for a prolonged period.

The tradition and practice of appointing Directors of the Board of the SCBs based on the political loyalty and affiliation have to be changed

3.4.3 Political Baggage of the Board of Directors

The tradition and practice of appointing Directors of the Board of the SCBs based on the political loyalty and affiliation have to be changed. Members of the Board of the SCBs should be independent, qualified, efficient and socially acceptable persons with unquestionable integrity. *Bangladesh Bank Guidelines 2010* for the Directors of banks spelt out the 'Fit and Proper Test Criteria' for the nomination of Directors along with their responsibilities and power. These criteria are yet to be implemented fully. Due to political baggage, Directors of SCBs cannot perform their duties independently and remain morally obliged to listen to political instructions of the government. This results in weak corporate governance. As the Board members are also members of various committees of a bank that are constituted in order to closely guide various operations of the bank, the independence of the Audit Committee, the most important board committee which has to ensure compliance of business strategy and policy of the Board, cannot be maintained as well. Given the emerging challenges and dynamism of modern banking business, it is thus important that Directors of the Board have the pertinent knowledge and skill of running bank with efficiency and sincerity.

It is thus important that Directors of the Board have the pertinent knowledge and skill of running bank with efficiency and sincerity

The accountability of the Directors should also be determined clearly. In case of the Hall-Mark scam it has been reported that the Board was not informed of the unscrupulous inland bill trading. However, the fact that the responsible branch was not audited and the accused Branch Manager was not transferred even after completion of his three years tenure are some of the issues which the Board cannot shrug off as its oversight responsibility.

3.4.4 Inappropriate Appointment of CEOs and Senior Officials

The scam has also exposed total failure of the CEO and responsible senior managers of the bank in discharging their duties. In the SCBs, preoccupation of most CEOs is to keep the Board in good humour and sing the songs the way the Board likes to hear so that their position is well-secured under any circumstances. It is difficult to find any instance where the CEO has been asked to leave the job because of bad performance. One may argue that in a setting where the Board is constituted of political candidates, the CEO is handicapped in taking any decision guided purely by banking ethics, norms and perceived risks. This however, is not a saleable point. Good business plan, effective people management programme, regulatory compliance practice, effort towards clients' satisfaction and high work ethics of any CEO of a bank are bound to be endorsed by a Board, no matter how political it may be. Performance of CEOs should be evaluated from time to time by the Board based on the Key Performance Indicators (KPI). The Board can only guide and support the CEO to achieve the targets that are of benefit to the bank.

In a setting where the Board is constituted of political candidates, the CEO is handicapped in taking any decision guided purely by banking ethics, norms and perceived risks

In appointing GMs, suggestions have been made to have a common and single selection and promotion committee under Bangladesh Bank and the Ministry of Finance (MoF) for selecting GMs, or promoting DGMs to GMs, and for posting them in different banks following their selection. GMs should also be transferred from one SCB to another in order to not only help transfer of good practices, but also to reduce the possibility of fraudulent and unethical practices.

3.4.5 Shortcomings of Human Resource Policy

Human resource (HR) development has been a neglected issue in the SCBs. As mentioned earlier, the World Bank supported reforms of 2007 recommended a number of measures for the improvement of skills and performance of the officials in the SCBs. However, the HR Department of the SCBs remains weak and powerless to take decisions on recruitment and promotion, partly due to lack of capacity, and partly due to external influence. In the modern day business, banks have to provide value added products and services to customers in addition to traditional banking functions. However, the SCBs suffer from skilled and qualified human resources for undertaking such operations. The HR policy of banks should not only arrange for appropriate training, but also should include reward and punishment practices in the banks.

Human resource development has been a neglected issue in the SCBs

3.4.6 Inertia for Automation and Management Information System (MIS)

An issue related to the HR development is the automation and Management Information System (MIS) in banks. It is apprehended by experts with fair amount of certainty that there may be many more Hall-Mark cases that wait to be uncovered in other banks. Unless these are dug out through transparent and automated banking practices with the help of IT, the mess may get piled up and reach an unmanageable stage. Even after several reform initiatives, the inertia of the SCBs in adopting IT-based banking services and the MIS is not only disappointing but also quite surprising. Due to lack of MIS, the Hall-Mark case was not detected in time even though clearing was going against SBL continuously for many months due to loan increase in a branch of the bank.

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There have been comprehensive programmes for the last several years to establish automated clearing house and credit information bureau (CIB), computerisation of the head offices and branches of all banks, electronic banking services, online corporate banking service, electronic fund transfer, automated teller machine (ATM) and internet banking. While all the FCBs and most of the PCBs have implemented these automated and electronic banking services, the SCBs are way behind in meeting these requirements. This is not only affecting their efficiency and profitability, but also giving rise to opportunities for committing scams such as the Hall-Mark. The archaic manual system of transaction records has indeed facilitated the Hall-Mark forgery. It may be mentioned here that as part of the reform programme, the World Bank had supported a consultant in the rank of the GM for IT in the SCBs for two years with a higher compensation package. The GMs for IT were supposed to work on procuring computers, developing and buying software, and training the officials. These initiatives are yet to see any meaningful result as the automation process is almost non-existent in the SCBs.

3.4.7 Dualism in the Regulatory Mechanism and Regulator's Oversight

It is no secret that there exists a strained relationship between the Bangladesh Bank and MoF over the supervisory and regulatory role on SCBs. Though Bangladesh Bank can exercise its full authority in supervising the PCBs and FCBs, the MoF oversees the SCBs to some extent. The MoF appoints the Directors of the Board, CEOs, DMDs and GMs of the SCBs. However, due to less articulated mandate, Bangladesh Bank faces problems in implementing recommendations of audits and ensuring overall governance of the SCBs.

It is no secret that there exists a strained relationship between the Bangladesh Bank and MoF over the supervisory and regulatory role on SCBs

Full autonomy of the central banks has been suggested by many concerned stakeholders including the donors. The IMF has asked for amendment of the Banking Company Act (BCA) giving full legal supervisory and regulatory authority of Bangladesh Bank over all commercial banks within September 2012 as a pre-condition for contracting a loan to Bangladesh for USD 987.06 million under the Extended Credit Facility (ECF) in April 2012. There has also been suggestion by many to dismantle the Banking and Financial Institutions Division at the MoF in order to keep the SCBs away from political influence. While this is necessary for smooth functioning of the banking sector, the supervisory and monitoring role of Bangladesh Bank needs to be significantly strengthened as well. Though the MoF is in the driving seat to monitor and control the SCBs, Bangladesh Bank has to perform audit and inspection in all commercial banks including the SCBs. As in the other previous financial chaos in the country such as the capital market debacle, Bangladesh Bank played a reactive role long after the irregularities have actually been taken place. Firm supervision and effective monitoring could have controlled the damage suffered by SBL. The fact that clearing of SBL was going against the bank, the amount of loan was increasing, and finally the bank became a borrower from a lender in the inter-bank market, indicates the weak off-site supervision mechanism of Bangladesh Bank.

Bangladesh Bank has to perform audit and inspection in all commercial banks including the SCBs

3.4.8 Need for a Commission for the Financial Sector

Though banking sector has achieved considerable success due to the reforms in the 1990s and 2000s, the sector will have to prepare for the next generation global regulatory framework and meet emerging clients' needs. In the coming days the banking industry will have to achieve the ability to absorb shocks arising from financial and economic stress, improve risk management and governance, and strengthen bank's transparency and disclosures through complying with Basel III requirements which is scheduled to be introduced from 2013 until 2018.

In view of the recent shocks in the banking sector and emerging challenges a Commission for the financial sector should be formed which will scrutinise the overall performance of the sector, assess the needs of customers and the economy, identify the current problems and emerging challenges, and suggest concrete recommendations for prudential banking to be implemented in the short to medium terms

In view of the recent shocks in the banking sector and emerging challenges a Commission for the financial sector should be formed which will scrutinise the overall performance of the sector, assess the needs of customers and the economy, identify the current problems and emerging challenges, and suggest concrete recommendations for prudential banking to be implemented in the short to medium terms. Considering the emerging need and in order to build up more transparent and responsible banking sector, the Commission can also include NBFIs, such as insurance companies and capital market under its jurisdiction as they are interconnected. The broad terms of reference (ToR) of the Commission will be to critically assess the problems and weaknesses of the banking industry in order to find whether there is any disconnect between demand of the growing economy and the realities of a backdated financial system that is failing to meet the emerging need. On the basis of a comprehensive scrutiny the Commission will prepare guidelines and make recommendations as regards automation, risk management, internal control, the role of various players in banks and other financial institutions.

3.5

CONCLUDING REMARKS

The Hall-Mark incident is not only a case of financial loss, but also a deep dent on the confidence and trust of the customers of the bank

The Hall-Mark incident is not only a case of financial loss, but also a deep dent on the confidence and trust of the customers of the bank. It is also not the loss of good will of the particular bank only, but of the total banking industry. Such an erosion of reputation of banks could have multiple chain effect including reduction of deposit in the concerned bank and fall of share prices of the whole banking sector. This can also constrain the role of the banking sector in catalysing the growth of the economy. Without radical changes in the banking practices in the country such expectations may remain largely unfulfilled. During the run-up to attaining the ambition of being a middle-income country, there is a need to significantly strengthen the banking industry if goals are to be realised. From the 1990s onwards, the Bangladesh economy has evolved and the banking sector has evolved as well. With the speed up of economic growth through higher investment, the demand on the banking sector will still be higher. This reiterates the need for improved efficiency of the sector in terms of resource allocation for the productive sectors and management. As the global regulatory environment is becoming tighter, global economic environment is facing more volatility and resources are getting more scarce, banks in Bangladesh will have to find innovative ways to conduct their business. There will be demand for higher capital and skilled human resources for smooth functioning of banks and for ensuring compliance in the coming days. Therefore, the banking sector in Bangladesh has to focus on using both its financial as well as human resources in a far more innovative and efficient way to cater to the demands of the future.

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1 ANNEX

Dialogue Report on

Analysis of the National Budget for FY2012-13

This Dialogue Report is prepared by *Mr Mashfique Ibne Akbar*, Research Associate of the Centre for Policy Dialogue (CPD).

THE DIALOGUE

The dialogue on *Analysis of the National Budget for FY2012-13*, organised by the Centre for Policy Dialogue (CPD), was held on 16 June 2012, at the La Vita Hall, Lakeshore Hotel, Dhaka. The event was held with the view to share CPD's observations on and analysis of the various proposals set out in the National Budget for FY2012-13 presented by the Finance Minister on 7 June 2012. The idea was to create an opportunity for an in-depth discussion with participation of major stakeholders including policymakers. *Mr M Syeduzzaman*, Member, CPD Board of Trustees and Former Finance Minister was the Chair at the dialogue whilst *Professor Mustafizur Rahman*, Executive Director, CPD was the keynote presenter. The Hon'ble Minister for Planning *Air Vice Marshal (Retd) A K Khandker, MP* was present at the dialogue as the Chief Guest. *Mr Amir Khosru Mahmud Chowdhury*, Member, Advisory Council of the Chairperson, Bangladesh Nationalist Party (BNP) and Former Minister for Commerce was the Special Guest, and *Dr A B Mirza Azizul Islam*, Former Advisor to the Caretaker Government, Ministries of Finance and Planning was the Guest of Honour at the programme. The dialogue saw a lively exchange of views among a broad spectrum of participants which included representatives of the civil society, lawmakers, senior government officials, economists, academicians, representatives of grassroots organisations and development agencies. List of participants is attached at the end of the report.

WELCOME NOTE

Mr M Syeduzzaman, as Chair of the dialogue, warmly welcomed the participants on behalf of CPD. He particularly thanked the Chief Guest for his presence and hoped that deliberations at the dialogue will be reflected in the revised budget document.

Mr Syeduzzaman noted that the Finance Minister in his Budget Speech has elaborated on the measures, steps and programmes taken by the government in the course of the past three years. He also appreciated the extensive discussion the Finance Minister had with major stakeholders prior to formulating the 2012-13 Budget proposals. *Mr Syeduzzaman* observed that such extensive consultation was important not only to gauge public sentiment, but also for buy-in of the budgetary proposals by citizens. The Chair felt that the practice of presenting quarterly reports before the Parliament about progress of implementation of the budgetary proposals was a commendable initiative. Regarding the size of the budget, he thought that it was commensurate with the tasks at hand, but that the 18.4 per cent share of the budget for public expenditure was lower than in most of the South Asian countries.

The Chair was of the opinion that the most notable success of the government in the past three years was the steady increase in revenue as percentage of the gross domestic product (GDP). However, the state-owned enterprises (SoEs) were a drag on the economy, and also there was the fact that Bangladesh's revenue-GDP ratio was lower than those of other South Asian countries. Additionally, negative public savings for the last couple of years, decline in national savings in FY2011-12 after several years of slow progress, and lower debt-GDP ratio remained continuing concerns. Growth in domestic borrowing and unsatisfactory level of utilisation of domestic resources in recent years had put a limit on the fiscal space that was required to deal with any unforeseen external or internal shocks. Declining foreign aid disbursement also limited the fiscal space available. He also highlighted a number of challenges facing the implementation of the Budget FY2012-13. The economy was at a state where the import-export gap was widening, overall balance of payments (BOP) was in a deficit for the first time in about a decade, and exchange rate faced some pressure along with upward pressure on the interest rate. Lack of fiscal space could constrain private investment, which was the engine of growth, the Chair observed.

KEYNOTE PRESENTATION

The keynote paper was presented by *Professor Mustafizur Rahman* on behalf of CPD's Independent Review of Bangladesh's Development (IRBD) Team.

Professor Rahman noted that the Budget for FY2012-13 would be the last budget for which the incumbent government will get a full fiscal year to implement. Dwelling on the positive indicators, he noted that major such features of the outgoing fiscal year included encouraging performance of the National Board of Revenue (NBR), steady growth of agriculture and robust remittance flows. However, there were also tensions that were gaining within the economy in FY2011-12. One of the major weaknesses of this fiscal year was the state of fiscal management. Additionally, there was high inflation, stagnation in the investment scenario in terms of its share in the GDP, and this was true for both public and private investments; the BOP was also under some pressure. GDP growth rates were likely to experience slowdown and would be lower than what was projected. The speaker felt that major objectives of the budget should be fiscal consolidation, reversal of the investment downturn, restraining inflation and revitalising the lost momentum in terms of the economic growth.

Professor Rahman observed that achieving the growth target for FY2012-13 would be a challenge and would demand a significant improvement in many key macroeconomic indicators. He expressed doubts over realisation of some of these key targets which include investment (both public and private), Annual Development Programme (ADP), inflation and non-tax revenue targets in the budget. *Professor Rahman* presented an analysis of the factors which underwrote such an outlook. As an example, he noted that if share of investment in the GDP had to rise by 4.6 per cent more than last year (as projected in the budget), growth in investment would have to be 32.4 per cent which entailed a significant departure when compared with the performance of the recent past years.

Professor Rahman commented on a number of fiscal and budgetary measures included in FY2012-13 Budget. He felt that tax on mobile phone bill was likely to adversely affect the prospect of further expansion of mobile telephony where the additional market opportunities are lying mainly among the relatively low-income people. The possible impact of the proposed 2 per cent tax to be levied on mobile usage was somewhat ambiguous because it was not clear whether the tax would be in the form of an advance income tax (AIT). With regard to land tax he expressed apprehension that the way the tax was being proposed, it would perhaps be passed on to the consumers. About the whitening of undisclosed money, *Professor Rahman* reiterated CPD's earlier stance and stated that this was not desirable both on fiscal discipline and moral grounds. If past record in this respect gave any cue, this also failed to bring-in additional resources.

FLOOR DISCUSSION

Incentives for Readymade Garments (RMG) Sector

Concern was raised by *Mr Anwar-Ul-Alam Chowdhury Parvez*, Former President, Bangladesh Garment Manufacturers and Exporters Association (BGMEA) about the state of RMG sector in recent times. He felt that the RMG sector had to be competitive in order to achieve higher growth. The budget did not speak of any measures to make the RMG sector competitive. Rather high interest rates, high level of government borrowing crowding out private sector, and high at-source AIT acted as deterrents to growth prospects of this key sector of the economy. To be competitive, the sector had to have a conducive environment. Uninterrupted power supply was a key demand of the entrepreneurs. He was of the opinion that the government should have assessed the requirements of the export-oriented industries carefully, and should have employed the mechanism of deducting tax from profit rather than doing so at source.

Dr Wajedul Islam Khan, General Secretary, Bangladesh Trade Union Kendra highlighted the issue of workers' welfare in the RMG sector. He mentioned that approximately four million RMG workers are working in the sector, where the minimum wage was only Tk. 3,000. This was one of the primary reasons for the current unrest in Ashulia and other places. Another reason was that the house rent had increased by two to three times in the very recent period. *Dr Khan* demanded construction of low-cost dormitories for workers in areas where there is high concentration of industrial workers. He urged the government to take up the matter with utmost seriousness.

Mr Haider Akbar Khan Rano, Convener, Workers' Party of Bangladesh (Reconstructed) was of the opinion that rationing will be a very good step to mitigate the dissatisfaction of the workers. This was supported by number of other speakers. They urged upon the government to seriously consider the proposal and look for resources that will be needed for implementing this proposal.

Agricultural Subsidy

Referring to the subsidy for agriculture *Mr Rano* noted that it has decreased in the proposed FY2012-13 Budget compared to the Revised Budget of FY2011-12. As a result, it will be difficult to ensure continuity of the success of the agriculture sector attained in recent years. Concerns were also expressed with regard to the proposed increase in the price of fuel which could raise the cost of production by raising expenditure for irrigation in the next season.

Dearness Allowance

Dr Wajedul Islam Khan felt that introducing dearness allowance for workers merited favourable consideration. This was particularly needed for the RMG workers. He noted that workers' minimum wage was set according to certain criteria, at a particular time, but the prices of essentials were determined in the free market economy which tended to rise on a continuing basis. Defining dearness allowance, the speaker explained that this was a mechanism to adjust salaries and wages in view of rise in the price of essentials to safeguard against erosion of purchasing power. Later when the minimum wage would be revised upward by the employers, the dearness allowance would be merged with that of the new salary structure. Indeed, the employers would not have to spend for higher wage and also the workers would not get any extra payment; this would simply mean that higher prices for food and non-food commodities would be adjusted. *Dr Khan* demanded that the budget should make adequate provision for dearness allowance for RMG workers.

Tax Augmentation

The Finance Minister had proposed an increase in tax at source from the prevailing 0.6 per cent to 1.2 per cent for the export-oriented industries. *Mr M Fazlul Azim, MP* from the Noakhali-6 Constituency and also the Chairman of Azim Group thought that such a rise would definitely have a negative impact on FY2012-13 export earnings as this would create a disincentive for the entrepreneurs.

Mr Habibullah N Karim, Managing Director of Technohaven Group of Companies drew attention of the audience to the fact that there was no statutory time limit for direct taxation which would mean that the government can claim tax on income going back even for 20 years. Such a policy was never pursued by any other country in the world. He strongly felt that the harassment in the name of tax collection should be looked into by the government very carefully. *Mr Karim* in this regard called for introduction of a realistic statutory time limit concerning direct tax claim by the government.

Energy and Power Sector Crisis

A number of commentators expressed concern as regards the problems faced by the energy sector. *Professor M Tamim* of the Department of Petroleum and Mineral Resources Engineering, Bangladesh University of Engineering and Technology (BUET) and Former Special Assistant to the Chief Advisor, *Mr M Fazlul Azim, MP* and *Mr Rashed Khan Menon, MP*, Chairman of the Parliamentary Standing Committee on Ministry of Education and President, Workers' Party of Bangladesh made interventions drawing attention to the concerns involved. *Professor Tamim* noted that budgetary allocation was based on policy decisions, and budgetary shortfall in terms of investment was rather prominent as far as this sector was concerned. Foreign direct investment (FDI) in this sector was also at low levels. He thought that appropriate policy actions were needed to be taken by the government to address the attendant concerns. According to him, the biggest problem in the energy sector was related to the primary energy. Towards long-run solution to energy deficit, emphasis ought to be given to primary energy, including development of both natural gas and coal. There should be adequate budgetary allocation towards this.

Elaborating his thoughts, *Professor Tamim* observed that development of the Coal Policy was not given proper emphasis, and hence, there was persistent reliance on rental power plants as quick solution. He drew attention of the audience to the fact that good quality coal was available within the boundaries of the country; but, electricity generation based on imported coal was being considered. Coal extraction from Jaipurhat with appropriate compensation to land-owners was a viable option which was not explored by the government, he observed.

Oil-based power plants were a short-term solution to the energy problem of Bangladesh, which were creating significant pressure on the budget. *Professor Tamim* was concerned that the budget failed to come up with medium to long-term solutions to the energy problem. He also felt that there was no exit plan for quick fix solutions which was haemorrhaging the economy.

Sea Port

Mr M Fazlul Azim, MP felt that with growing international trade Bangladesh will have to ensure significant extension of its port facility. He observed that in spite of the longstanding proposal, no concrete step has been taken for the construction of the deep sea port. He also stressed that the economy will require credible investment in the infrastructure if the targeted growth rates were to be achieved.

Social Safety Net Programmes

It was noted by *Mr Azim, MP* that in the Budget for FY2012-13, allocation for the social safety net had been scaled down. He also argued that the social safety nets in Bangladesh are largely based on charity, and charity alone cannot improve the fate of a nation. He opined that, there was a need to create adequate job opportunities in the economy, particularly in the rural areas. This was also necessary for the accelerated reduction of poverty. He felt that corruption was being promoted in the rural areas in the name of social safety nets. Agreeing with Mr Azim, *Mr Menon, MP* also acknowledged that the safety net programmes faced significant implementation problems due to corruption. He, however, felt that the safety net programmes were very helpful for the underprivileged and low-income segment of the population of Bangladesh.

Health and Education Sectors

According to *Mr Rashed Khan Menon, MP* the proposals articulated in the country's education policy were not being implemented. He also noted that in relative terms there was a decline in the allocation of health and education sectors as share of GDP. He argued that subsidy in other sectors of the economy could be attributed as major reasons behind the decline in the allocation for these two sectors.

Mr Isa Achoba, Chief, Social Policy, Monitoring and Evaluation, UNICEF, Dhaka Country Office pointed out that to improve the productive capacity in the medium term, the country should put emphasis on the education sector, more particularly on the quality aspect of education for the development of human capital. Improved quality of education would also help to bring higher flow of remittances. Majority of the Bangladeshi workers were low-skilled, and because of this they earned less. He added that the investment made in education in the past had given Bangladesh rich dividends. This should be continued in future.

Mr Haider Akbar Rano felt that the allocation in health requires to be scaled up in order for Bangladesh to achieve the status of a middle income country. The market-oriented approach towards health and education was adversely impacting by leading to higher costs for these services for the common citizens. In this regard state should play a more proactive role. *Mr Rano* also proposed introduction of free medical service for the poorer sections of the population in the face of escalating medical costs in the private sector.

Inequality

Mr Isa Achoba felt that good rationale has to inform budget preparation, and this comes from knowing the magnitude of problems that exists. In Bangladesh, there was significant inequality between urban and rural areas. It is a question of how much gap has been closed between urban poor and their rural counterparts, he added. He pointed out that lack of good governance and institutional weaknesses do not allow benefits to trickle down to the poor. Some of the basic services were provided to women and children in the urban areas, but when rural people are deprived from such services the gap does not get reduced.

Whitening of Black Money

Some of the participants observed that black money may be categorised into two sub-categories: legally earned money not incorporated in income tax return or wealth statement, and illegally earned money. *Mr Hafiz Ahmed Majumder, MP*, Chairman of Pubali Bank Ltd and Brindabon Tea Estate commented that although the government is not legally entitled to exercise the authority of whitening of black money, nonetheless successive governments had resorted to this. He, however suggested the government to channel the black money towards investment that would create employment; furthermore, the black money would then be included in the tax net. Several avenues including investment through buying of Bangladesh Investment Facilitation Fund (BIFF) shares, bonds or investing in the capital market could be considered. But the option of legalising black money by paying only 10 per cent fine was not an ethical proposition, the Member of Parliament noted.

Tax Lawyer *Mr Jahangir Alam Chowdhury* added that there is no guarantee clause added to the whitening of black money. The law states that no investigation would be carried out according to the particular law which would imply that the black money may be questioned from the vantage point of other sections of the law. Additionally, if the rate of fine to whiten the black money is very high, this would be a discouraging factor.

Some participants, on the other hand, pointed out that whitening of black money goes against the spirit of Anti-Money Laundering Act. In this connection, *Mr Haider Akbar Rano* shed light on a newspaper article which stated that the Dhaka Chamber of Commerce had urged to remove the 10 per cent fine which was to be imposed. But it would mean that the one who is corrupt and evaded tax, would not be punished for his/her actions. This would have negative implications for common taxpayers' propensity to pay taxes.

Banking

In response to CPD's comment that an extra 5 per cent tax could be imposed on non-TIN (Tax Identification Number) holders which would encourage the people to acquire TIN certificates, *Mr Mohammed Nurul Amin*, Managing Director & CEO, NCC Bank Limited and Chairman, Association of Bankers, Bangladesh Limited said that this would not be the case, since TIN holders are numbered in lakhs whilst account holders are numbered in crores. Majority of the population in Bangladesh live in the rural areas; the Ten-Taka bank account facility was created for them. If these people were to pay an additional 5 per cent tax now, they would be discouraged to hold bank accounts, and unscrupulous non-banking organisations will be encouraged as a part of potential savings will be diverted to them. In today's competitive market, the banks have to compete for deposits. When the call money rate increases, there are banks waiting to capitalise on the opportunity to lend at a higher rate. *Mr Nurul Amin* said that the government could encourage buying of bonds for investment purposes in order to reduce the burden borne by the primary dealers.

Capital Market Dilemma

Mr Rashed Khan Menon, MP stressed the importance of mobilising funds from small investors rather than concentrating on the funds and finances originating from the capital market. The Chair, *Mr M Syeduzzaman* intervened to mention that capital market was important, and that the Finance Minister had devoted a substantial amount of text to highlight the capital market in the Budget Speech. Several fiscal measures were in place including 10 per cent tax rebate for listed companies.

Dr Kamal Hossain, Former Minister and President of Gono Forum stressed on the need for demutualisation of the stock exchange and expressed his concern regarding the inordinate delay in financial reporting for the promotion of transparency in the capital market. In this connection he recalled the boom and bust of the capital market crisis in 1997. He demanded justice on behalf of those who had suffered because of the capital market scam, and called for the perpetrators of the two scams to be brought to justice. The Chair intervened to add that electronic buying and selling of shares are being discussed together with the option of demutualisation.

Local Government

Decentralisation and strengthening of the local governments have been in the discussion for many years now, and in this context, *Dr Kamal Hossain* drew attention to the fact that there is provision of local government in the constitution of Bangladesh, in the policy statement of the present government, and even in the Awami League manifesto. However, there was lack of initiatives in this regard, and the resultant burden of overcentralisation had to be borne by the common people. Decentralisation was one of the means to reduce corruption. It was previously proposed that Tk. 1,500 crore would be disbursed for upazila and union parishad, but no funds have been made available or disbursed till date. It is a fact that if resources are not made available, the question of implementation of activities with allocated funds becomes rather immaterial.

Mr A K M Mayeedul Islam, MP, Member of Parliamentary Standing Committee on Ministry of Finance who is from Kurigram-3 Constituency commented that the upcoming budget is a Dhaka-centric budget. He felt that an increasingly large number of people are being driven towards the capital; however, this need not be the case. Although good quality infrastructure are present in the rural areas, especially health complex, colleges and schools, the number of doctors or teachers who were ready to live and work in the rural areas was rather very low. It is a fact that no sector in the rural areas has sufficient employees other than the Police department. He felt that people should be given incentives to move to the rural areas. *Mr Mayeedul Islam* proposed that the divisions could be made into provinces. These would have provincial governments, a Chief Minister and an independent Governor. This would raise the efficacy of governance in general in the country.

Institutions and Rule of Law

With regard to functioning of the institutions, *Dr Kamal Hossain* questioned the quality of public service, methods and governance and the related processes and procedures. He believed that if the processes were transparent and inter-ministerial coordination was proper, delays in decision making process could be significantly avoided. *Dr Hossain* highlighted the importance of ensuring compliance with the Constitution and impartial and effective application of the rule of law, and not on partisan basis. He was critical of the appointment of judges during the tenure of the current government, and stated that there should be an objective election procedure with transparent appointment in the public services. The rule of law in the country have come to a point where bypassing the law and ring fencing other areas of the law are necessary. This is also important for promoting investment and economic growth, he opined.

Gender

Ms Rekha Chowdhury, Andolon Secretary, Bangladesh Mahila Parishad said that a gender responsive budget is important for the women of Bangladesh. She recommended to set up a gender budget monitoring cell with the assistance of a committee having representatives from the government and the 'Mahila Parishad'. She also mentioned that the contribution of women in the agriculture sector and other sectors are not recognised properly; that health and educational empowerment of women in general should be given prominence. Measures should be in place so that women farmers can benefit from those, and also there should be provisions for development of expertise for women in the RMG sector.

COMMENTS FROM THE GUEST OF HONOUR

Dr A B Mirza Azizul Islam agreed with most of the proposals in the budget. He felt that the proposed NBR target will be met since NBR has done commendably well in the last couple of years in terms of mobilising resources. However, the proposed level of non-NBR tax revenue will not only be difficult to attain, but will perhaps be impossible. There was, thus, an apprehension that there will be a shortfall in domestic revenue collection due to the expected shortfall in non-tax revenue. He added that the SoEs were incurring huge losses and eventually have become a burden on the exchequer. *Dr Islam*, while backing up his statement with facts and figures, projected that aid financing from external sources would not experience a drastic change. He felt that the proposed escalated domestic non-bank borrowing of Tk. 7,400 crore will be very hard to achieve. The implied effect would be that bank borrowing, set at Tk. 23,000 crore, will exceed the expected targets. He also noted that tax on mobile bills and increased taxes on non-TIN bank accounts should be applied only above a certain threshold amount. Looking forward to FY2012-13, *Dr Islam* felt that low export growth, low FDI and higher trade deficit would be the major challenges together with exchange rate pressure, lower revenue collection and lower disbursement of foreign aid, lower than targeted sale of national savings certificates leading to higher bank borrowing. Increase in call money rates and constrained access to bank borrowing by the private sector were also major problems the economy was likely to face in FY2012-13, according to him.

COMMENTS FROM THE SPECIAL GUEST

Mr Amir Khosru Mahmud Chowdhury thanked CPD and its Executive Director for the valuable budget analysis that was presented at the dialogue. *Mr Chowdhury* discussed issues that he found to be lacking in the proposed Budget for FY2012-13. He agreed with other discussants who expressed their concerns regarding the prospect of the implementation of the budget. He stated that in view of the macroeconomic stability including conducive investment policies, the Bangladesh business community was able to take advantage of investing in the economy in a significant manner. However, this would now be at risk, he noted.

Mr Chowdhury mentioned about a number of key points reflecting on the need for maintaining sound investment environment which was essential for the growth target mentioned in the FY2012-13 Budget. Investment had been suffering from inadequate infrastructure and liquidity crisis in the economy. Commenting on the targets of growth and inflation proposed by the Finance Minister, *Mr Chowdhury* said that everything boils down to investment. He also thought that the growth target and downward adjustment of inflation to 7.5 per cent would depend on the financing of investment, and whether investment was taking place or not.

He noted some factors that were essential for investment. Firstly, he expressed his discomfort regarding inflation rate which was very high; he commented that high inflation rate does not go with higher levels of investment. He did not think that trend of high inflation of both food and non-food components will come down in any significant manner. Secondly, he mentioned that the targeted flow of credit in the proposed budget was not in consonance with the projected investment. Besides that, Bangladesh Bank was pursuing a contractionary monetary policy on one hand, and on the other hand, there is the presence of liquidity crisis and poor inflow of foreign aid. Thirdly, he pointed out that both private and public sectors were having to borrow with high interest rate, and this would affect the investment by raising the unit cost of fund. Regarding the issues of higher price of power and fuel, *Mr Amir Khosru Mahmud Chowdhury* noted that Bangladesh had advantage in labour which was good for investment, but this was now suffering erosion. He said that the governmental decision to increase oil, energy and power tariffs will prove to be a disadvantage rather than an advantage from the perspective of investment.

Mr Chowdhury then commented on power shortage and its effect on production and investment. He expressed concerns regarding Bangladeshi Taka (BDT) losing its value against the United States Dollar (USD) which increased the cost of raw materials, capital, transportation and production cost. He argued that good investment was not possible without adequate infrastructure. The government talked of investment in infrastructure through public expenditure, but this was not reflected in the ADP. The much needed infrastructure for private investment in energy, water, power was lacking and the cost of providing these services were also on the rise.

Mr Chowdhury felt that political stability was very important for any country to attract investment, both domestic and foreign. Rule of law was also important. These are the basic requirements of investment, and consequently are also the primary concerns for investors. According to him, rule of law was a persistent problem in Bangladesh and there was a lack of confidence in the judiciary in Bangladesh.

Showing concern about the fragility of the capital market, *Mr Chowdhury* mentioned about the Securities and Exchange Commission (SEC) and the scam which afflicted the stock markets in spite of the presence of the regulatory body. Mentioning his personal contribution in the development of the stock market in Bangladesh, he expressed that the general people have lost confidence in the regulatory bodies and institutions. If government intervention continued, the market would not be able to function. He felt that the government should not intervene in the operation of the market.

Mr Chowdhury expressed his discomfort with regard to the alleged corruption concerning the Padma Bridge and felt that the whole episode was symptomatic of crony capitalism. He tried to draw government's attention to the functioning of the regulatory institutions which were not operating independently. Because of the above mentioned factors including lack of political stability, investors were transferring their money abroad which was affecting the country's economy in an adverse way.

Agreeing with Mr Habibullah N Karim, the Special Guest noted that cronyism was another aspect which was affecting the economy. Machineries imported for the quick rental power plants had issues as regards quality, and that questions were raised about the credibility of the declared capacity as well. He said that the country imported equipment worth of USD 3 billion – a big question mark remained as the BOP position was not so comfortable. The quick rental issue needs to be investigated and the government should produce a white paper on what had actually happened.

Commenting on the need for fund for investment, *Mr Chowdhury* expressed his concern over financing from the stock market, and also with regard to credit from the banking system in the face of liquidity crunch. He said that it would be difficult to achieve 7.2 per cent growth together with attaining 7.5 per cent inflation target in view of the current macroeconomic scenario. He stated that future development and financing for development were major concerns. The government was undermining the cause of productivity by making political appointments. The Special Guest concluded his speech by thanking the honourable Chair, Chief Guest, invited guests and journalists coming from the electronic and print media.

RESPONSE OF THE CHIEF GUEST

The Chief Guest, Planning Minister *Air Vice Marshal (Retd) A K Khandker, MP* initiated his speech by inviting everyone to work together, and said that the discussions at the dialogue were realistic and forward looking. *Mr Khandker* highlighted key aspects of the economy including GDP growth rate, education, health, social safety net programmes and rural development. The Chief Guest mentioned that the size of the budget was Tk. 191,738 crore, of which Tk. 55,000 crore was allocated for ADP. He felt that relative share of ADP and non-developmental expenditure was justified. He noted that development budget was 18.93 per cent higher than that of last year's in terms of current market prices. He further added that FY2012-13 Budget was not a *big* or *mega* budget because if annual 10.5 per cent inflation rate in deducted, then real budget increase would be only about 8 per cent.

The Chief Guest noted that the budget deficit was to the tune of Tk. 52,068 crore. The channels from which this deficit would be financed were bank loan, bank borrowing and foreign aid. He showed that the projected amount to meet the deficit was higher than the deficit in the budget. He argued that the government bank loan was within the safe limit – it was reduced to 2.21 per cent of GDP and budget deficit was within 5 per cent of GDP. Considering the government bank loan, Bangladesh was in a favourable position when compared to India, Nepal and Sri Lanka.

The Minister maintained that the high growth rate projected in the budget was justified. All major indicators including ADP implementation, manufacturing and industrial sector performance, remittance receipt, foreign aid inflow, macro framework, etc. were improving. He supported the imposition of 10 per cent tax on undisclosed income and felt that the opportunity of whitening black money was reasonable.

The Chief Guest highlighted the sectors which received priority allocation in FY2012-13 ADP and mentioned development allocations were distributed into 17 sectors which was 94.44 per cent of total development budget and the rest 5.56 per cent was disbursed as development assistance to local government bodies including Chittagong Hill Tracts (CHT). He said that transport sector got the highest allocation followed by power, education and agriculture. Transport and power would ensure creation of jobs by providing facilities to private sector investment; around 35 per cent of budget was devoted to physical infrastructure. The reasoning of the distribution of the lion's share of allocation to these priority sectors was to achieve higher growth and stimulate development of human resources. Showing concerns with the education system, he mentioned that all the public exams were held and results were given in a timely fashion without allowing any chance of unfair means.

Regarding the issue of food security, he said that Bangladesh was self-sufficient in food production. He highlighted the remarkable success in agriculture, including increase in vegetables, horticulture and spices production. He also argued that inflation was coming down, and this year's remittance earning would be the highest ever, amounting to about USD 13 billion.

Mr Khandker, MP reiterated government's good performance record in terms of robust export earnings, highest ever remittance inflow, highest reserve of foreign currency and achievement in terms of GDP growth. These were the cumulative outcomes of the successful implementation of the past three budgets of the present government. The government had emphasised on domestic resource mobilisation and had been successful in increasing revenue by 18 per cent over the last year. He underscored that high GDP growth rates were achieved with unchanged inequality co-efficient which contribute to social stability.

The Chief Guest noted that if 90 per cent of development budget could be implemented, the total budget implementation will stand at a satisfactory 97 per cent. He agreed that in case of implementation of the development projects, the government needs to be more prudent and judicious in project selection and approval. He underscored the importance of maintaining high quality of expenditures. He noted that in the FY2012-13 Budget, the highest subsidy allocation was made to agriculture. For the employment generation of the hardcore poor, the budget had made a provision of Tk. 1,200 crore, and Tk. 1,439 crore for the *Food for Works* programme. Besides, Tk. 14,130 crore was to be distributed as agricultural credit. The Planning Minister termed the budget as pro-poor and growth-augmenting. He concluded with the thought that the current budget was formulated in a judicious manner, based on government's capacity to implement the budget.

CONCLUDING REMARKS BY THE CHAIR

Mr M Syeduzzaman concluded by mentioning a number of dimensions that should inform the analysis of the National Budget for FY2012-13. He cited short assumptions like current production level, growing revenue collection, projected inflation rate, private investment in public-private partnership (PPP), BOP and exchange rate manoeuvre, etc. based on which the budget was proposed. In view of these assumptions, a very tight management of the economy was necessary. According to the Chair, the monetary policy was not given enough emphasis though it had a significant role on inflation rate, performance of the banking sector, liquidity management, and consequently on the real economy.

He dwelt on the projected deficit financing for FY2012-13, and noted the lack of clarity as regards the large amount of subsidy shifting from FY2011-12 to FY2012-13. He mentioned about the understanding between the International Monetary Fund (IMF) and the government with regard to reduction of anti-export bias, improving the investment climate, fiscal space for foreign aid and FDI inflow. However, this understanding was not mentioned in the budget, he noted. He pointed out the ambiguity about the time when 'automatic adjustment in the energy pricing policy with changes in international prices' will come to effect. The indecision about the Coal Policy was unacceptable and unfair; the proposition of nuclear power of 5,000 mega watts (MW) per annum in 2030 was somewhat mind-boggling. The Chair hoped that small bridges, access roads and highways and local government sectors would get proper resource allocation.

From the point of view of ADP implementation, he emphasised on the need to concentrate on smaller number of priority projects, which would be completed promptly instead of being time consuming and costly. For the implementation of the projects, non-politicisation of the bureaucracy was necessary; meritocracy need to be encouraged in the public service. *Mr Syeduzzaman* also highlighted the achievement of the government in areas such as improvement in revenue-GDP ratio, globalisation of the economy, success in agriculture sector, social safety net programmes and health and education. However, two isolated areas namely, unprogressive direct tax and increasing public investment without any available alternative remained to be concerns. The local government system needs to be strengthened through concrete measures. He reminded the audience about the importance of quality of implementation of budgetary measures. The political will, leadership of ministers, engagement of top bureaucracy, efficient use of procurement processes, avoidance of corruption were important to enter into the *7 per cent club* or the *Next 11 Group*. He termed the Budget of FY2012-13 as a 'test case for the government'.

The Chair ended the session by profoundly thanking all those who participated in the CPD dialogue. He expressed his sincere appreciation of the support of the audience towards CPD's initiatives and activities.

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