Report No. 34

STATE OF THE ECONOMY AND BUDGET RESPONSES 2000

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The Centre for Policy Dialogue (CPD)*, established in 1993, is an innovative initiative to promote an ongoing process of dialogue between the principal partners in the decision making and implementing process. The dialogues are designed to address important policy issues and to seek constructive solutions to these problems. The Centre has already organised a series of such major dialogues at local, regional and national levels. These dialogues have brought together ministers, opposition front benchers, MPs, business leaders, NGOs, donors, professionals and other functional groups in civil society within a non-confrontational environment to promote focused discussions. The expectation of the CPD is to create a national policy consciousness where members of civil society will be made aware of critical policy issues affecting their lives and will come together in support of particular policy agendas which they feel are conducive to the well being of the country. The CPD has also organised a number of South Asian bilateral and regional dialogues as well as some international dialogues.*

In support of the dialogue process the Centre is engaged in research programmes which are both serviced by and are intended to serve as inputs for particular dialogues organised by the Centre throughout the year. Some of the major research programmes of CPD include The Independent Review of Bangladesh's Development (IRBD), Governance and Development, Population and Sustainable Development, Trade Policy Analysis and Multilateral Trading System and Leadership Programme for the Youth. The CPD also carries out periodic public perception surveys on policy issues and developmental concerns.

As part of CPD's publication activities, a CPD Dialogue Report series is brought out in order to widely disseminate the summary of the discussions organised by the Centre. The present report contains the highlights of the dialogue organised by CPD, which was held at the CIRDAP Auditorium, Dhaka on June 17, 2000 on the theme of ***State of the Economy and Budget Responses 2000.***

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Dialogue on
State of the Economy and Budget Responses 2000

Dialogue

A dialogue on the *State of the Economy and Budget Responses 2000* was organised by the Centre for Policy Dialogue (CPD) on June 17, 2000 at CIRDAP auditorium. Finance Minister S A M S Kibria was present as the Chief Guest at the dialogue, former Minister of State for Planning Dr Moyeen Khan MP, Chairman of Chittagong Stock Exchange Amir Khashru Mahmud Chowdhury MP, and former Advisor to the President Professor Wahiduddin Mahmud were present as Special Guests at the dialogue.

Dr. Debapriya Bhattacharya and Professor Mustafizur Rahman made the keynote presentations at the dialogue, which was chaired by Professor Rehman Sobhan. The presentations were made on the basis of authors' work for the Independent Review of Bangladesh's Development (IRBD) 2000.

Opening Remarks

Professor Rehman Sobhan in his opening remarks said that the opportunity to present the fifth IRBD before the participants was a recognition of their collective responses towards engaging in constructive discussions on the state of the national economy.

The Chairperson noted that the Finance Minister had been a participant in the CPD's dialogue process since 1995, when he was a senior figure of the Awami League which was then a party in opposition.

He also said that, irrespective of the state of political parties, a forum should be set up to function on a continuous basis which would hold constructive debate on major policy issues in a non-rhetorical, non-confrontational environment where people could be either critical or supportive of a policy depending on his/her perceptions and understanding of the issues and concerns under scrutiny.

Résumé of the Keynote Presentations

Dr Debapriya Bhattacharya

Dr Debapriya Bhattacharya, Executive Director of CPD presented his keynote paper on the *State of the Economy and Budget Responses 2000*. Dr. Bhattacharya noted that the Finance Minister, while presenting the national budget for 2000-2001, had also touched upon many of the issues which came under the scrutiny of the keynote paper.

Bhattacharya's paper covered three major aspects of the state of the economy. These were *fiscal sector*, *monetary sector* and *real sector*. He informed the participants that the data, as they had been presented in the paper, had been taken from official sources. Essentially, therefore, if there was any divergence of views, this was due to differences of analyses and interpretation of the data.

According to Dr Bhattacharya, as far as the fiscal sector performance in FY 2000 was concerned, the most important issue which arrested attention was that of revenue shortfall. This shortfall came in the context of a very high revenue target which was set for FY 2000, concretely, 22 per cent higher than the previous year.

He mentioned that the revised budget for this year had been slashed by as much as Tk 28 billion from the original target. As a result, during the last 3-4 years, the total revenue receipts as a percentage of GDP had been stagnating. In 1996-97, the share was 9.5 per cent of the GDP, from where it steadily came down to 8.9 per cent by 1999-00. If the projected revenue target is achieved in the next fiscal year, it would marginally go up to nine per cent.

The keynote speaker offered three explanations for the revenue shortfall in FY2000.

The first explanation was that the revenue target was over-programmed. Never in the history of Bangladesh had more than ten per cent growth in the revenue target been achieved. He said an unachievable target was put before the administration from the desire to push the tax-GDP ratio. As a result, the credibility of target fixation was put to question.

His second explanation maintained that revenue collection was very much import dependent and there had been a slowdown in imports, particularly during the first half of the fiscal year. He said one needed to analyse whether this factor had resulted in lower revenue collection and lower import duty collection, thus making the revenue target unattainable.

Bhattacharya's third explanation was that the revenue collection targets for FY2000 critically hinged upon a number of administrative reform measures within the tax administration. Some of these measures included the launching of Pre-shipment Inspection (PSI), creation of Large Taxpayers Unit (LTU) and reforms of the tax inspectorate. But the launching of PSI had been delayed till mid-February. Even after its introduction, the situation did not improve much. Therefore, the fact remained that the tax-GDP ratio continued to stagnate at less than ten per cent, which obviously created a major weakness in the fiscal system.

Dwelling on public expenditure, Debapriya Bhattacharya informed the participants at the dialogue that it had increased during the latter part of the 1990s up to 13.5 per cent of GDP and had then taken a slide during 1998. Soon, it picked up once more, going up to 14.5 per cent of GDP as per the revised figure for FY2000. The target of total public expenditure for FY2001 was slightly lower at 13.9 per cent of GDP.

Within this public expenditure-GDP ratio, a major concern has been the dichotomy between the revenue expenditure and ADP. Only on rare occasions, in 1994-95 and in 2000-2001, had ADP and the revenue budget been planned to be equal in terms of GDP. But, by and large, revenue expenditure dominated the public expenditure composition.

Bhattacharya said the major issue in this regard was whether there was any opportunity to improve the public expenditure composition by reducing the revenue expenditure and increasing the ADP. He, however, served the reminder that the Finance Minister in his budget speech had noted that the difference between these two types of expenditures was rather thin. He also pointed out that while there had been arguments for a bigger ADP from the desire for a more productive public expenditure package, there had at the same time been some kind of financial posturing and shadow financing with respect to ADP. In the year gone by, there was a need, necessitated by the floods, to strengthen the ADP. And this made the revised allocation higher than the original ADP. The same also happened in FY 2000. But, interestingly, the actual implementation of ADP had been lower than the original target, saying nothing of the revised higher target.

The keynote speaker questioned the purpose of revising the ADP up over the original target while its actual implementation fell short of the original target. He said such practices would have major implications because this would call for an increase in terms of resource mobilisation. This would need more revenue collection, and if case of revenue shortfalls - more borrowing or more fiscal deficit financing from other sources. Dr. Bhattacharya referred to such factors as *shadow financing* and *fiscal posturing*.

Talking about the revenue expenditure components, he made note of the fact that the fiscal deficit went down till 1997-98 and since then it has increased to about 7 per cent of GDP in FY 1999 and 6.9 per cent of GDP in FY 2000, according to CPD estimation. The total bank borrowing as a percentage of GDP also increased by as much as almost 7 percent.

He said that the fiscal deficit and bank borrowing needed to be put in the context of overall credit expansion. Since the mid-90s, expansion had been higher in the case of the private sector. Since 1995-96, there had been an equalisation of the expansion rate between the private and public sectors. But the worrisome development was that since 1999, the growth of public borrowing had been at a much higher rate than the growth of the private sector credit.

Thus, although the overall general expansion of credit rate had been very moderate, the two divergence poles were very much evident here. He also said that it was important to observe the macroeconomic implications of the bank borrowing and fiscal deficit. Bank borrowing became a compulsion against the backdrop of a revenue shortfall. Since there was no scope to cut back on the committed expenditures in the revenue budget as well as in the ADP, the government had no other option but to go for bank borrowing.

But, more importantly, the other explanation was that the government might have consciously opted for deficit financing to prop up the economy, particularly when it needed a fillup against the backdrop of a slight slowdown during the early part of 1999. This particular approach was thought to be very opportune given the fact that the inflation rate was down because of successive good harvests. At the same time, there were loanable funds available within the banking system, particularly with the NCBs.

Dr Debapriya Bhattacharya, however, said that it remained to be analysed whether the fund was available in spite of private sector demand for credit. He said that the hike in interest rates perhaps screened the private sector out.

He mentioned that this was for the first time (FY2001) that the government had shown bank borrowing as a part of its fiscal programming. He appreciated this effort since it improved the quality of monetary policy and credit policy. In case there was unforeseen revenue shortfalls, such a preplanned fiscal programming was a good deal better as a second best solution than bank borrowings and adjustments taken on an ad hoc basis.

He noted that the government's fiscal stance appeared to be a little ambivalent between bank borrowing and raising money through the sales of savings instruments. This was so because in both cases, there had been a growth of thirty eight per cent during the first nine months, showing that the government did not have any specific preference between generating resources from the banking sector and the non-banking sector.

About agriculture credit, he said that the banking system usually had acted as a conduit to siphon off real money from the rural economy. The disbursement of agriculture credit has always been less than the recovery except in 1999. It was only in 1999 that there was a net Tk 11 billion flow to the rural areas. It was one of the rare years when the country witnessed a real flow of money into the rural area. But again, 1999 was a wonder year as the level of disbursement was higher than the historical rate.

Turning his attention to industrial loans, Bhattacharya said the disbursement had for the first nine months increased by twenty five per cent. These term-loans were used for capital machinery imports and imports of other goods. As a rule of thumb, twenty per cent of such loans are used in civil works and eighty per cent in the import of machinery and the like.

Therefore, instead of using nominal values in taka terms, one can convert the amount into dollars and see what was the real growth as such. The real growth in terms of the dollar showed that industrial credit remained steady at around 250 million dollars every year. In FY2000, the growth of industrial credit in the third quarter was almost equal to the first six months' figure of this fiscal year. This meant that loan disbursement and import had picked up in FY 2000.

Dr Debapriya Bhattacharya pointed out that an upturn in industrial credit disbursement had been evident since the third quarter. He then dwelt on the loan classification situation because it not only reflects on the old directed credits, but also shows the current loan situation in terms of recovery. During December 1998 and December 1999, the overall classification rate increased from 40.65 per cent to 41.11 per cent. However, there was an improvement, for the private commercial banks could reduce their classified loans from 32 per cent to 26 per cent. Unfortunately, similar improvements were not seen in NCBs, which witnessed an increase in classified loans. The situation, however, did not reflect only on the corporate management of NCBs, but also exposed problems including that of directed lending to the state-owned enterprises (SOEs) and others. Bhattacharya appreciated the government's recent effort to take over the SOE liabilities in the banking sector in a very transparent manner.

He also contradicted the popular belief that a large portion of the classified loans belonged to SOEs. The SOE classified loans do not constitute more than 10 per cent of the total loans, and 90 per cent of the loans belong to the private sector, having more than Tk 10 million worth of loans. So, he said, one should not think that SOEs were the root of all evils. He, however, pointed out that 50 per cent of SOE loans were classified, a sign of the gravity of the situation.

Turning his attention to the inflation rate, the keynote speaker said both the moving average and point to point inflation rates showed that since 1999, there had been a downturn in the inflation rate, which actually increased during the preceding three years. The inflation rate moving average for food items, in spite of the good harvest, was 6 per cent till March, 2000 and for non-food items, it was 3 per cent. Together, it stood at 5 percent. He posed the question about why food prices remained so high.

Speaking about the real sector, Dr Bhattacharya said that agriculture sector had been characterised by a good performance during the last couple of years and agriculture output growth had also been reaching an all time high in both *aman* and *boro*. Besides the crop sector, the fisheries sub-sector recorded 9-10 per cent growth during the last three years, which was also very significant.

But unfortunately, things did not appear to be equally good in the industrial sector. Dr Bhattacharya wanted to know why the industrial sector could not capitalise on the growth of the agriculture sector, particularly when the prices of wage goods were so low and the labour intensive industrialisation could have taken advantage of it. He said that there might have been some other problems which did not allow the industrial sector to take advantage of the low wage rate.

Analysing the quantum index of industrial production, Bhattacharya said the BBS figures showed that industrial production growth rate was at present at 4.5 per cent, less than the earlier projection. The index of 15 important industrial products showed 13 per cent growth between July 1999 and January 2000. The weight of these sectors in the total industrial sector is 68.2 per cent.

But, then, some of the major sectors such as jute, textiles, cement and petroleum sectors had been incurring losses. He drew the attention of the participants to the case of tea which was regarded as an industrial item and had shown 117 per cent growth because of the total tea production loss in the preceding flood year. So, if tea was taken out from the index, the growth rate would drop to negative 0.64 per cent in the industrial sector. This, he said, represented a gloomy picture of the industry. In this connection, he appreciated a number of budget proposals ranging from tax holiday to setting up of equity fund for the industry. But, he said, the question was whether these kinds of fiscal stimuli would really prop up industrial growth. He stated that the economy might be facing much more serious structural rigidities relating to inadequate - trade supportive infrastructure, e.g. port, customs and telecommunication, which really increase transaction costs.

Regarding FDI, he said figures showed that it slowed down after 1997-98 when the energy sector equipments were imported. The net portfolio investment flow was still negative. He said that there was a definite need to improve the calculations of FDI flow because FDI has macroeconomic implications not only in terms of creating new capital formation, but also regarding the balance of payment.

Dr Bhattacharya supported such proposed steps in the budget for the capital market as making dividends tax free, giving remission to high dividend declaring companies and making their investment in secondary market tax-free. However, he said the tax rates between the listed and non-listed companies could be increased further. But currently the market capitalisation had gone down along with index. During 1999, there had been some marginal improvements in DSE and the number of Initial Public Offerings (IPOs) also increased along with sponsor equity. The rate of over-subscription was two times, and, more importantly, the trend had continued during the first quarter of FY 2000.

Bhattacharya also observed that there had been a creeping de-industrialisation of the economy. During the last four years, the contribution of the industrial manufacturing sector to GDP had, come down from 15.8 per cent to 15.2 per cent. He thought that a large part of the industrial sector was possibly undergoing some painful restructuring and continued to stagnate, if not decline. He considered this a major structural problem.

Within the macroeconomic balances, Dr Bhattacharya pointed out major challenges in the following fields:
1. Restoring fiscal discipline
2. Augmenting investment in the modern industrial sector
3. Consolidating the achievements in agriculture

Bhattacharya maintained that if policies went wrong in one of these areas, it would have negative implications for the other two sectors and resultantly, the economy will be subject to more vulnerability.

Professor Mustafizur Rahman

Professor Mustafizur Rahman’s keynote paper centred around the performance of the external sector during fiscal year 2000 and the consequent budget response. His focus was on the policies which had been initiated to address some of the major problems in the external sector and the strategic issues which are likely to emerge for Bangladesh in the global market during the next decade.

Rahman pointed out that Bangladesh had gradually been turning into a trading country from a predominantly aid recipient one. He said this trend should be kept in perspective when designing the country's policies. The market access issues and the implications of globalisation are becoming very important for Bangladesh's macroeconomic performances in terms of industrialisation, GDP growth, national income growth rate and per capita income.

Talking about the export sector performances, he said exports grew by about 6.9 per cent during the last 10 months of FY2000. But the Finance Minister in his budget speech said that exports had grown by 8.4 per cent over the first nine months, which indicated a substantial deceleration of exports during the month of April.

Within the export sector, the star performer was the knit-Ready Made Garments sector, which had grown by 20.3 per cent while leather sector had grown by 13.3 per cent. He highlighted that the growth rate of woven RMG had come down to 3.4 percent and the reason for such a decline should be properly analysed. Rahman's view was that the structure of exports had undergone important changes. The woven RMG still dominates the export structure, laying claim to half the nation's exports, while knit RMG is 19.4 per cent of it. The structure of exports is now fast changing in favour of the knit-RMG sector. In the next three years, knit-RMG will overtake the woven RMG in net exports. Dr Mustafizur Rahman said that this was a positive change and that in formulating policies, these emerging structural changes within the sector should be kept in the perspective.

Rahman also noted that although the net exports had grown by 7.7 per cent, it should be noted that last year, the growth rate was only 2.9 per cent. So, from such a low base, this 7.7 per cent growth rate was not very encouraging. This is more evident from the export growth rate in 1997 and 1998, which were 13 per cent and 16 per cent respectively.

Professor Rahman dissected the growth structure, observing the contributions of volume and price to export growth. He opined that it was very disquieting that the volume index was contributing much more than the price index. So, almost the entire incremental growth in exports came from the increase in volume index. It proved that Bangladesh was still stagnating at the lower end of the demand curve and needed to export more to have growth rates. He said that it was cause for concern that this trend had been continuing for the preceding few years, which made it imperative that policy makers look at the decomposed figures of export performance to understand the reason behind such occurrences.

The keynote speaker also pointed out that even for knit-RMG, incremental growth had been coming from the growth in volume and the trend was also true for woven RMG. In woven RMG, the unit price increased only marginally and volume increased to a great extent.

The trend of falling prices also impacted on the terms of trade. If 1979-80 is taken as the base year, it will become clear that the terms of trade have been deteriorating over the last few years, which is also a cause for alarm.

Turning to import performance, he said that the LC settlement figures showed only a one per cent growth in imports during the first nine months. But if the import of consumer goods was excluded, then it would show an import growth of 17.4 per cent. LC openings for the first nine months also showed a robust performance of 3.6 per cent. Imports of textile machinery picked up by 8.6 percent while that of garment by 50 per cent. And if the import of food items was excluded, then LC openings showed a 22 per cent growth, which was a positive sign for the economy.

Capital machinery and back-to-back LC openings also indicated a robust RMG sector performance in the next few months. But one must review what has been happening to the global market and how the RMG sector has been performing in that context.

The current account balance showed that the balance of trade deteriorated by 10.7 per cent because of import pick-up. At the same time, remittances grew by 11 per cent. The incremental part of the current account balance came from remittances. But the per capita remittance of workers was very low, highlighting the need for high-value manpower export for higher per capita remittance. Mustafizur Rahman noted that the disbursement of foreign aid showed weak governance in the implementation of projects.

He stressed the point that the foreign exchange reserves had declined from a peak of over 3 billion dollars in 1995 to 1.6 billion dollars, which was equal to 2.5 months of import. It further came down to 1.4 billion dollars in the third week of June because of the payment to ACU. He said that the reserve figure was not what could be defined as a safe margin for the country.

Professor Mustafizur Rahman however appreciated the budget incentives given as export subsidy and subsidies to IT sector.

He said competitive depreciation and export incentives are two major vehicles to stimulate the country's export. But he said that exchange rates and the export performances did not suggest any correlation.

Talking about the finance minister's proposed $125 million export incentives next year, he said when such incentives were given, importers tended to take advantage of the incentives by keeping the prices down. If exporters are to be ensured maximum benefit, other steps need to supplement such measures. In this context, Dr Rahman laid emphasis on improving infrastructure. He pointed out that export-handling costs at Chittagong port were much higher than at any other port in the region. If such shortcomings could not be overcome, incentives alone could not prevent cost escalation for exporters.

Talking about the quota utilisation status of readymade garments (RMG), Dr. Rahman expressed concern that the quota fill rates in some categories were not as good as in the previous year. He felt that the reason for this should be analysed. He also said that China's entry to the WTO should be evaluated properly because it would have an impact on the Bangladesh economy.

The US Development Act for the Caribbean and Sub-Saharan African countries was also important for Bangladesh, as some Caribbean countries were major exporters of apparels, Mustafizur Rahman noted.

Comments by the Finance Minister

At this stage, Professor Rehman Sobhan invited the Finance Minister to initiate the discussion on the papers presented by Dr. Debapriya Bhattacharya and Professor Mustafizur Rahman.

Initiating the discussion, the Finance Minister mentioned that whilst the keynote paper raised a number of important and critical issues, these were not balanced. According to him, the papers have emphasised only the negative aspects of the economy. He thought that an attempt had been made to deliberately ignore the positive aspects and thereby cause a kind of negative impression despite the fact that the economy was doing well.

The Finance Minister recalled that there was a raging debate in the United States when the country had a huge budget deficit coupled with a very large trade deficit in the 1980s. This had influenced many people into speculating about the future of the US economy, but years later their fears turned out to have been misplaced.

Turning to the state of the economy in Bangladesh, he said the country had four years of more than 5 per cent growth rate on the basis of the old measurement of GDP and added that Bangladesh never had such high growth rate in its history. He said the keynote papers missed this basic fact. He added that this high growth was non-inflationary in nature, which is the dream of every finance minister. Kibria said that the country had had a period of a very high growth of prices following the floods. But prices had now come down.

Kibria aimed his criticism at Dr Debapriya Bhattacharya for finding fault in the price trend. According to BBS, the non-food prices on a point to point basis were 3.44 per cent in April and food prices 2.94 per cent, while the general rate was 3.09 per cent. The Minister said that by any international standard, the inflation rate was very satisfactory. He also reminded the audience that non-inflationary growth in the economy was a satisfactory situation.

Talking about the good agriculture harvests for the last four years, he said that it was achieved owing to the government's contribution to the sector. Kibria also criticised Bhattacharya for, what he said, not fully appreciating the mechanics of agriculture credit. Agriculture credit is given on repayment of old loans, he explained. Very often the loan is taken by the same person. After repayment of old loans, farmers take fresh loans for the new season. This does not mean siphoning of money out of the rural economy.

The Finance Minister also said that before the Awami League government came to power the average annual agricultural credit disbursement was around Tk 1100 crore. Currently, it had increased to more than Tk 2000 crore, showing that the amount of agricultural credit had almost doubled. This has helped the farmers to use available resources to buy agricultural inputs like power tillers and pumps, which have been made duty-free.

Kibria said that the government was very careful about the delivery of fertiliser to the farmers. There was also no interruption of electricity from 11 pm to 6 am in the rural areas so that farmers could manage irrigation in an efficient way. This, he said, was an example of good governance.

He also said that agricultural credit was considered to have a very poor mechanism because of corruption. But the Awami League government took strong measures and reduced corruption, resulting in a dramatic improvement in credit disbursement.

About the development programme, Kibria said that 100 per cent ADP implementation had never been achieved. ADP implementation always falls short of the target by a few percentage points. The shortfall in ADP implementation is often matched by a shortfall in revenue collection. From 1980, with the exception of one year when VAT was introduced by the BNP government, revenue collection also invariably fell short of the target.

On the question of budget deficit Kibria read out a paper provided by the finance secretary:

"Dr Debapriya Bhattacharya has stated the level of budget deficit for the year 2000-2001 should be 6.9 per cent and not 5.9 per cent as mentioned in the budget speech. Similarly, the budget deficit for the year 19999-2000 is 6.97 per cent and not 5.8 per cent mentioned in the budget speech. He also expressed concern over the overall budget deficit which had exceeded 6 per cent of GDP, what according to him is a safe limit. In arriving at his deficit figures, Dr Debapriya Bhattacharya seems to have simply divided the overall budget deficit shown in the budget document by the nominal GDP for the corresponding year. This indeed gives figures similar to this. However, for the purpose of economic analysis, the following adjustments have been made in the deficit figures shown in the budget documents:

1. self financing extra budgetary resources have been deducted from the ADP;
2. surplus in the suspense account has been deducted from the expenditure side;
3. foreign financing has been taken as net by deducting debt amortisation from foreign loans and grants. Consequently contrary to what has been shown in the budget document in arriving at the figures of budget deficit, debt amortisation does not appear as an expenditure item;
4. the previous year's surplus in food deposit account has been added as an expenditure item.

When the above adjustments are made which are in line with IMF practice, then the overall budget deficit for 1999-2000 is found to be 5.8 per cent and that for 2000-2001 is 5.9 per cent. The major difference is due to the netting out of foreign debt amortisation or retirement from the total foreign loans and grants to arrive at net foreign financing.
With regard to the argument that the safe limit for budget deficit is 6 per cent, it may be mentioned that there is no such fixed number for any country. Safe limit varies depending on the modes of financing and the constraints imposed by inflation, growth, interest rate and balance of payment."

Kibria also informed the participants that borrowing had come down to Tk 3385 crore from the previous week's Tk 3700 crore. So, he said, there was not much cause for concern.

On the question of loan classification, the Minister said Bhattacharya's paper should have contained an analysis of the situation and he should have mentioned that the classification standard had been changed to conform to the international standard.

At present, a borrower who fails to repay loans for three months is classified as a defaulter. But Kibria said that businessmen felt that three months' time was too short a period. Many businessmen, who otherwise possess good reputation, become defaulters simply because of this time factor.

Kibria said that the international standard was unfortunately applied without taking into account the local conditions. He hoped that the Bangladesh Bank Governor would give this matter due consideration. He also said that following the payment of Tk 1800 crore to NCBs, their default loan ratio will also improve.

The Finance Minister also differed with Bhattacharya on the state of the industrial sector. He maintained that a large number of industries went sick following rapid liberalisation of import duty in the 1990s. All the import substitution industries were thrown into distress because of such liberalisation. A committee was set up which had been working for the last two years to salvage some of these sick industries. The committee on sick industries has already settled the cases of 1100 industries.

Talking about the export sector, he said that deceleration in growth in recent years had been a consequence of the decline in the growth of the RMG sector. Traditional sectors such as leather and jute were not faring well in the international market. He said that there was no alternative but to export more in volume when the international prices fall.

Discussion

Fear of Inflation Hike

Former Finance Minister M Syeduzzaman said that one of the implications of bank borrowing was its inflationary impact, which should be very seriously considered, especially since there was no mention of monetary expansion programmes for the coming year in the proposed budget for FY2001. The overall monetary expansion was 19 per cent in FY2000. In the light of the last three years, the next year's monetary expansion will be about 15 per cent or so.

Mr Syeduzzaman argued that there was no doubt about the impact of such monetary expansion on the domestic price level. This had not happened till now and several reasons could be cited for this, but there was no scope for complacency.

He also pointed out that the sustained growth of the agriculture sector helped absorb part of the monetary expansion. The international commodity prices have gone down in most cases except oil. This also kept the level of inflation down. At the same time, the draw down of the forex reserves also acted as a cushion against growth in domestic price level.

Dr Moyeen Khan, a BNP lawmaker and former minister of state for planning, was of the opinion that the inflation rate had gone up significantly over the last three years. This year’s downward trend in inflation, which the Minister has mentioned, had not compensated for the increase in the price levels of the previous year. He also said that this had tremendously affected the buying power of the people. Coupled with this, the proposal to raise Tk 2000 crore new taxes this year would further affect the lower income group, he opined.

Revenue Shortfall

Dr Moyeen Khan further said that from the first year of the Awami League government, total revenue as a percentage of GDP has gone down drastically. During the first year of the government, it was 9.49 per cent, next year this was 9.38 per cent and went down to 8.47 per cent the following year; during the current year, the share further came down to 8.85 per cent. Under such circumstances, it could not be said that the economy stated by Dr Bhattacharya in doing well.

A Muyeed Chowdhury, Chairman of the National Board of Revenue, offered an explanation for the reasons for revenue shortfall during the current year and admitted that the target itself was ambitious. He said that while reducing tariff rates on many raw materials the international commodity prices, which fell drastically, were not factored into the calculation. As a result, low tariff rate along with low commodity prices affected revenue realisation. He also said that the late introduction of PSI also affected revenue collection. Even after introduction of PSI in February, a lot of problems were detected in the system and it took time to make the necessary adjustments.

On the other hand, the Large Taxpayers’ Unit (LTU) has been delayed by bureaucratic tangles for a year. Muyeed Chowdhury hoped that things would improve once the LTU takes off and the customs modernisation programme begins to be implemented.

BNP lawmaker MK Anwar, however, expressed his doubts about whether the additional Tk 800 crore tax in FY2001 could be realised through improvement of administrative measures as has been envisaged in the budget.

Corruption in System

NBR Chairman A Muyeed Chowdhury, acknowledging the presence of governance problem in the NBR administration, said that the NBR's performance in the past has been seriously undermined by corruption and malpractice. He said this issue had been raised with the Finance Minister, who had then taken it to the notice of the higher authorities. Explaining the tax reforms, he said that NBR had tried to remove the interfaces between taxpayers and collectors in the last two years. The revenue realisation approach had been relaxed to make people pay taxes. The introduction of spot assessment system, to some extent, has eliminated chances of corruption and hassle.

He also said that the tariff structure has been readjusted and the system changed to reduce the possibility of corruption.

Fiscal Deficit and Bank Borrowing Get Most Attention

M Syeduzzaman said that the overall fiscal imbalance in excess of 5 per cent of GDP in FY 1999 and the likely 5.9 per cent outcome for the current year were matters of considerable concern.

He said that the budget deficit in a free economy is reflected by an increase in the rate of interest. But in Bangladesh situation where the interest rate is administered, this was not visible.

Taking India as an example, he said a massive change in India’s policy orientation had taken place because of the increasing budget deficit beyond a sustainable level, loss of competitiveness, huge draw-down of foreign exchange reserves and high inflation rate. India now has a law limiting the government’s borrowing capacity from the Reserve Bank of India.

For a developing country like Bangladesh, the concern is development of new capacity through savings, investments, and access to foreign savings. It is not important to give stimulus to idle capacity through monetary expansion because the only idle capacity that we have is the sick industry capacity.

Syeduzzaman mentioned that the trend all over the world was to reduce budget deficit and fix limits on spending. Noting that Bangladesh had deliberately adopted an expansionary budgetary posture, he said that the government should think of a safe limit of deficit financing.

He also said that it is important to understand the monetary framework against which the next year's planned deficit figure has been worked out. The sources of deficit financing should also be kept under the watch because the impacts will be different depending on the sources of meeting the deficit.

Syeduzzaman also pointed out that the government's borrowing has been going up very rapidly, though it has slowed down of late.

But Bangladesh Bank Governor Dr M Farashuddin said the discussion on bank borrowing was not fair. He said that the share of government borrowing was no more than 22 per cent of the total credit from the banking system. Therefore, the picture of public borrowing overtaking the private sector credit did not convey the right spirit. It raised questions in the public mind about the government doing its business only through borrowing from the banks and depriving the private sector of the same.

Dr. Farashuddin added that even on the day of the dialogue, the excess liquidity in the banking system was no less than Tk 4000 crore. He said that a recession was inevitable if it was true that the private sector was reluctant to take credit. He also supported the government strategy to accelerate borrowing during the initial months of the fiscal year and keep the ADP going. He assured that the Bangladesh Bank was keeping a very careful watch on the situation.

The Governor also said that the central bank makes sure that the composition of borrowing is least inflationary. The central bank does not allow borrowing from the central bank to exceed 40 per cent of the total borrowing. The rest is taken from the members of the public and commercial banks which do not have any effect other than the transfer of purchasing power from the people's hands to the government hands, Farashuddin explained.

However, Dr. Moyeen Khan raised his concern over the impact of government borrowing on the private sector. He claimed that borrowing by the private sector has significantly gone down. He also questioned how the government is going to repay the borrowing.

He said that the Finance Minister's claim that borrowing did not affect the liquidity of the banks was counterproductive, because such heavy borrowing should have created a liquidity problem. The high liquidity situation proved that there were some serious problems with the private sector.

BNP lawmaker M K Anwar said that the country's interest payment obligation would go up significantly to repay the deficit financing.

BNP lawmaker Amir Khasru Mahmud Chowdhury contradicted the government's stand that the government was borrowing for investment in productive sectors. He said that good investment must have good output. On the contrary at present, there was a severe power crisis and problems in the water, gas and education sectors were very acute. He thought that investments in MIG29s, frigates and memorials do not serve national priorities.

A former DCCI president M. H. Rahman said that borrowing from the bank was better than printing notes. He said that it was important to know why the government was borrowing and whether it was going to affect the private sector.

BNP lawmaker Khaliquzzaman said that the government was planning to go for heavy bank borrowing even for the next year. In such a situation, the government would either have to go for monetary expansion or it would result in the crowding out of the private sector, both of which did not auger well for the country.

The Finance Minister countered the criticisms about excessive borrowing by stating that there was no ad hoc borrowing as has been claimed in the dialogue. He said that, the economy was devastated following the 1998 floods and it was not easy for the industry to recover. There was also a recessionary trend in the economy. He noted that the government had fought against the recession and as a result the country had come out of a bad situation. At present, the country not only had robust agriculture performance, but also an industrial sector which was recovering modestly. This was all a result of a conscious policy of moderate expansion, he explained.

Agriculture Credit

Bangladesh Bank Governor Dr M Farashuddin said that the government had successfully brought back two institutions to life – Bangladesh Krishi Bank (BKB) and Rajshahi Krishi Unnayan Bank (RAKUB) with a view to raising efficiency in the agriculture credit disbursement. Their boards and management have been improvement. We replaced politicians in the boards with university professors. Through these two banks, credit was made available to farmers in time to buy inputs, he claimed. Because of good harvests, farmers were paying back their credit and in FY2000, the recovery would be Tk 1000 crore more than any year in the past.

Narrow Money and Broad Money

M Syeduzzaman said that the difference between M1 and M2 had been narrowing down, which according to him was a danger signal.

Later, the Bangladesh Bank Governor said that narrowing of the band between M1 and M2 essentially means that FDRs are declining. He said that the fixed deposits in the banking system have been replaced by savings instruments carrying much better returns. He hoped that the correction in savings interest rate would encourage people to save more with the banks.

Concern over Foreign Exchange Reserves

Bangladesh Bank Governor M Farashuddin said that the time-honoured practice of measuring forex reserves by weeks and months of imports should be seen in the perspective of the country’s need for imports. He said that the country needed foreign exchange reserves for maintaining confidence, bringing imports and buying foodgrains in times of emergency. As the need for grain import was now at a minimum, he argued that the calculation of reserves should be reconsidered.

Loan Classification Up

Responding to Dr Bhattacharya’s observation that the loan classification situation had not improved and the Finance Minister’s remark about changing the classification system, Bangladesh Bank Governor M Farashuddin made a brief remark on the topic. He informed the dialogue audience that the internationally accepted standard was applied in case of loan classification in Bangladesh from January 1, 1999 following years of scrutiny and analysis. He said the central bank would be completely defeated if it yielded to pressure from the business community to redo the classification system.

He observed that the new standard has done a lot of good to the banking system. Despite its adoption, the private sector banks have done remarkably well. He stated that if the government gives more authority to the central bank regarding the NCBs, the same kind of improvement would take place in the state-owned banks.

Growth, Agriculture and Industry

M Syeduzzaman said that GDP growth rate, its composition and the incremental capital output ratio of the non-agriculture growth showed that the incremental capital output ratio was going up. He said it would need much higher level of investment to reach 6 or 7 per cent growth in the coming years.

Dr Moyeen Khan said that the basic parameters of savings and investments did not corroborate the claimed growth rate. Even the indices of savings and investment did not corroborate themselves.

He said that while the government data spoke of increased savings, it did not show an increase in investment. He said an increased growth rate was attributed to the performance of agriculture sector and there were claims of successive bumper crops. Had there been bumper crops, its impact would have shown in other indices of the economy, he observed. Unfortunately, this did not happen, Dr Khan maintained.

He also said that such high boro output would have been reflected in the retail market rice prices, but again this did not happen. The claimed good agriculture growth was also not reflected in the industrial production, he pointed out. Dr Khan also questioned proper utilisation of the Tk 100 crore agriculture subsidy, saying that he was not convinced that this money was spent for the right purpose.

Finance Minister Kibria later explained that the government raised the procurement price from Tk 11 to Tk 13 and launched a massive procurement drive to give farmers a fair price. Had the prices collapsed, the country would not have seen three years of bumper crops, he observed.

BNP lawmaker M K Anwar said that the industrial growth came down to 5.2 per cent in the last four years while it was 8.21 per cent on an average during 1992-96. The contribution of industry to GDP during 1991-96 was 12.9 per cent. It went up to 15.4 per cent in 1995-96. But in 1999-2000, it still remained at 15.4 per cent.

However, Bangladesh Bank Governor M Farashuddin said that during the first quarter of FY 2000, the disbursement of working capital expanded much faster than term-lending. This meant that the existing industrial capacity was being utilised at a higher rate compared to the past. This along with the increase in imports, exports and modest industrial growth showed that the economy had picked up.

ADP

Dr Moyeen Khan said that next year’s deficit of over Tk 18,000 crore did not fare well with the proposed Tk 17,500 crore development budget. He also found no reason to prop up the ADP by borrowing over Tk 3000 crore next year.

He stated that it was surprising that the ADP implementation in the first nine months of this fiscal year was only 50 per cent of the total amount. In spite of this, the ADP was revised upwards without any logic, he observed.

Disbursement of project aid has drastically gone down over the last four years, Dr Khan said. If this was any indication of the confidence of donors on the capability of the government to manage finances, then this would be very sad.

The Finance Minister drew attention of the dialogue participants to the fact that the foreign aid was expected to decrease considerably in the future. He said that there was no fundamental change in donor position as far as foreign aid was concerned.

BNP lawmaker M K Anwar said that ten per cent of the budget has been kept for unanticipated expenditures, while miscellaneous sector claimed another Tk 1309 crores. If this amount could be saved, then the revenue budget would have come down significantly to finance the ADP. At the same time, the budget for the Prime Minister's Office has more than doubled. In this context, Finance Minister SAMS Kibria clarified the issue of budget for the Prime Minister's Office. He said this budget included items like the Ashrayan Prakalpa (Tk 115 crores), canal digging project (Tk 13.13 crores), four projects of BEPZA (Tk 45 crores), some food for works (Tk 38 crores) which are all included in the PMO's ADP budget. On the revenue side, NSI, NGO Bureau, Anti-corruption Bureau and BOI expenses were also included in the budget.

Governance

BNP lawmaker and former Commerce Minister M K Anwar said that the economy was marked by huge losses of the SOEs, government borrowing, precarious forex deposit position and industrial and export growth stagnation. These problems could not be solved with economic measures alone and the remedies lie somewhere else about which the finance minister did not say anything in his budget speech.

He said the main problem was that there was no security of property and individuals. Businesses were subjected to illegal toll collection and smuggling has increased – these were adversely affecting businesses. According to him these reflected a failure in governance.

Dr Moyeen Khan said one of the election promises of AL was to reduce corruption and the World Bank's recent report points out that not much success was achieved here either. Many of the urgent reforms in the judiciary and the administration have also not been implemented.

The Finance Minister said corruption is a topic that must be debated and there was no denying that stern actions should be taken about to tackle corruption. He said that the government moved to eliminate corruption from the customs administration through the introduction of steps like PSI and self-assessment. He also mentioned that Bangladesh Bank's strict action had gone a long way to improve the banking system. At present sponsor directors who used to take money from their own banks are barred from doing this.

Amir Khashru Mahmud Chowdhury noted that the law and order situation was the biggest hindrance to the country's development. A rise in smuggling also reflected on the weak law and order situation and lawless elements were collecting more 'taxes' than the government.

Liquidity

Responding to questions from some participants as to why the banks had such excess liquidity, the Finance Minister said that two to three years earlier, a scare had been spread that there was no liquidity. It was artificially created with a view to generating loss of confidence in the government's financial management. He said the banks now had plenty of liquidity, to the extent of Tk 4000 crore. However, the issue of why the borrowers were not coming forward in sufficient numbers to invest need to be reviewed. He said the present government campaigned for the last four years towards speedy recovery of loans. As a result of this, the default culture days were gone. The cause of why people did not want to invest needs to be linked to this. They know that they may lose everything if they cannot repay, the minister explained. They would invest only when they were assured of a profitable return. He also said that the government lowered the interest rate to encourage the investors.

RMG Fund Sought

Anisul Huq, Vice President of BGMEA said that the RMG sector might face a problem after 2004. Developing backward linkage would be one solution to face the situation. He suggested for a fund of between Tk 500 crore to Tk 1000 crore in the budget for backward linkage industries. He also suggested that one of the steps the government should take was to declare that no questions will be asked in cases of investment of black money in backward linkage industries which, he thought, would encourage the process of industrialisation.

Reliable Projection of Economic Situation Sought

Dr Toufiq Ali Chowdhury said that since a budget is a projection for the next year, the question was how to make such projections reliable and better. He said other countries used certain models and fitted the figures in it and then got projections for the next year or even longer.

He said this was a way of arriving at a meaningful discussion on the budget. But what was being done at present was making a projection from past records. He suggested that CPD start working on such models.

Professor Salahuddin observed that because of the lack of technical analyses, some of the dialogue discussions had been misguided. He pointed out that there were projections of international prices by the UN and therefore the NBR should project its revenue based on such price projections instead of arbitrarily fixing targets. NBR should incorporate all the factors in its model when projecting growths. There was, thus, a need for a model for projecting the fiscal performance during the following year, he said.

Illegal sector

Dr Mahbubullah said it was a misplaced comparison to put Bangladesh alongside another country while judging its performance. He said Bangladesh economy should be divided into two parts -- *Legal sector* and *Illegal sector*.

He said the illegal sector must be stopped to strike a balance between revenue earning and expenditure in the budget. The budget should have recommendations in order that incentives for illegal economic activities are reduced and brought within the ambit of the legal sphere, he said.

Concluding Remarks by the Chair

Professor Rehman Sobhan concluded the session by underpinning the importance of fiscal and financial discipline and good governance in the management of the economy. In absence of such discipline the underlying tensions in the economy discussed during the dialogue could manifest in the form of serious macroeconomic instability, he cautioned.

Annex A

List of Participants (in alphabetical order)

Dr Salahuddin Ahmed	Deputy Team Leader, PATC World Bank
Dr Toufiq Ali	Additional Secretary Ministry of Foreign Affairs Government of Bangladesh
Advocate Abul Kalam Ajad,MP	Chairman Parliamentary Standing Committee on Information
Mr M K Anwar	Member of Parliament and Former Minister of Commerce Government of Bangladesh
Mr Major (Rtd.) Md Akhtaruzzaman, MP	
Mr Sahabuddin Ahmed	Director, Proshika
Mr Waliur Rahman Bhuiyan	President *Foreign Investors Chamber* *of Commerce and Industry* *(FICCI)*
Dr Debapriya Bhattacharya	Executive Director, CPD
Shahidul Alam	Program Officer SADO
Mr Mosharraf Hossain Bhuiyan	*PS to Mr S A M S Kibria* Hon'ble Minister for Finance Bangladesh Secretariat
Dalem Chandra Barman	Department of Political

	Science Dhaka University
Dr Omar Haider Chowdhury	Research Director, BIDS
Paolo Craviolatti	European Commission (Bangladesh)
Mr Abdul Muyeed Chowdhury	Chairman National Board of Revenue (NBR)
Iqbal Chowdhury	Chartered Accounted M I Chowdhury & Company
Amir Khosru Md Chowdhury	Chairman CSE
Syed Nasir Ershed	Assistant Secretary ERD Ministry Of Finance
Dr Nawshad Faiz	Consultant
Dr Mohammed Farashuddin	*Governor, Bangladesh Bank*
M Z Hossain	Consultant Ministry of Finance
S M Al-Husainy	Former Secretary, *GOB* Chairman Swanirver Bangladesh
Annisul Huq	Vice President, Bangladesh Garments Manufacturer Exporting Association (BGMEA)
Mr Ronald P Hicks	Resident Representative International Monetary Fund
Dr Fouzul Kabir	Executive Director *IDACOL*

Mr Mohammad Khalequzzaman, MP

Ms Khushi Kabir	Chairperson, ADAB and Coordinator, Nijera Kori
Mr S A M S Kibria	Hon'ble Minister for Finance *Government of Bangladesh* Bangladesh Secretariat, Dhaka
Mr Manzurul Ahsan	President Communist Party of Bangladesh (CPB)
Dr M Abid Khan	Bangladesh Tariff Commission
Dr A Moyeen Khan	Member of Parliament and Former State Minister for Planning
Mohammad Abul Kalam	Senior Assistant Secretary Finance Division
Dr K A S Murshid	Research Director, BIDS
Mr John Moore	Counselor & Head of Aid Canadian High Commission
Dr Md Masum	Department of Economics Jahangirnagar University
Professor Wahiduddin Mahmud	Department of Economics University of Dhaka and President, Bangladesh Economic Association and Former Advisor to the Caretaker Government of Bangladesh
Mr Md Nurun Nabi	Joint Secretary Ministry of Finance Government of Bangladesh Bangladesh Secretariat,

	Dhaka
Mrs Rokia A Rahman	Director MIDAS
Dr M Rahmatullah	Former Director UN-ESCAP
Professor Mustafizur Rahman	Research Director, CPD
Mamun Ur Rashid	Secretary Statistics Division
Mr M H Rahman	Former President, The Dhaka Chamber of Commerce and Industry (DCCI)
Mr Mahbub Ur Rahman	President, International Chamber of Commerce Bangladesh (ICC, B)
Mr Md MostafizurRahman Sardar	Joint Director Monetary Management and Technical Unit Bangladesh Bank
Mr Zillul Hye Razi	Information Officer Commission of the European Communities
Mr A K M Shamsuddin	Former President, Foreign Investors Chamber of Commerce and Industry (FICCI) and Managing Director Rhône-Poulenc Rorer Bangladesh Ltd.
Mr M Syeduzzaman	Member, CPD Board of TresteesFormer Finance Minister, Government of Bangladesh
Monaem Sarker	Awami League

Professor Mustafizur Rahman	Research Director, CPD
Dr Zaidi Sattar	Economist The World Bank Dhaka Office
Dr M I Talukdar	Former Division Chief, Planning Commission
Dr Mahbub Ullah	Department of Economics Chittagong University
HE Mr Kazuyoshi Urabe	Ambassador Embassy of Japan
Ms Fahmeeda Wahab	Development Advisor, CIDA
Paul Walters	DFID British High Commission

Journalists

Mr Inam Ahmed	The Daily Star
Mr Zahirul Abedin	The New Nation
Mr Faruqu Ahmed	The Independent
Mr Zulfikar Ali	The Mukthakantha
Mr Zahir Ahmed	Press
Mr Rejaul Karim Byron	Weekly Bichitra
Mr A Malek Chowdhury	Free Lance
Mr Mukhlesur R Chowdhury	The Daily Dinkal
Mr Akhter Farouk	Free Lance
Mr Titu D Gupta	UNB
Mr Rashed Hossain	The Daily Martibhumi
Mr Farid Hossain	The Associated Press
Mr Ezaz Hossain	The Jhanakantha

Mr Monowar Hossain	The Financial Express
Mr Sk Enamul Haq	The Daily Star
Mr Helal Uddin	The Banglabazar Patrika
Mr Siddique Islam	The Banglar Bani
Mr Sayed Islam	The Bhorer Kagoj
Mr A T M Ishaque	The Azker Kagoj
Mr Shahriar Karim	The Daily Star
Mr Abul Kasem	The Daily Inqilab
Md Mizanur Rhaman Khan	The Independent
Mr Subir Kumar	The Daily Arthaneeti
Mr Husnien Khurshed	ETV
Mr Masud Karim	Manabzamin
Mr M Karim	The Protham Alo
Mr Masumur Rhaman Khalili	The Daily Inqilab
Mr Manjur Mahmud	The Daily Star
Mr S Hossain Masum	The Ittefaq
Mr Syed Shamsul Islam Nipu	The Daily Arthoneeti
Mr Saiful Alam	The Daily Jugantar
Mr Shishir Shil	Daily Mukta khantha
Mr Ranjan Sen	Weekly Bichitra
Mr Selim	New Nation
Mr Khawaza Monir Uddin	The Bangladesh Observer