Chapter 1

STATE OF THE BANGLADESH ECONOMY IN FY2004: A MACROECONOMIC OVERVIEW

1.1 INTRODUCTION

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

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

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

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

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

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

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

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

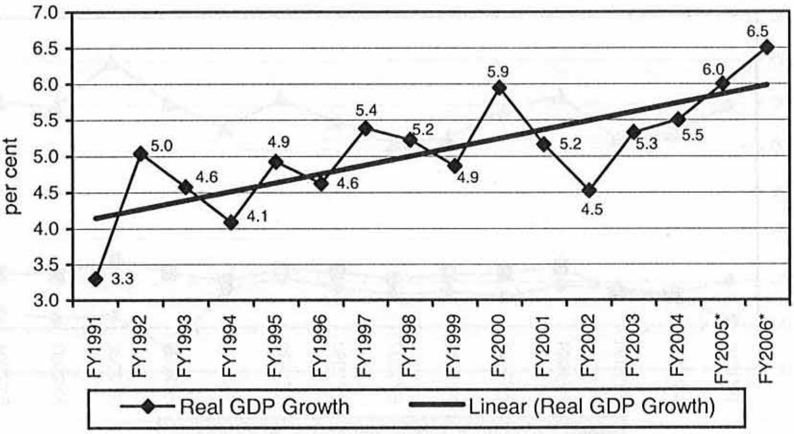
The information used in the analysis are primarily derived from official sources including Bangladesh Bank, Bangladesh Bureau of Statistics (BBS), Bangladesh Export Processing Zones Authority (BEPZA), Board of Investment (BoI), Economic Relations Division (ERD), Export Promotion Bureau (EPB), National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

1.2 GROWTH, SAVINGS AND INVESTMENT

1.2.1 Growth Rate – Plateauing?

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

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



Note: *I-PRSP Targets.

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

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

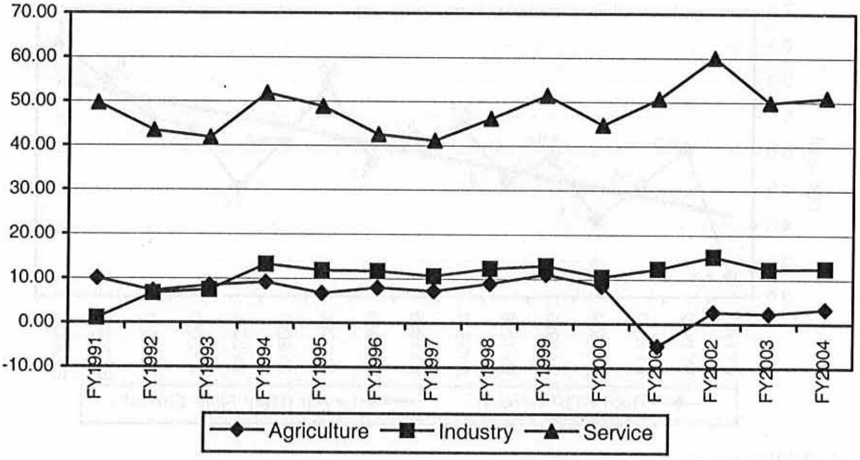
However, as was mentioned in IRBD2003, acceleration of the growth momentum is tapering off and the growth rate since 2000 has plateaued at 5.0 per cent-plus level (Bhattacharya, 2004). It may be recalled that economic growth experienced acceleration, from 3.7 per cent average growth in the 1980s to 4.8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

1.2.2 Sources of Growth – Service Sector Dominated

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

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

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



Source: Computed from CPD (2004).

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

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

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

1.2.3 Per Capita Income

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

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

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

1.2.4 Savings

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

TABLE 1.1

Savings/Investment Scenario, FY2004-FY2005

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

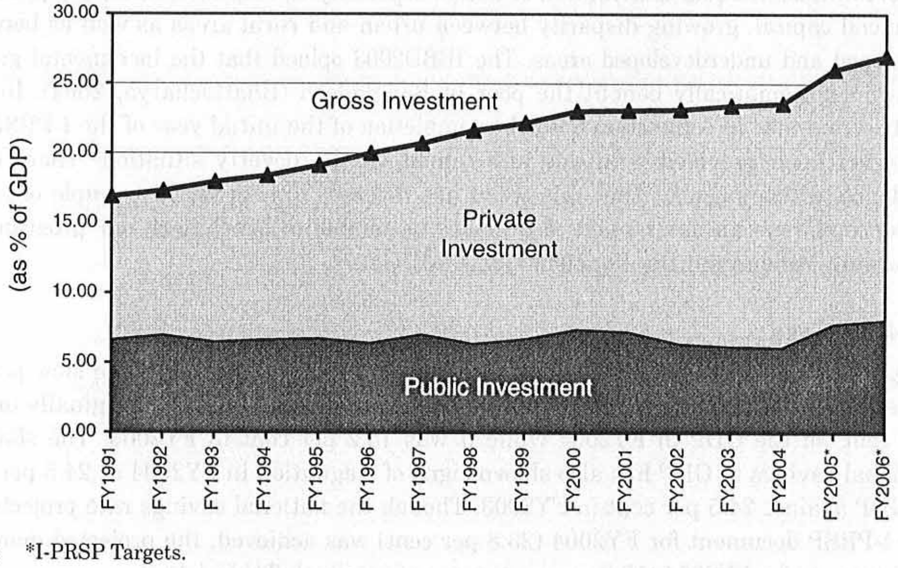
Source: Computed from Finance Division (2004c) and ERD (2003).

1.2.5 Investment

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

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

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



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

Figure 1.3: Investment Trend (as % of GDP)

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

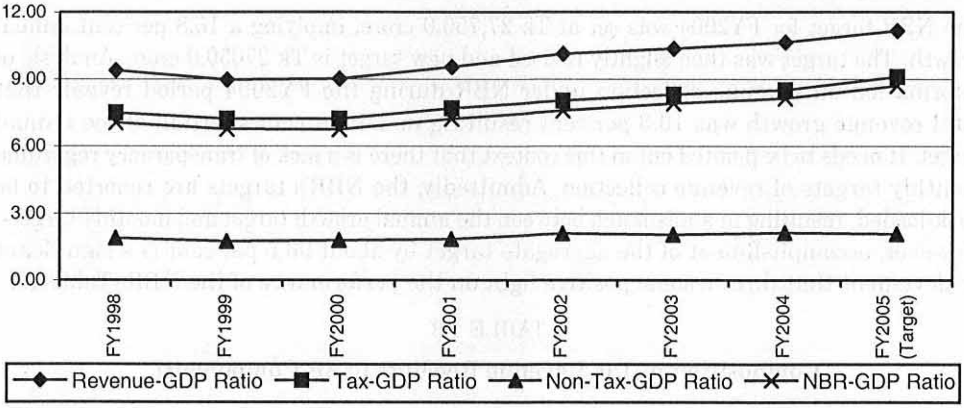
Paradoxically, Bangladesh continues to remain an under-invested country, while its national savings rate (24.5 per cent) supposes its gross investment rate (23.6 per cent). Bangladesh has been failing to convert all its savings into investment, as it continues to borrow from foreign sources. Private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

1.3 PUBLIC FINANCE

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

1.3.1 Revenue Earning

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



Source: Computed from CPD (2004).

Figure 1.4: Revenue as % of GDP

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

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

TABLE 1.2

Trends in Total Revenue Receipts: FY2001-FY2005

(in billion Tk)

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

Notes: Figures in the parentheses depict annual growth rates.
[a] Based on target. GDP for FY2005 has been estimated by the government at Tk 3,701.2 billion.
n.a. not available/not applicable.

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

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

NBR Components

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

TABLE 1.3

Composition of Tax Revenue Receipts (NBR Component)

(in crore Tk)

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

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

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

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

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

Box 1.1: Failure to Raise Revenue through Income Tax

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

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

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

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

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

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

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

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

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

Non-NBR Components

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

TABLE 1.4

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

(in crore Tk)

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

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

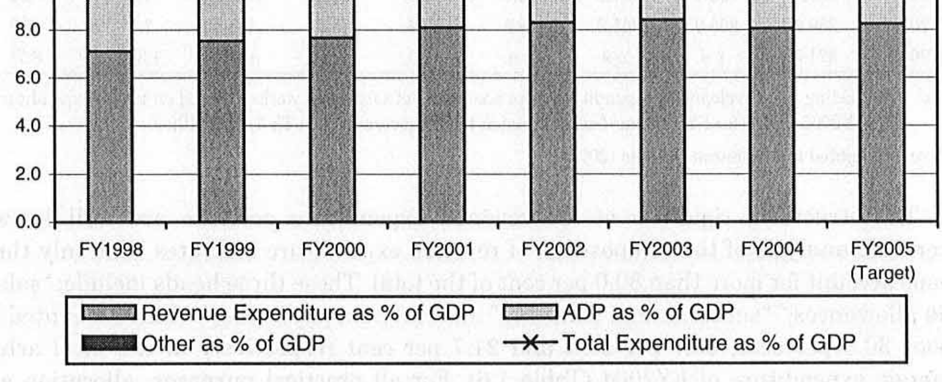
Tk 1,450.0 crore; targeting a higher growth in *land developments taxes* and *non-judicial stamp duties*. If the FY2005 target is achieved, it would be a 17.3 per cent growth over the realised figure of FY2004.

Non-Tax Revenue

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

1.3.2 Public Expenditure

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



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

Figure 1.5: Public Expenditure (as % of GDP)

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

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

1.3.3 Revenue Expenditure

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

TABLE 1.5

Trend in Revenue Expenditure (FY2001-FY2005)

(in billion Tk)

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

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

Source: Computed from Finance Division (2004a).

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

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

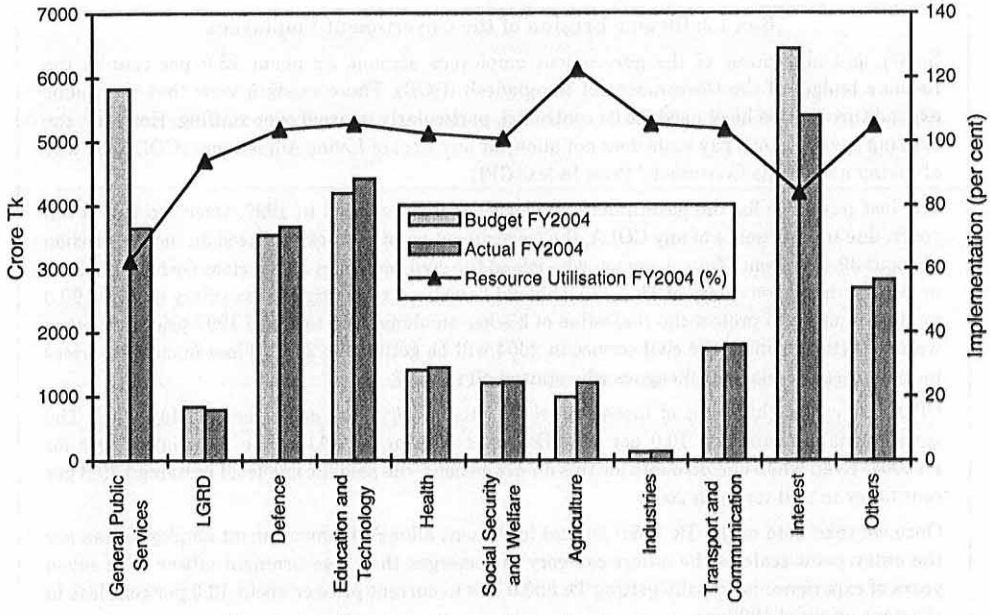


Figure 1.6: Revenue Expenditure by Sector in FY2004

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

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

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

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

Box 1.2: Income Erosion of the Government Employees

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

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

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

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

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

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

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

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

TABLE 1.6

Economic Analysis of Revenue Expenditures in FY2004-FY2005

(per cent)

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

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

Source: Computed from Finance Division (2004b).

1.3.4 Annual Development Programme

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

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

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

TABLE 1.7

Annual Development Programme

(in billion Tk)

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

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

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

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

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

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

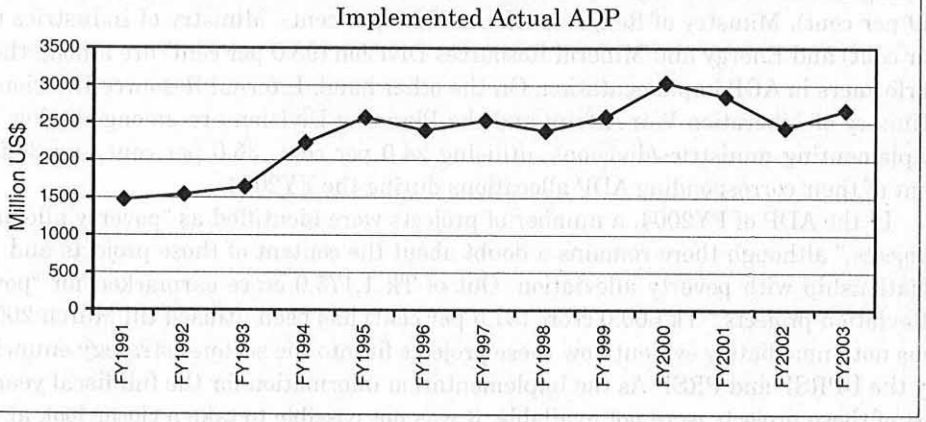
In the past years, one of the primary criticisms of the ADP budget management was related to the tardy use of ADP allocations in the first three quarters of the fiscal year and the subsequent rush by the line ministries to spend their remaining budget allocations in the last quarter. This approach to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

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

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

Box 1.3: Annual Development Programme Stagnates

In the face of the increasing development needs of the country, Bangladesh remains an under-invested economy. Gross investment – GDP ratio has been stagnating at around 23.0 per cent for the last four-five years. In this context public investment is expected to play a greater role in creating an enabling physical and social infrastructure for promoting private investment. However, the realised size of the ADP has stagnated in real term and has hovered between US$3,000.0 million and US$2,500.0 million during the last five-six years. The largest ever ADP was implemented in FY2000 (US$3,033.5 million), followed by FY2001 (US$2,850.0 million). From all indications it seems that FY2004 will not be able to break these records.



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

Box 1.4: Declining Public Expenditure in Agriculture

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

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

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

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

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

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

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

1.3.5 Budget Deficit and Financing

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

TABLE 1.8

Actual Budget Deficit and Financing

(in billion Tk)

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

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

Source: Computed from CPD (2004).

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

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

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

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

1.4 MONETARY AGGREGATES, CREDIT EXPANSION AND INFLATION

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

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

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

1.4.1 Domestic Credit Expansion

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

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

TABLE 1.9

Domestic Credit Expansion

(in billion Tk)

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

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

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

1.4.2 Reserve Money and Liquidity Position

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

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

Box 1.5: Did Interest Rate Spread Decline?

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

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

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

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

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

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

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

1.4.3 Government Borrowing

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

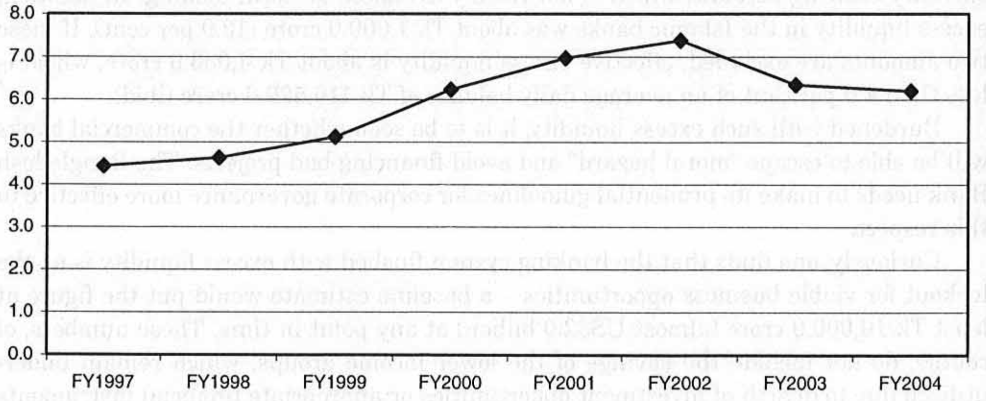
TABLE 1.10

Net Government Borrowing

(in billion Tk)

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

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



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

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

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

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

1.4.4 Agricultural Credit

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

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

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

TABLE 1.11

Agricultural Credit Expansion

(in billion Tk)

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

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

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

1.4.5 Industrial Loans

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

TABLE 1.12

Disbursement and Recovery of Term Loan

(in billion Tk)

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

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

TABLE 1.13

Sanction and Disbursement of Term Loan

(in billion Tk)

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

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

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

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

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

Box 1.6: Effect of Declining Interest Rate

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

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

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

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

TABLE 1.14

Sanction and Disbursement of Working Capital

(in billion Tk)

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

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

Loan Classification

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

TABLE 1.15

Classified Loan

(in billion Tk)

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

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

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

1.4.6 Price and Wage Inflation

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

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

Box 1.7: Effect of Rising Inflation

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

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

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

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

TABLE 1.16

Inflation Rate (Base: FY1996=100)

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

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

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

Box 1.8: Price Trend of Some Imported Commodities

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

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

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

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

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

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

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

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

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

1.5 REAL ECONOMY

1.5.1 Agricultural Production

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

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

TABLE 1.17

Annual Growth of Agricultural Output (Base FY1996=100)

(per cent)

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

Note: p = Provisional.

Source: Computed from CPD (2004).

TABLE 1.18

Foodgrain Production

(in million M Ton)

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

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

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

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

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

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

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

1.5.2 *Monga* Situation

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

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

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

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

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

Box 1.9: Poverty Trends and Spatial Variation in Poverty

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

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

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

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

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

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

1.5.3 Industrial Production

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

TABLE 1.19

Growth of Industrial Production (1995-96=100)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1.5.4 Privatisation

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

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

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

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

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

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

1.5.5 Foreign Investment

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

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

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

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

TABLE 1.20

Foreign Investment

(in million US$)

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

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

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

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

1.5.6 Capital Market

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

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

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

TABLE 1.21

Capital Market

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

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

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

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

Box 1.11: Trend in Over Subscription of IPOs

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

(Contd.)

(Contd. of Box 1.11)

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

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

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

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

TABLE 1.22

Initial Public Offerings (DSE)

(in million Tk)

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

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

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

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

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

1.6 EXTERNAL SECTOR[15]

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

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

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

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

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

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

1.6.1 Import

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

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

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

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

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

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

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

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

1.6.2 Export

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

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

TABLE 1.23

Categorywise Exports

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

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

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

1.6.3 Remittance

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

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

TABLE 1.24

Foreign Remittance and Foreign Exchange Reserve

(in million US$)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1.6.4 Foreign Aid

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

TABLE 1.25

Foreign Aid and Debt Services

(in million US$)

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

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

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

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

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

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

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

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

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

1.6.5 Balance of Payments

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

TABLE 1.26

Balance of Payments, FY2003-FY2004

(in million US$)

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

(Contd.)

(Contd. of Table1.26)

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

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

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

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

1.6.6 Foreign Exchange Reserve

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

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

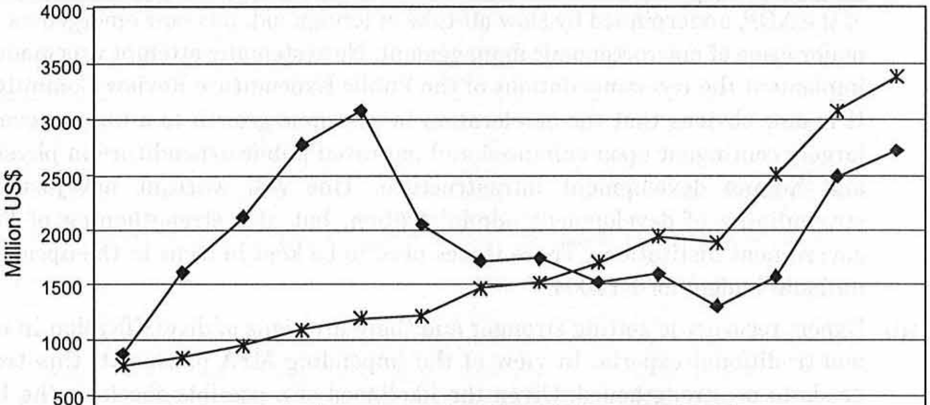

Figure 1.8: Foreign Exchange Reserve during FY1991-FY2004

1.7 CONCLUDING REMARKS

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

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

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

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

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

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

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

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

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

Box 1.14: Increasing Disparity and Marginalisation of Middle Class

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Box 1.16: Independent Commission on National Statistics

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

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

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

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