State of the Bangladesh Economy in Fiscal Year 2014

(Third Reading)

A report prepared under the programme

Independent Review of Bangladesh's Development (IRBD)

of the Centre for Policy Dialogue (CPD)

Released to the Media on

1 June 2014

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

Contents

SECTION 1. INTRODUCTION 4
SECTION 2. THE MACROECONOMIC SCENARIO: A TALE OF TWO WOES 5
SECTION 3. PUBLIC EXPENDITURE: ISSUES AND CONCERNS 23
SECTION 4. FINANCING PUBLIC EXPENDITURE: A SMART MIX NEEDED 35
SECTION 5. SUSTAINABLE POWER SECTOR DEVELOPMENT: WHETHER IN RIGHT DIRECTION? 41
SECTION 6. EXPORT SECTOR PERFORMANCE: FLUCTUATING FORTUNES 54
SECTION 7. CONCLUDING REMARKS 63
REFERENCES 65
ANNEXTURE 67

CPD IRBD 2014 Team

Professor Mustafizur Rahman, Executive Director, CPD and *Dr Debapriya Bhattacharya*, Distinguished Fellow, CPD were in overall charge of preparing this report as the Team Leaders.

Lead contributions were provided by *Dr Fahmida Khatun,* Research Director; *Dr Khondaker Golam Moazzem*, Additional Research Director and *Mr Towfiqul Islam Khan*, Research Fellow, CPD.

Valuable research support was received from *Ms Khaleda Akhter,* Senior Research Associate; *Mr Kishore Kumer Basak,* Senior Research Associate; *Mr Md. Zafar Sadique,* Senior Research Associate; *Ms Mehruna Islam Chowdhury,* Senior Research Associate; *Mr Mashfique Ibne Akbar,* Research Associate; *Ms Farzana Sehrin,* Research Associate; *Ms Saifa Raz,* Research Associate; *Ms Umme Salma,* Research Associate; *Mr Md. Naimul Gani Saif,* Research Associate*; Mr Mohammad Afshar Ali,* Research Associate; *Ms Shahida Pervin,* Research Associate*; Mr Mostafa Amir Sabbih,* Research Associate; *Ms Shahzeen Hafiz,* Programme Associate; *Mr Ziad Quader,* Research Intern; *Ms Nadee Naboneeta Imran,* Research Intern and *Ms Anika Zaman,* Former Research Intern, CPD.

Mr Towfiqul Islam Khan was the Coordinator of the CPD IRBD 2014 Team.

Acknowledgement

The CPD IRBD 2014 Team would like to register its sincere gratitude to *Professor Rehman Sobhan*, Chairman, CPD for his advice and guidance in preparing this report.

As part of the CPD IRBD tradition, CPD organised an Expert Group Consultation on 29 May 2014 at The Westin Dhaka. The working document prepared by the CPD IRBD 2014 Team was shared at this meeting with a distinguished group of policymakers, academics and professionals. The CPD team is grateful to all of those present at the consultation for sharing their views, insights and comments on the draft report. A list of the participants of the meeting is provided below (in alphabetical order):

Dr. Salehuddin Ahmed	Former Governor Bangladesh Bank
Dr M Asaduzzaman	Professorial Fellow Bangladesh Institute of Development Studies (BIDS)
Dr Zahid Hussain	Lead Economist South Asia Finance and Poverty Group The World Bank
Dr A B Mirza Azizul Islam	Former Advisor to the Caretaker Government Ministries of Finance and Planning
Dr Ahsan Habib Mansur	Executive Director Policy Research Institute of Bangladesh
Mr Muhammad Abdul Mazid	Former Chairman National Board of Revenue (NBR)
Dr Mustafa K Mujeri	Director General Bangladesh Institute of Development Studies (BIDS)
Mr M Syeduzzaman	Member, CPD Board of Trustees and Former Finance Minister
Professor M Tamim	Bangladesh University of Engineering and Technology Former Special Assistant to the Chief Advisor of the Caretaker Government
Dr Hassan Zaman	Chief Economist Bangladesh Bank

The Team gratefully acknowledges the valuable support provided by *Ms Anisatul Fatema Yousuf*, Director, Dialogue and Communication Division, CPD and her colleagues at the Division in preparing this report. Contribution of the CPD Administration and Finance Division is also highly appreciated. Assistance of *Mr A H M Ashrafuzzaman*, Deputy Director (System Analyst) and *Mr Hamidul Hoque Mondal*, Senior Administrative Associate is particularly appreciated.

Concerned officials belonging to a number of institutions have extended valuable support to the CPD IRBD Team members. In this connection, the Team would like to register its sincere thanks to *Bangladesh Bank, Bangladesh Bureau of Statistics (BBS), Bangladesh Export Processing Zones Authority (BEPZA), Bangladesh Garment Manufactures & Exporters Association (BGMEA), Bangladesh Power Development Board (BPDB), Board of Investment (BoI), Bureau of Manpower, Employment and Training (BMET), Chittagong Stock Exchange (CSE), Dhaka Stock Exchange (DSE), Export Promotion Bureau (EPB), Ministry of Finance (MoF), National Board of Revenue (NBR),* and, *Planning Commission.*

The CPD IRBD 2014 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

State of the Bangladesh Economy in FY2014
(Third Reading)

SECTION 1. INTRODUCTION

Bangladesh's macroeconomic performance has experienced formidable challenges in the course of the ongoing FY2014. During the first half, the economy was confronted with severe disruption in production, transport and service delivery that afflicted both domestic and export-oriented activities. In the second half, in the backdrop of the political uncertainties, a deceleration in the investment growth, particularly that of private sector investment, constrained efforts to translate the relative macroeconomic stability into higher economic growth. In the context of these twin developments, reinvigorating the investment environment to regain the lost momentum of accelerated GDP growth has emerged as a major concern from the perspective of macroeconomic management in FY2014 and in view of the upcoming budget for FY2015.

This report, the third interim one on the performance of the Bangladesh economy in FY2014 under CPD's IRBD (Independent Review of the Bangladesh's Development) exercise, has made an attempt to present CPD's assessment of the emerging economic scenario in Bangladesh based on the latest available data and information. Four thematic areas have also been taken up for closer scrutiny which include an analysis of allocational patterns, prioritisation and efficacy of public expenditure, an assessment of financing of the public expenditure, an evaluation of the evolving power sector scenario and an analysis of the export sector performance from the perspective of product composition and market destination.

Thus, the report has five core sections following this introduction:

- Macroeconomic Scenario
- Public Expenditure: Issues and Concerns
- Financing Public Expenditure: A Smart Mix Needed
- Sustainable Power Sector Development: Whether in Right Direction?
- Export Sector Performance: Fluctuating Fortunes

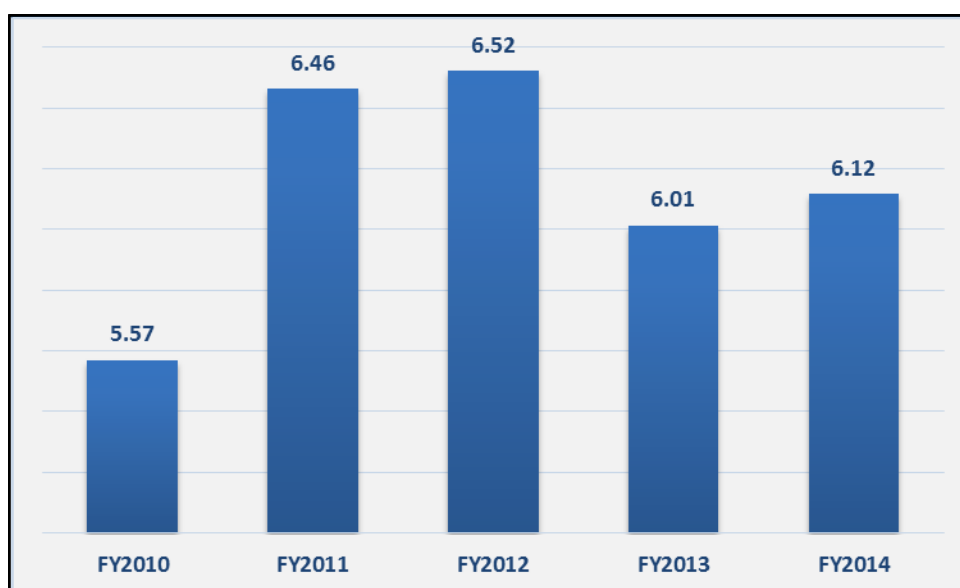
The report ends with some concluding remarks.

SECTION 2. THE MACROECONOMIC SCENARIO: A TALE OF TWO WOES

2.1 Economic Growth, Investment and Savings

Bangladesh Bureau of Statistics (BBS) has recently come up with the provisional estimate of 6.1 per cent for the GDP growth in FY2014 (Figure 2.1). This was 1.1 percentage point lower than the target of 7.2 per cent set in the FY2014 Budget.[1] It needs to be recalled that many analysts including the World Bank and Asian Development Bank expected the economic growth in FY2014 to be between 5.5-6.0 per cent in view of political unrest in the first half of the fiscal year and the trends of associated macroeconomic correlates (See World Bank (2014) and ADB (2014)). CPD in January 2014 also predicted that GDP growth rate in FY2014 would be in the range of 5.6-5.8 per cent (CPD 2014a).

FIGURE 2.1: GDP GROWTH RATE (%)



Source: BBS data.

In FY2014, per capita GNI of Bangladesh has been estimated to be about USD 1,190, which is USD 136 more than that of the preceding year (12.9 per cent growth). However, in real terms, per capita GNI has increased to USD 682 in FY2014 from USD 642 in FY2013 (6.3 per cent). On the other hand, per capita GDP also increased to USD 1,115 in FY2014 from USD 976 in FY2013, i.e. USD 139 increase (14.2 per cent growth; 7.6 per cent in real terms). Following the revision and rebasing of national accounting systems which included new economic activities and information, the per capita income of Bangladesh experienced a 13.6 per cent growth in FY2012.[2] The new GDP and hence per capita GNI estimates indeed has increased the likelihood of Bangladesh graduating to a lower middle income country in near future. The threshold of inclusion as a lower middle income country was USD 1036 (calculated following World Bank's

---

[1] The estimates of national accounts is prepared based on the new year of 2005-06. It is however unclear as to whether the targeting of GDP growth considered the new base year.

[2] FY2012 is the last fiscal year for which final estimates are available for both accounting systems.

Atlas Method[3]) in 2012. As is the case, the threshold for middle income country status is revised annually. Indeed, over the last ten years (2004-2013), on an average, the threshold has increased by 3.4 per cent every year. Thus, Bangladesh will need to wait for the new estimates of the World Bank (which is released on 1 July of each year) to learn as to where it stands in this regard. However, in all likelihood Bangladesh will become a lower middle income country in the next few years. In view of this possible scenario Bangladesh will need to prepare itself to face new challenges. One of the major implications of no longer being a low income country would be that Bangladesh may not be considered for concessional credit lines. It implies that development financing from foreign aid could become costlier for Bangladesh in future. However, it is also conceivable that Bangladesh will still remain a least developed country (LDC) for some years since the thresholds for graduation from the LDC status relate to other specific criteria which include both income and non-income indicators.

According to BBS statistics, industry sector remains a key driver of the estimated economic growth rate for FY2014. However, the growth rate of industry sector was estimated to come down from 9.6 per cent in FY2013 to 8.4 per cent in FY2014 (Table 2.1). Within the industry sector, growth of manufacturing sector is estimated to slip to 8.7 per cent in FY2013 which was the lowest growth rate since FY2010. On the other hand, construction sector is expected to register a growth rate of 8.6 per cent which is the highest in the last five years. At the same time, agriculture sector is projected to achieve a much improved performance with a growth rate of 3.4 per cent which was only 2.5 per cent during the previous year.

TABLE 2.1: GDP GROWTH (%)

Sector	FY12	FY13	Provisional FY14
Agriculture	*3.0*	*2.5*	*3.4*
Crop	1.8	0.6	1.9
Industries	*9.4*	*9.6*	*8.4*
Manufacturing	10.0	10.3	8.7
Construction	8.4	8.0	8.6
Services	*6.6*	*5.5*	*5.8*
GDP	**6.5**	**6.0**	**6.1**

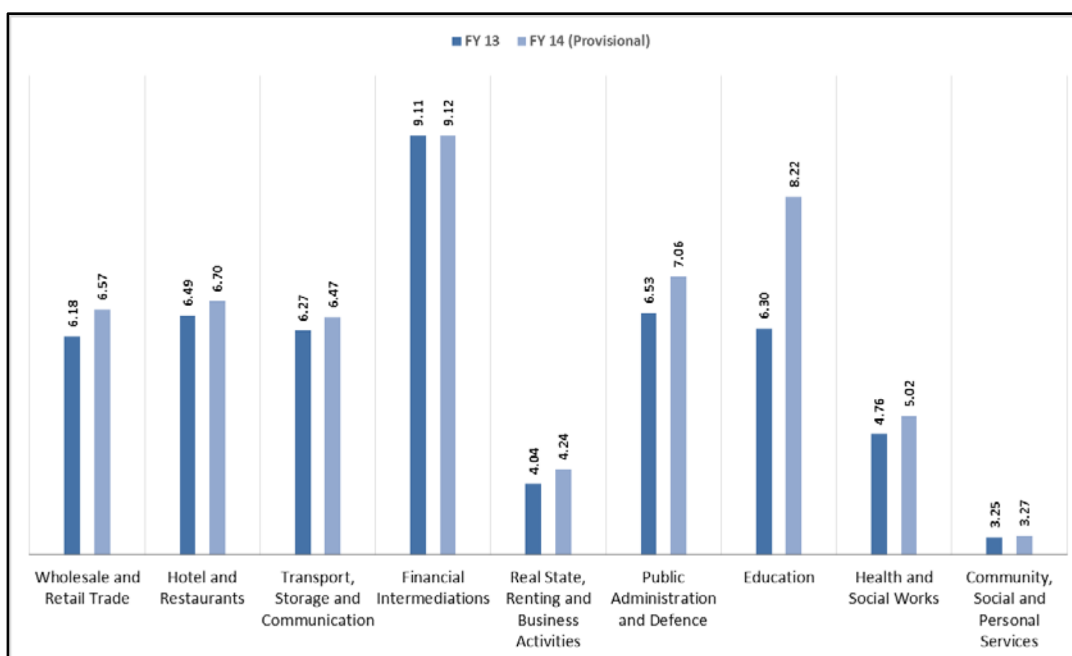
Source: BBS data.

The services sector's growth rate of 5.8 per cent in FY2014 has been a surprise. Indeed, all the nine sub-sectors under the services sector is expected to attain higher growth in the current fiscal year, compared to last year (Figure 2.1). The growth of Education sector is expected to increase by 1.9 percentage points compared to last year. It was anticipated that in view of the political turmoil, the services sector was significantly affected. The BBS estimate has shown an improved performance for all the sectors which were relatively more adversely affected during the political violence - e.g. land transport, wholesale and retail trade, hotel and restaurant and real estate, renting and business activities. Growth of 'tax less subsidy' is also expected to attain a higher growth rate of 5.1 per cent which was 3.1 per cent in FY2013.[4]

FIGURE 2.2: GDP GROWTH RATE OF SUBSECTORS UNDER SERVICES SECTOR (%)

[3] The Atlas Method considers a conversion factor to reduce the impact of exchange rate and inflation rate fluctuations in the cross-country comparison of national incomes. In 2012, according to the Atlas Method, per capita GNI of Bangladesh was USD 840. For details on World Bank's Atlas Method see http://data.worldbank.org/about/country-classifications/world-bank-atlas-method

[4] The share of 'tax less subsidy' is about 4.1 per cent in GDP.



Source: BBS data

To ascertain the sources of incremental increase in GDP growth rate, a comparative decomposition exercise of the GDP growth rates of FY2013 and FY2014 was undertaken (Table 2.2). Such a scrutiny reveals that the fall in industry sector's contribution to GDP growth corresponds to the overall increase in the combined contribution of agriculture and services sectors. The 'tax less subsidy' component, on the other hand, is responsible for some rise, albeit not significant, in GDP growth.

TABLE 2.2: CONTRIBUTION TO GROWTH (%)

Sector	FY13	FY14	Difference (FY14 and FY13)
Agriculture Sector	0.41	0.54	0.13
Industry Sector	2.59	2.33	(-) 0.26
Service Sector	2.88	3.03	0.15
Tax less subsidy	0.13	0.21	0.08
GDP	**6.01**	**6.12**	**0.10**

Source: Estimated from BBS data.

Note: The difference between growth rates of FY2013 and FY2014 appeared 0.10 due to round-off error.

The provisional estimate of GDP for FY2014 is expected to be revised at a later date based on data for the full fiscal year. As would be recalled, in the last ten years final GDP growth estimates were lower than provisional estimates six times (including for FY2013 when the figures were 6.18 per cent and 6.01 per cent respectively). Indeed, a number of adjustments will need to be made in finalising the GDP estimate for FY2014. The provisional estimate of growth rates for crop sector will need to take into account the production of Boro, the most important crop. It is also likely that estimates of construction and service sectors and 'tax less subsidy' may require downward adjustments to bring these closer to reality.

From the expenditure side, private consumption as a share of GDP declined by about (-) 1.5 percentage points (Table 2.3). The provisional figure for GDP for FY14 projects an improved public investment performance with a distinctive fall in private investment's share in the GDP. It

is to be noted that the provisional GDP estimate has considered planned public investment figure. As is most likely, development expenditure will fall short of its target which will call for the figure of public expenditure to be adjusted downward. The deficit in external resource balance (export minus import) in FY2014 has also seen notable contraction.

TABLE 2.3: SHARE OF GDP COMPONENTS BY EXPENDITURE METHOD

Industrial origin sector	Share (%)		Difference in share (%)
	FY13	FY14	
Domestic demand	106.4	105.3	-1.1
Consumption	78.0	76.6	-1.4
Private	72.8	71.4	-1.5
General Government	5.1	5.2	0.1
Investment	28.4	28.7	0.3
Private	21.7	21.4	-0.4
Public	6.6	7.3	0.7
Resource balance	-7.2	-5.5	1.7
Exports	19.5	19.8	0.2
Imports	26.8	25.2	-1.5
Gross Domestic Expenditure at Market Price	99.1	99.8	0.7
Gross Domestic Product at Market Price	100.0	100.0	N/A
Statistical Discrepancy	0.9	0.2	-0.7
Gross Domestic Savings	22.0	23.4	1.4
Gross National Savings	30.5	30.5	0.0

Source: Calculated from BBS data.
Note: N/A denotes not applicable.

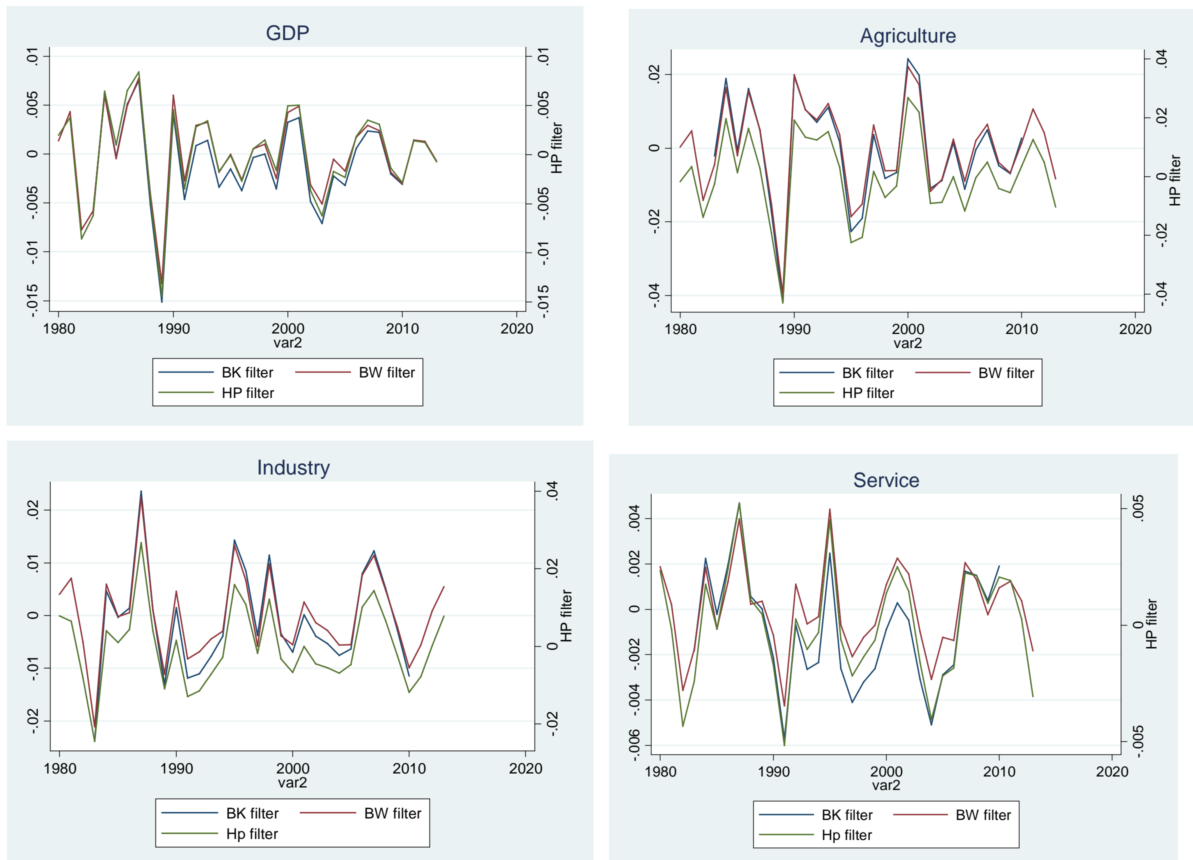
In FY2014 domestic savings as a share of GDP experienced a significant increase– from 22.0 per cent in FY2013 to 23.4 per cent, i.e. by 1.4 percentage points. Indeed, the rising trend of domestic savings, as reported by the new GDP estimates, has continued since FY2011. What is not immediately evident from the aggregate figure is to what extent this rise in domestic savings is driven by changes in government savings, private-corporate savings and household savings. Indeed, as is known, at present the banking sector is flushed with excess liquidity to the tune of 135 thousand crore taka (end-February 2014). At the same time, it is curious to observe that this trend is a quite different one when juxtaposed to the old national accounts estimates. National savings on the other hand has stagnated at 30.5 per cent in the backdrop of the decline in remittances inflow. It is hoped that BBS will come up with satisfying answers to these queries.

An attempt to discern the trend of Bangladeshi GDP. While there is an ongoing conjecture regarding the growth rate of GDP and its components, an attempt to decompose GDP is deliberated as part of the present study. Potential GDP is an unobserved variable, which represents the total GDP that could be produced if all the resources in the economy were fully employed under conditions of stable inflation. The Hodrick-Prescott (HP) high-pass filter has been employed together with the Baxter-King (BK) band-pass filter and the Butterworth (BW) high-pass filter[5]. These techniques used time series data (1980-2013) to decompose total GDP

[5] For detailed methodologies of the filters, please refer to Cerra and Saxena (2000), Alter, Necula and Bobeica (2010), Brouwer (1998), Razzak and Dennis (1999), European Communities (2003), Nguyen (2014) and Bordoloi, Das and Jangili (2009). Multiple methodologies are used to check the robustness.

and those of the three major sectors - agriculture, industry and services sectors of a year[6] into its growth (trend) and cyclical components[7]. Output gaps[8] are measured using the HP technique. Figure 2.3 which employed three techniques mentioned above established that the results of the HP filter are robust.

FIGURE 2.3: OUTPUT GAP AS MEASURED BY THE HP, BK AND BW FILTERS



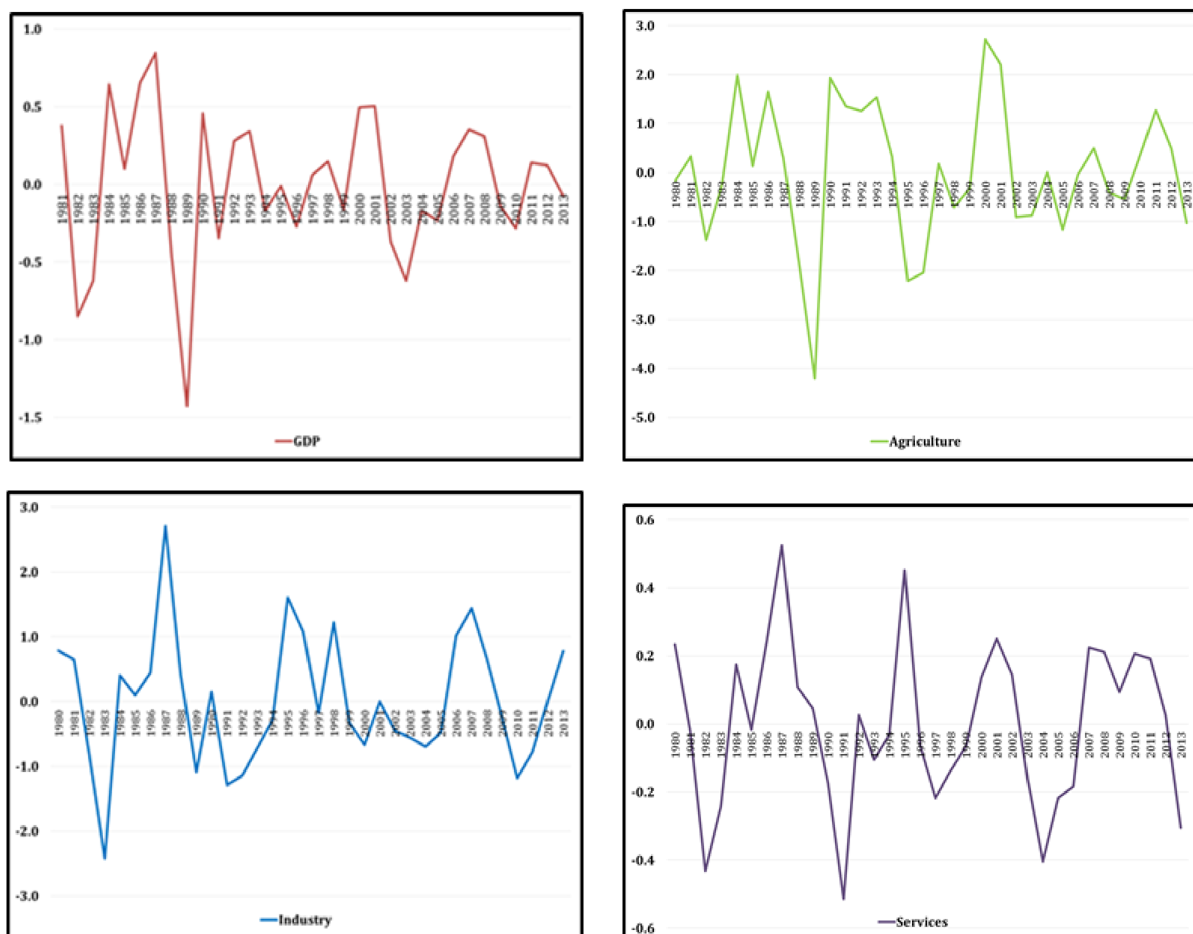
Source: Authors calculations.

Following HP filter, output gaps (as a percentage of potential value added) of overall GDP and its three major constituents have been estimated for this report (Figure 2.4). From the analysis, a number of observations may be made. *First*, it is observed that GDP has had breakthrough in each of the past three decades. At the same time, volatility was reduced by a significant margin. GDP remained below the potential level in FY2009 and FY2010, which could be attributed to the global financial crisis. Actual GDP performance went below its potential (-0.07 per cent) in FY2013, which can be attributed to the political turmoil. *Second*, as regards value added in agricultural sector, output gap remained negative (realised output being less than potential output) for the majority of the fiscal years during the last decade. In FY2013, the output gap was -1.02 per cent of the potential GDP in the agricultural sector. *Third*, in contrast to the agricultural sector, value added from the industrial sector experienced lower troughs but higher peaks during the course of the last decade, which helped the sector to move to a higher growth

[6] GDP data with 1995-96 base has been used. From FY2014 GDP is estimated using base year 2005-06.
[7] The cyclical component is inclusive of the other irregular components.
[8] Output gap represented in terms of percentage change is defined as actual output minus potential output relative to potential output.

trajectory. For instance, industrial sector's actual output remained 0.78 per cent per cent higher than its potential in FY2013. *Fourth*, changes in output gap in services has been the most volatile. The services sector performed above potential between FY2007 and FY2012. However, the potential output of the services sector remained (-) 0.31 per cent lower compared to the potential GDP from this sector.

FIGURE 2.4: OUTPUT GAP PERCENTAGE OF GDP MEASURED BY THE HP FILTER



Source: Authors calculations.

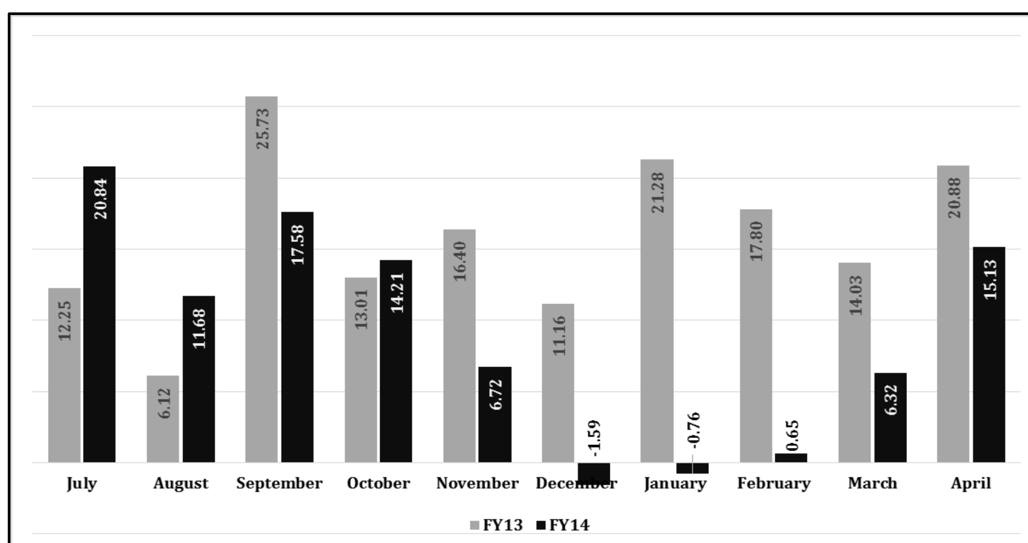
From the above-reported decomposition exercise, it can be inferred that the Bangladeshi GDP could not elevate to a higher potential during the early years of this decade (2010s). World Bank (2012) indicated that enhancing labour productivity was the key to reach a higher growth trajectory. To attain this, it was critically important to go for capital deepening, and higher total factor productivity by a way of skills development and capital and labour productivity enhancement. Following the 'Growth Diagnostics Framework', Rahman and Yusuf (2010) concluded that for Bangladesh, 'low levels of human capital, poor infrastructure, market failures relating to some key industries, missed opportunities in international trade, corruption and cumbersome regulations' are impeding economic growth prospect of the country. The study pointed to the need for addressing infrastructure bottlenecks, market and product diversification and regulatory reforms as urgent priorities facing the policymakers over the short to medium terms.

2.2 Public Finance

Revenue earnings. Having been able to surpass budgetary targets for three years in a row, the National Board of Revenue (NBR) faced a revenue shortfall in FY2013 when compared to the target set out in the budget. Revenue collection by the NBR continued to struggle for the second consecutive year in FY2014. During the first ten months of FY2014, NBR attained 9.2 per cent growth over the same period of FY2013 against the annual target of 25.3 per cent. As a result, NBR targets have been revised downward for the first time in FY2014 since FY2009 (by Tk. 11,090 crore). To achieve the revised annual target of 15.1 per cent growth, NBR collection will need to grow at 34.4 per cent in the last two months of FY2014. This will be difficult.

One may note the following trends in the revenue collection effort demonstrated by NBR in FY2014. *First*, revenue collection by NBR experienced relatively low growth since November 2013; the poorest trend observed in last five years. *Second*, for two consecutive months, in December 2013 and January 2014, revenue mobilisation by NBR failed to attain positive growth figures ((-) 1.6 per cent and (-) 0.8 per cent respectively) on month-on-month (MoM) basis (Figure: 2.5). However, collection has gained some momentum in the last two months for which data is available. In March and April of FY2014 NBR revenue collection registered 6.3 per cent and 15.1 per cent growth respectively compared to corresponding figure for FY2013. *Third*, tax collection at import stage struggled to generate revenue in the first half of FY2014 in the backdrop of sluggish import trends. *Fourth*, while chasing the ambitious targets set by the budget, both direct and indirect tax collection at domestic level lost momentum in the middle of FY2014 when business activities as well as revenue collection mechanism were significantly undermined due to violent political activities.[9]

FIGURE 2.5: MOM GROWTH (%) OF NBR REVENUE COLLECTION



Source: Estimated from NBR data.

Efforts from non-NBR and non-tax sources has also lagged behind the target growth in FY2014. During the first three quarters of FY2014, non-NBR tax sources attained 8.0 per cent growth

[9] Indirect taxes from local level sources registered 13.5 per cent growth in the first ten months of FY2014 against a revised target of 19.7 per cent growth. Collection of direct taxes increased by 12.2 per cent during this period over the matched period of previous fiscal year. The annual growth target for direct tax was 21.9 per cent.

against the annual target of 24.5 per cent. Non-tax revenue sources registered a 10.6 per cent growth (July-March FY2014) when compared to the annual target of 26.9 per cent.

NBR's revenue collection faced a shortfall of Tk. 8,000 crore (after three quarters of FY2014) against the lower revised target. At the same time the lower growth incurred by 'other than NBR' sources also signal a shortfall. In view of the present context, one may recall that CPD in its early review in October, 2013 suggested that, it was critically important to readjust the fiscal parameters; CPD also highlighted the urgent need to maintain fiscal discipline in FY2014 (CPD 2013). Indeed, FY2014 may be the first year in the last five years when tax-GDP ratio will decline compared to the previous fiscal year.

In response to the emerging scenario of the likely shortfall, the tax-revenue authority expressed its intention to boost tax collection in the remaining months of FY2014. The drive focused on collection of unpaid taxes by targeting tax dodgers and through resolution of pending tax related disputes in a speedy manner. Higher duty earnings from restored import payments in recent months also somewhat boosted tax collection by NBR. Inspite of these measures, one may still expect a shortfall of about Tk. 4,000-5,000 crore from the revised target for the NBR.

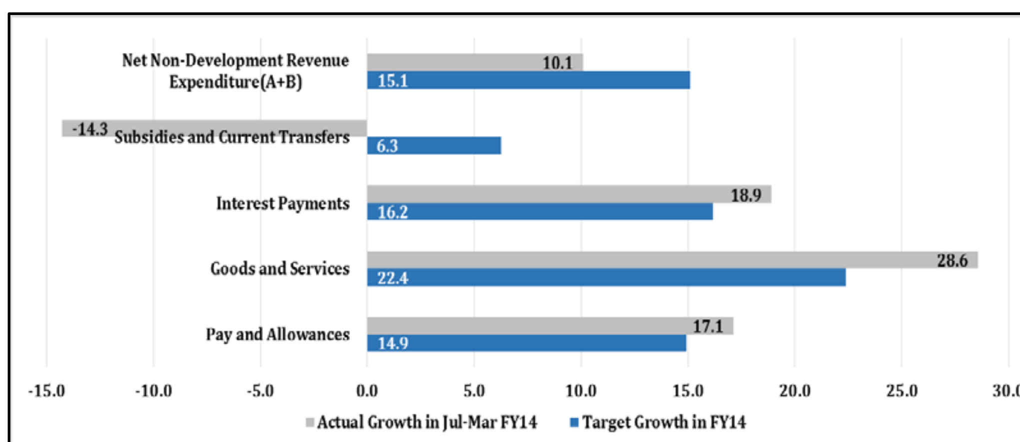
Public expenditure. According to data available for the first three quarters of FY2014, public expenditure (including both development and non-development expenditure) recorded 18.8 per cent growth while the annual target was set to increase by 28.4 per cent. The sluggish growth was attributed mainly by low implementation of the Annual Development Programme (ADP) and limited subsidy requirements. A detailed analysis of public sector expenditure is presented in Section 3.

Net non-development revenue expenditure[10] in the first three quarters of FY2014 increased by 10.1 per cent while the annual target was set at 15.1 per cent (Figure 2.6). Domestic interest payment accounted for a significant incremental share (about 24.4 per cent) in this growth. Expenditure under 'Pay and Allowances' and 'Goods and Services' accounts also experienced higher than envisaged growth during the abovementioned period. However, high negative growth for 'Subsidies and Current Transfer'[11] head (by (-) 14.3 per cent) compared to the corresponding period of FY2013 kept the overall non-development expenditure growth in check. Besides net non-development expenditure, disbursement of Tk. 4,168 crore for recapitalisation of the state-owned banks constituted a major expenditure item.

FIGURE 2.6: GROWTH (%) OF NET NON-DEVELOPMENT REVENUE EXPENDITURE

[10] Net non-development revenue expenditure takes into account all public expenditures except capital expenditure, development expenditure financed from non-development budget, ADP programme, loan and advances and net food account operations. Net non-development revenue expenditure has an annual target spending worth Tk. 113,470 crore in FY2014.

[11] 'Subsidies and Current Transfer' head does not capture whole subsidy requirements of the Government.



Source: Calculated from MoF Data.

Progress as regards implementation of ADP was rather slow in FY2014. About 49.8 per cent ADP allocation was spent during the July-April period of FY2014, while the matched figure for FY2013 was 56.3 per cent. In nominal terms, only Tk. 1,838 crore additional ADP has been utilised during the mentioned period of FY2014 against the corresponding months of previous fiscal. No major breakthrough could be achieved in this regard which resulted in both the local (GoB component) and project aid (PA) components of ADP remaining underutilised.[12]

As a result the ADP has been slashed by 8.9 percentage points (or Tk. 5,872 crore) to Tk. 60,000 crore. An amount of about Tk. 4,500 crore was reduced from the allocation reserved for Padma Multipurpose Bridge Project (PMBP) in FY2014. However, the revised ADP (RADP) has included about two hundred new projects.

Budget deficit and its financing. At the end of the first three quarters of FY2014, amount of deficit remained at only 1.4 per cent of planned GDP.[13] About 30.3 per cent of overall deficit (excluding grants) planned for FY2014 was incurred in this period (the target budget deficit was 4.4 per cent of GDP). The margin of deficit was large compared to the same period of FY2013 (Table 2.4).[14] The surge was evident in the backdrop of falling revenue performance in FY2014. According to MoF data, revenue mobilisation as share of annual target fell by 6.8 percentage points[15] compared to the matched figures of FY2013. However, expenditure structure envisaged in the budget remained almost unchanged in line with previous year's trend.[16] Overall, the size of the budget deficit in FY2014 was likely to be within the budgetary target.

TABLE 2.4: FISCAL FRAMEWORK DURING JULY-MARCH PERIOD OF FY2013 AND FY2014

[12] In July-April period of FY2014 spending under GoB and PA components were 50.3 per cent and 48.9 per cent respectively.
[13] Indeed, annual budget deficit did not reach the threshold of 5.0 per cent (of GDP) since FY2008.
[14] Budget deficit during the first nine months of FY2014 remained at Tk. 16,648 crore while the amount was only Tk. 5,330 crore during the same period of FY2013.
[15] About 58.8 per cent of budgetary target as regards revenue mobilisation was met during the first three quarters.
[16] Total expenditure hovers around half way mark of the planned expenditure after nine months with similar ADP and non-ADP budget implementation structure of FY2013.

Description	B FY13	B FY14	Implementation rate as % of Budget	
	In crore Taka		Upto Mar FY13	Upto Mar FY14
Revenue Collection	**139,670**	**167,459**	**65.6**	**58.8**
Total - Expenditure	**191,731**	**222,491**	**50.6**	**51.8**
ADP	55,000	65,870	36.3	37.6
Non-ADP	136,731	156,621	56.3	57.7
Overall Deficit (Excl. Grants):	*-52,061*	*-55,032*	*10.2*	*30.3*
Foreign Grants	**6,044**	**6,670**	**15.1**	**12.0**
Foreign Borrowing-Net	**12,541**	**14,398**	**2.6**	**4.2**
Foreign Loan	20,398	23,729	33.3	32.1
Amortisation	-7,858	-9,331	82.4	75.0
Domestic Borrowing	**33,484**	**33,964**	**11.9**	**44.8**
Bank Borrowing (Net)	23,000	25,993	46.8	50.9
Non-Bank Borrowing (Net)	10,484	7,971	-64.7	25.1
National Savings Schemes (Net)	7,400	4,971	9.9	150.8
Others	3,084	3,000	-243.8	-183.4
Total Financing	*52,069*	*55,032*	*10.0*	*30.2*

Source: Estimated from MoF Data.

As regards financing of the budget deficit, the utilisation of foreign finances (in terms of both foreign grants and foreign net borrowing[17]) was offset by robust earnings from sale of national savings bonds. Indeed, during first nine months of FY2014, 91.6 per cent of the total deficit was financed from domestic sources. Net sale of National Savings Directorate (NSD) certificates already surpassed the budget target by a significant margin (1.5 times higher net sale was reported when compared to the annual budget target). As a result, on the one hand, government borrowing from banking sources remained within the limit (only 50.9 per cent of planned target amount was borrowed), while on the other hand, the government managed to repay its short term loans under 'other non-bank sources' (non-bank borrowing sources other than National Savings Schemes).

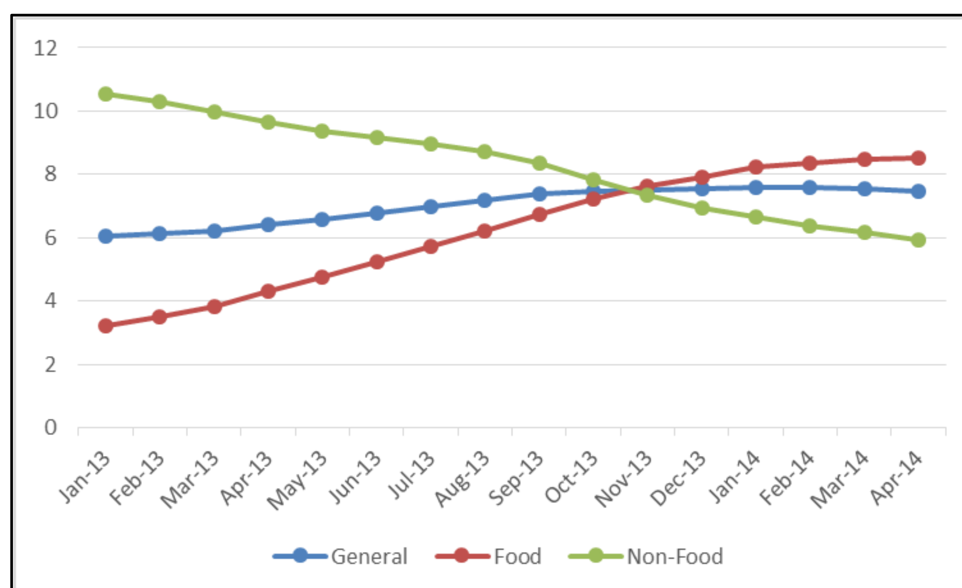
'Within-limit' budget deficit was envisaged in the backdrop of subdued subsidy requirements for FY2014. As has been mentioned, ADP implementation also experienced a set back in FY2014. Government has already made downward adjustment to the ADP allocation, full utilisation of which is also unlikely. On the other hand, NBR had slashed its revenue targets. Under the not-so-encouraging investment scenario, the demand for private sector credit remained lacklustre. In view of this emerging scenario, borrowing from bank sources should not be a major challenge for the government as FY2014 moves towards the finishing line. In view of interest payments emerging as one of the major sources of non-development expenditures, it will be advisable to keep the high cost domestic borrowing within the manageable limit.

2.3 Monetary Sector

[17] 12.0 per cent of planned foreign grants and 4.2 per cent of planned net foreign borrowing were utilised during 9 months of FY2014.

Inflation. Annual food inflation posted a rise since February 2013 while non-food inflation has commenced to decline. Both these trends were linked very closely to the political turmoil experienced in the first half of FY2014 (Figure 2.7). The food supply chain was severely disrupted due to nation-wide and regional strikes (hartals) and blockades. At the same time non-food inflation declined in the face of lower domestic demand. Additionally, exchange rate of Taka was stable; growth of broad money supply declined in this period. Annual average non-food inflation declined sharply to 5.9 per cent in April 2014 (from 9.2 per cent in June 2013). In contrast, food inflation increased to 8.5 per cent (from 5.5 per cent in June 2013). The rising trend of food inflation in recent months is largely explained by the higher rice price at the retail level. Indeed, during the ongoing harvest season of Boro, rice prices at retail level were found to be significantly higher than those similar period in the previous year.[18] Nonetheless, inflation appears to have stabilised at about 7.5 per cent. Inspite of the declining trend, reining in average annual inflation rate to between 6.0-6.5 per cent in FY2014 was likely to remain an unattained target. On the other hand, the central bank should not be too preoccupied with containing inflation through demand side management. Rather, the task is to search for ways to stimulate investment demand.

FIGURE 2.7: ANNUAL AVERAGE INFLATION RATE (%)

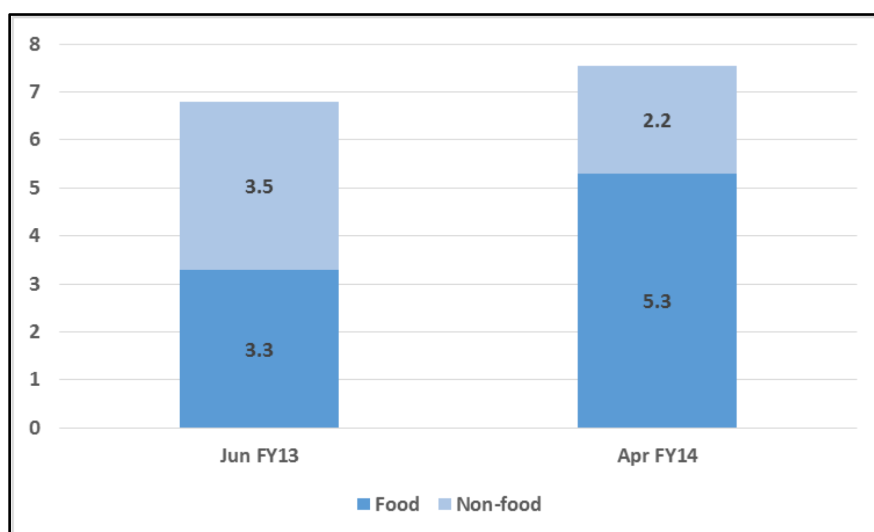


Source: Estimated from BBS data.

A decomposition of inflation figures for June 2013 and April 2014, reveals that, of the 6.8 per cent inflation in June 2013, 3.3 per cent originated in rise in food prices, while the rest 3.5 per cent came from non-food inflation (Figure 2.8). Of the 7.5 per cent inflation in April 2014, 5.3 per cent was contributed by food inflation and 2.2 per cent was account for by non-food inflation. Hence, contribution of food commodity prices (about 2.0 percentage points) was higher than the incremental inflation between the two periods (by 1.2 percentage points).

[18] According to the data from Trading Corporation of Bangladesh (TCB), on 26 May, retail prices of rice were about 8-17 per cent higher compared to the same for the previous year. Curiously, rice prices at the international market at present is lower than last year.

FIGURE 2.8: SOURCES OF ANNUAL AVERAGE INFLATION



Source: Estimated from BBS data.

Monetary Aggregates. Growth of money supply at the end of March 2014 (15.3 per cent) remained below the target of 17.0 per cent for the end of June, 2014 (Table 2.5). Indeed, much of this growth is explained by the high growth of net foreign assets which stood at 36.9 per cent as of March 2014. In contrast, growth rates of domestic credit remained at subdued level. Domestic credit was only 11.3 per cent as of March 2014; the target for this was 17.8 per cent for end of June 2014. Growth of government bank borrowing was 16.4 per cent at the end of March 2014 as a result of the lower demand.

TABLE 2.5: GROWTH OF MONETARY INDICATORS

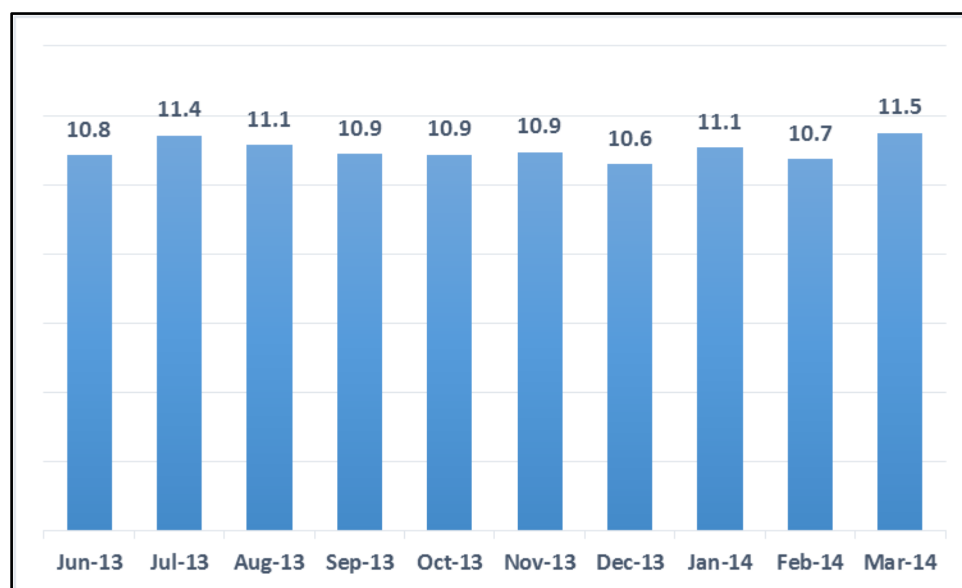
Indicator	Target FY13	Jun 2013	Target FY14	Mar 2014
Broad Money	17.7	16.7	17.0	15.3
Net Foreign Assets	14.0	43.9	10.0	36.1
Domestic Credit	18.9	11.0	17.8	11.3
Credit to Public Sector	20.3	11.7	22.9	10.8
Net Credit to the Govt. Sector	NA	20.1	NA	16.4
Credit to the Other Public Sector	NA	(-) 38.4	NA	-21.9
Credit to the Private Sector	18.5	10.8	16.5	11.5

Source: Bangladesh Bank Data from Monthly Economic Trends, May 2014 and MPS.

The growth of private sector credit was at 11.5 per cent at end of March FY2014; this was 10.8 per cent at the end of June FY2013 (Figure 2.9). However, private sector credit growth remained well below the FY2014 target of 16.5 per cent. The figure for end-March is the highest since end-April FY2013 when private sector credit registered a growth of 12.7 per cent. The trends in the data on credit to private sector suggests that possibility of any significant turnaround in credit uptake and investment is somewhat uncertain in the near term future. Indeed, the lack of credit demand for new investment is also demonstrated by the lower disbursement of industrial term loan. During the first half of the fiscal year, term loan disbursement declined by (-) 1.8 per cent. Lack of demand for private sector credit also resulted in significant excess liquidity in the

banking system. At the end of February 2014, excess liquidity in the banking system reached Tk. 135.4 thousand crore. Much of these liquid assets are kept in the form of low interest bearing 'unencumbered approved securities'. Indeed, in recent months the auction of government bills has experienced significant oversubscription.

FIGURE 2.9: PRIVATE SECTOR CREDIT GROWTH (%)



Source: Estimated from Bangladesh Bank data.

Monetary Policy Stance. Whilst inflation has been somewhat tamed, pick up in the investment demand is yet to be seen. A number of long standing issues also remain unresolved. *First*, despite having a low appetite for credit and availability of significant amount of excess liquidity with the banking system, interest spread has continued to remain high at 5.1 percentage points (in February 2014 which was the same in June 2013). Government has allowed the private sector to go for significant amounts of commercial borrowing from foreign sources (CPD 2014). Higher lending rate in the domestic financial market was an important consideration in this regard. It was also felt that this would infuse more competition in the domestic financial market. At the same time nine commercial banks have come into operation. However, these developments did not have favourable impact on the interest rate spread. Whilst private sector borrowing from foreign sources was not bad *per se*, at a time of high excess liquidity in the banking system and high forex reserves, the rationale of this policy may need to be revisited. CPD has earlier suggested that private sector's commercial lending from overseas should be allowed on a limited scale and to foreign exchange earning industries only (CPD 2014). In this context, possible currency and maturity mismatches need to be considered. The risk of possible illicit financial outflow also needs to be assessed.[19]

Second, as is known, the large amount of classified loans is hurting the banking system. In view of the loss of business emerging from political violence in the first half of FY2014, the central

[19] According to the estimates of Global Financial Integrity, on an average, annual illicit financial outflow from Bangladesh over the past ten years was to the tune of USD 1.4 billion (Global Financial Integrity, 2013). Moreover the trend of illicit financial outflow was on the rise.

bank allowed relaxation of loan provisioning for six months. As a result, share of classified loan to total outstanding loan had declined from 12.8 per cent as of September 2013 to 8.9 per cent at the end of December FY2014. One may recall that, in October 2012 a new loan provisioning guidelines was issued following the implementation plan of Basel III. Share of classified loan to total outstanding loan registered another rise at the end of March FY2014 when it increased to 10.5 per cent. High levels of classified loan was also a major reasons behind the persistently high interest rate spread. Following the Hall Mark Group scam and the more recent BASIC Bank scam, state of governance in the banking sector has once again been put under scrutiny. One may recall that weak governance in the banking sector, particularly in managing the state owned commercial and specialised banks, has cost about Tk. 4,100 crore of tax payers' money in FY2014 in the form of recapitalisation of state owned banks. It is also reported in the media that an additional Tk. 6,000 crore has been sought for the same purpose. One should not forget that this type of measures have important trade-off effect particularly in the context of unmet resource availability for social sectors and social safety net programmes for which share of resources have been on the decline in recent years (CPD 2014).

Third, the central bank has rightly maintained the stability of exchange rate of BDT against USD by augmenting foreign exchange reserves. Throughout FY2014, through a number of measures[20], the central bank introduced a more liberal foreign exchange policy. However, with mega projects such as the Padma Bridge to be implemented in the coming days, the central bank will need to examine the likely pressure on foreign exchange carefully to maintain the exchange rate stability.

Fourth, on March 31, 2014, the central bank issued a circular with regard to implementation of Basel-III. The action plan/roadmap of Bangladesh Bank envisaged that following the issuance of the detailed guideline in June 2014, a capacity building programme will be undertaken for commercial banks during June-December 2014. Commencement of Basel III implementation process will take place from July 2014 whilst full implementation is expected to be completed by January 2019. During this process, the commercial banks will have to raise their Capital Conservation Buffer, Minimum Common Equity Tier-1 (CET-1) Capital Ratio, and Minimum T-1 Capital Ratio. The implications of Basel-III requirements will be significant and the central bank will need to put in place the appropriate measures in view of this.

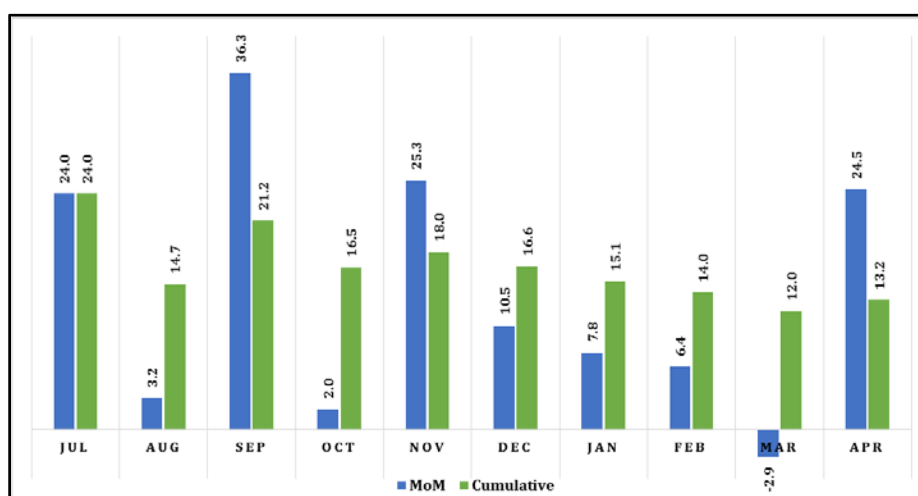
2.4 External Sector

Export earnings. Export earning is one of the few macroeconomic correlates where actual performance was on target as envisaged for FY2014. Export earnings registered 13.2 per cent growth during July-April of FY2014 over corresponding months of previous fiscal against the annual growth target of 12.9 per cent (Figure 2.10). Export sector dynamics of FY2014 will be explored in more detail in Section 6. However, the following trends are important to note. *First*, export growth experienced considerable volatility in FY2014 particularly in the early months of 2014. After relatively weak performance in the third quarter of FY2014, export earnings bounced back again in April 2014 with a spectacular growth of 24.5 per cent (Figure 2.10). This recovery has indeed helped keep export outlook for FY2014 more optimistic. *Second*, RMG

[20] Including release of foreign exchange for private travel abroad, Release of foreign exchange on account of transit expenses to students proceeding abroad for study, foreign exchange quota for exporters, importers and producers for the local market while traveling abroad etc.

exports led the overall export growth as the share of RMG products (HS 61 and 62) increased to 81.0 per cent during July-April of FY2014 from 79.5 per cent during the same period of FY2013. *Third*, among the two major traditional markets of the US and the EU, accelerated growth of RMG products in the early months (particularly in the first quarter) was sustained in the EU market to reach 18.6 per cent during the July-April FY2014 period. However, non-RMG exports has gradually slowed down in the EU. In case of the US market, early robust performance of RMG exports in FY2014 did not sustain. Exports of RMG products in the US market increased by 18.0 per cent and 8.4 per cent during the first and second quarter respectively over the corresponding periods of FY2013. However, during the January-April period of FY2014, exports declined by (-) 5.6 per cent. Particularly, export of woven garments experienced significant setback in the US market (3.6 per cent)[21]. *Fourth*, growth in major non-traditional[22] markets (19.6 per cent) continued to be higher compared to traditional market[23] (13.9 per cent); this augurs good in terms of enhanced market diversification. However, RMG led growth was also evident in both market groups mentioned above. Indeed, RMG export growth in the abovementioned non-traditional markets remained resilient (26.8 per cent), although the growth rate somewhat declined during January-April FY2014 (13.0 per cent).[24]

FIGURE 2.10: MOM AND CUMULATIVE GROWTH (%) OF EXPORT EARNINGS IN FY2014



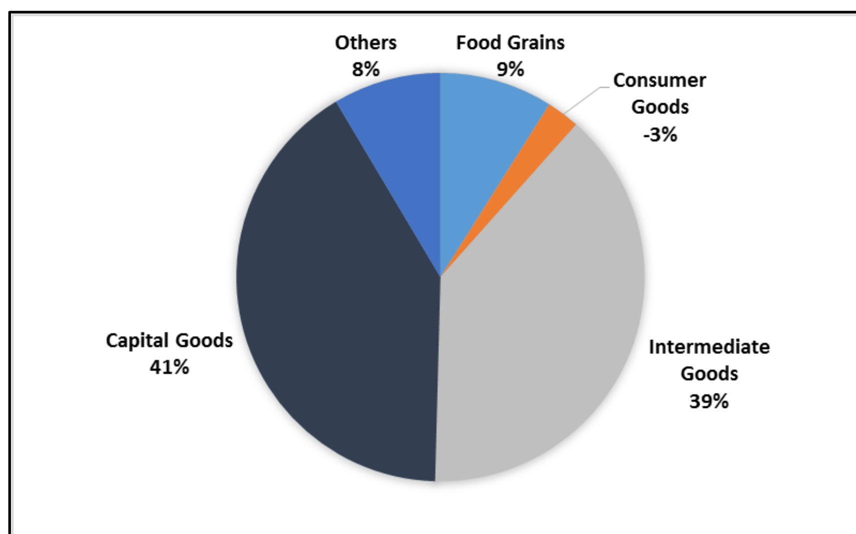
Source: Calculated from EPB data.

Import payments. Import growth was sluggish in the early months of FY2014 and with growth reaching (-) 0.1 per cent during first six months. In the second half import growth started to move into positive terrain and in July-February of FY2014 import (recorded by customs and reported by Bangladesh Bank) registered 6.2 per cent growth over corresponding months of FY2013. In March FY2014, the situation changed drastically and import shipment figures recorded a historically high 54.5 per cent growth in a single month which pushed the import

[21] Indeed, woven exports in the US market declined by (-) 8.0 per cent during January-April FY2014. The growth figure was 12.8 per cent for the first half.
[22] Includes Australia, Brasil, Chile, China, India, Japan, South Korea, Mexico, Russia, South Africa, and Turkey. These countries contribute about 15 per cent of overall export of Bangladesh.
[23] Includes the US, Canada and EU (27) countries. Traditional and emerging non-traditional markets in 11 countries mentioned above, cover more than 90 per cent export.
[24] RMG export growth to Indian, Japanese and Turkish markets fell by a significant margin.

growth figure to 11.1 per cent in the first nine months of FY2014.[25] It is seen that the higher import of intermediate goods and capital goods significantly contributed to this growth (growth of 41.0 per cent and 43.3 per cent respectively) (Figure 2.11). Capital machinery import was USD 731 million in a single month of March 2014 which was more than five times the amount of import in March of FY2013.

FIGURE 2.11: INCREMENTAL CONTRIBUTION TO IMPORT GROWTH DURING JULY-MARCH FY2014



Source: Estimated from Bangladesh Bank data.

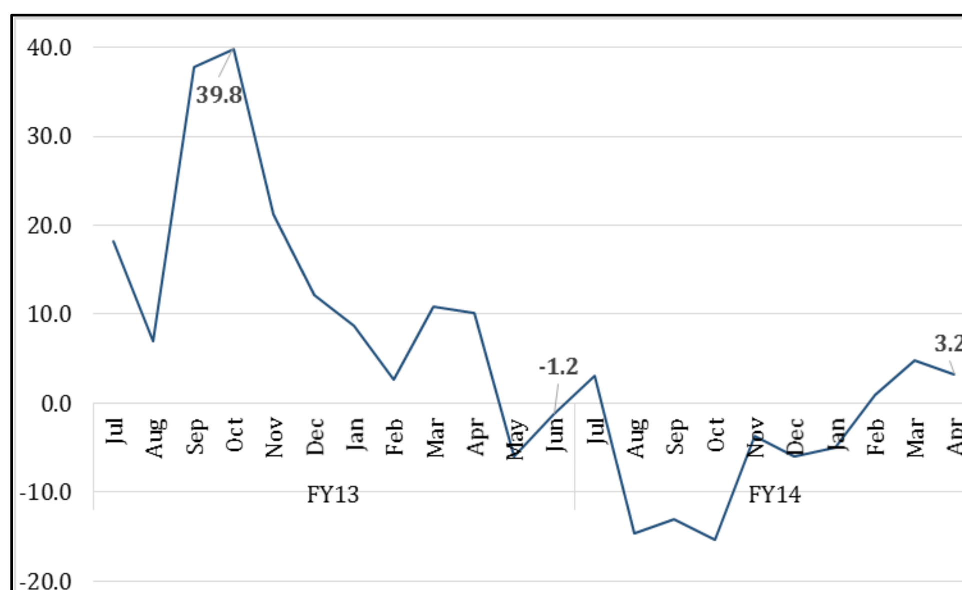
To investigate the sources of the recent rise in import at a more disaggregated level, CPD examined the detailed import shipment data for the July-March period. It was identified that 17 import items (at HS 8-digit level)[26] accounted for about 40 per cent of total import and 93.5 per cent of incremental growth during July-March of FY2014.[27] More precisely, three of the items which include tanks, casks, drums, cans, made of steel or iron (50-300 litre), different types of cranes and aeroplanes and other aircrafts (unladen weight =<2000kg) (i.e. HS code 73101000, 84261900, 88022000 respectively), contributed about 73.4 per cent of the incremental growth in imports during the aforementioned period.[28] Data received from Bangladesh Bank shows that these crane items were imported from France in the month of March 2014 which amounted for about USD 433 million. Import of such a large amount of cranes in a single month warrants a double check. Such exception pattern of import figures will call for appropriate scrutiny on the part of the NBR. It is perhaps worth mentioning that customs duty on crane product was only 2.0 per cent; on aeroplanes and other aircrafts it was zero.

Remittances. Remittances experienced negative growth of (-) 4.8 per cent during the first ten months of FY2014. Decline in overall remittance inflow was underwritten by a fall in

[25] On the other hand, import payments statistics of Bangladesh Bank showed 17.5 per cent growth during the same period.
[26] These items had at least USD 200 million worth import during the aforementioned period. Details of the 17 items are provided in the Annex 2.1.
[27] These estimates are based on data received from NBR. It is to be noted that import data of NBR excludes bond, baggage and back-to-back imports.
[28] Combined share of these three products in total import during July-March FY2014 was 5.5 per cent.

remittances originating from the major sources. Indeed, remittance inflow from six major Middle East countries[29], which accounted for about two-third of total remittance inflow, declined by 16.2 per cent compared to the previous year. For the six consecutive months between August-January of FY2014, the (month-on-month) growth rate remained in the negative terrain (Figure 2.12). Sustained growth of remittances inflow has been a life-line for Bangladesh over the last several years, particularly from the perspectives of maintaining stability of the BoP position. It is possibly right that the current fall in inflow of remittances will not put the comfortable situation of BoP in any risk; however, it has a number of other important implications. *First*, a decline in remittances imply a lower domestic demand, particularly in rural Bangladesh. It may be also recalled that remittances from abroad has a significant role in the poverty reduction of Bangladesh during the past decade (2000-2010). Indeed, during July-April period of FY2014, the decline in remittances inflow was higher in Taka terms ((-) 7.9 per cent) than in USD terms ((-) 4.8 per cent). *Second*, high growth of remittances helped the per capita GNI to grow faster than that of per capita GDP.[30] As has been mentioned above, with a decline in remittances inflow, it will take Bangladesh longer to reach her development goals.

FIGURE 2.12: MOM GROWTH (%) OF REMITTANCES IN FY2013 AND FY2014



Source: Estimated from Bangladesh Bank data.

The fall in the remittance figure is partly explained by the decline in manpower export.[31] One may recall that outflow of migrant workers from Bangladesh in FY2013 declined by (-) 36.2 per cent. This trend continued in FY2014. During the first ten months of FY2014, outflow of migrant workers from Bangladesh declined by (-) 10.5 per cent. As a matter of fact, every month (on an

[29] The major Middle East market for Bangladeshi workers include KSA, UAE, Kuwait, Qatar, Oman and Bahrain.

[30] Skill upgradation of the migrant workers is one of the key determinants in this regards. An IOM Survey (IOM, 2010) found that annual remittance per migrant worker was only USD 1,672 for Bangladesh whilst the figures for India, China and Philippines were USD 4,843, USD 6,112 and USD 4,982.

[31] It is also argued that due to somewhat appreciation of Taka against major currencies, the remitters found sending money through informal channels such as hundi more profitable. Due to the costs associated with renewals of work permits in a number of countries including KSA, the remitters could manage save a lower amount of their income.

average) about 57.6 thousand people went abroad for work during FY2012. This figure came down to 36.8 thousand in FY2013 and 33.4 thousand during the first ten months of FY2014. This would imply that more than 20 thousand additional labour force in Bangladesh are having to search for jobs now within the domestic economy compared to what the scenario was couple of years ago. Whether the stable exchange rate, with some fall in take earnings, has discouraged flow of remittances through formal channels, is something which may need to be closely examined.

Balance of Payments (BoP). BoP in July-March FY2014 experienced favourable situation because of sustained export performance. This has helped offset the decline in remittance inflow. Slower growth of imports also contributed to good BoP position and maintenance of healthy current account surplus. Current account balance was USD 1,517 million during July-March of FY2014. However, this was higher at USD 2,606 million for the corresponding months of FY2013. Overall, BoP enjoyed a surplus balance of USD 3,885 million in July-March FY2014; this was USD 3,948 million for the corresponding periods of FY2013.[32] The large surplus in BoP pushed the foreign exchange reserve to newer heights. Foreign exchange reserve on 27 May 2014 was USD 20.2 billion which was USD 15.3 billion at the end of FY2013. The central bank rightly maintained the stability of exchange rate of BDT against USD by augmenting foreign exchange reserves. The outlook of external balance suggests that the recent pick up of import payments may be maintained during the remaining months of FY2014. The present trends in remittance inflow, foreign aid disbursement and FDI are likely to be maintained. Under such a scenario, the central bank should continue its current policy stance of keeping exchange rate stable and allow foreign exchange reserves to adjust accordingly.

The macroeconomic performance of Bangladesh in FY2014 was largely impacted by the prolonged and violent political impasse during the first half of FY2014. The aforesaid analyses and scenarios as regards Bangladesh's recent macroeconomic developments reflect a mixed signal. The economic growth in FY2014, as provisionally estimated by BBS, exceeded all expectations despite the private sector investment declining as a share of GDP for the second consecutive year. On a welcome note, it was observed that a number of other macroeconomic correlates including export earnings and BoP were able to maintain past resilience. Indeed, some of the correlates including import payments have started to demonstrate signs of recovery. At the same time, performance of a number of macroeconomic indicators continued to remain unfavourable including high level of food inflation, lower utilisation of ADP allocation, declining remittance inflow and low intake of foreign aid. Although macroeconomic stability has been largely maintained, economic growth was yet to regain the lost momentum as the economy approached the finishing line of the ongoing FY2014.

[32] Another contributing element of the higher BoP surplus emanated from the commercial borrowing of private sector from foreign sources.

SECTION 3. PUBLIC EXPENDITURE: ISSUES AND CONCERNS

Public expenditure in Bangladesh has increased significantly over the last five years. This rise in expenditure can be analysed from a number of perspectives including allocative efficiency, its nature and extent of maintaining aggregate fiscal prioritisation in resource allocation and achievement of the intended outcomes. This section will highlight public expenditure management from three broad aspects of efficiency angle: a) aggregate fiscal discipline, b) resource allocation based on strategic priorities and c) efficiency of operational performance.

3.1 Total Expenditure: Aggregate Efficiency

Public expenditure has registered considerable growth during FY2008 and FY2013 both in nominal and constant terms - about 91 per cent and 36 per cent respectively (Table 3.1).[33] This accounts for a rise in expenditure-GDP ratio by one percentage point.[34] During FY2014, total expenditure has further increased (during July-March FY2014 total expenditure in nominal term was Tk. 1,15,180 crore) although its share in GDP according to the new base year (2005-06) is likely to come down. This increased public expenditure was attained by keeping to a moderate level of budget deficit (5-6 per cent of the GDP); but the deficit is increasingly being financed by domestic borrowing from commercial banks at a relatively high cost leading to increasingly growing domestic debt which will be equivalent to 21.5 per cent of GDP in FY2014 (projected) (IMF, 2013).

Over the last five years, government has tried to improve public expenditure management through MTBF. However, the targets set for various components of development expenditure in the MTBF-2009 have been revised number of times (Table 3.2). More importantly, the actual expenditure varied significantly from the revised targets set for a number of components in the latest revision of the MTBF (Table 3.2). Indeed, the frequent revisions of targets in the medium term budgetary strategies has rather weakened the efficacy of public expenditure management.

[33] Please also see Annex Table 3.1 for fiscal trends in constant term during FY2008 to FY2013.
[34] Expenditure-GDP ratio has changed from 17.3 per cent in FY2013 to 18.2 per cent in FY13. Total expenditure-GDP ratio in India in 2013-14 is 15.87 per cent. However, expenditure on interest payment, defence, subsidies, plan expenditure and other capital expenditure etc. appears to be excluded from the calculation of total expenditure.

TABLE 3.1: FISCAL TRENDS

Indicator	FY08	FY09	FY10	FY11	FY12	FY13
In crore Taka						
Public Expenditure	90,696	89,316	1,01,521	1,28,286	1,52,428	1,73,340
Non-Development Expenditure	*57,690*	*65,623*	*73,168*	*82,878*	*96,463*	*1,04,231*
Development Expenditure	*19,827*	*21,684*	*28,115*	*35,734*	*40,672*	*52,584*
Other	*13,178*	*2,009*	*238*	*9,674*	*15,293*	*16,523*
As percentage of GDP						
Total Revenue	11.1	11.3	11.4	11.9	12.5	13.5
Total Expenditure	17.3	15.3	15.9	16.3	17.6	18.2
Budget Deficit (excl. grants)	6.2	4.1	4.5	4.4	5	4.8
Deficit Financing	4.4	4.1	4.5	4.4	5	4.8
Net Foreign Financing	*1.8*	*1.8*	*2*	*1.3*	*1.3*	*1.7*
Net Domestic Financing	*2.6*	*2.3*	*2.5*	*3.1*	*3.8*	*3.1*
Credit from commercial banks	*2*	*1.7*	*1.2*	*2.3*	*3.2*	*2.7*

Source: Ministry of Finance, GoB.

TABLE 3.2: MEDIUM TERM FISCAL FRAMEWORK PROJECTED/REVISED FOR FY2013

Components	Target set for FY2013			Actual in FY2013
	MTBF (FY2011)	MTBF (FY2012)	MTBF (FY2013)	
Total Revenue	**13.1**	**13.4**	**13.4**	**13.4**
Tax Revenue	*10.8*	*11.2*	*11.2*	*11.2*
Non-Tax Revenue	*2.3*	*2.2*	*2.2*	*2.2*
Total Expenditure	**17.4**	**18.4**	**18.4**	**18.2**
Revenue Expenditure	*11.8*	*13.1*	*13.1*	*13.2*
ADP	*5.6*	*5.3*	*5.3*	*5.0*
Overall Balance	**-4.3**	**-5.0**	**-5.0**	**-4.8**
Financing	**4.3**	**5.0**	**5.0**	**4.8**
Domestic Borrowing	*2.3*	*3.0*	*3.2*	*3.1*
Banking System	1.7			2.7
Non-Bank	0.6			0.4
External Financing	*2.1*	*2.0*	*1.8*	*1.7*

Source: Ministry of Finance, GoB

Over the past years, the composition of public expenditure has undergone changes along with the change in size. Both non-development and development expenditures have registered considerable rise both in nominal and constant terms – average yearly change between FY2008 and FY2013 was from 16.1 per cent and 33.0 per cent in nominal terms and from 5.6 per cent and 17.6 per cent in constant terms). Although the share of non-development expenditure has declined over time (from 61.4 per cent in FY2009 to 54.4 per cent in FY2013) this still constitutes the major share in public expenditure. [35] Development expenditure, on the other hand, has experienced a rise over the years (nominal and constant terms) (share of ADP has

[35] Non-development expenditure includes revenue expenditure, net outlay for food account operation and loans & advances (net) whereas development expenditure includes ADP, development program financed from revenue budget, non-ADP project, non-ADP FFW and transfer.

increased from 24.0 per cent of total expenditure to 27.7 per cent during the same time) because of higher growth of public investment.[36] In recent years, expenditures on net outlay for food account operation and net loans and advances particularly for subsidies and allocations for state-owned enterprises have significantly increased. There has not been any rigorous assessment to measure allocative efficiency and returns on subsidy expenditure. Without any visible progress in overall performance of the SoEs (e.g. operating profitably), rise in subsidy expenditure on this account remains questionable. The significant rise in non-development expenditure for share and equity investment in recent years (from Tk. 1981 crore in FY2008 to Tk. 4797 crore in FY2013 (budget) has given rise to concerns about quality of the public stake in the SoEs.

Compared to the previous years, growth of development expenditure was higher in July-March, 2014 as against that of non-development expenditure over the same period of FY2013 (26.1 per cent vis-a-vis 16.2 per cent (nominal and constant)) (Table 3.3). Among the components of non-development expenditure, net outlay for food account exceeded the budget allocation by about 20 times during July- March FY2014 due to rise in import of food grains to meet the shortfall in domestic market availability. On a positive note, net loans and advances which include subsidy has declined during the mentioned period due to reduced international prices of petroleum and fertiliser where subsidy is provided on import to maintain the administered prices. But non-ADP projects and development programme financed from revenue budget has shown an upsurge (303 per cent and 61.8 per cent respectively) during the aforesaid period. However, budget deficit as a share of GDP remained within the five per cent of GDP threshold.

TABLE 3.3: PUBLIC EXPENDITURE DURING FY2013 AND FY2014

Description	FY2012-13 Actual (Jul-mar) (crore Tk.)	FY2013-14 Actual (Jul-mar) (crore Tk.)	Growth (%) over Jul-Mar, FY13	Actual Expenditure in Jul.-Mar., FY2013-14 as % of Budget FY2013-14
Non-Development Expenditure	**68,073.2**	**79,071.7**	**16.2**	**58.8**
Net Outlay for Food Account	3,132.1	5,665	80.9	2157.3
Loans & Advances (Net)	5,401.5	4,801.8	-11.1	31.0
Development Expenditure	**20,330.8**	**25,641.7**	**26.1**	**35.5**
Development Program financed from Revenue Budget	219.3	354.9	61.8	18.4
Non-ADP Project	136.8	551.8	303.4	18.3
Annual Development Programme	19,974.7	24,734.9	23.8	36.7
Non-ADP FFW and Transfer	0	0.1	--	0.0
Total Expenditure	**96,937.5**	**1,15,180.2**	**18.8**	**51.8**

Source: Ministry of Finance (MoF)

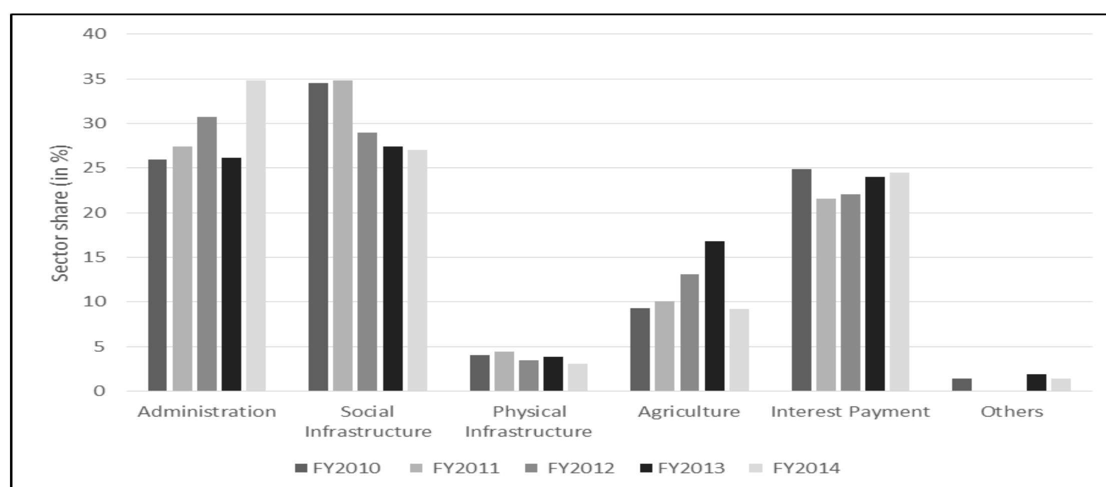
[36] Government's spending on development expenditure has registered a higher growth (21.8 per cent average annual growth rate) compared to that of non-development expenditure (12.6 per cent annual average). Shares of other development expenditures have increased from 14.6 per cent to 17.9 per cent over the same period.

3.2 Non-Development Expenditure

Priorities in Resource Allocation. Over the past years, non-development expenditure has registered significant rise – from Tk. 66,371 crore (actual) in FY2009 to Tk. 1,36,382 crore (budget) in FY2014. However, its share in GDP has remained within 11-13 per cent for over the last several years.[37] Although sectoral priorities in the allocation especially for top five sectors has more or less remained the same, total share has increased further (from 59.4 per cent of total non-development expenditure to 66 per cent during the same period). The top five priority sectors in terms of allocation are interest payment, education and technology, defense, general public services and agriculture. Other than interest payment, allocations for all other sectors have increased between FY2009 and FY2014. It is important to examine the implications of this rise on allocations for other sectors. Given the fact of the structural rigidities which tend to leave only limited scope for understanding the required changes in the composition of public spending in the short run, intersectoral allocation with attendant better 'degrees of freedom', should reflect required changes in allocation over medium to long term.

Allocations according to broad sectoral classification indicate that rise in expenditures on account of administration, interest permanent and agriculture may have involved significant trade-offs (Figure 3.1). For example, the share of allocation for social infrastructure has come down over the years (Figure 3.1). In fact, other than education, allocations for other social infrastructure (such as health, social welfare and others) has come down significantly over the years. During July-March, 2014, allocation for social sectors was 0.4 per cent less compared to that of the previous year. Allocation for physical infrastructure has remained at low levels which needs to be examined from the point of view of the need for providing necessary public services in the backdrop of increasing demand.

FIGURE 3.1: SECTORAL SHARE IN ACTUAL NON-DEVELOPMENT PUBLIC EXPENDITURE



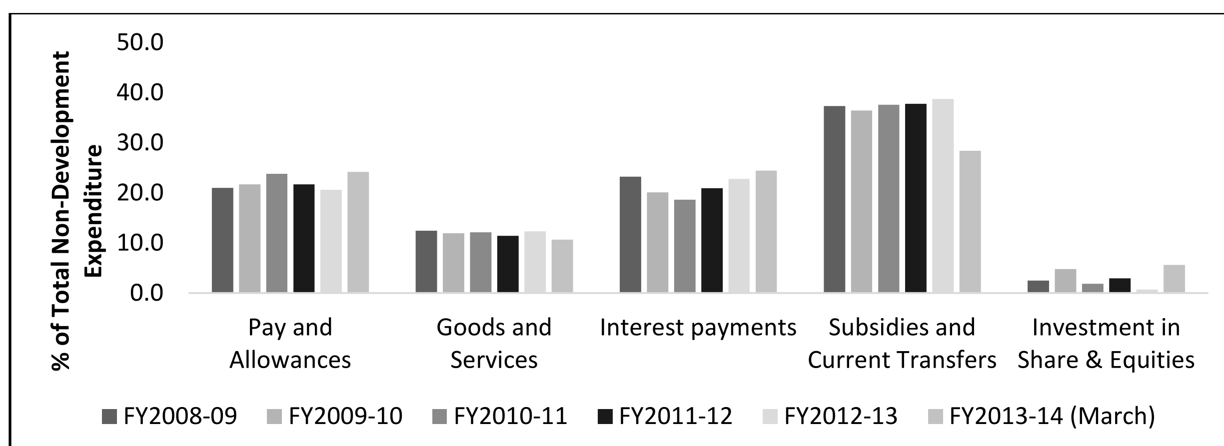
Source: Ministry of Finance (MoF)

According to broad economic classification, priorities in non-development expenditure (according to FY2013 budget) were pay and allowances (24.2 per cent), interest payment (24.5 per cent) and subsidy payment (28.4 per cent) (Figure 3.2). However, composition of the priority sectors has changed in FY2014 as allocation for pay and allowances has increased in FY2014 particularly on account of *dearness allowance* to public sector employees (20 per cent).

[37] However, its share in GDP will be declined in the new base year (2005-06).

Rise in domestic borrowing for deficit financing led to higher share in the allocation for interest payment (Figure 3.2). Till March FY2014 interest payment for domestic borrowing was Tk. 18,169 crore; to contrast, interest payment for foreign sources was very low (Tk. 1,274.8 crore). With the rise in domestic borrowing in recent years, the gap between the two will further widen in future. This change in sourcing strategies for debt financing contradicted with the strategy set in the Medium Term Debt Strategy (MDTS) which had put more emphasis on borrowings from the external sources (MoF, 2013).

FIGURE 3.2: PUBLIC EXPENDITURE BY ECONOMIC CLASSIFICATION



Source: Ministry of Finance (MoF)

Rise in expenditure for subsidy payment was a key concern as regards non-development expenditure. In recent years, subsidy was provided for three sectors: agriculture, fuel and electricity. In order to address the policy priorities of the government, expenditure for subsidy has increased over time - from 16.1 per cent of non-development expenditure in FY2009 to 39.9 per cent in FY2013. However, its share in FY2014 has decreased by 15.9 per cent during July-March of FY 2014 from the corresponding period of FY2013. The rise in expenditure has, however, been accompanied by changes in the share of different components. The subsidy allocation for electricity and fuel has increased over the years followed by allocation for agriculture. Till February, 2014 subsidy expenditure for energy and fuel was much below the allocation target for FY2014 (about Tk. 800 crore during July-February, 2014 against the budgetary allocation of Tk. 16,911 crore). After the payment of large amount dues of the Bangladesh Petroleum Corporation (BPC) in late June, 2014 a large part of this gap will be diminished. A major reason behind the yawning gap fall in international price of crude petroleum and declining fertiliser prices in the international market which caused reduction in agricultural subsidy by 25 per cent.[38] There has been a rise in allocation for SoEs, particularly for BJMC. Information is not available as regards the considerations and the basis which have informed this decision. As of 30 June, 2012, there is a significant amount of dues of debt-service liabilities to the government incurred by 104 different public sector entities which amounted to Tk. 1,20,68,771 crore; the highest amount of dues of DSL was with the Power Division (42.4 per cent of total DSL) followed by BPC (11 per cent) and Petro Bangla (8.4 per cent). A large amount of these dues have already expired the timeline (24 per cent of total principal loan) which was

[38] However, subsidy allocation to the power sector has been increased in the revised budget for FY2014 by Tk. 500 crore, which has been done to reduce the burden of price hike on targeted consumer groups at retail level.

even as high as 100 per cent in selected organisations (MoF, 2014). A transparent and accountable mechanism to be developed for repayment of the due DSL of various public sector organisations was needed to ensure appropriate financial management.

The changes in the composition of allocation as well as rise in the share of allocation in selected sectors over the last five years may be considered as indicative of government's policy perspective and priorities regarding public expenditure (subsidy for fuel and energy, underwriting loss-making SOEs) and also in-built demands (interest payment). There is, however, a need to examine closely this shifting dynamics from the perspective of development strategy, implications and efficiency.

Operational Performance: Efficiency and Effectiveness. The prevailing high share of non-development expenditure particularly for pay and allowances is likely to be continued in the coming years. The new pay scale for public sector employees to be implemented in FY2015 will cause additional fiscal burden which will need to be addressed both by raising additional revenue and by measuring against expected improvements in productivity and efficiency of public services. It will be important to see how public service efficiency issues are dealt with at a time when the pay scale is revised (Table 3.2). Defense expenditure has increased over the years; however its share in total public expenditure was lower than most of the South Asian countries and also other low income countries (WDI, 2013). However, there was a need to bring greater transparency in defense expenditure.

Declining share of social infrastructure (other than education) has emerged as a cause for concern. One understands that, with limited resources available at the disposal of the government of a developing country such as Bangladesh, it is difficult to balance the urgent needs and medium to long term needs concerning social priorities. Hence important trade-offs are involved. On the other hand, current priorities in the non-development expenditure needs to be examined from the point of view of 'efficiency' and 'effectiveness'.

A significant rise in expenditure on 'recapitalisation' under the category of investment in shares and equities has raised concern in recent times. During July-March, FY2014, expenditure on recapitalisation for the SoCBs was Tk. 4,167.5 crore against Tk. 541 crore for the corresponding period of the previous year (revised budget). The initiative of the government to recapitalise the SoCBs with a view to meet the shortfall of capital and to make their operation viable has been carried out as part of the understanding with the IMF as part of the ECF-supported programme. However, without addressing the core weaknesses of the SoCBs including malgovernance, insider lending, undue interference of the Board, political pressure, corruption, lack of transparency and accountability and low productivity etc. mere injection of capital will hardly make any change in the sorrow state of affairs that afflict the SoCBs. The public has a right to know why taxpayers' money is being spent when corrective measures are not being put in place and not enforced.[39]

Issues related to allocational and operational efficiency of the non-development expenditure needs to be closely aligned with those of development expenditure. The rise in expenditure for

[39] Recently, the Central Bank has fired the managing director of Basic Bank one of the troubled SoCBs as part of measures to bring changes in the management of the Bank. The Central Bank has requested the Ministry of Finance to initiate steps against the board of the Basic Bank to restore discipline in the bank.

administration particularly for payment and allowances and subsidies and interest payment needs to be aligned with necessary allocation to be made for development expenditure in respective sectors. Similarly, sectoral priorities in the allocation of development expenditure need to be aligned with those of non-development expenditure. Lack of coherence between the small share of non-development expenditure for physical infrastructure and high priority given to the same sector in the development expenditure could pose serious problems when viewed from the perspective of sustainability of investment.

3.3 Development Expenditure

Priorities in Resource Allocation. Allocation for development expenditure in nominal terms has increased over the years – from Tk. 19,050 crore (actual) in FY2008 to Tk. 67,327 crore (budget) in FY2014. However, its share in GDP has remained within 4-5 per cent level.[40] A major weakness is revealed by the persistent gap between budgetary allocation and actual utilisation (Table 3.4). This gap has, however, narrowed over the past years thanks for various measures including introduction of medium term budgetary framework and gradually bringing all sectors under its coverage, some improvements in development administration and changes in the procurement rules and regulations. Quality of expenditure and implementation, however, remain the major concern.

TABLE 3.4: DEVELOPMENT EXPENDITURE FROM FY2008 TO FY2014 (IN CRORE TAKA)

Year	Budget	Actual	Actual as % of Budget	Yearly % change of actual expenditure
FY08	26,964	19,050	70.6	--
FY09	27,379	20,733	75.7	8.8
FY10	31,639	26,480	83.7	27.7
FY11	39,694	34,002	85.7	28.4
FY12	47,276	38,648	81.7	13.7
FY13	56,439	52,584	89.6	36.1
FY14 (upto March)	67,327	24,735	36.7	--

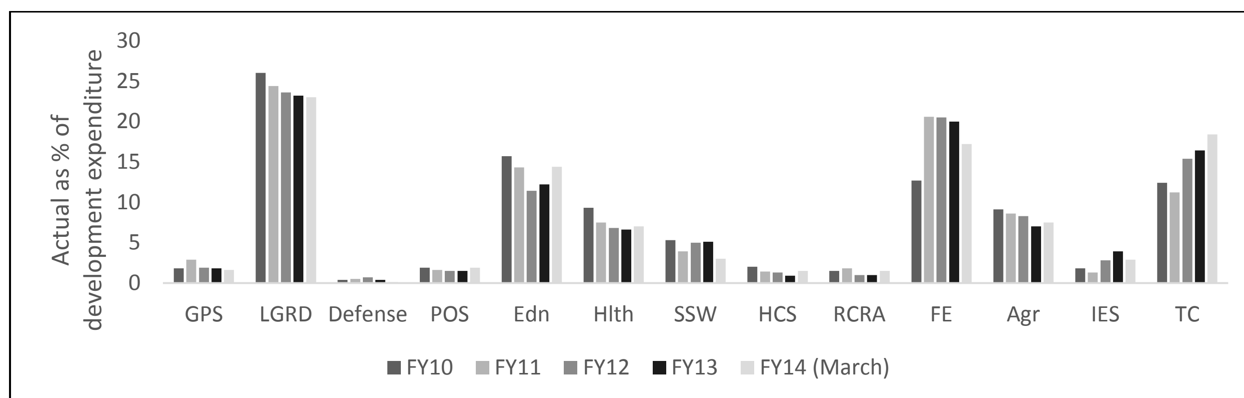
Source: Ministry of Finance (MoF)

With the rise in expenditure, composition of allocation has also changed (Figure 3.3). Top ten ministries received about 77 per cent of total allocation of the development budget in FY2014 which was 84 per cent in FY2009 (budget). This is indicative of some changes in allocative priorities from the core ministries to other ministries. As is known, LGRD has been receiving the highest allocation over the past years (23 per cent of actual expenditure upto March, FY2014) although its share has declined. The allocational priorities have changed for other key sectors– transport and communication and fuel and energy have become key sectors in ADP allocation although the share of fuel and energy has decelerated over time. Such allocative priorities are by and large consistent with the medium to long term needs of an emerging economy; indeed, there are enhanced allocations for public investment in those sectors have assumed greater urgency in the emerging context. In fact, the allocated and realised amount for infrastructure development continues to lag far behind the required amount. According to the World Bank (2013), Bangladesh needs an annual investment of USD 7.4 billion to USD 10 billion until 2020

[40] Under new base (2005-06), the share is 4.98 per cent of GDP in FY2014 (budget).

to bring its power grids, roads and water supplies up to the standard needed to serve its growing demand. The current expenditure for infrastructure sector (both non-development and development) needs to be increased from 6 per cent to 7.4 per cent of the GDP. Given the limited resources available, allocative efficiency ought to receive highest priority to generate the optimum outcomes and results.

FIGURE 3.3: SECTOR-WISE ACTUAL DEVELOPMENT EXPENDITURE AS A % OF TOTAL DEVELOPMENT EXPENDITURE



Source: Ministry of Finance (MoF)

A number of sectors has experienced decline in allocation during FY2009-FY2013; of these a few sectors have experienced a rise in FY2014 – agriculture, health, housing and social security. Allocation for education sector has increased over the last two years. The priority given to the development of transport and communication and energy and fuel sectors is justified but important trade-offs are involved. Allocation for social infrastructure sectors remain low both in non-development and development expenditure which is a concern. Overall, Bangladesh remains behind the level of South Asia and low income countries in terms of health expenditure in the budget although it is above the South Asian level in terms of expenditure in education.

The large number of projects often undermine the quality of implementation as they create pressure on development administration. A large part of the problem here originates from the burden of carry on projects, cost overrun, timelines of resource availability etc. According to the IMED (2012), the number of unapproved projects has risen significantly in recent years- from 144 (14 per cent of total revised projects) in FY2009 to 662 (63.2 per cent) in FY2014. The logic put forward in including unapproved but allocated projects is that time is needed to emerging needs and preparation of project proposals for placement before ECNEC. However, a large number of unapproved projects is included without allocation. Inclusion of unapproved and unallocated projects seriously undermine the overall allocative efficiency of the development budget.

With a view to addressing the scarcity of resources, particularly for undertaking large scale projects, public-private partnership (PPP) programme was introduced in 2009.[41] After adoption of the PPP Act, budgetary allocations are being made in successive budgets since 2009 (Tk. 12.8 million in FY2013 and Tk. 24.5 million in FY2014). So far a total of 27 projects under IDCOL and IPFF have been either financed or at various stages of implementation with a total investment of

[41] In fact, IIFC and IPFF of Bangladesh Bank have been involved in PPP related activities since early 2000s in terms of preparing proposal, screening, creating opportunities for financing and policy formulation etc.

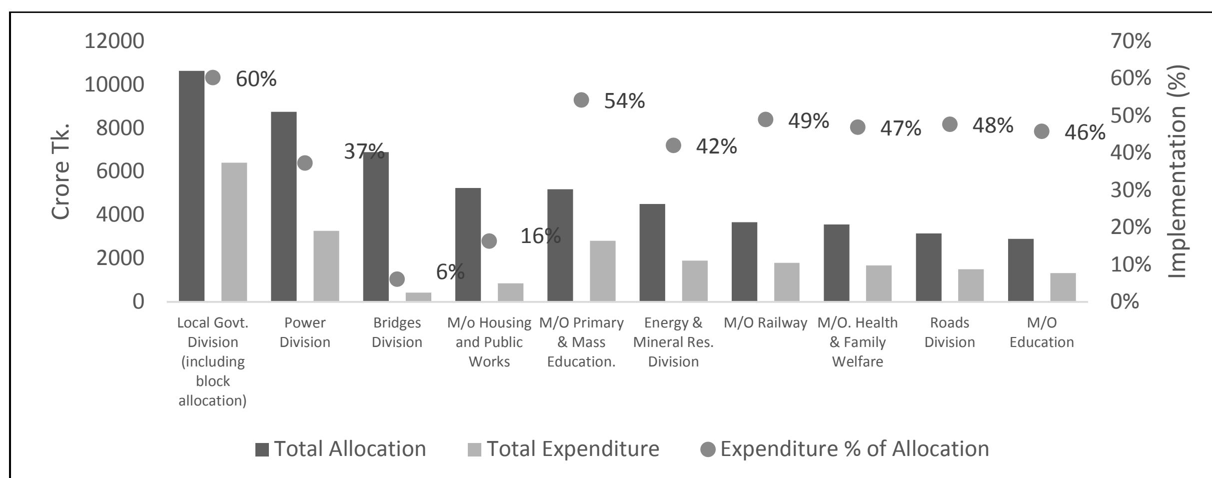
Tk. 125,855 million. However, progress here, as is known, has been rather slow due to various reasons including problems in setting up the pricing formula, lack of proper mechanism for risk sharing, debate as regards sectoral priorities and the unresolved issue relating to the scope of using foreign commercial loans. Without making necessary changes, the target set in the MTBF for investment under the PPP for the period of 2015-2018 will be difficult to achieve.

Operational Performance: Efficiency and Effectiveness. The utilisation of Annual Development Programme (ADP) of Bangladesh lags behind the target set in the budget is well-known. However, the rate of implementation of ADP projects has improved in recent years. In FY2014, ADP implementation has been sluggish due to various internal and external reasons (Figure 3.4). During July-March, FY2014, about 43 per cent of total allocation has been implemented compared to 48 per cent in the same period of the previous year.[42] Out of the total of 54 ministries, rate of implementation was above the average in case of 29 ministries while the implementation record of rest of the ministries was below the average. Even after allowing that 75 per cent of funds of approved projects may be released upfront, to address the constraints of availability of funds, pace of implementation could not be enhanced because of other bottlenecks.

As was noted earlier, ADP is increasingly being financed by domestic resources – from 42 per cent in FY2009 to 67 per cent in FY2014. This does not necessarily portray an increased capacity to implement development projects using domestic resources. The choice of using domestic resources is not always the 'first-best' option since a large part of this financing is undertaken through borrowing from commercial banks at high interest rate. More importantly, greater reliance on local financing was not due to lack of availability of low-cost funding from foreign aid - in fact about USD 16.6 billion worth of foreign aid remained in the pipeline as of 1 July, 2013. Monitoring and evaluation of projects financed by foreign aid usually follow standard international norms and practices which is often found to be onerous. Other options (e.g. local funding) where monitoring and evaluation mechanism are more relaxed are thus preferred. More importantly, quality of project implementation continues to remain a nagging concern.

[42] Total allocation for the ADP was Tk. 65872 crore which has been reduced to about Tk. 60000 crore in the revised ADP for FY2014. ADP implementation for first ten months is 55 per cent of total allocation for FY2014.

FIGURE 3.4: ADP IMPLEMENTATION STATUS OF TOP 10 MINISTRIES/DIVISIONS WITH LARGE ALLOCATION (JUL-MAR FY2014)



Source: Implementation Monitoring and Evaluation Division (IMED)

Operational efficiency of ADP projects depends not only on achieving allocation target but also on completion of project on time and maintaining the needed quality of project. According to IMED (2011), backlog in project implementation causes significant delays in implementation of projects and results in time-overrun and cost-overrun. In 2011-12, out of 199 completed projects, only 19 per cent projects were completed within the stipulated time and allocation, 7 per cent projects completed on time but with increased allocation, about 40 per cent projects were completed with increased timeline and stipulated allocation, whilst 35 per cent projects were completed with both increased time and allocation.[43] According to the IMED, based on the assessment of the ADP 2010, average amount of cost-overrun for projects was 9 to 227 per cent and time overrun was to the tune of 40 to 266 per cent for projects completed under top ministries in FY2010. This created pressure on resources available in the ADP. As a matter of fact, time and cost overruns, deferral of project benefits long into the future and declining returns on investment have historically been associated with poor management of the development budget in Bangladesh (World Bank 2010). Major reasons behind the low implementations as identified by the IMED are lack of proper feasibility study, lack of proper planning, weak budgeting, inefficient monitoring, unsynchronised and poor disbursement of funds. As is the case, assessment reports prepared by the IMED are not reviewed and examined in the ECNEC meetings for undertaking corrective measures. Operational inefficiencies lead to significant wastage and pilferage of public money and causes inordinate delay in getting the expected return from development projects.

[43] IMED (2012). *Year-wise ADP Review Summary 2011-12*

TABLE 3.5: ASSESSMENT OF THE IMED REGARDING COMPLETED PROJECTS UNDER SELECTED MINISTRIES (BASED ON THE PROJECTS COMPLETED IN FY2009-10)

Ministries/Divisions	No. of Completed Projects	No. of Projects with extended time	No. of projects with extended budget	Reasons for extension of budget/time
Ministry of Communications	23	23 (Extended by 40% to 266%)	14 (Extended by 9% to 227%)	1. Lack of proper feasibility test 2. Inefficient budgeting 3. Lack of proper planning and project management 4. Hiring inexperienced contractor 5. Poor fund disbursement
Local Government Division	29	22 (Extended by 10% to 266%)	12 (Extended by 1% to 40%)	1. Lack of proper planning and project management 2. Salary/wage increase during the project period 3. Increase of land price for acquisition 4. Time consumed during purchase
Power Division	14	11 (Extended by 20% to 275%)	3 (Extended by 20% to 99%)	1. Price increase of machineries/construction materials during purchase 2. Increase of land price for acquisition
Ministry of Education	10	4 (Extended by 320% for 1 project)	7 ------	1. Inadequate allocation in ADP 2. Without assessing future demand of the project 3. Revising projects multiple times
Energy and Mineral Resources Division	3	2 (Extended by 75% to 300%)	0 ------	1. Re-tendering 2. Inefficient contracting 3. Inefficient monitoring of implementation 4. Delayed purchasing of materials

Source: IMED.

A major limitation as regards the current practice of assessment of operational efficiency of the ADP projects concerned the narrow focus put in on financial auditing of the respective projects where the rate of implementation is assessed only from allocation and disbursement points of view. This type of financial auditing do not tell much about quality of the projects, achievement of objectives and targets, and not to speak of outcome of the projects. Time has come for the IMED to put the spotlight on performance-based auditing along with financial auditing.[44] Overall, monitoring and assessment processes should be geared towards guaranteeing 'value for money' as regards completed projects. This will ensure that actual returns are commensurate with those in the project proposal.

Two key ministries – ministry of finance and ministry of planning play the lead role in public expenditure management. Work efficiency of these two ministries has direct implications for improving both fiscal and development management. In order to improve the operational efficiency at the institutional level, a number of initiatives have been undertaken over the years which have resulted in some improvement in management practices. As the analysis above has shown, there is a need to synchronise developmental and non-developmental expenditures and to follow through the strategies in the MTBF. Development administration should be equipped

[44] A number of countries follow performance-based auditing system for different public sector activities such as India, Pakistan, Thailand and Malaysia etc.

with the adequate human resources and be innovative enough to address the loopholes and bottlenecks in that impede project implementation. Reforms currently being pursued by the IMED are commendable. However much more needs to be done in all key areas of implementation, human resources development, quality assurance, involving local government and good governance.

SECTION 4. FINANCING PUBLIC EXPENDITURE: A SMART MIX NEEDED

With increased public expenditure, efforts have been put in place to generate higher resources, with mixed success. The nature and composition of resource mobilisation efforts indicate some changes in recent years. Over the past years, revenue collection has been on the rise, but the pace has varied, with significant slow down in FY2013 and FY2014. The gap between the targeted and achieved revenue collection is widening. In order to offset the budget defict the governmnet is resorting to increasing domestic borrowing, particualry from the banking system.

4.1 Revenue Collection Grows at a Lower Rate

Till April 2014, achievement in NBR collection was 72.2 per cent of the revised budget while the growth of NBR revenue was about 9.2 per cent during July – April of FY2014 as opposed to 16.1 per cent during the same period in the previous year. A comparison among various components of NBR revenue collection indicates that all components of tax revenue except for import duty and local SD have experienced a lower growth rate in FY2014 (up to April) compared to the same period in FY2013 (Table 4.1).

TABLE 4.1: GROWTH (%) COMPOSITION OF NBR SOURCED TAXES

Particulars	Actual Growth FY13	Original Growth Target FY14	Revised Growth Target FY14	Achieved Growth Jul-Apr FY13	Achieved Growth Jul-Apr FY14	Required Growth May-Jun FY14
External Total	**3.2**	**10.7**	**1.6**	**4.4**	**1.1**	**3.8**
Import Duty	1.2	9.9	1.0	-1.9	0.1	4.8
VAT Import	7.3	8.9	0.1	12.3	2.9	-12.0
SD Import	-3.8	18.8	9.1	0.6	-1.3	63.7
Local Total	**13.2**	**30.3**	**19.7**	**12.9**	**13.5**	**41.3**
VAT Local	19.9	23.6	13.6	17.7	13.3	14.5
SD Local	0.5	47.2	35.2	3.9	14.4	126.5
Total Direct Tax	**27.5**	**32.7**	**21.9**	**35.8**	**13.5**	**45.8**
Income Tax	27.6	32.1	21.3	36.0	12.5	42.9
Grand Total	**14.3**	**25.3**	**15.1**	**16.1**	**9.2**	**34.4**

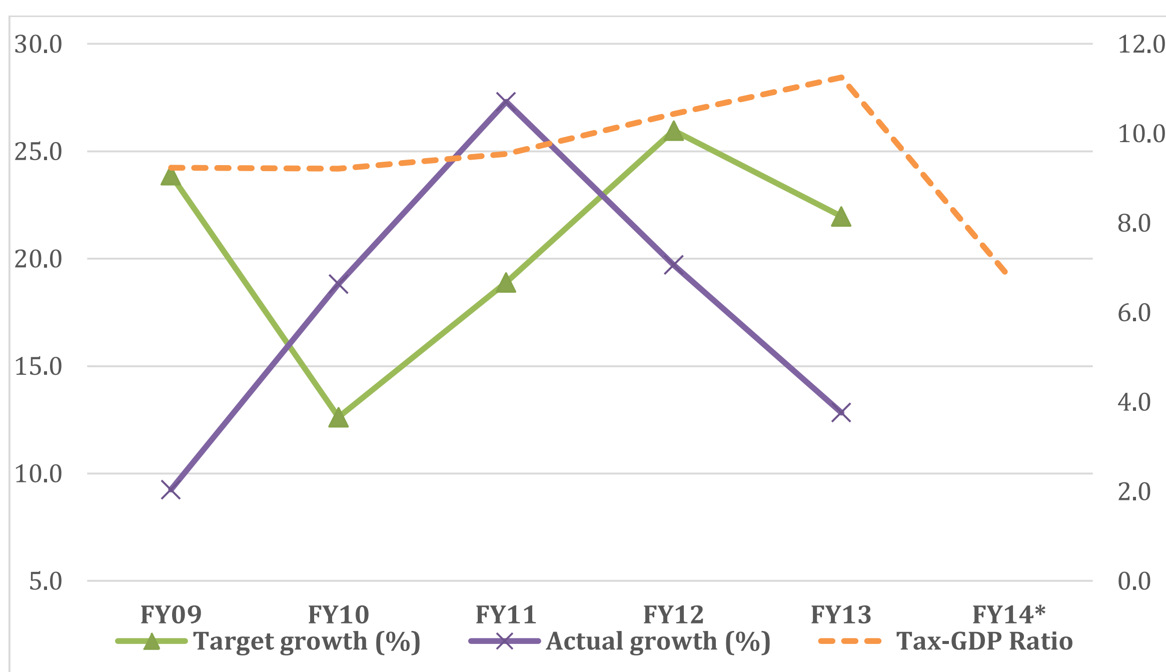
Source: Compiled from NBR data.

Lower than targeted revenue collection during the first ten months of FY2014 was a reflection of the decline in economic activities. To a large extent, political turmoil during the first half of FY2014 was the main cause. A medium term trend in revenue collection effort also reveals that, actual growth rate has decelerated by a significant margin from FY2012 and continuing in FY2014.

4.2 New Tax Measures Require Institutional Strengthening

In spite of the success in generating higher revenue, tax-GDP ratio continues to remain a concern as it is yet to pick up to the targeted level (Figure 4.1). Various reform measures have been undertaken in recent years to enhance revenue generation through tax collection. Targeted efforts have been undertaken to raise the share of direct taxes in total tax. Additionally, the new VAT law which is expected to enter into effect on 1 July 2015 will hopefully broaden the tax base. Under the new VAT law, all economic sectors namely import, manufacturing, services and distribution will be brought within the ambit of the VAT. However, mobilising resources through the new VAT act will require significant strengthening of institutions such as the NBR, redesigning of the VAT administration processes, automation of NBR, and recruitment and capacity building of new staff. Efforts should be taken to raise awareness of taxpayers, tax advisors and people in general about the new VAT law before it starts to be implemented.

FIGURE 4.1: TAX COLLECTION GROWTH (%) AND TAX-GDP RATIO



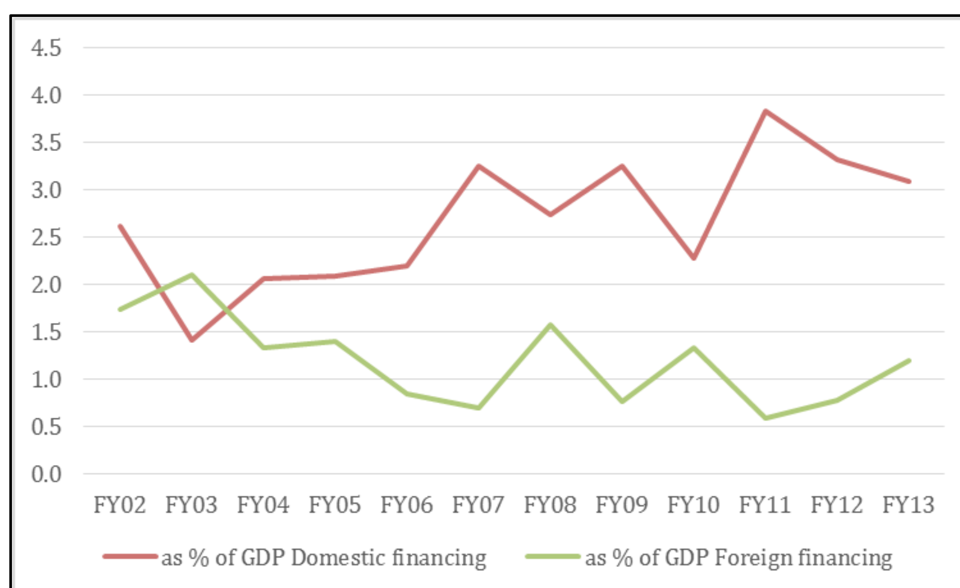
Source: MoF and BBS Data.

4.3 Increased Dependence on Domestic Sources for Deficit Financing

In a resource poor country the traditional mechanism to offset budget deficit is financing from foreign capital inflows through both the public and private sector. This helps the government to carry out expansionary domestic policies without drawing on the scarce domestic resources which could otherwise be used to underwrite for prioritised activities. In Bangladesh, the tradition has been to contain the budget deficit (excluding grants) within 5 per cent of the GDP. While this has been maintained over the past years, the composition of deficit financing has been undergoing some changes.

The pattern of deficit financing since FY2006 indicates that Bangladesh is becoming increasingly dependent on domestic resources to finance her expenditures (Figure 4.2). In recent years the gap between financing from domestic and foreign sources has widened further. In FY2010 the difference between financing from domestic sources and foreign sources was 0.5 per cent of GDP, which reached as high as 3.3 per cent in FY2011 before declining to 1.9 per cent in FY2013. For FY2014, deficit finance has been targeted at 4.6 per cent of GDP. Though up to March 2014 deficit finance was 1.4 per cent of GDP but this is expected to rise significantly towards the end of FY2014. Lower figure, till March 2014 was not because of any significant improvements in revenue generation but because of the lower development expenditure (discussed in detail in Section 3 of this report). In terms of financing the deficit, about 72.1 per cent of total budget deficit was financed by domestic resources in FY2013. The dependence on domestic resources as a source of financing has increased even further to more than 91.6 per cent in FY2014 (up to March 2014). Increased dependence on domestic resources for deficit financing is a matter of concern from the point of public finance management, particularly when domestic resources are not enough to meet the demand of the country.

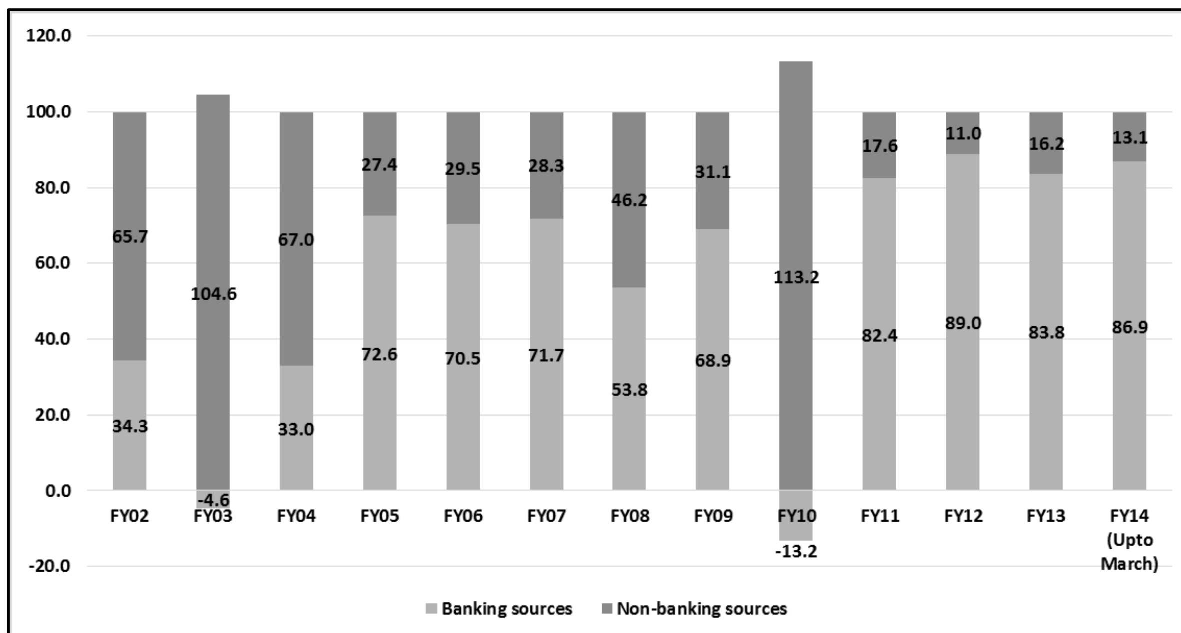
FIGURE 4.2: DOMESTIC AND FOREIGN SOURCES OF FINANCE



Source: MoF Data.

The government has been resorting to bank borrowing in the recent years for the purposes of deficit financing. As a result, borrowing from the banking sector in FY2013 was 2.6 per cent of GDP as opposed to 0.5 per cent from non-banking sectors. In the early 2000s, a large part of the budget deficit was financed from non-bank sources. This trend got reversed since FY2008 when bank borrowing started to outpace non-bank borrowing (Figure 4.3). In FY2014 (up to March), the amount of bank borrowing was seven times higher than non-banking sources. A detailed fiscal framework is attached in Annex 4.1.

FIGURE 4.3: COMPOSITION OF DOMESTIC SOURCES OF BUDGET FINANCING



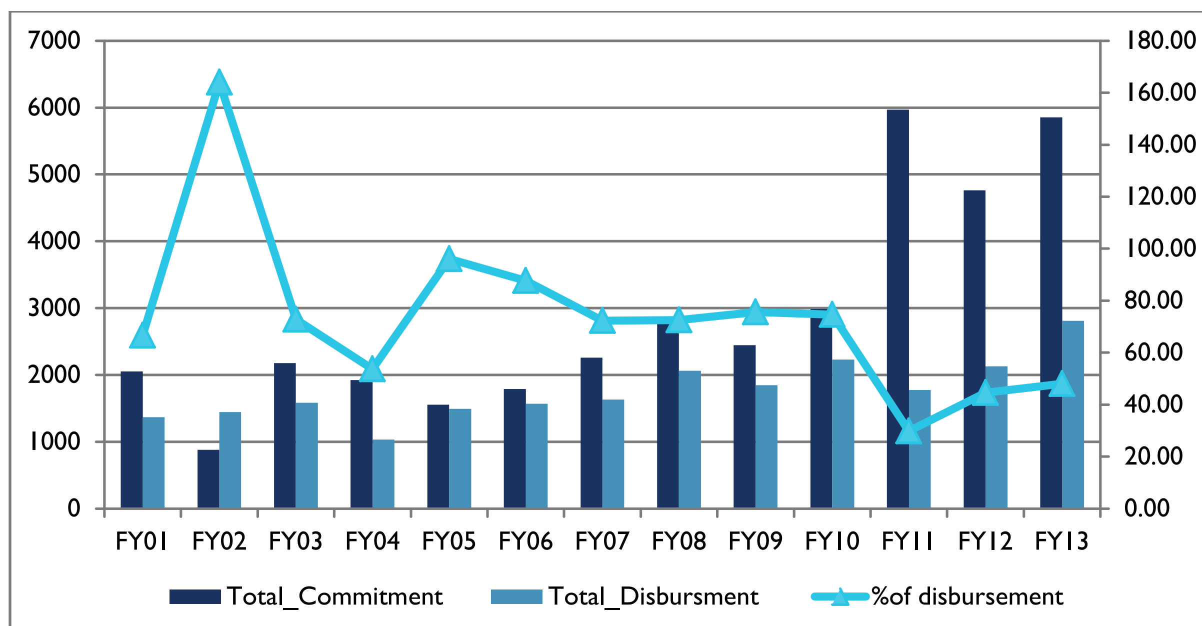
Source: MoF.

4.4 Changing Pattern of Foreign Aid

The concern of lower flow of external resources for budget financing gets compounded by the fact that the amount of grant component has been on the decline since FY2006, excepting FY2011. In FY2014 foreign grants was planned to be Tk. 6,670.0 crore, which was about 3 per cent of total expenditure in the budget for FY2014. During the first nine months of FY2014, realisation of grants was Tk. 799.4 crore which was about 12 per cent of proposed total grant and 0.7 per cent of total expenditure. As is the case, a significant part of foreign aid goes as amortisation payment, making the net foreign loan even smaller. In FY2014 (up to March), an amount of Tk. 7002.6 crore has already been paid as amortisation as against a loan of Tk. 7606.5 crore.

Between FY2006 and FY2014 (up to March), about 41 to 92 per cent equivalent of foreign borrowing has been used for amortisation payment. Additionally, debt servicing has to be made against the accumulated foreign debt, resulting in lower net inflow on account of foreign borrowing. Unsatisfactory disbursement of the committed foreign aid adds to the problem of financing. Disbursement as percentage of commitment is declining since FY2005 (Figure 4.4). Progress on aid disbursement, to a large extent, depends on the success of project implementation. Lower than planned implementation of foreign aided projects under ADP leads to lower disbursement of foreign aid against the committed amount which results in both unrealised infrastructural development and additional burden on domestic sources. Enhanced efficiency of the public administration and related institutions through capacity building, institutional strengthening, civil service reforms, strengthening line Ministries and involving local government institutions have been emphasised repeatedly towards higher absorption of foreign aid. However, these remain unfinished agendas.

FIGURE 4.4: COMMITMENT AND DISBURSEMENT OF FOREIGN AID



Source: Bangladesh Economic Review 2013, Ministry of Finance, Government of Bangladesh.

4.5 Way Forward

Financing public expenditure will continue to be a challenge for the government if the current trends of revenue collection and foreign aid disbursement continue in future. Indeed, the involved problems could accentuate if carefully crafted strategies are not put in place now. Resource needs will likely rise at a fast pace in the coming years and smart mix of domestic and foreign resources will be needed to underwrite the increasing demands. In its budget recommendations for FY2014-15 (CPD 2014), CPD made a number of proposals in order to rejuvenate the revenue mobilisation effort and strengthen its fiscal policy framework. Given the importance of the issue these recommendations are highlighted once again.

First, the government should revisit and rationalise the tax incentive structure. It is also important to account for, analyse and publish the revenue foregone emerging from these tax incentives. It will be prudent to tie the incentives with the intended objectives. For example, the recent cut in the advanced income tax (AIT) at source for readymade garments (RMG) exports (which is also the final settlement) should be tied with implementation of the new minimum wage. Concurrently, the government must have a plan to "phase out" the incentives gradually. The government may consider phasing out the tax holiday while considering renewal of (quick) rental power plants. The government should also stay away from continuation of provision for legalising undisclosed income/wealth in any form.

Second, the NBR needs to be vigilant to curb tax evasion emerging from trade mispricing, re-invoicing and misdeclaration. A strong and well-equipped specialised taskforce should be set up to deal with this issue appropriately; a number of public institutions (e.g. NBR, Bangladesh Bank and others) will need to act in a coordinated manner to make this successful. At the same time

the NBR needs to emphasise operationlising the newly introduced transfer pricing cell without any delay.

Third, the government will have to put emphasis on collection of wealth tax surcharge. This is particularly important from the perspective of establishing economic and social justice. To generate adequate amount of revenue from this source, there is a need to review valuation of wealth, particularly those of real estate (both land, house and flats). The NBR has already proposed to consider to bring this issue under the jurisdiction of income tax ordinance. This is a welcome initiative. In connection with this, the NBR has recently conducted a survey and found that about 162,000 homeowners from major metropolitan cities (e.g. Dhaka and Chittagong) did not submit their tax returns. It was also found by the NBR (as reported by the newspaper) that about 90 per cent of the professionals such as doctors, lawyers and engineers do not pay proper amount of tax. The NBR needs to design an action plan for FY2015 to bring tax defaulters and dodgers under tax net and take measures to enforce the plan.

Fourth, in recent times there is a growing allegation that a number of non-Bangladeshi citizens are working in Bangladesh, who are doing so without any proper paperwork and without paying the due income taxes. This issue needs to be investigated and corrective measures ought to be put in place.

Fifth, the government must not be detracted from ongoing implementation strategy of the forthcoming VAT law. To implement this new law, the government will need to introduce an awareness raising plan among the stakeholders. This will help to mobilise more revenues, ensure buy-ins by stakeholders and reduce hassle faced by business people. The NBR will also have to explore the possibility of expanding the VAT net particularly in the services sector. However, the government needs to consider raising the threshold for turnover tax to safeguard the interests of small traders and entrepreneurs, who were most severely affected by the political impasse.

Sixth, the NBR chairman informed (through the media) that, the government plans to reduce the number of items that face supplementary duties from 1,362 to 170 by 2015. While trimming this list, the NBR should consider both economic benefits and possible revenue loss. (According to the same media report it is anticipated that this will lead to reduction of revenue mobilisation by Tk. 600-700 crore).

Seventh, government will have to explore new ways to tap non-tax revenues. Government should formulate a 'leasing policy of public property' (similar to the recent 'toll policy') on an urgent basis. This policy may consider including a binding constraint in the form of a minimum annual increase of leasing fee taking into cognisance the inflation rate. It is also important to ensure efficiency of public enterprises including financial entities to ensure higher revenue in the form of dividends and profits.

Finally, capacity development and institutional reform as regards revenue mobilisation should be accelerated. It is important to decentralise the revenue collection efforts for widening the outreach and identify new sources.

SECTION 5. SUSTAINABLE POWER SECTOR DEVELOPMENT: WHETHER IN RIGHT DIRECTION?

Development of the power sector is one of the major policy priorities of the present government. Over the last five years a number of different initiatives have been undertaken in this regard including introduction of new policies, amendment of existing rules and regulations, large public investment in generation, transmission and distribution of electricity, allowing private sector to go for higher investment in independent power plants (IPPs), not to speak of the setting up of much-talked rental and quick rental (QRRs) power plants. All these measures and initiatives have contributed to improving the power generation capacity, its availability and accessibility which went a long way to address the increasing public demand for electricity. In view of the experience in this regard, spanning more than five years, it is important to examine the development of the power sector from the sustainability point of view i.e. to assess the record from the perspective of improvements in efficiency in power generation, better access by various categories of consumers and availability of alternate sources of energy.

5.1 Access to Electricity

According to the BPDB, power generation capacity has increased to 10,341 MW in April, 2014 which was 9,151 MW in FY2013 and 5,166 in FY2009 (Table 5.1). However, actual generation did not rise in tandem with the rise in the generation capacity. Maximum generation till date was 7,356 MW which indicates a large gap between the generation capacity and actual generation. It is also important to note that, this gap has widened over successive years (from 1,004 MW in 2009 to 2,985 MW in April, 2014).[45] Official data shows a limited amount of 'load shedding' in the country (e.g. 139 MW in Dhaka and 12 MW in Barisal as of 19 May, 2014 and 0 MW in 28 May, 2014); however, the extent of load-shedding experienced in recent months portrays rather an 'opposite' view as regards this. More importantly, there is large unmet demand for electricity in the country.[46]

The incremental share of generated electricity has been supplied more to domestic and agriculture activities and relatively less to small and medium industries and for commercial activities (Table 5.2).[47] Besides the reduction in the number of connections in the REB (from 185 bulk buyers in FY2009 to only 70 in FY2013) indicate lower levels of connections to the REB perhaps due to shifting of connections from REB to other sources (e.g. PDB).[48] Overall,

[45] In April, 2014 about 29 per cent of the capacity was remained unutilised.
[46] Coverage for electricity has reached more than half of the total demand (59 per cent of total population in 2013) and per capita availability of electricity has increased to 284 kWh in 2013.
[47] During FY2013 out of total retail consumption of 7683 MkWh, 46.5 per cent was utilised for domestic purposes, 37.4 per cent for industrial purposes, 10.3 per cent for commercial purposes and 3.2 per cent for agriculture purposes.
[48] On the other hand, the recent reforms in the REB Act through adoption of the *Rural Electrification Board Act, 2013* in place of the *Rural Electrification Board Ordinance, 1977* (Ordinance No. LI 1977) was expected to lead to improvement in the management with increased and better access to electricity in rural areas for non-agricultural activities.

electricity supply to different categories of consumer cannot be termed 'robust' in view of rising demand and Bangladesh's record still lags behind the average level of South Asia (WDI, 2013). In this backdrop, whether the existing initiatives would be adequate to enhance the coverage of access to electricity to 100 per cent by 2021, as in the vision of the government, ought to be subjected to close scrutiny.

Table 5.1: Generation of Electricity during FY09-FY14

Indicators	FY09	FY10	FY11	FY12	FY13	2014 (as of Apr.)
Installed Capacity (MW)	5166	5271	6639	8100	9151	10341
Average Generation (MW)		3926	4101	4936	5492	5968
Maximum Generation (MW)	4162	4606	4968	6066	6350	7356
Gap between Installed and Maximum Generation (MW)	1004	665	1671	2034	2801	2985
Electric power consumption (kWh/person)*						
South Asia	540	572	605	..	..	
Bangladesh	221	247	259	..	284	
Access to electricity (% of population)*						
South Asia	..	70.7	73.2	..	..	
Bangladesh	..	46.5	59.6	..	..	
Time required to get electricity (days)*						
South Asia	162	133	134	147	145	
Bangladesh	137	142	295	404	404	

Source: BPDB & WDI

Note: *In Calendar year.

Table 5.2: Changes in Number of Connections for Different Categories of Consumers (%)

Year	Domestic	Agriculture	Small Industry	Small Commercial	Large Inds. & Comm.	REB	Others	Total
2009-2010	8.5	14.1	4.6	3.5	6.1	0.0	4.9	7.5
2010-2011	5.1	6.3	1.7	1.8	5.8	0.0	0.8	4.5
2011-2012	14.2	19.6	3.9	5.8	11.9	-62.2	4.0	12.6
2012-2013	10.2	9.1	3.6	3.9	8.8	0.0	10.3	9.1

Source: BPDB

5.2 Generation of Electricity

To address the huge demand for electricity over the shortest possible time, the government took the strategy to allow the private sector to establish small scale power plants under IPP/SIPP, rental and quick rental system along with establishment of power plants under the public sector. Although public sector power plants still generate the major share of electricity (55 per cent of total generated capacity), the rental and quick rental power plants has overtaken the IPPs and its share has reached to 21.5 per cent (2096 MW) as of April, 2014 (Table 5.3). Since the electricity generation cost through rental power plants is significantly higher than that of BPDB's and IPP's power plants (Tk. 10.99/kWh vis-à-vis Tk. 3.8/4.07 per kWh), average generation cost has considerably increased over the years (111.2 per cent between FY2010 and FY2013). More importantly, the existing mix of sources for power generation cannot be considered 'sustainable' as the costly rental and quick rental power plants could only met the temporary demands which need to be replaced by low cost, large scale power plants and other alternate sources. In this connection, rise in generation of electricity through alternate sources (e.g. renewable energy and nuclear power plants) and import of electricity from India and other South Asian countries, at reasonable price, were expected to make significant positive contribution.

Table 5.3: Power Generation through Different Sources

Particulars	Derated capacity (MW) (as of April, 14)	Additional generation in FY2014 (till April, 14) (MW)	Share of total derated capacity (MW)	Cost (Tk./ kWh) 2012-2013
Public sector	5381	562	55.3	3.8
IPP/SIPP	1750	128	18.0	4.08
Rental	2096	0	21.5	10.99
Import	500	500	5.1	6.00-6.35
Total	9727	1190	100	5.47

Source: BPDB

In all likelihood electricity generation will continue to be one of the major policy priorities in the medium term future (Table 5.4). The cumulative generation target by 2018 is set at 20086 MW which will be sourced both by using the existing capacities (10341 MW) as well as by installing additional capacities (11497 MW between FY14 to FY18) mainly by BPDB and IPP. This indicates that the existing rental and quick rental plants will be one of the major sources of electricity, at least till 2018 (when their share would be about 10 per cent of total capacity). Hence the likelihood of exit of the rental and QRRs power plants in immediate future is rather low.

Table 5.4: Projected Year wise Generation of Electricity (from 2013 to 2018) (in MW)

Year	2014	2015	2016	2017	2018	Total
Public	679	1837	1510	0	1320	5933
Private	2007	1097	638	1271	0	5064
Power Import						500
Total	2686	2934	2148	1271	1320	11497
Share (%)						
Public	25.3	62.6	70.3	0.0	100.0	51.6
Private	74.7	37.4	29.7	100.0	0.0	44.0
Power Import	0.0	0.0	0.0	0.0	0.0	4.3
Cumulative generation (upto April, 2014= 10341)	12413	15347	17495	18766	20086	

Source: BPDB

5.3 Efficiency in the Power Sector

The efficiency in the power sector has been discussed in terms of efficiency in fuel-mix, operational efficiency of power plants operated by BPDB, IPP and QRR, terms set for renewal of contract of existing QRRs and progress made as regards establishment of large scale power plants.

Fuel-mix in Power Generation: No major change can be discerned in fuel-mix in the power generation– gas continues to be the major fuel for power generation (Table 5.5). Reducing the current dependence on liquid fuel (such as HFO and HSD) from the existing level (16.7 per cent) to 6.1 per cent by 2016, as per the generation plan, appears to be highly unlikely given the limited progress in power generation through alternate sources such as coal and LNG. On the other hand, given the limited gas reserve (proven)[49] and low growth in supply of gas for power generation, import of HFO, mainly for power plants, has doubled within one year - from 5.9 per

[49] Please see the section 5.5 on availability of gas.

cent in FY2012 to 14.6 per cent in FY2013. Thus, the existing pattern of fuel-mix is likely to continue to have implications for generation cost of electricity.[50] Recently, the power development board has set the long term target for diversifying the fuel-mix by 2030 whereby about 50 per cent electricity was to be generated by coal, 25 per cent by natural gas, 10 per cent by liquid fuels and 15 per cent by other sources (e.g. cross-border electricity trade, renewable energy and nuclear energy). This indicates that out of total targeted generation of 37000 MW, about 18000 MW will be generated by coal; of which about 60 per cent (about 11000 MW) is targeted to be generated by local coal. Given the slow progress in developing the local coal base (both from local coal mines as well as from imported coal) the targeted level of change in fuel mix will be difficult to attain. This was likely to lead to further revision of the long term plan perhaps with more emphasis on other alternate sources such as increased import of electricity from India (estimates have been put at as high as 3500 MW) and from Nepal and Bhutan.

Table 5.5: Fuel-Wise Power Generation Plan

	Fuel-mix at present (FY2014)	Plan for fuel-mix		
		2013-14	2014-15	2015-16
Import Based		2.5	4.8	4.5
LNG based				1.6
Liquid Energy Based	16.5	16.7	12.5	6.1
Hydro	2.3	1.9	1.7	1.5
Coal	3.1	1.9	1.7	6.9
Gas	78.1	77.0	79.4	79.4
Total (%)	100.0	100.0	100.0	100.0

Source: BPDB

Operational Efficiency - PDB: The choice of fuel use has significant impact in the generation cost of the PDB's power plants. Of the total capacity of BPDB (5,088 MW), about 50 per cent is generated by gas, 15.3 per cent by HFO, 4.9 per cent by coal and 4.5 per cent by water (Table 5.6). However, generation cost significantly varies for different kinds of fuel - from as low as Tk. 0.88 in hydropower and Tk. 1.97 in gas-based power-plants to as high as Tk. 17.8 in HFO and even Tk. 43.9 in case of use of diesel. Cost of fuels such as HFO and diesel account for the major share in the generation cost of the plants use such fuels. There is significant difference in operation and maintenance cost between diesel-based power plants vis-à-vis other plants. Overall, the operational efficiency for BPDB is likely to be high in plants where generation cost is low. From this consideration, the low plant factor[51] (6 per cent) for costly diesel based power plants is well understood. In contrast, failure to more use (low plant factor) of the low cost gas, water and coal-based power plants (low plant factor) at the required high level because of low level of efficiency of the plants, due to outdated machineries and lack of adequate supply of gas,

[50] The generation cost has increased by 7.6 per cent between FY2012 and FY2013.
[51] The plant factor indicates how much share of total available generation capacity is being used for power generation.

are resulting in incurring the burden of additional cost. Due to weaknesses in power generation strategy, PDB is facing operational inefficiency.

Table 5.6: Generation Costs for BPDB's Power Plants

Generation plant under power station	Capacity	Share (%)	Plant Factor (%)	Variable cost		Fixed cost Tk./ kWh	Generation cost Tk./kWh
				Fuel cost Tk./kWh	O & M cost Tk./ kWh		
Water	230	4.5	44		0.14	0.74	0.88
Gas	2537	49.9	42	1.03	0.17	0.77	1.97
Coal	250	4.9	53	4.65	0.25	0.81	5.71
HFO	791	15.5	15	15.15	0.29	2.41	17.85
Diesel	146	2.9	6	28.78	9.26	5.88	43.91
Sub-total	3954	77.7	36	2.63	0.24	0.94	3.8
Public Co.	1134	22.3	54	0.26	0.75	1	2.01
Grand total	5088	100.0		1.9	0.4	1.0	3.3

Source: BPDB

Operational efficiency - IPP: Over 80 per cent electricity generated by of IPP and SIPP power plants is by gas and the rest 20 per cent is by HFO. However, the cost structure of BPDB and IPP/SIPP of similar fuel-based plants are not same - overall generation cost in the IPP is about Tk. 0.22 per kWh higher than that of BPDB (Table 5.7). It is interesting to note that, generation cost in HFO-based plants is Tk. 0.08 per kWh less than that of BPDB and that of gas-based plants is Tk. 0.3 per kWh higher than that of BPDB. On the other hand, the plant factor for gas-based IPP is about 26.1 percentage points higher than that of BPDB given the fact the generation cost in the former is higher than that of the latter. Similarly, efficiency in fuel-use as well as operation and maintenance cost in IPP plants appears to be lower than that of BPDB. Given the limited supply of gas, it is better to supply gas to well-maintained BPDB plants to generate electricity at lower cost by increasing use of their unutilised capacities. In the same logic, it is better to use IPP plants using HFO for ensuring better operational efficiency. However, the needed changes are difficult to attain in most cases because of locational and other constraints (inadequate availability of primary energy).

Table 5.7: Generation Costs for IPP's Power Plants

Generation plant under power station	Capacity	Share	Plant Factor (%)	Variable cost		Fixed cost Tk./ kWh	Generation cost Tk./kWh
				Fuel cost Tk./ kWh	Variable O & M Tk./ kWh		
Total IPP & SIPP	**1516**	**100.0**	**69**	**2.91**	**0.12**	**1.76**	**4.08**
HFO	297	19.6	41	13.81		3.95	17.77
Gas	1219	80.4	76	0.65	0.14	1.47	2.27
Difference in costs (IPP/SIPP is less/greater than PDB)							
HFO	-297			-1.34	-0.29	1.54	-0.08
Gas	-1318			0.68	0.03	-0.7	0.3

Source: BPDB

Operational Efficiency - Rental/QRR: Rental power plants generate electricity by using gas (40 per cent), HFO (42.3 per cent) and diesel (18.7 per cent). There is wide difference in the plant factor for different kinds of plants reflecting operational priorities in fuel-mix based on the differences in the generation cost (Table 5.8). Compared with HFO- and gas-based plants of BPDB, rental power plants generate electricity in HFO and diesel-based power plants at lower cost; but they generate electricity in gas-based power plants at higher cost. In fact, rental HFO plants generate electricity even at a lower price compared to that of IPP/SIPP. This could perhaps be due to their comparatively new machineries which were set up within last five years.[52] With high generation cost in gas-based rental and QRR power plants, an average plant factor of 71 per cent indicates inefficiency in operation when low cost plants of BPDB and IPP remain underutilised (plant factor: 42 per cent and 76 per cent respectively). As mentioned earlier, this is difficult to attain because of locational and other constraints.

[52] Although per unit fixed cost (Tk./kWh) of rental plants is higher than that of IPP and BPDB in all kinds of fuel use, because of their efficiency in fuel-use specifically in HFO and diesel based plants, overall generation cost is lower than that of BPDB and IPP plants.

Table 5.8: Generation Costs for Rental and Quick Rental Power Plants

Generation plant under power station	Capacity	Share (%)	Plant factor (%)	Variable cost		Fixed cost Tk./ kWh	Generation cost Tk./kWh
				Fuel cost Tk./kWh	Variable O & M Tk./ kWh		
Total Rental	**2169**	**100.0**	**50**	**6.56**	**0.31**	**4.11**	**10.99**
Gas	874	**40.3**	71	0.83	0.34	3.40	4.58
HFO	917	42.3	43	13.35	0.27	3.96	17.58
Diesel	405	18.7	19	16.43	0.36	10.45	27.24
Difference in costs (Rental is less/greater than PDB)							
HFO	126			-1.8	-0.02	1.55	-0.27
Gas	-1663			-0.2	0.17	2.63	2.61
Diesel	259			-12.35	-8.9	4.57	-16.67

Source: BPDB

It appears that there is operational inefficiency involving various types of power plants which is contributing towards higher cost burden to the users (Table 5.9). Public entities entasked to maintain operational efficiency (e.g. National Load Dispatch Centre-NLDC) needs to be strengthened to cope with and more efficient in order to reduce the overall generation cost. Even after considering structural constraints (e.g. location, low availability factor due to old plants and lower supply of gas against the requirement), if operational inefficiency continues, then it will be indicative of adverse impact of non-economic factors which influence choice of different plants for generating electricity. A major challenge for the power sector is to take into account the rapid changes in the structure of demand for electricity (e.g. changes in seasonal demand and changes in the nature of consumer demand) and thereby to generate adequate amount of electricity accordingly. In the long term, BPDB will need to cater to the growing demand for electricity by using more low-cost power plants as well as by bringing down the share of high cost power plants and also by ensuring the right balance between base load and peaking plants.

Table 5.9: Inefficiency in Power Plant Operation

	BPDB		IPP/SIPP		Rental/QRR	
	Plant factor	Generation cost	Plant factor	Generation cost	Plant factor	Generation cost
Gas	49.9	1.97	80.4	2.27	40.3	4.58
HFO	15.5	17.85	19.6	17.77	42.3	17.58
Diesel	2.9	43.91			18.7	27.24

Source: BPDB

Exit issue of QRRs: A total of 18 quick rental power plants are currently in operation and the majority of these plants are supposed to exit by 2014-17. A total of six plants have been contracted for the second term (with a generation capacity of 434 MW) with the same contractual arrangements as were the case earlier. According to the estimated projection, as well as anecdotal information of BPDB, the contracts of the rest of the rental and quick rental plants are likely to be renewed for yet another term. If such decision is taken by the Ministry, following issues need to be examined: a) Under what condition, a similar contractual arrangement prevails with QRRs which has already appropriated the establishment costs and has already exhausted its most efficient operational period and b) Under what conditions, the government decided to continue operation of fuel-based QRRs given the fact that operational cost of these plants is significantly high.

Regarding the first issue, there is little justification to renew the contracts of six rental plants with the same contractual arrangement.[53] Since the fixed cost of these plants is supposed to be paid back while they are in operation in the first phase, the same fixed cost should not be considered while calculating the generation cost. If these plants use the same machines in the second phase (only by replacing parts and components) then the component of fixed cost is supposed to be close to zero. However, the changes in the tariff after the renewal of the contract in most of the plants are rather insignificant (this was even unchanged in one particular case) which indicate inclusion of almost the same amount of 'fixed cost' for the new phase (Table 5.10). If alternate estimates are used (assuming two scenarios: no fixed cost and 20 per cent fixed cost), the average tariff would be reduced by as low as Tk. 3.20 to as high as Tk. 4.22. In other words, a huge amount of additional costs are to be borne under these new contractual arrangements. If similar kinds of contractual arrangement are followed for rest of the rental plants, a huge burden will need to be borne by the government which will eventually be passed on to the retail consumer's level.

[53] According to anecdotal information, BPDB took the decision to renew the contract considering 50 per cent of the plant's capacity cost (fixed cost) in the estimation of generation cost. Analysis shows that contract of only one plant out of the six has been renewed under this term and rest of the plants have been contracted at significantly higher than 50 per cent of the fixed cost.

Table 5.10: Estimated Tariff under Different Terms and Conditions

Name of plants	Under the new contractual arrangement			Possible alternatives for adjustment of costs			
	Tariff Before Renewal	Tariff after renewal	Changes in tariff (Tk./kWh)	Liberalised tariff (fixed cost=zero)	Liberalised tariff (fixed cost=20 % of the initial rental cost)	Changes in tariff (Tk./kWh) (fixed cost=zero)	Changes in tariff (Tk./kWh) (fixed cost=20 % of the initial rental cost)
1	2	3	4= (3-2)	5	6	7 = (5-2)	8=(6-2)
Siddhirganj 100 MW QRPP	19.57	19.54	-0.03	16.4	17.1	-3.17	-2.47
Ghorarshal 78.5 MW QRPP	5.41	3.29	-2.12	1.22	2.0	-4.19	-3.41
Khulna 55 MW QRPP	21.26	19.55	-1.71	18.1	18.6	-3.16	-3.16
B Baria 70 MW QRPP	5.42	5.36	-0.06	1.2	2.0	-4.22	-3.42
Ashuganj 80 MW QRPP	5.4	5.4	0.0	1.2	2.0	-4.2	-3.4
Pagla 50 MW QRPP	20.4	20.0	-0.41	17	17.2	-3.4	-3.2

Source: Calculated by authors based on BPDB data

Secondly, it appears that BPDB tries to avoid using HFO and HSD based power plants in generating electricity (average plant factor 20-40 per cent) because of their high generation cost. In that case, there is little opportunity to utilise maximum available capacity of those power plants in the future as well. However, these costly power plants, given the advantage of quick load particularly of diesel-based plants, should be used for meeting the immediate peak demand.

Regarding the second issue, the progress of power generation plants currently being implemented under the BPDB is not satisfactory. A total of 14 ADP-projects related to power generation is supposed to be completed in FY2014. But only two projects are likely to be completed; another two projects have made considerable progress (50 – 70 per cent). However, rest of the projects has made only insignificant progress. The progress of three large scale

power plant projects[54] which are supposed to be completed in 2014-2015 have not been able to make appreciable progress till date (as of March, 2014) (Table 5.11). Lack of planning in project implementation is a major weakness which is partly related to failure to get confirmation about supply of gas from the Petrobangla. In fact, because of the delay of public sector projects, the likelihood of discontinuing the QRRs after the existing phase was rather bleak.

Table 5.11: Implementation Status of Selected Power Sector related ADP Projects

Name of Project	**Expected time of Implementation**	**Total Cost**			**Cumulative Expenditure up to March, 2014**			**% Expenditure of total Cost**
		Total Cost	GOB	Project Aid	Total	GOB	Project Aid	
Bhola 225 MW Duel Fuel Combined Cycle Power Plant	9/30/2014	200141.69	59561.88	140579.812	37632.86	32908.09	4724.77	18.8
Shahjibazar 330 MW Combined Cycle Power Plant	12/30/2015	271642.93	84063.64	194579.29	0.52	0	0.52	0.0
Bheramara Combined Cycle Power Plant (360MW) Development	12/31/2014	414048	91937.59	322108.42	31672.88	2316.24	27486.69	7.6

Source: BPDB

5.4 Generation of Electricity through Alternate Sources

According to the renewable energy policy, about 5 per cent of total electricity was planned to be supplied by 2015 from alternate sources which will be increased to 10 per cent by 2020. The targeted level of renewable energy is about 800 MW to be generated through solar and biogas (Ten Year Perspective Plan, 2021). However, progress made so far has been insignificant- about 139 MW of renewable energy generation capacity has been installed till FY2013-14 while another 39MW of capacity was to be installed in FY2014-15 (projected) (Table 5.12).[55] According to IDCOL, out of the target of 6 million SHS to be installed by 2016 about 2.98 million has been installed till now. However, the progress with respect to other programmes is rather

[54] These projects are: Bhola 225 MW duel fuel combined cycle power plant; Shahjibazar 330 MW combined cycle power plant and Bheramara combined cycle power plant (360MW) development.

[55] Among various programs of renewable energy, solar home system (SHS) has produced over 137 MW of electricity which has made Bangladesh the sixth largest renewable energy producer in the world in 2013.

slow including that of solar mini grid (installed capacity till FY13-14 100 kW against the target of 1434 kW by 2014-15) and the solar irrigation pump program (till 38.9kW against target 1789 kW by 2014-15) (Table: 5.12).[56] Scarcity of resources is one of the major problems in implementing renewable energy related projects; more grants and subsidised credit are needed to make renewable energy available at the consumer level. Bangladesh needs to put focus on technology upgradation and emission reduction if it is willing to get low-cost global fund to be available by 2020 for the promotion of renewable energy.[57] Recently government has taken a plan to introduce "Feed-in-Tariff" in renewable energy which is a cost-based compensation or subsidy to renewable energy producers. This has been implemented in many countries under long-term contracts to keep the production cost near to the conventional electricity.

Table 5.12: Renewable Energy: Installed Capacity

Sources	Installed Capacity		
	Till FY2013-14	During FY2013-14	FY2014-15 (Projected)
Solar Home System	137MW	29.21MW	38.61 MW
Biogas Plant for Cooking	33,166	4,745	15,400
Solar Mini Grid	100kW	382kW	1434kW
Solar Irrigation Pump	38.92kW	217.45kW	1789.46kW
Biogas based Power Plant	518kW	64kW	207.5kW
Biomass based Power Plant	650kW	0	0

Source: IDCOL

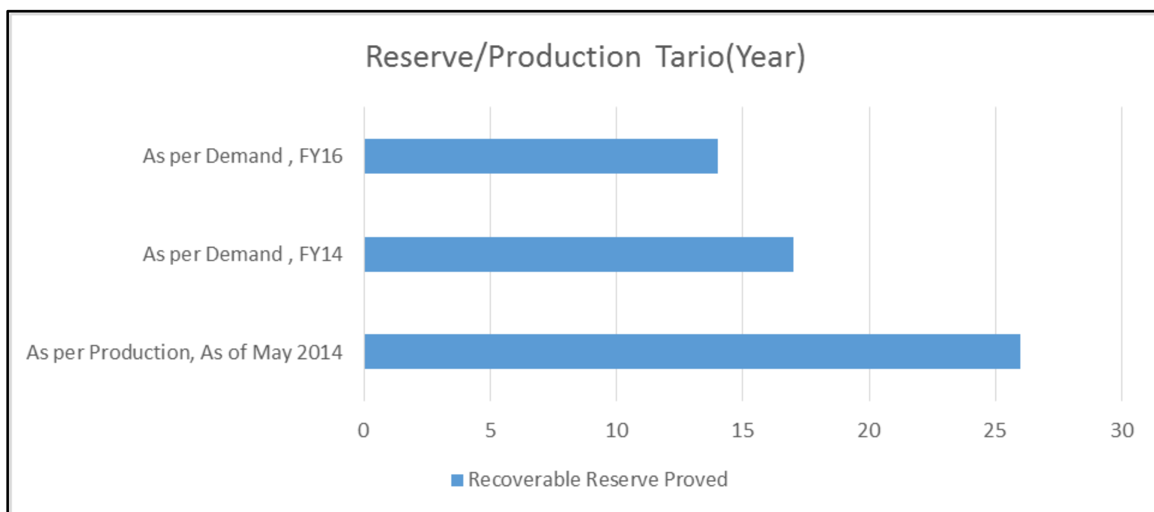
5.5 Availability of Gas as Primary Energy

Domestic supply of gas is the main source of fuel in gas-based power plants. At present about 60 per cent of total supply of gas is being used for generating electricity. However, domestic gas reserve has been depleted over the past years which reduced the scope of using gas for the power sector. The Petrobangla will be able to supply gas only till 2016-2017 to the BPDB for generation of power. The gas reserves in Bangladesh as per proven, probable and possible estimates are 20.7 tcf, 27.04 tcf and 31.34 tcf respectively. The question that begs answer is for how long the gas reserve could be used for domestic economic activities? The length of availability will depend on level of utilisation of gas in each year. At present, domestic supply of gas per year is 0.8 tcf which is likely to be increased in the coming years given the possible rise in economic activities.

[56] All these programs have been implemented by the IDCOL, a public-private infrastructure financing entity. Investment in IDCOL has both international and local components comprising of grant from the government.
[57] A number of Pacific island countries have taken strategies towards that direction.

Using different levels of consumption of gas as suggested by the Petrobangla (0.8 tcf, 1.22 tcf and 1.45 tcf per year) an exercise has been carried out to understand the possible duration of availability of gas (usually called reserve/production ratio- R/P ratio) for recoverable proven, recoverable proven plus probable and recoverable proven plus probable plus possible (Figure 5.1). According to the Petrobangla, out of the total available reserve of 31.34 tcf, till now 16.34 tcf has been produced and about 15.0 tcf gas is still available. The R/P ratio for the remaining gas reserve under the three different scenarios of consumption level was likely to be as low as 14 years (with the projected demand level of 1.45 tcf for FY 2016) to as high as 26 years (with the current level of production of 0.8 tcf). Under such a scenario the remaining available gas reserve will be exhausted between 2028 and 2040.

Figure 5.1: Possible Years of Gas Reserve in the Country



Source: PETROBANGLA

Unlike the power sector, development of the gas sector has not yet received the attention that it deserves from the government as a priority sector. The oil, gas and mineral sector is implementing eight ADP projects in FY2014. Five projects are supposed to be completed by 2014. However, none of these are likely to be finished on time (completion rate below 32 per cent as of November, 2013.[58]

The current status of exploring and exploiting the resources of off-shore gas blocks leaves much to desire. Conoco Philips is scheduled to undertake survey in Block 10 and 11. In February 2014, a contract has been signed with the ONGC for blocks 4 and 9. In March, 2014, one more contract has been signed with SANTOS and Kriss energy for block 11. Even if gas was discovered, it will take significant time to get gas from these contracted blocks as activities in most of these blocks are at a very early stage.

[58] Completion rate for one project is less than 1 per cent; one project is supposed to be completed by 2012 but it is yet to be started. Two projects are expected to be completed by 2015 but the completion rate is below 15 per cent.

SECTION 6. EXPORT SECTOR PERFORMANCE: FLUCTUATING FORTUNES

Bangladesh's export sector was able to record an impressive growth rate of 13.2 per cent during the July-April period of FY2014 compared to the corresponding period of FY2013 in the backdrop of political instability and the adverse implications this had an export-related activities. However, while the RMG sector's performance was notable (15.4 per cent growth), the performance of the non- RMG sector remained a cause for concern. From both product as well as market diversification, the record of non-RMG sector does not augur well, necessitating a closer look at the underlying factors.

6.1 RMG: Impressive Growth

During July-April period of FY2014, export earnings from knitwear registered 16.9 per cent growth and woven sector's growth was 13.9 per cent compared to the corresponding months of FY2013. RMG exports experienced fluctuating fortunes and some volatility in FY2014. While RMG export growth in the early months of the current fiscal year was quite robust, earnings were rather sluggish during January-March of FY2014. Table 6.1 shows that RMG export earnings recorded a high growth of 24.2 per cent in the first quarter (July-September) of FY2014 but then tapered down to 6.8 per cent during the third quarter (January-March). In a significant turnaround, export in April of FY2014 posted an impressively high growth of 17.6 per cent.

TABLE 6.1: GROWTH OF RMG AND NON-RMG EXPORTS IN DIFFERENT QUARTERS OF FY2014

(Growth in Per cent)

Products	Quarter 1, FY2014 (July-September)	Quarter 2, FY2014 (October-December)	Quarter 3, FY2014 (January-March)	April in FY2014
RMG	24.2	15.7	6.8	17.6
Non-RMG	10.0	-2.1	4.5	10.1
Total	21.2	11.9	6.4	16.0

Source: Export Promotion Bureau (2014).

Market decomposition for the RMG exports illustrates that Bangladesh's exports in the US market posted a moderate growth of 8.4 per cent during the period of July-March of FY2014 compared to the corresponding period of FY2013 (USITC, 2014). Data also shows that over the corresponding period growth of earnings from knitwear (14.3 per cent) was higher compared to the woven items (6.5 per cent) in the US market. Table 6.2 shows that competing countries of Bangladesh such as Vietnam (16.1 per cent), India (10.2 per cent) and Turkey (12.0 per cent) performed better than Bangladesh over the corresponding period. To compare, Bangladesh's performance was better than China (2.2 per cent), Indonesia (-2.8 per cent) and Cambodia (2.6 per cent) in the US market. Two conclusions could be made from here: first, orders are continuing to shift from China in the increasingly large US market; second, along with Vietnam, a

traditional competitor of Bangladesh, some of her other competitors such as India and Turkey are consolidating their foothold in the US market.

TABLE 6.2: RMG EXPORT GROWTH OF BANGLADESH AND OTHER COMPETING COUNTRIES IN THE EU AND US

(Growth in Per cent)

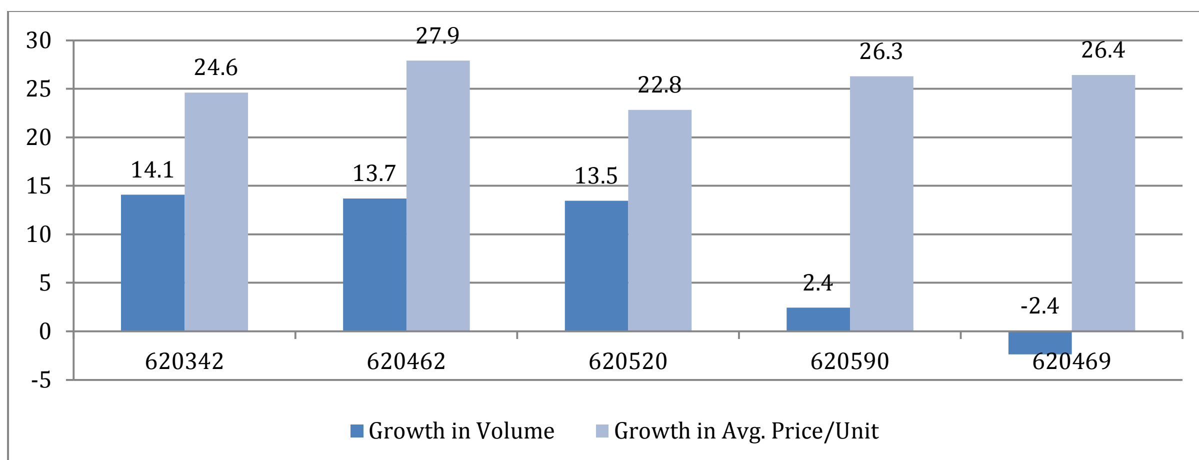
Country	EU (July-February, FY2014)			USA (July-March, FY2014)		
	Knit	Woven	Total RMG	Knit	Woven	Total RMG
Bangladesh	14.7	14.3	14.6	14.3	6.5	8.4
China	3.0	-0.8	1.0	4.8	-0.7	2.2
Vietnam	6.2	6.5	6.4	16.3	15.8	16.1
Turkey	3.7	-2.4	1.4	18.2	7.9	12.0
India	12.8	-0.9	5.6	13.6	7.9	10.2
Cambodia	26.9	28.6	27.3	6.7	-7.5	2.6
Indonesia	-0.3	-4.6	-2.8	-5.2	0.4	-2.8

Source: Eurostat, European Commission (2014) and United States International Trade Commission (2014).

As opposed to the US market, Bangladesh's performance in the EU was better. Bangladesh has continued to strengthen her competitive position in this market and this was true for all major exportable items. Eurostat (2014) data shows that RMG export achieved 14.5 per cent growth in the EU market with about 14.7 per cent for Knit and 14.3 per cent growth for woven items during July-February in FY2014 compared to the corresponding months of FY2013. The data also reveals that in case of exports of the RMG items Bangladesh performed better than her major competitors such as Vietnam (6.3 per cent), Turkey (1.3 per cent), Indonesia (-2.7 per cent), India (5.6 per cent) and China (0.9 per cent). However, Cambodia was able to post a significantly high growth of 27.3 per cent in case of RMG exports to the EU.

It is important to identify whether the growth during July-April of FY2014 was driven by volume or price effect. As can be seen from Figure 6.1, in this period both the volume and average price per unit of woven products have registered some increase, for the top five woven items, when compared to the same months of FY2013. It is seen that growth was primarily driven by price effect. Trends for volume and price effects for the top five knitwear items was found to be somewhat mixed.

FIGURE 6.1: VOLUME AND PRICE GROWTH FOR TOP FIVE WOVEN ITEMS (JULY-MARCH, 2014)



Source: Export Promotion Bureau (2014).

As is known, despite the impressive export performance the RMG industry is facing formidable challenges in view of the Rana Plaza tragedy. As may be recalled, a National Tripartite Committee was constituted in 2013 to deal with policy and legislative, administrative and practical issues concerning building safety, electrical safety and fire safety and other concerns. Over the next years, the fate of the export-oriented RMG sector will critically hinge on the successful implementation of various elements of this Action Plan. A number of incentives have been put in place by the government to ease the difficulties faced by RMG entrepreneurs including bringing down the advance income tax from 0.8 per cent of f.o.b. value to 0.3 per cent, raising incentives for exports to non-traditional markets and arranging low-cost credit for struggling RMG units. There was a need to relate such incentives to the implementation of the 2013 minimum wages in the enterprises, and this is yet to be done. Regrettably, providing compensation for the dead and injured workers has remained an unfinished task as of now; needs and problems faced by workers who have lost their jobs and have been injured and of enterprises which are being closed down, are not being addressed in a speedy manner.

The sub-contracting led model of apparels sector development in Bangladesh has come under scrutiny and to address the post-Rana Plaza challenges and take advantage of the emerging opportunities in the global market Bangladesh will need to pursue a coordinated strategy that should include factory relocation, compliance assurance, living wages for workers and product and market diversification. CPD's reports on post-Rana Plaza monitoring (available on CPD website) have dealt with these concerns in a detailed manner.

BOX 6.1: COMPLAINCE ISSUES IN THE RMG SECTOR

The National Tripartite Committee (NTC), established in 2013, was set up to undertake comprehensive actions to ensure safety and security of workers at workplace through the needed safety measures in the RMG enterprises. Initiatives included recruitment of factory inspectors, reviewing and adjusting factory licensing and certification procedures, development and implementation of a factory fire safety programme and to provide legislative supports.

Accord, a platform of 150 European retailers, and Alliance, another platform of 27 North American retailers have brought together major brands dealing with Bangladesh in an effort to improve compliance situation in the Bangladesh RMG industry. Bangladesh University of Engineering and Technology (BUET) and ILO are taking measures to assess RMG units both for structural integrity and fire and electrical safety. Alliance and Accord have carried out inspection in three areas: A. Fire safety, B. Electrical safety and C. Building structure standards. Some progress have been made so far in assessing the safety record in the RMG factories.

FACTORY INSPECTION REPORT BY ACCORD, ALLIANCE AND ILO & BUET

Initiatives	Total number of factories	Number of Factories Inspected	Factories Closed Down
ACCORD	1500	550	16
ALLIANCE	626	519	3
ILO & BUET	1300	252	2
Total	3426	1321	21

Source: Accord and Alliance (2014).

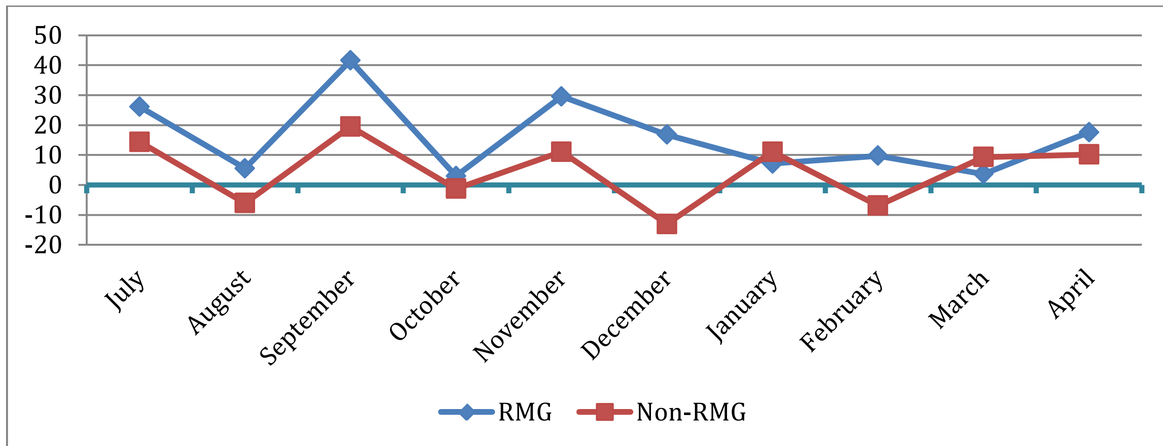
As can be seen from the table, the Alliance has completed about 80 per cent of its target for inspection. 519 of the 626 factories listed with the Alliance have been inspected. On the basis of inspection results, 3 factories have been asked to close down operation. Accord had planned to inspect 1700 factories by September 2014; of these inspections of 550 factories have been completed 16 factories were asked to close down for not being able to meet with compliance standards. ILO & BUET inspected 252 factories of which 2 factories were asked to discontinue production. It is important to note that, BGMEA had provided a list of 176 RMG factories which were closed down during the post Rana Plaza period. However, initial findings of CPD's survey of these 176 factories indicate that several factories were closed down due to various reasons including ownership problems, wage hikes, lack of competitiveness, infrastructural issues and other reasons.

It has been reported that about 14 thousand workers have lost jobs as a result of the closure of about 20 RMG factories. Alliance has agreed to pay 50 per cent of the salary of workers in those factories. However, Accord and ILO are yet to agree to pay any compensation to the workers laid off due to compliance issues. In view of the emerging concerns, an effective mechanism of financial supports for the laid-off workers should be put in place, under the aegis of the government and with support from Alliance, Accord and ILO. Low cost fund and soft loans should be provided to the factories to help them to take the necessary corrective measures. Particular attention ought to be given to the needs of SME RMG units which will need both technical and financial support to weather the current difficulties.

6.2 Non-RMG: Short of Target

Growth performance of the non-RMG sector leaves much to desire. Export growth target for non-RMG sector in FY2014 was 15.5 per cent. However, the actual growth was much lower at 4.7 per cent. Over the next two months the required growth, 62.5 per cent, will be impossible to achieve. Figure 6.2 shows the month-on-month growth rate of RMG and non-RMG exports during July-April period of FY2014 as compared to the corresponding months of FY2013.

FIGURE 6.2: MONTH-TO-MONTH GROWTH RATE OF BANGLADESH'S RMG AND NON-RMG EXPORT (JULY-APRIL, FY2014)



Source: Export Promotion Bureau (2014).

Within non-RMG sectors some have been able to post commendable performance: leather (33.9 per cent), footwear (30.2 per cent) and frozen food (23.3 per cent) experienced very high growth in the first ten months of FY2014 (Table 6.3).

TABLE 6.3: EXPORT GROWTH IN MAJOR NON-RMG PRODUCTS (JULY-APRIL, 2014)

(Million USD)

No.	Products	FY2013 (July-April)	FY2014 (July-April)	Growth
	Positive Growth			
1	Home Textiles (Chapter: 53)	648	650	0.22
2	Frozen Food (Chapter: 02 & 03)	431	528	22.6
3	Footwear (Chapter: 64)	341	444	30.2
4	Leather (Chapter: 41)	317	424	33.9
5	Vegetables (Chapter: 07)	84	119	42.7
	Negative Growth			
1	Jute & Jute Goods (Chapter: 53)	860	679	-21.1
2	Petroleum Bi Products (Chapter: 27)	264	152	-42.4
3	Cotton (Chapter: 52)	102	99	-2.7
4	Plastic Products (Chapter: 39)	70	68	-3.2
5	Ores, Slag and Ash (Chapter: 26)	17	17	-2.1

Source: Export Promotion Bureau (2014).

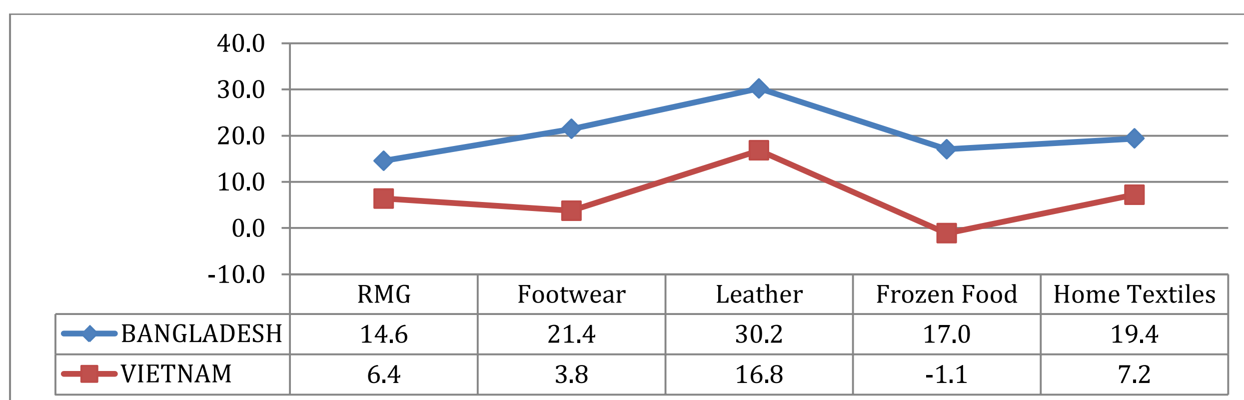
Among major non-RMG items for the July-April period of FY2014 performance records of home textiles (0.22 per cent growth), Jute and Jute goods (-21.1 per cent), Petroleum Bi Products (-42.4 per cent) and cotton (-2.7 per cent) were discouraging. Performance of jute and jute goods exports has continued to show downward trend with concomitant adverse multiplier effects in the economy.

Market decomposition data indicates a mixed picture for Bangladesh's non-RMG exports. In the US market, Bangladesh's export of frozen food (45.3 per cent) and footwear (81.3 per cent) experienced extraordinarily high growth during July-April in FY2014. On the other hand, leather (-27.3 per cent) and home textile (-26.7 per cent) experienced significant negative growth over

the same period. Despite the negative growth in the US market for leather products, the leather industry crossed the threshold of USD 1 billion mark for exports for the first time in the first ten months of the current fiscal.[59] As is known the leather sector has formidable potential to emerge as the next RMG sector in Bangladesh. Its global market, worth of USD 230 billion, indicate the potential market opportunities that Bangladesh has. The local value addition in this sector is also significantly high. However, several health, environmental and compliance issues need to be addressed; the tannery industry need to be shifted; Tannery Park needs to be established on an urgent basis.[60] The Central Effluent Treatment Plan (CETP) needs to be established at the Savar tannery park to ensure environmental compliance.[61]

According to the Eurostat (2014) data, in the EU market Bangladesh's export earnings from footwear (21.4 per cent), frozen food (17.0 per cent) and home textile (19. 4 per cent) and leather (30.2 per cent) posted impressive growth during July-February in FY2014 compared to the same months of FY2013.[62] Eurostat (2014) data shows that the performance of Bangladesh either matched or surpassed the growth performance of other major competing countries such as Vietnam, Cambodia and Turkey. Figure 6.3 provides a comparison of Bangladesh and Vietnam's performance in the EU market for some major items such as RMG, footwear, leather, frozen food and home textiles.

FIGURE 6.3: COMPARISON BETWEEN BANGLADESH AND VIETNAM'S EXPORT GROWTH IN EU-27 (JULY-FEBRUARY, FY2014)



	RMG	Footwear	Leather	Frozen Food	Home Textiles
BANGLADESH	14.6	21.4	30.2	17.0	19.4
VIETNAM	6.4	3.8	16.8	-1.1	7.2

Source: Eurostat, European Commission (2014).

As is known, Bangladesh's South-South trade has been on the rise over the past few years which is good for both market and product diversification.[63] It is also important to mention that the non-RMG exports contributed an important share in Bangladesh's South-South trade. However, Bangladesh's export to the major developing countries for non RMG products is rather mixed.

[59] It is important to note that, leather exports was USD 980.7 million during the whole FY2013.
[60] European Union have set a time limit that they would not import lather products from environmentally non-complaint countries.
[61] The leather industry will relocate to the Savar Tannery Park by 2014.
[62] For the footwear items, Turkey (16.8 per cent) experienced high growth while Vietnam (3.8 per cent) posted moderate growth during July-February in FY2014 as compared to the same months of FY2013. However, China (-1.9 per cent), Indonesia (-5.9 per cent) and Cambodia (-2.7 per cent) experienced negative growth in the EU market for footwear items during the abovementioned period.
[63] Between FY2009 and FY2013, share of Bangladesh's export to the rest of the world (barring non-OECD countries) increased from 15.9 per cent to 19.7 per cent. The share decreased slightly to 19.2 per cent during July-April of FY2014 compared to the same months of FY2013.

TABLE 6.4: SHARE OF RMG AND NON-RMG IN BANGLADESH'S SOUTH-SOUTH TRADE (JULY-APRIL, FY2014)

(Share in Per cent)

Country	RMG	Non-RMG	Total Export (Million USD)
China	30.8	69.2	611
India	23.2	76.8	334
Hong Kong	29.4	70.6	237
Saudi Arabia	25.5	74.5	151
Turkey	72.6	27.4	722
Korea, Republic of	39.5	60.5	297
Russia	72.8	27.2	225
United Arab Emirates	64.0	36.0	196
Brazil	95.5	4.5	149

Source: Export Promotion Bureau (2014).

Bangladesh's non RMG export experienced commendable growth in China (66.0 per cent) and Korea (74.4 per cent) during July-April period of FY2014 as opposed to the same months of FY2013. Export earnings registered a moderate growth in Turkey (6.1 per cent) and Russia (15.2 per cent) during the abovementioned period. However, non-RMG exports registered negative growth in other major markets such as Brazil (-26.4 per cent), UAE (-19.1 per cent), Hong Kong (-19.7 per cent) and India (- 40.3 per cent).

It is important to note that, India has emerged as an important trading partner of Bangladesh. Bangladesh's total trade with India reached USD 5303 million in 2013 from USD 2170 million in 2005. Despite the higher growth in recent years, it is notable to observe that Bangladesh's export to India decreased by (-) 33.2 per cent during July-April of FY2014, in spite of the recently offered duty free market access initiative of India. But the fact remains that the offer could potentially help Bangladesh to consolidate her position in the growing Indian import market (490 billion USD in 2013). Where Bangladesh's current share is only 0.13 per cent in 2013.[64] In a recent study, Rahman and Akhter (2014) identified that trade facilitation related measures including infrastructure bottlenecks, customs and port related facilities and non-tariff barriers are crucial to promote trade with India.[65] The study concluded that better infrastructure, adequate port and customs related facilities, strengthening and modernisation of BSTI, introduction of e-documentation, electronic interchange data, implementation of Single Window, and signing of mutual recognition agreements will be required to take full advantage of India's market access offer.[66]

---

[64] India provided duty-free (and quota-free) market access virtually for all exportable products (excepting 25 products which includes drugs, tobacco and arms) of Bangladesh in 2011.

[65] Rahman and Akhter (2014) identified five major trade facilitations related issues in the Indian marked which are : (a) infrastructure-related bottlenecks; (b) Inadequate Customs and Port related facilities; (c) Cumbersome export procedures and documentation and (d) Non-Tariff Barriers related to testing requirements, registration or licensing, certification, packaging and labeling and restriction on use of food additives.

[66] Export to India from Bangladesh is dominated by non-RMG exports; this is a distinguishing feature when compared to Bangladesh's traditional export markets of the US, Canada and the EU.

6.3 Jute Export: Drastic Reduction

The negative growth in the Jute sector is a disquieting feature of the export earnings during July-April of FY2014 as opposed to the same months of FY2013. While the growth of raw jute dropped significantly by (-) 50.0 per cent, export of jute sacks and bags also declined drastically by (-) 52.2 per cent during the abovementioned period. Only jute yarn and twine experienced a positive growth of 5.6 per cent. Market decomposition data for jute and jute goods indicate that Bangladesh's export to the top ten importing countries has suffered significantly in recent times. On the other hand, Bangladesh's jute exports to traditional markets of India (- 60.5 per cent), Thailand (- 81.0 per cent), Iran (- 13.8 per cent), Pakistan (- 19.5 per cent), Egypt (- 11.8 per cent), Indonesia (- 20.5 per cent) and Sudan (- 35.5 per cent) experienced significant negative growth during the above-mentioned period. On the other hand, export earnings from jute goods registered positive growth in Turkey (6.5 per cent) and China (16.5 per cent) during July-April months of FY2014.[67]

There are several reasons for the drastic deceleration of jute exports. *First,* the demand for jute and jute goods have experienced deceleration in several traditionally importing countries. As was seen, in the first nine months of this fiscal, Bangladesh's jute exports to Thailand fell by (-) 80.9 per cent whereas Thailand's total global import of jute goods declined by (-) 33.2 per cent during the same months (Customs Department, Thailand, 2014). In India, total global import of jute goods has also declined by (-) 33.84 per cent during April-December period of FY2014 (April-March) as opposed to the comparable months of fiscal year 2013.68 Total global import of jute goods also declined in other major importing countries of Bangladesh such as Indonesia (-23.5 per cent), Thailand (-33.2 per cent) and Turkey (-4.9 per cent).

TABLE 6.5: TOTAL IMPORT OF JUTE GOODS BY MAJOR MARKETS OF BANGLADESH IN FY2014

(Million USD)

Country	FY13 (July-March)	FY14 (July-March)	Growth
India[69]	378	250	-33.8
Indonesia[70]	39	30	-23.5
Thailand	81	54	-33.2
Turkey	223	212	-4.9
Pakistan	39	39	-4.9

Source: Statistics Indonesia (2014), Information and Communication Technology Centre, Thailand (2014), Turkish Statistical Institute (2014), State Bank of Pakistan (2014) and Department of Commerce, India (2014).

Second, the international price for jute and jute goods have suffered. For example, the price of 100 pieces *cut size jute bags* was about USD 54 in FY2013 which came down to USD 50 in FY2014 registering (-) 7.4 per cent negative growth. As per the price projection of BJMC (2014), the price for Hessian Bags (HC 40-100z/40 Food Grade) was likely to come down by (-) 5.6 per

[67] Bangladesh also experienced positive growth in the in Russia (9.8 per cent), Japan (4.7 per cent) and Germany (21.5 per cent) during July-April of FY2014 as compared to the same months of FY2013.
[68] Indian fiscal year runs from April to March.
[69] Figures of India represents the period of April-December of each fiscal year.
[70] Figures of Indonesia represents the period of July-February of each fiscal year.

cent during May-July of FY2014 as compared to the same months of FY2013.[71] *Third,* the price of raw jute in the domestic market has seen some rise in recent times. The price of raw jute per *maund* was about Tk. 1300-1400 in 2013 which increased to Tk. 1400-1600 in 2014. Exporters were of the opinion that price hike for the raw jute reduced their profitability and the exports. *Fourth,* depreciation of Indian Rupee also worked as a major reason for the falling jute exports in the Indian market. *Fifth,* political developments in several jute importing countries also worked as a major impediments to export of jute. Exporters complained that jute exports suffered because of political turmoil in the middle-east (Egypt, Syria) and Africa (Sudan) which were traditionally important markets for Bangladesh.[72]

To revive the declining fortune of jute and jute goods, Bangladesh will need to take a number of short and medium term measures. Proper implementation of "Jute Packaging Act, 2010" will be crucial to increase domestic demand and rejuvenate the jute industry.[73] Jute has been identified as an environmentally friendly items because of its biodegradable qualities. Technological up gradation, Research and Development (R&D) and improvement of the quality and designs for the jute products will be needed to raise competitiveness of the jute items in the global market. An earlier CPD study (Moazzem et al., 2012) has identified a number of steps in this regard, including suggestions for restructuring of the BJMC, strengthening relevant institutions, undertaking necessary reforms and raising the efficacy of privatisation of the State Owned Enterprises (SOEs) related to the jute sector. It may be noted that India provides minimum support price for the Indian jute producers, and the enforcement of mandatory use of jute bags is forcefully quite stringent in India.[74] With its exceptionally high domestic value addition, significant multiplier effects in the economy and the renewed interest in jute products globally, jute sector should command a refreshing look by Bangladeshi policymakers. A comprehensive plan covering productivity growth, allocative efficiency of supportive measures and restructuring of the jute industry will be needed if Bangladesh is to take advantage of the emerging opportunities in this regard.

The upshot of the above discussion is that to sustain the growth momentum, reduce vulnerability, ensure sustainable growth of the export-oriented sectors of the country and to take advantage of the growing opportunities in the growing global market, Bangladesh should undertake a comprehensive strategy to pursue the objectives of the twin diversification: product diversification, both within RMG and extra-RMG, and market diversification. In this regard South-South export opportunities and sectors such as leather and footwear should receive high priorities from the policymakers.

---

[71] Jute exporters also complained about the "undercutting" as a major factor for low export price. It has been mentioned that the behaviour of the big jute firms is quite oligopolistic. Some large exporters offer low price to the buyers and the price decreases for the whole jute and jute goods market.

[72] Sudan has imposed restrictions on import of jute yarn from Bangladesh.

[73] Jute Packaging Act, 2010 ensures mandatory use of jute for several packaging products. To facilitate domestic use of jute bags instead of polythene or polypropylene, Jute Packaging Act-2010 became effective from January, 2014.

[74] India Cabinet Committee on Economic Affairs (CCEA) approved the Minimum Support Price (MSP) for 2014-15 for TD-5 grade of Jute at Rs.2400 per quintal which is a 4 per cent increase from fiscal year 2013-2014.

SECTION 7. CONCLUDING REMARKS

As our analyses reveal, the fiscal framework envisioned in the budget for FY2014 has weakened to a considerable degree. Domestic resource mobilisation has been losing its buoyancy and has underperformed; the value for money spent for public expenditure has suffered erosion in view of weak implementation record of projects; private sector credit is not picking up; because of reasons of lower net aid flow, dependence on domestic resources to underwrite deficit financing has been on the rise.

As is known, the first half of FY2014 saw significant disruption in macroeconomic management. However, in the second half of FY2014, despite the relative respite, uncertainties continued to adversely affect private sector investment. Both the above woes had undermined the performance of key macroeconomic performance indicators and attainment of medium term developmental targets of the economy. Whilst the economy has been able to demonstrate a modicum of stability, manifested in contained inflation, sustained exchange rates and high foreign exchange reserves, structural weaknesses continue to persist and afflict the economy. In this backdrop, the key challenge confronting macroeconomic management in FY2015 will be to ensure accelerated growth through reinvigoration of the investment scenario.

This report has made an attempt to flag some key concerns emanating from the analysis of the state of Bangladesh's macroeconomic management in FY2014. Many of these concerns are of medium to long term in nature and will not only serve as benchmark of FY2015, but will also be shaping the outcomes of the FY2015 budgetary proposals. The evolving situation may be corrected and addressed only through concerted efforts at institutional strengthening, targeted reforms, good governance at all levels and by putting in place an inclusive and participatory political culture.

Indeed, in the report titled 'A Set of Proposals for the National Budget FY2015'; dated 4 May 2014, CPD had underscored the importance of non-economic factors in defining the economic prospect of the country over the coming years. The three 'traditional' non-economic factors identified in this connection, broadly, were: (i) *weak implementation capacity* of the state relating to, inter-alia, human resource management, devolution of power and autonomy; (ii) *weak oversight capacity* relating to, inter-alia, rule of law, democracy and representativeness and control of corruption and leakages; and (iii) *weak capacity for reforms* relating particularly to regulatory, administrative and legal and institutional reforms. It was also noted that the adverse impact of these 'traditional' factors have been further accentuated by newly emerging ones which are, on the one hand, results of aggravation of the old ones and, on the other, new ones emanating from the current political scenario triggered by non-participatory elections that have produced a government whose legitimacy is truncated and moral foundation questionable.

In this backdrop, restoring investors' confidence, undertaking and enforcing regulatory reforms, enhancing service delivery capacity of institutions, taking advantage of the window of opportunities of strengthened global market integration, addressing the ever increasing infrastructure demand in cost-effective manner and realising the ambition of attaining the status of a "modern" middle income country will become increasingly challenging.

In the aforesaid report, CPD emphasised five following aspects:

a. Setting up of a Task Force to address pending reform measures including enactment of the Civil Service Act;

b. Local governments to be vested with more effective devolution of power and fiscal autonomy;

c. Enhancement of capacities of agencies involved with implementation of major public investment projects;

d. Reduction of transaction costs of contract enforcement, and

e. Concrete initiatives towards promotion of a participatory and pluralistic democratic polity, driven by inclusive and credible national elections.

It is maintained that the aforesaid recommendations remain crucial as we move towards a new fiscal year, with new ambitious targets as regards resource mobilisations, resource allocation, project implementation and growth performance. The experience of macroeconomic management and likely economic performance record of FY2014 strongly suggest that both accelerated GDP growth and distributive justice will critically hinge on how strategically Bangladesh is able to address these formidable tasks, which are often beyond the ambit of budgetary measures.

REFERENCES

Alter, N., Necula, C., & Bobeica. G. (2010). *Estimating Potential GDP for the Romanian Economy. An Eclectic Approach*. Journal for Economic Forecasting, 3, 5-25.

Andres, L., Biller, D., & Dappe, M. H. (2013). *Reducing poverty by closing South Asia's infrastruture gap.* Washington, DC: World Bank Group.

Bank, B. (2013). *Annual Report 2012-2013.* Bangladesh Bank, Central Bank of Bangladesh. Retrieved from http://www.bangladesh-bank.org/pub/annual/anreport/ar1213/app03.pdf

Bank, W. (2010). *Bangladesh-Public expenditure and institutional review: towards a better quality of public expenditue.* Public expenditure review (PER) (Vol. 1). Washington, DC: World Bank.

Bank, B. (2014). *Major Economic Indicators, Monthly Update: April 2014*, Bangladesh Bank, Central Bank of Bangladesh. Retrieved from http://www.bangladesh-bank.org/econdata/openpdf.php?i=6

Bordoloi, S., Das, A., & Jangili, R. (2009). *Estimation of Potential Output in India.* Reserve Bank of India Occasional Papers, 30 (2).

Brouwer, G. D. (1998). *Estimating Output Gaps*. Research Discussion Paper 9809. Economic Research Department, Reserve Bank of Australia.

Cerra, V., & Saxena, S. C. (2000). *Alternative Methods of Estimating Potential Output and the Output Gap: An application to Sweden.* IMF Working Paper WP/00/59. European Department, International Monetary Fund (IMF).

European Communities. (2003). *Statistical Methods for Potential Output Estimation and Cycle Extraction.* Working Papers and Studies. Luxembourg: Office for Official Publications of the European Communities.

Fan, S. (2008). *Public expenditure, growth, poverty in developing countries: Lessons from developing countries* (No. 51). International Food Policy Research Institute (IFRI).

MoF. (2013). *Bangladesh Economic Review 2013*, Finance Division, Ministry of Finance, Peoples Republic of Bangladesh. Retrieved from http://www.mof.gov.bd/en/index.php?option=com_content&view=article&id=249&Itemid=1

MoF. (2014). *Monthly Report on Fiscal Position*, Finance Division, Ministry of Finance, Peoples Republic of Bangladesh. Retrieved from http://www.mof.gov.bd/en/index.php?option=com_content&view=article&id=68&Itemid=1

MoF. (Various Issues).*Budget Speech*, Finance Division, Ministry of Finance, Peoples Republic of Bangladesh. Retrieved from http://www.mof.gov.bd/en/index.php?option=com_content&view=article&id=245&Itemid=1

MoF. (2014). *Flow of External Resources into Bangladesh 2012-2013*, Economic Relations Division (ERD), Ministry of Finance, Peoples Republic of Bangladesh. Retrieved from http://www.erd.gov.bd/images/FlowBook/Overview_BG_Press_revised_13042014.pdf

MoF. (2012). *Year End Report on Fiscal Position Fiscal Year 2011-12*, Finance Division, Ministry of Finance, Peoples Republic of Bangladesh. Retrieved from http://www.mof.gov.bd/en/budget/year_end_fiscal/year_end_report_2011_12.pdf

NBR. (2011). *Annual Report 2010-11*, National Board of Revenue, Peoples Republic of Bangladesh. Retrieved from http://www.nbr-bd.org/annual_report_2010-2011.html

NBR. (2012). *Revenue Statistics*, National Board of Revenue, Peoples Republic of Bangladesh. Retrieved from http://www.nbr-bd.org/statistics.html

NBR (2013). *Revenue Statistics*, National Board of Revenue, Peoples Republic of Bangladesh. Retrieved from http://www.nbr-bd.org/statistics.html

NBR. (2014). *Revenue Statistics.* National Board of Revenue, Peoples Republic of Bangladesh. Retrieved from http://www.nbr-bd.org/statistics.html

Nguyen, G. H. (2014). *Estimating the Output Gap to Support the Management of Interest Rates in Vietnam*. Graduate Institute of International and Development Studies Working Paper No: 05/2014.

Rahman, J., & Yusuf, A. (2010). *Economic Growth in Bangladesh: Experience and Policy Priorities*. The Bangladesh Development Studies, 12 (1).

Razzak. W. A., & Dennis, R. (1999). *The output gap using the Hodrick-Prescott filter with a non-constant smoothing parameter: an application to New Zealand*. Discussion Paper Series.

World Bank. (2012). *Bangladesh: Towards Accelerated, Inclusive and Sustainable Growth: Opportunities and Challenge*s. Report No. 67991, Volume II: Main Report. Poverty Reduction and Economic Management Sector Unit, South Asia Region, The World Bank.

ANNEXTURE

ANNEX 2.1: MAJOR IMPORTED ITEMS IN JUL-MAR FY2014 AT 8-DIGIT HS CODE LEVEL

HSCODE	Items	Jul-Mar FY2013	Jul-Mar FY2014	Share (%)	Growth (%)	Incremental Growth (%)
		AV (in mln USD)				
10011990	Durum wheat, other than seed, *excl.* wrapped/canned upto 2.5 Kg	322	525	2.6	63.0	13.4
12019090	Soya beans, whether or not broken other than seed, *excl.* wrapped/canned upto 2.5 Kg	137	284	1.4	107.2	9.7
15071000	Crude Oil; whether or not degummed	331	246	1.2	-25.7	-5.6
15111010	Crude palm oil imported by VAT registered edible oil refinery industries	229	227	1.1	-1.0	-0.2
15119090	Palm oil (*excl.*crude) and its fractions....n.e.s. *incl.* refined palm oil	537	532	2.6	-1.0	-0.4
17011400	Other cane sugar	294	252	1.2	-14.4	-2.8
25231020	Cement clinkers, imported by VAT registered manufacturers	460	488	2.4	6.0	1.8
27101262	High speed diesel oils	650	651	3.2	0.3	0.1
27101911	Other fuel oils, furnace oils	198	303	1.5	52.8	6.9
31021000	Urea; whether or not in aqueous solution	391	375	1.8	-4.0	-1.0
52010000	Cotton (not carded or combed)	1,655	1,759	8.6	6.3	6.9
72071100	Semi-products of Iron/Steel, <0.25% Carbon, of squarish section	247	251	1.2	1.6	0.3
73101000	Tanks, casks, drums, cans (*excl.* for Gas) of Iron/Steel, 50-300 L	1	329	1.6	32,079.7	21.7
84261900	Transporter cranes, Gantry cranes, Bridge cranes, Overhead travelling cranes n.e.s.	7	466	2.3	6,225.7	30.3
85171210	Cellular (mobile/fixed wireless) telephone set	276	365	1.8	32.2	5.9
88022000	Aeroplanes and other aircraft, n.e.s, of an Unladen weight =<2000kg	2	326	1.6	17,605.4	21.4
89080000	Vessels and other floating structures for breaking up	976	750	3.7	-23.2	-15.0
SUM OF 17 PRODUCTS		6,713	8,127	39.7	21.1	93.5
Total Customs Shipment		**18,937**	**20,450**	**100.0**	**8.0**	**100.0**

Source: NBR.

Note: Data exclude bond, baggage and back-to-back imports.

ANNEX 3.1: FISCAL TRENDS (IN CONSTANT TERM)

Indicator	FY08	FY09	FY10	FY11	FY12	FY13	Av. yearly % change
In crore Taka							
Public Expenditure	53,460	49,423	52,761	62,001	67,910	72,429	7.1
Non-Development Expenditure	34,005	36,313	38,026	40,055	42,976	43,553	5.6
Development Expenditure	11,687	11,999	14,611	17,270	18,120	21,972	17.6
Other	7,768	1,112	124	4,676	6,813	6,904	-2.2
As percentage of GDP							
Total Revenue	11.1	11.3	11.4	11.9	12.5	13.5	
Total Expenditure	17.3	15.3	15.9	16.3	17.6	18.2	
Budget Deficit (excl. grants)	6.2	4.1	4.5	4.4	5	4.8	
Deficit Financing	4.4	4.1	4.5	4.4	5	4.8	
Net Foreign Financing	*1.8*	*1.8*	*2*	*1.3*	*1.3*	*1.7*	
Net Domestic Financing	*2.6*	*2.3*	*2.5*	*3.1*	*3.8*	*3.1*	
Credit from commercial banks	*2*	*1.7*	*1.2*	*2.3*	*3.2*	*2.7*	

ANNEX 4.1: COMPOSITION OF DEFICIT FINANCING

Year	*Type of Estimate*	*Total Deficit (Tk.in Crore)*	*% of GDP*	*% of total expenditure*	*Financing (%)*					
					Domestic			*Foreign*		
					Total (% of total deficit)	*Bank (% of total domestic)*	*Non-bank (% of total domestic)*	*Total (% of total deficit)*	*Grants (% of total foreign)*	*Loans (% of total foreign)*
2009-10	Budget	34358	5.0	30.19	59.83	81.51	18.49	40.17	37.17	62.83
	Revised	31244	4.5	28.27	55.45	49.99	50.01	43.89	27.29	72.71
	Actual	25,074	3.7	24.68	63.09	-13.23	113.23	36.90	34.77	65.23
2010-11	Budget	39323	5.0	29.75	60.22	66.22	33.78	39.78	30.74	69.26
	Revised	34824	4.4	26.79	71.26	74.06	25.94	28.74	42.21	57.79
	Actual	34,881	4.5	27.19	87.70	82.42	17.58	14.56	48.24	51.76
2011-12	Budget	45,204	5.0	27.63	60.19	69.67	30.33	39.81	27.44	72.56
	Revised	46,328	5.1	28.74	74.40	84.47	15.53	25.60	37.61	62.39
	Actual	37,735	4.1	24.76	80.94	89.03	10.97	19.06	49.59	50.41
2012-13	Budget	52,068	5.0	27.16	64.31	68.69	31.31	35.69	32.52	67.48
	Revised	49656	4.8	26.23	65.40	87.77	12.23	34.60	30.73	69.27
	Actual	44461.9	4.4	25.65	72.10	83.77	16.23	27.90	52.96	47.04
2013-14	Budget	55,032	4.6	24.74	61.72	76.53	23.47	38.28	31.66	68.34
	Actual*	16634.1	1.4	14.44	91.56	86.88	13.12	5.49	87.5	12.49

* Up to March 2014.

Source: Based on various issues of Budget Speeches and Monthly Fiscal Report, MoF.