CHAPTER 1

State of the Bangladesh Economy in FY2009-10

1.1 INTRODUCTION

FY2009-10 was the first full fiscal of the incumbent government. During this period, the main challenge faced by the government was mitigating the lagged impact emanating from the global financial and economic crises of the immediate past year. It also had to prepare itself for taking advantage of the recovery process of the global recession. Besides, the government had to remain vigilant to safeguard the economy from further deterioration originating from a second round of the crisis. To deal with the impact of the global crisis, the budget for FY2009-10 made provisions through stimulus packages, for the affected export-oriented industries and to stimulate domestic production, particularly in the agriculture sector. Although exports did suffer from the fall in global demand and the depressed prices in the international markets, Bangladesh was able to escape the second round of economic dip by the end of FY2009-10. Subsequently, the Bangladesh economy had to focus on preparing itself for the ensuing recovery phase. In doing so, stimulating investment had to be put at the top of the priority list. As may be recalled, country's investment suffered considerably, to a large extent, because of the acute and prolonged power crisis. The government took a number of short-term initiatives including commissioning rental power plants (RPPs) to improve the power situation in the near-term future. However, there was a broad consensus that long-term and sustainable solutions were required to address the emergent situation. A sizeable public investment programme (given the implementation capacity of the line ministries) was adopted for FY2009-10 with a view to improving the investment scenario. Although the overall annual development programme (ADP) implementation record was much better compared to the trends of the recent past, the Power Division, a key actor, was unable to achieve its ADP targets. This had a detrimental impact on private sector investment since potential crowding in opportunities were lost as a consequence. At the same time, no notable headway could be made with regard to the envisaged public-private partnership (PPP) initiatives, which was given emphasis in the budget for FY2009-10, one of the reasons being the delay in putting in place the policy framework and guidelines for the PPP.

To deal with the impact of the global crisis, the budget for FY2009-10 made provisions for the affected export-oriented industries and stimulation of domestic production

In the agriculture sector, although rice production registered a 3 per cent growth in FY2009-10 over the high benchmark growth of 8.2 per cent in the previous year, food security continued to be a concern due to depressed public procurement of foodgrains and also the low level of imports, which resulted in significant reduction in public stock at the end of the fiscal year. On the other hand, industrial production could not pick up during the fiscal year 2009-10 due to low export demand.

Food security continued to be a concern due to depressed public procurement of foodgrains and low level of imports

The strain on the recovery was to some extent relieved by a number of positive developments in FY2009-10. In line with the global price situation, inflationary pressure declined compared to the previous year. The stock market experienced buoyancy in FY2009-10 with higher market capitalisation - partly due to lack of alternative investment opportunities in the economy. Commendable success was achieved by the National Board of Revenue (NBR) in terms of revenue mobilisation. Higher revenue collection, coupled with restrained public expenditure (revenue and development), contributed to containing fiscal deficit to only 0.21 per cent of the gross domestic product (GDP) in FY2009-10. Macroeconomic stability was further strengthened with high remittance flow that helped in maintaining surplus both in the current account and in the balance of payment (BOP). This helped maintain a healthy foreign exchange reserves. In the backdrop of these mixed developments, the Bangladesh economy managed to attain a growth of 5.8 per cent which was very close to the target of 6.0 per cent.

The strain on the recovery was to some extent relieved by a number of positive developments in FY2009-10

1.2 MACROECONOMIC BENCHMARK AT THE BEGINNING OF FY2009-10

FY2008-09 ended with some setback primarily on account of the initial wave of adverse impact arising from the global financial and economic crisis

It may be recalled that FY2008-09 ended with some setback primarily on account of the initial wave of adverse impact arising from the global financial and economic crisis. Export growth slowed down to 9.9 per cent from 15.9 per cent in the previous year; further deceleration was apprehended. Overseas employment became an issue of concern as there were some signs of retrenchment of guest workers in some of the host countries. In the end, however, a healthy growth of 22.4 per cent in remittance was recorded, thanks to the large stock of workers who managed to stay in the host countries, particularly in the Middle East, in spite of the crisis. Revenue earnings from NBR declined, mainly on account of reduced import duties. The pace of overall revenue mobilisation decelerated significantly recording only 8.6 per cent growth over the previous year. Gross investment stagnated, at the low level of 24.4 per cent of the GDP. Power shortage reached a critical level while public investment declined to as low as 3.2 per cent which was the lowest ever. On the positive side, falling commodity prices in the global market had positive impact on the domestic market by way of low levels of inflation. A good Boro harvest further eased the pressure for the consumers. Trade balance improved, but for the wrong reason - imports were low, which was a reflection of depressed industrial activities. Given the global and domestic environment, the task of macroeconomic management in FY2008-09 was indeed a challenging one. In view of this, achievement of the 5.7 per cent GDP growth in FY2008-09 must be considered as commendable.

Box 1.1: Growth Rhetoric

The release of provisional growth estimates for FY2009-10 by the BBS ignited a debate over the reliability of the data. The Ministry of Agriculture (MoA) raised this issue, and following long discussions, the Ministry of Finance (MoF) revised the GDP growth estimates upward, by 0.5 percentage points, to make it 6.0 per cent when the budget documents were being prepared (Table 1.1). Major upward revisions were made in the agriculture (mainly crop) and industry (manufacturing) sectors, and in the import duty component. The acceleration of export receipts and improvements in public investment during the last months of the fiscal year were mentioned as the rationale for the upward revision of the GDP. Later on, BBS released the final estimate of GDP for FY2009-10 which turned out to be somewhere between the estimates of BBS's earlier and MoF's revised estimate.

Table 1.1: Various Estimates of GDP Growth in FY2009-10

(in Per cent)

Sector	BBS Preliminary Estimate	MoF Revised Estimate	BBS Final Estimate
Agriculture & Forestry	2.8	4.4	4.7
Crops	2.2	4.2	5.1
Industry	6.0	6.4	6.0
Manufacturing	5.3	5.9	5.7
Services	6.6	6.6	6.4
Import Duty	1.4	4.3	3.5
GDP	5.5	6.0	5.8

Source: BBS (2010b and 2010c); MoF (2010a).

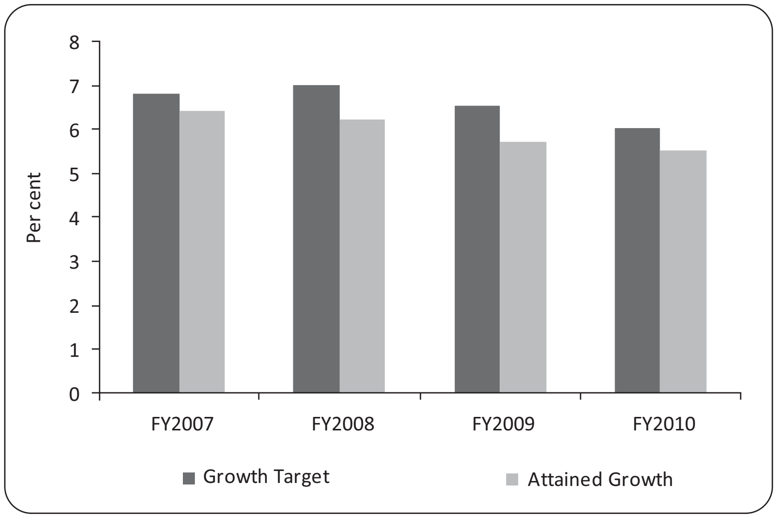
The objectives of FY2009-10 annual budget were thus spelled out in the backdrop of the aforesaid developments in the economy. Major goalposts of the budget were — revitalising public and private investment, sustaining agricultural growth, protecting external sector and strengthening revenue mobilisation. In order to realise these goals, good governance was a key factor, and this in turn was critically dependent on reforms in development administration.

1.3 GROWTH, SAVINGS AND INVESTMENT

1.3.1 GDP Growth

The initial estimate of GDP growth for FY2009-10 by the Bangladesh Bureau of Statistics (BBS) created a commotion among the policymakers (Box 1.1). This compelled the BBS to reexamine the data and come up with a new set of estimates. Final estimates of the BBS revealed that GDP posted a growth of 5.8 per cent in FY2009-10, which was 0.2 per cent lower than the targeted growth of 6.0 per cent. An impressive performance of the agriculture sector, the resilience of the services sector, some momentum in public investment, and sustained high levels of remittance flow helped the economy to attain a near-six per cent growth rate. The possibility of a better performance of the economy was undermined by the lagged impact of global recession and lack of adequate infrastructural support for the manufacturing sector. As may be recalled, over the last four years GDP growth rates were consistently lower than the targets set in respective budgets (Figure 1.1). Had the targets in last four years been met, GDP growth in FY2009-10 would have been 2 per cent higher than what was actually achieved.

Figure 1.1: Targeted and Attained GDP Growth Rates: FY2006-07 — FY2009-10

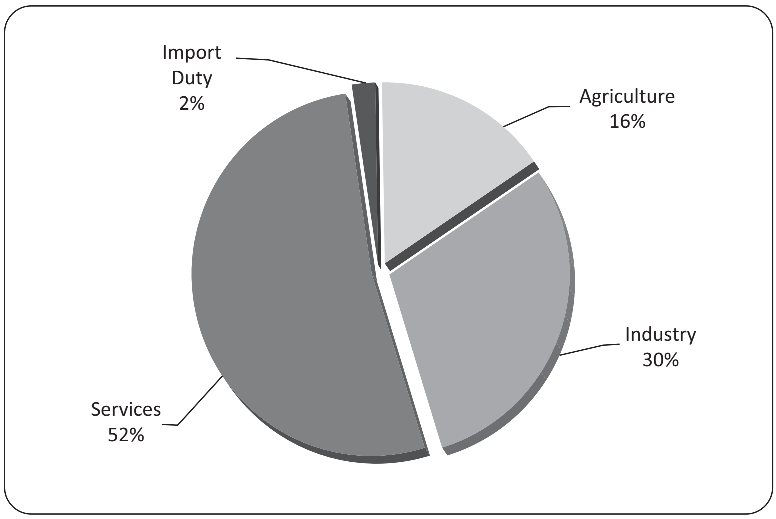


Source: Estimated from BBS (2010b) data.

1.3.2 Sources of Growth

Despite the robust performance of country's agriculture sector, the tangible sectors of the economy[1] posted a moderate growth of 5.4 per cent, while intangible sectors recorded a somewhat higher growth of 6.1 per cent. The manufacturing sector failed to achieve the projected targets due to lagged impact of the global recession. In the incremental GDP of FY2009-10, the industrial sector contributed only 29.7 per cent, whereas the services sector continued to be the front-runner with a share of 52.4 per cent. The agriculture sector responded positively to the policy initiatives of the government, and contributed a share of 15.8 per cent to the incremental GDP (Figure 1.2). Overall, the agriculture sector posted an impressive 4.7 per cent growth. Within the agriculture sector, the crop sector had posted a commendable growth of 5.1 per cent (Table 1.1), and contributed much to ensuring food security in the country. The sector played a crucial role in keeping the inflationary pressure on food prices experienced during the last few months of FY2009-10, at a tolerable level.

Figure 1.2: Sources of Incremental Growth



Source: Estimated from BBS (2010b) data.

It is to be noted that the industrial growth of 6 per cent in FY2009-10 was lower than growth rate of 6.5 per cent registered in FY2008-09. The sector's performance was hampered by lack of infrastructure, particularly by severe power outage and natural gas shortage, as well as the ongoing economic crisis. Within the industrial sector, growth rate of the manufacturing sub-sector (contributing 17 per cent in the incremental GDP) experienced significant slowdown. The sector posted a growth of only 5.7 per cent in FY2009-10 against 6.7 per cent in FY2008-09.

[1]'Tangible' sectors of the economy, as defined by the BBS, include Agricultural sector (both Agriculture & Forestry and Fisheries), Mining & Quarrying, and Manufacturing. The rest of the sub-sectors are defined as 'Intangible.'

Performance of the services sector has been consistently good. In FY2009-10, the sector recorded a 6.4 per cent growth compared to 6.3 per cent in FY2008-09. Among the nine sub-sectors of this sector, only three experienced lower growth performance compared to the previous fiscal year; these are: wholesale and retail trade, transport and communication, and financial intermediaries.

1.3.3 Per Capita Income

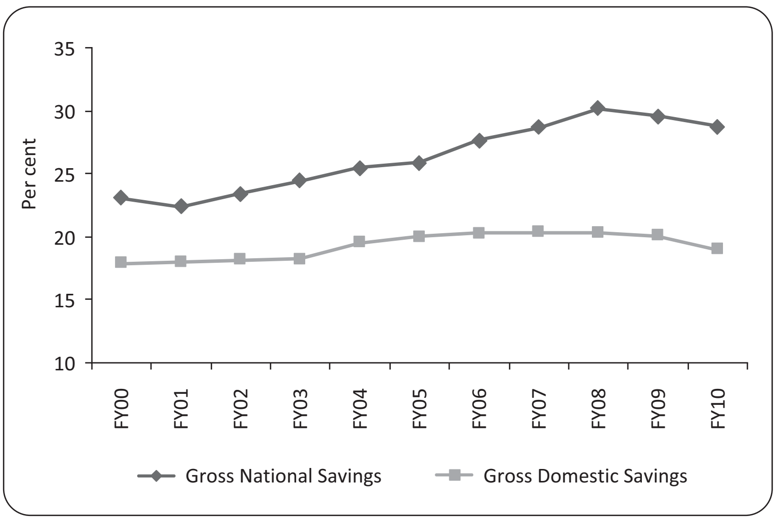
The projected growth would indicate a per capita GDP growth of about 4.5 per cent over the previous fiscal year

Per capita GDP of Bangladesh was estimated to be about USD 685 in FY2009-10, while per capita gross national income (GNI) was estimated to be about USD 751. In Taka terms (1995-96 constant prices), the projected growth would indicate a per capita GDP growth of about 4.5 per cent over the previous fiscal year. The per capita GNI growth was expected to be higher at 5 per cent during the same period. The growth in GNI was primarily attributed to high remittance flow in FY2009-10. However, it should be noted here that these averages conceal the considerable gap in income distribution in Bangladesh. At the same time, it is also pertinent to mention here that an increase in incremental share of agriculture sector in GDP might have helped contain the rise in income inequality.

1.3.4 Savings

Share of domestic savings in GDP has stagnated in the recent past. In FY2009-10, domestic savings as a percentage of GDP experienced substantial deceleration from 20.1 per cent in FY2008-09 to 19 per cent (Figure 1.3). Price hike of essential items in the second half of FY2009-10, particularly of food items, was perhaps a contributing factor to this decline.

Figure 1.3: Savings Rate as Percentage of GDP



Source: Estimated from BBS (2010b) data.

At the same time, due to a slowdown in remittance inflow during the latter half of FY2009-10, national savings as a share of GDP have decelerated to reach 28.8 per cent of GDP, as against 29.6 per cent in FY2008-09. This fall was equivalent to a reduction of 0.8 per cent of GDP in FY2009-10. It is to be noted here that, a wide gap exists in Bangladesh between national and domestic savings, equivalent to 9.8 per cent of GDP. Continuation of this trend, however, may result in further deterioration in the income distribution scenario of the country because remittance, though critically important to poverty alleviation in Bangladesh, is an inequalising factor in the society.

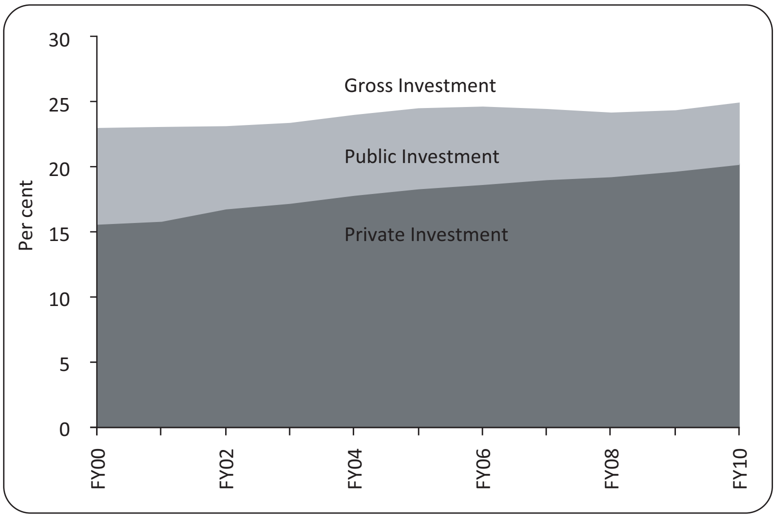
1.3.5 Investment

Gross capital formation, in terms of FY1995-96 prices, registered lower growth rate in FY2009-10, posting 5.8 per cent compared to 6.2 per cent in FY2008-09. This was much lower than the relevant general trend which hovers between 8 to 9 per cent. As mentioned earlier, investment in FY2009-10 had suffered from both lack of infrastructure and lagged impact of global recession. There was a marginal improvement in gross investment as percentage of the GDP, recording 25 per cent in FY2009-10 compared to 24.4 per cent of GDP in FY2008-09

(Figure 1.4). This was higher than the pessimistic target of the Medium Term Macroeconomic Framework (MTMF) which was set at 23.7 per cent of the GDP.

Improvement in the implementation pace of ADP is underwritten by somewhat higher realisation of public investment. Public investment stood at 4.8 per cent of GDP in FY2009-10, insignificantly higher than 4.7 per cent recorded in FY2008-09. The share of private investment in GDP which covers four-fifths of total investment in the country also increased to 20.2 per cent in FY2009-10 from 19.7 per cent in FY2008-09. The proposed modality to boost investment through projects mainly under the PPP initiative, held back any substantive improvement in the investment scenario (Box 1.2).

Figure 1.4: Investment as Percentage of GDP



Source: Estimated from BBS (2010b) data.

Box 1.2: Unrealised Public-Private Partnership (PPP)

The PPP component of the FY2009-10 budget was unveiled with great excitement, but was hardly able to take off the ground. With a PPP investment target of Tk. 7,000 crore, government had earmarked an amount of Tk. 2,500 crore separately under the PPP budget. Later on, Tk. 500 crore was slashed from the PPP budget in the revised budget for FY2009-10. However, the PPP budget has remained mostly unutilised in spite of some progress being made in terms of putting in place the regulatory framework.

At the end of FY2009-10, the government was finalising the PPP Policy Guideline following the submission of the report by the committee set up to review the earlier draft prepared by the Board of Investment (BoI). The envisaged guideline was likely to incorporate some provisions of the Private Sector Infrastructure Guidelines 2004 relating to transparency modalities with regard to profit-sharing allocation of risks, responsibilities, mode of operation in terms of structure of ownership (Build-Own Operate (BOO), Build-Operate-Transfer (BOT), Build-Own-Operate-Transfer (BOOT)). In FY2009-10, the PPP policy guideline did not see the light of the day in spite of repeated promises.

The Centre for Policy Dialogue (CPD) in its interim review of macroeconomic performance of FY2009-10 made a number of recommendations related to the envisaged PPP policy guideline (CPD 2010).

- To harmonise the dichotomy of public and private interests, appropriate legislation should be enacted in order to provide both the parties (government and civil society) necessary legal coverage.
- The government could contemplate on developing a legal framework to put the PPP agenda in effect. Lessons can be drawn from other countries such as Mauritius which has both (a) PPP Act laying out the principles guiding public-private relations; and, (b) a comprehensive document dictating the PPP programmes of action.
- According to the Private Sector Infrastructure Guidelines 2004, institutional framework and organisational structure for designing projects (which includes seven stages starting from identification to construction of the project) are generally quite cumbersome. To accelerate the process of project implementation, the new policy guideline needs to engineer a comprehensive framework in order to ensure competent administration, regular monitoring and sound accountability.
- Furthermore, the envisaged policy guideline should provide transparent time-lines dependeing on project categories. A separate PPP office, vested with adequate power and endowed with human resources, will need to be set up in order to generate the required momentum.
- Government will need to design an appropriate PPP strategy which should have clear guidelines for financial participation of the government, incentives and risk-sharing arrangement with private investors, and institutional framework for implementing the PPP.
- The PPP strategy should also have clear cut guidelines for appraisal of the proposed PPP projects and the procedure that will be followed for approval of the identified projects. The procedure for both appraisal and approval of different projects according to scale and size (three slabs had been identified for this purpose) should also be spelt out clearly and distinctly.

National savings rate as percentage of GDP remains higher (28.8 per cent) than the gross investment rate (25 per cent), indicating the availability of investible surplus. The surplus was estimated to average about Tk. 26,000 crore (3.8 per cent of GDP). This gap primarily originates from the lack of investment demand and limited scope to channel remittances towards investment.[2] Compared to countries such as India and Vietnam, investment scenario in Bangladesh looks rather depressing; these countries invest about 40 per cent of their respective national incomes. Bangladesh will need to substantially improve both savings rate and investment to attain higher GDP growth rate.

Compared to countries such as India and Vietnam, investment scenario in Bangladesh looks rather depressing

The incremental capital-output ratio (ICOR) which indicates efficiency of capital and levels of productivity was high at 4.24 in FY2009-10. In recent years the ICOR has tended to remain at the same level. In absence of significant rise in investment and consequent productivity growth, it will not be possible for Bangladesh to accelerate her growth rates. Thus, the need for ensuring higher rates of investment to attain higher GDP growth rate and the necessity of taking adequate measures to raise capital productivity cannot be overemphasised. This also underscores the need for the government to go for higher allocation of resources in large scale infrastructure development projects which could crowd in private sector investment. In view of this, a prudent and investment-friendly interest rate policy is critically important. In this regard, of the interest rate implications for attracting savings generated from the interest are also something which should inform policy choices. However, from policy perspective, maintaining a realistic spread between lending and deposit rates will be the important concern.

Two factors helped maintain macroeconomic stability with lower fiscal deficit: commendable revenue mobilisation and underutilisation of ADP allocation

1.4 PUBLIC FINANCE

Fortunately, FY2009-10 has been the second year in a row without any major incidence of natural disasters in Bangladesh. At the same time, as was the case in FY2008-09, prices in the global market were relatively low, owing to slump in global demand. As a result, public expenditure also happened to be lower than the target and trend levels. Two other factors also helped maintain macroeconomic stability with lower fiscal deficit: (a) commendable revenue mobilisation efforts, especially by the NBR; and (b) underutilisation of ADP allocation, even though ADP implementation was relatively better in FY2009-10 compared to the historical trends.

1.4.1 Revenue Earnings

Against the targeted increase of 23.1 per cent in total revenue collection, revenue mobilisation was only 15.4 per cent higher in FY2009-10 compared to FY2008-09. In case of revenue earnings two different trends were observed. First, NBR has maintained impressive growth performance. Second, achievements in non-NBR tax collection and non-tax collection were far from satisfactory. Revenue-GDP ratio has, however, improved from 10.5 per cent in FY2008-09 to 10.9 per cent in FY2009-10. Tax-GDP ratio on the other hand stood at 9.1 per cent against 8.6 in FY2008-09, showing some positive achievement.

Revenue-GDP ratio has improved from 10.5 per cent in FY2008-09 to 10.9 per cent in FY2009-10

NBR Revenue

In order to finance the higher expenditure target for FY2009-10, the budget for the fiscal year relied heavily on resource mobilisation by the NBR. Accordingly the

[2] There is, however, a debate with regard to the actual size of this gap. It is often argued that the practice of including all of the remittance flow as savings is somewhat misleading, since a part of remittance goes for consumption as well. If this be the case, national savings would be lower than what is generally estimated.

target set for the NBR was set at the high levels of Tk. 61,000 crore for FY2009-10, which was 21.5 per cent higher than the actual collection of FY2008-09. NBR, however, was able to achieve a growth of 18.9 per cent over the previous year, (Table 1.2), with total collection amounting to Tk. 59,719 crore at the end of the fiscal year.[3]

Table 1.2: Targeted and Actual Growth in NBR Tax Components

(in Per cent)

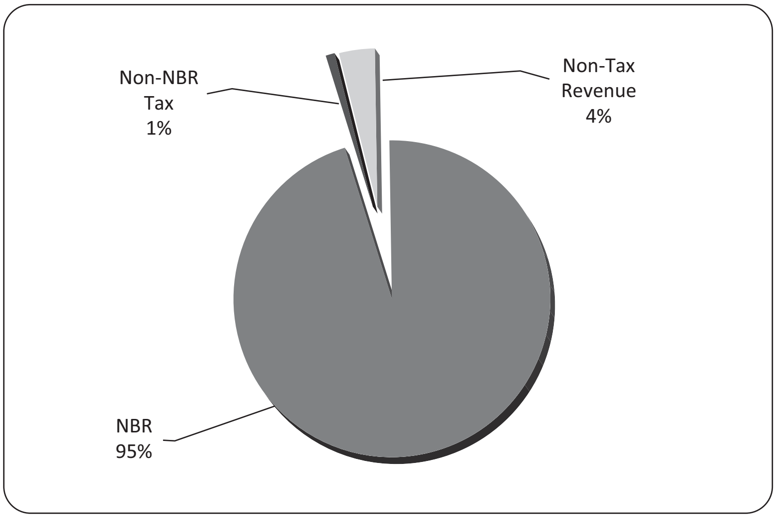
Component	Actual Growth in FY2009	Growth in FY2010	
		Budget	Actual
Income Tax	15.1	23.3	20.8
VAT	13.1	19.2	20.6
Import Duty	-3.7	23.6	5.0
Supplementary and Excise Duty	10.1	22.8	26.5
Electricity and Others	-5.4	6.7	11.8
Total NBR	**9.6**	**21.5**	**18.9**

Source: MoF (2010b).

In case of income tax collection in FY2009-10, though the target could not be achieved, the actual collection was significantly higher, at 20.8 per cent compared to FY2008-09. This robust growth was also possible due to an addition of 0.13 million new taxpayers (0.8 million in total) in FY2009-10 over the previous year, while income tax rates remained unchanged.

Among the other major heads, collection of import duty fell short of the target by a significant margin, realising only 5.0 per cent growth against the target of 23.6 per cent. This has happened in the face of lower imports that have taken place during FY2009-10, due to the depressed investment situation prevailing in the domestic economy, and also lower levels of imports of food items. On the other hand, supplementary duty (SD) collection by the NBR surpassed the target and attained a 26.5 per cent growth[4] (10.1 per cent growth was recorded in FY2008-09).

Figure 1.5: Incremental Contribution in Revenue Earning by Major Heads



Source: MoF (2010b).

Non-NBR Tax and Non-tax Revenue Collection

Both non-NBR tax and non-tax revenue collection fell short of their respective targets in FY2009-10 by a significant extent; the increase posted in FY2008-09 was not notable. In FY2009-10, non-NBR tax and non-tax revenue collection[5] rose only by 3.4 per cent and 3.1 per cent respectively, against the targets of 11.4 per cent and 32.5 per cent.

Overall, total revenue was Tk. 4,937 crore short of target in FY2009-10.[6] Of this, a shortfall of Tk. 3,444 crore was attributed to the non-tax revenue collection, Tk. 1,281 crore to the NBR tax collection and Tk. 212 crore to the non-NBR tax collection. On a different note, achieved revenue growth in FY2009-10 was primarily driven by the NBR; in the total incremental revenue in FY2009-10[7] NBR's share was about 95.4 per cent (Figure 1.5). This has

[3]Data on NBR revenue collection has been taken from the Ministry of Finance for the sake of consistency between earnings, expenditure and deficit figures. According to the data released by the NBR itself, total revenue earnings by the Board for FY2009-10 was actually Tk. 62,007.5 crore, which would indicate a higher than targeted NBR revenue collection for the fiscal year. Traditionally, revenue collection data released by the NBR and the MoF does not match, and this time around a mismatch to the tune of Tk. 2,288.5 crore was observed.

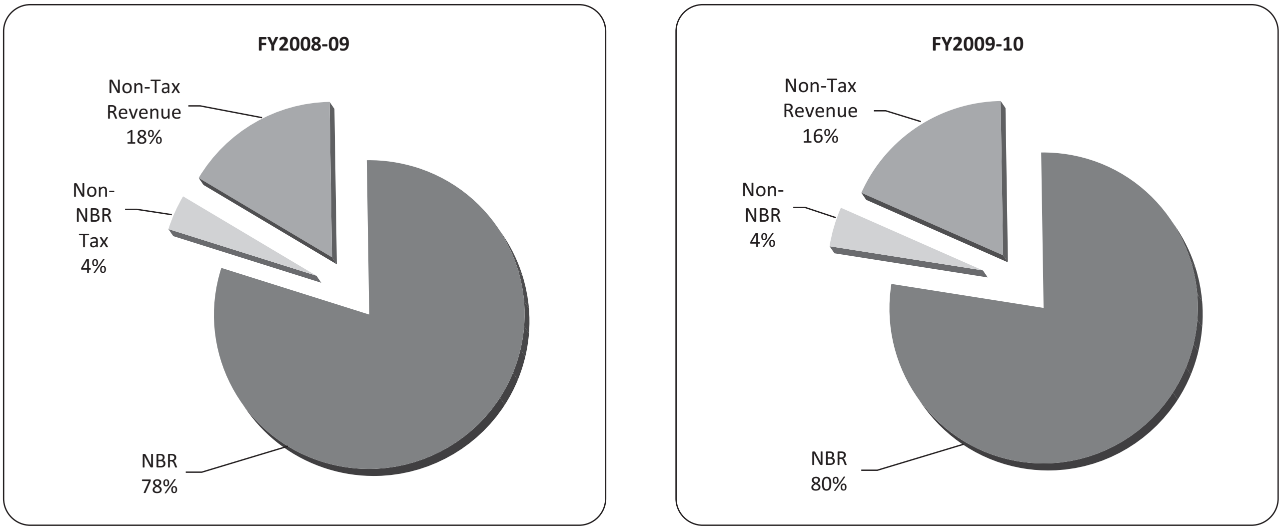
[4]Target growth for SD collection was set at 22.8 per cent for FY2009-10.

[5]During FY2008-09, 14.7 per cent and 3.2 per cent growth were achieved in non-NBR tax and non-tax revenue collection respectively.

[6]In FY2008-09, total revenue earnings fell short by Tk. 4,815 crore.

[7]Revenue earnings in FY2009-10 was Tk. 9,958 crore higher than in FY2008-09.

Figure 1.6: Comparative Share of Revenue Components in Revenue Earnings: FY2008-09 and FY2009-10



Source: MoF (2010b).

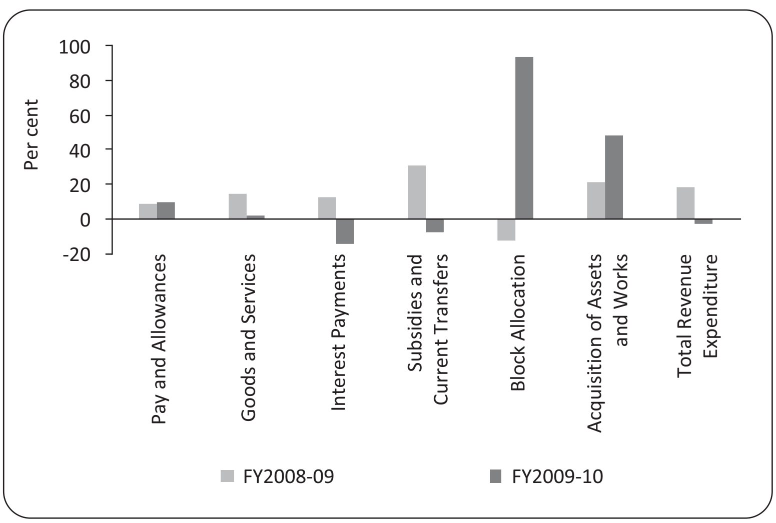
resulted in an increased NBR share of 80.1 per cent in the total revenue collection, which was 77.8 per cent in FY2008-09 (Figure 1.6).

It is to be noted that the revenue structure of Bangladesh has been moving, albeit slowly, towards a more progressive one over the recent years. Further progress in this regard was made when the share of income tax in total revenue increased from 20.8 per cent in FY2008-09 to 21.8 per cent in FY2009-10.

1.4.2 Revenue Expenditure

Revenue expenditure in FY2009-10 was lower compared to budgetary allocations. This has benefited the economy in a number of ways. No extraordinary or urgent expenditure had to be incurred on account of disaster management. Notwithstanding the higher food import than in FY2008-09, prices remained lower than the peak of 2008. Lower import prices arising from the suppressed demand situation in the global market kept the subsidy requirement lower in the economy. Consequently, total revenue expenditure[8] in FY2009-10 stood at Tk. 62,511 crore which was Tk. 10,468 crore less than what was anticipated in the budget.[9] Actual revenue expenditure of FY2009-10 in fact declined by 2.3 per cent compared to FY2008-09 (Figure 1.7).

Figure 1.7: Growth in Revenue Expenditure: FY2008-09 and FY2009-10



Source: MoF (2010b).

Revenue expenditure in FY2009-10 under all three major heads[10] was lower than projections made in the budget. Against

[8]Refers to 'Augmented Non-development Revenue Expenditure' (including Acquisition of Assets and Works) without adjusting for recoveries. Budget for FY2009-10 targets Tk. 1,205 crore as recoveries. However, actual recovery figures were not available.

[9]The FY2009-10 budget envisaged revenue expenditure of Tk. 72,979 crore.

[10]'Pay and Allowances,' 'Interest Payments,' and 'Subsidies and Current Transfers' – these three heads together constituted 81.9 per cent of the total revenue expenditure of FY2009-10 (84.2 per cent in FY2008-09).

the projected increase of 15.3 per cent, expenditure on Pay and Allowances increased by 9.8 per cent in FY2009-10 compared to the previous fiscal year. On the other hand, expenditure on Interest Payments and Subsidies and Current Transfers recorded a decline since FY2008-09, and achieved negative growth rates of (-) 14.1 per cent and (-) 7.5 per cent respectively[11] in FY2009-10 (Figure 1.7).

Surplus in the revenue balance eased the task of keeping the budget deficit at a manageable level during FY2009-10

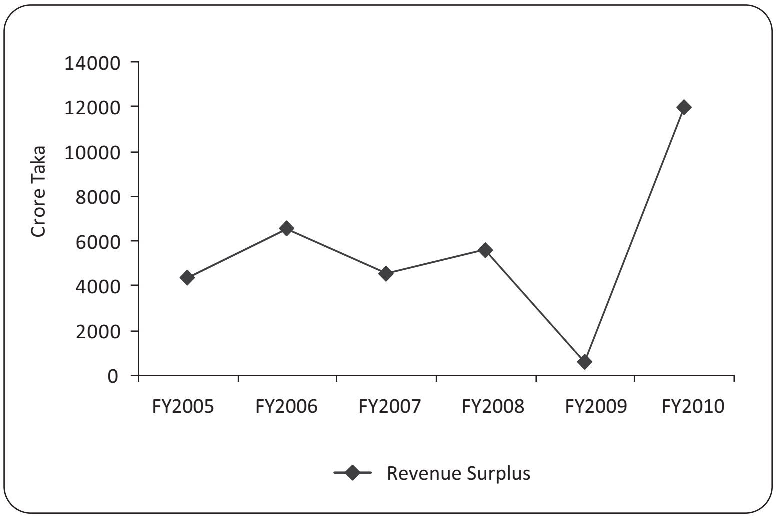
Expenditure on block allocation was set to increase significantly as per the FY2009-10 budget. This was due to an allocation of Tk. 2,500 crore for PPP projects and implementation of the new pay-scale. Total block allocation kept in the budget for FY2009-10 was of Tk. 4,288 crore.[12] However, as the allocation for PPP projects remained unspent, an amount of only Tk. 358 crore was spent in FY2009-10 from the block allocation.

1.4.3 Revenue Surplus

Reasonable achievements in revenue collection, thanks to the impressive performance of the NBR, and lower-than-anticipated revenue expenditure resulted in a significant revenue surplus[13] (as opposed to the historical trend) in FY2009-10. Against a revenue surplus of only Tk. 604.9 crore in FY2008-09, revenue surplus stood at Tk. 12,014 crore in FY2009-10 (Figure 1.8). This was, as a matter of fact, the highest ever.

To some extent, the surplus in the revenue balance eased the task of keeping the budget deficit at a manageable level during FY2009-10.

Figure 1.8: Trend in Revenue Surplus: FY2004-05 – FY2009-10



Source: MoF (2010b).

1.4.4 Annual Development Programme (ADP)

An ADP of Tk. 30,500 crore was undertaken for FY2009-10, which was later revised downward to Tk. 28,500 crore in the revised ADP (RADP).[14] At the end of the fiscal year an amount of Tk. 25,921 crore was actually spent on account of the ADP. This implies that in monetary terms, 85 per cent of the original ADP was actually implemented in FY2009-10.[15] This was a significant improvement over FY2008-09 when the implementation rate was 77 per cent. Only 73.6 per cent of the original project aid was spent in FY2009-10 (65.2 per cent in FY2008-09) as opposed to 93.3 per cent expenditure of the allocated local resources spent in FY2009-10 (87.3 per cent in FY2008-09).

85 per cent of the original ADP was actually implemented in FY2009-10

Among the top five ministries which received relatively high allocations in the original ADP compared to other ministries, the Ministry of Primary and Mass Education and the Local Government Division performed exceptionally well by

[11] Targeted growth rates were 2.9 per cent for Interest Payments, and 4.5 per cent for Subsidies and Current Transfers.
[12] Actual expenditure on block allocation was Tk. 184 crore in FY2008-09.
[13] Revenue surplus is accounted by deducting the revenue expenditure from the revenue earnings.
[14] Original ADP of FY2009-10 was 54.8 per cent larger than the implemented ADP of FY2008-09. The RADP was 44.7 per cent larger than the implemented ADP of FY2008-09.
[15] Including allocations for unapproved projects.

Table 1.3: Incremental Contribution of Ministries/Divisions in ADP Allocation and Expenditure

(in Per cent)

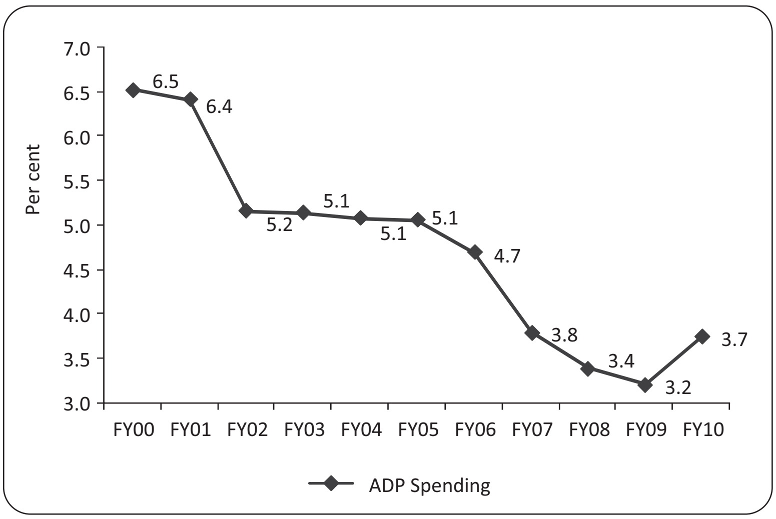
Ministry/Divisions	Incremental Share in Allocation Growth (Original ADP)		Incremental Share in Expenditure Growth	
	FY2009	FY2010	FY2009	FY2010
Top Five Ministries				
Local Government Division	36.3	26.6	35.0	30.0
Ministry of Communication	34.1	15.0	-9.7	18.7
Power Division	33.4	-7.0	-12.1	-5.1
Ministry of Health and Family Welfare	14.4	13.2	16.5	6.4
Ministry of Primary and Mass Education	-13.3	9.4	5.3	10.9
Other Ministries	-4.9	42.8	64.9	39.0

Source: IMED (2010).

spending of 96.5 per cent and 103.8 per cent[16] of their respective allocations. The Ministry of Health and Family Welfare (MoHFW) and the Ministry of Communication[17] demonstrated below average performance with expenditures of 78.6 per cent and 79 per cent of their respective allocations. Power Division was one of the worst performers, with an actual expenditure of only 63.3 per cent of the allocated resources. In recent years, despite the need for investment in power infrastructure, the inability of the Power Division to utilise the allocated funds has, in fact, held back the overall delivery of the ADP. Indeed, in the last two years (FY2008-09 and FY2009-10), the Power Division's incremental contribution to the overall growth in ADP expenditure was negative (Table 1.3).

Overall, the 33 ministries under the Medium Term Budgetary Framework (MTBF), however, performed quite well with an average resource utilisation rate of 94.1 per cent. This has been the first time when ministries under MTBF have demonstrated reasonably higher than average rate of implementation since MTBF came into force in FY2005-06.

Figure 1.9: Actual ADP Spending as Per cent of GDP



Source: Estimated from IMED (2010); MoF (2010a) data.

ADP expenditure in FY2009-10 marked a noteworthy growth of 31.6 per cent over the actual expenditure of FY2008-09. As a result, ADP as a percentage of GDP improved, albeit marginally, in FY2009-10 and stood at 3.7 per cent (as against 3.2 per cent in FY2008-09) (Figure 1.9).

However, the level of ADP delivery remains far from adequate given the overall low level of investment size in Bangladesh (24.3 per cent of GDP). It should also be kept in mind that, besides the quantum and rate of implementation, the quality of project implementation under the ADP is also an important issue that needs to be taken into consideration in the particular context of Bangladesh.

1.4.5 Budget Deficit and Financing

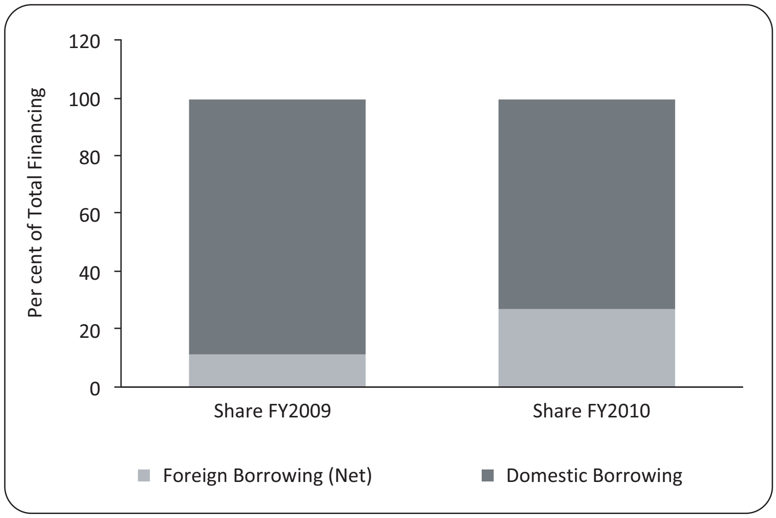
With significant revenue surplus, less than anticipated revenue expenditure, and lower than targeted ADP expenditure, budget deficit in FY2009-10 was significantly lower than projected. In the budget for FY2009-10, a deficit of Tk. 29,228 crore was estimated. Total deficit at the end of the fiscal year, however, stood at Tk. 18,412.3 crore which was lower by Tk. 10,815.7 crore. This

[16] Expenditure of the Local Government Division exceeded the actual allocation by Tk. 246.2 crore.
[17] At present, under two distinct headings: Roads and Railway Division, and Bridges Division.

implies a decline in budget deficit by (-) 19 per cent compared to FY2008-09. It is to be noted that budget deficit in FY2009-10 was only 0.21 per cent of the GDP (3.29 per cent in FY2008-09) whereas the projection for the matched figure was set at 4.3 per cent.

A compositional change in financing the deficit was observed in FY2009-10, reliance on foreign borrowing increased substantially. In FY2009-10 the share of net foreign borrowing in the total deficit financing increased from 11.5 per cent in FY2008-09 to 27.4 per cent in FY2009-10 (Figure 1.10). Foreign financing increased significantly in FY2009-10, by 93.8 per cent, albeit over a low benchmark figure of FY2008-09, and stood at Tk. 5,044.1 crore.

Figure 1.10: Composition of Deficit Financing: FY2008-09 and FY2009-10



Source: MoF (2010b).

In securing local resources in financing the deficit, the government resorted solely to non-bank borrowing despite the prevailing lower inflationary pressure. This reliance was observed notwithstanding the fact that non-bank borrowing tends to be more costly compared to bank borrowing and imposes a burden on the government's exchequer through higher interest payment. As a matter of fact, net bank borrowing during FY2009-10 has been negative (Tk. -2,092.5 crore), while non-bank borrowing posted a remarkable growth of 148.3 per cent compared to FY2008-09. Net financing from the sale of National Savings Directorate (NSD) certificates was almost two and half times[18] of the net sale recorded in FY2008-09.

However, future payment on debt servicing is likely to benefit from the lower budget deficit experienced during the last two years. In fact, FY2009-10 was the second year in a row when budget deficit declined from the previous fiscal year. On the other hand, foreign debt servicing, which as a percentage of GDP has been declining over the last several years, may rise because of the significant growth in foreign financing observed in FY2009-10.

1.5 MONETARY SECTOR

Bumper foodgrain production coupled with falling global prices led to a decline in inflation rate in Bangladesh since September 2008

Global commodity prices have experienced unprecedented volatility since FY2004-05 due to loss of production of major crops in some of the important food producing countries, and diversion of foodgrains for production of ethanol in a number of developed countries including the United States (US) and the European Union (EU). The situation had eased during the second half of 2008 in the face of global financial crisis which contributed to a sharp decline in the aggregate demand in the developed and developing countries. Bangladesh also experienced inflationary pressure in line with the global trend. Bumper foodgrain production coupled with falling global prices led to a decline in inflation rate in Bangladesh since September 2008 when 12-month average inflation rate reached as high as 10.06 per cent, and food and non-food inflation were at 12.63 per cent and 6.01 per cent respectively. After a short spell of respite as evidenced by lower inflation, the country has once again started to feel the pinch of high inflation as FY2009-10

[18]234.6 per cent growth.

set off. This had adverse impact on the day-to-day lives of the common people. Though Bangladesh had successfully navigated the headwinds of the financial crisis and remained largely unaffected by the first wave of the global economic slowdown mainly due to her limited openness to short-term capital flows, robust performance of export sector and remittance flows, creeping inflationary pressure continued to be a challenge for the economy during the year.

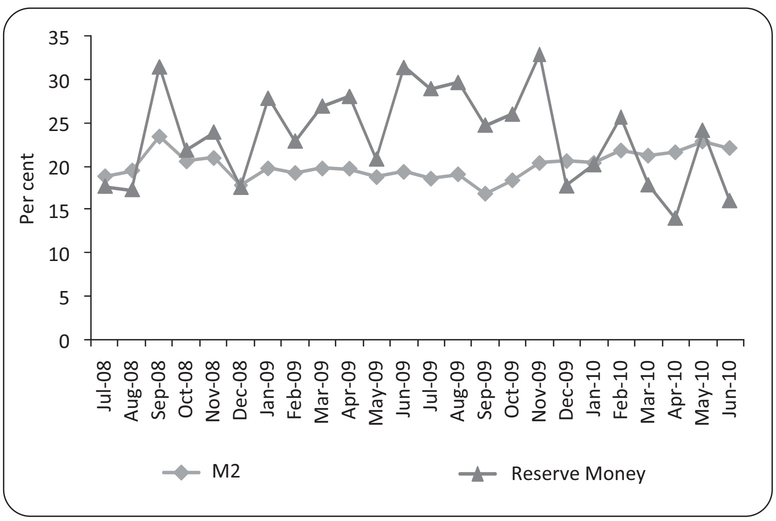
Bangladesh Bank in its Monetary Policy Statement for the first half of FY2009-10, emphasised primarily on growth of credit to support a targeted GDP growth of 6.5 per cent

The emerging challenges in an increasingly uncertain global economic environment required that the monetary policy stance of the country played a key role in stabilising inflation, ensured high rates of economic growth while maintaining an exchange rate which would balance the conflicting interests of exporters and consumers. Taking note of the trends in the global commodity markets, the Bangladesh Bank in its Monetary Policy Statement (MPS) for the first half of FY2009-10 (July-December 2009) emphasised primarily on growth of credit to support a targeted GDP growth of 6.5 per cent; an attempt to reduce money supply was undertaken through raising the cash reserve ratio (CRR). The MPS of Bangladesh Bank for the second half of FY2009-10 (January-June 2010) essentially continued to follow the monetary policy stance of the immediate past period. The following sub-sections provide an overview of the changes with regard to a number of important indicators pertaining to the monetary sector during FY2009-10.

1.5.1 Money Supply and Domestic Credit

Figure 1.11 shows the trend of broad money (M2) and reserve money during FY2008-09 and FY2009-10. At the end of June 2010, M2 rose by 22.18 per cent as opposed to a growth rate of 19.43 per cent in June 2009, and against the target of 15.5 per cent by June 2010 set by the Bangladesh Bank. The growth of reserve money in June 2010 was 16.03 per cent, a significant decline from the 31.45 per cent experienced in June 2009, but much higher than the target of 7 per cent by end of June 2010. The main determinant of this increase in money supply, i.e. net foreign assets component, had experienced an increase of 41.33 per cent during the same period.

Figure 1.11: Growth Rate of Money Supply and Reserve Money



Source: Estimated from *Major Economic Indicators*, various issues.

In May 2010, Bangladesh Bank increased the rate of CRR by 0.5 percentage point in order to dampen the rise of inflation.[19] The decision to increase the CRR was basically a contractionary monetary policy with a view to making credit more expensive. This policy stance was criticised by a number of relevant stakeholders on the ground that it could reduce credit to the private sector. Notwithstanding this rise, growth in domestic credit was higher at 17.89 per cent in June 2010 as opposed to the central bank's target of 15.6 per cent by June 2010. The increase was mainly due to the expansion in credit to the private sector.

[19] Similar measures were taken in 2006 when the central bank resorted to increasing the CRR by 0.5 percentage points (from 4.5 per cent) and statutory liquidity ratio (SLR) by 2 percentage points (from 16 per cent), in order to put a restraint on the money supply.

Past experiences in Bangladesh indicate that a cut in policy rates did not necessarily increase the appetite for credit in the private sector. For example, during the recent past global financial crisis when the interest rate was reduced globally in order to boost the investment and effective demand, Bangladesh Bank also reduced the repo and reverse repo rates in March 2009 by 0.25 basis points, to 8.5 per cent and 6.5 per cent respectively, from 8.75 per cent and 6.75 per cent with the objective of stimulating credit flow to productive activities. This initiative, however, had little success. One could infer from this that in the context of Bangladesh, interest rate was not a major motivating factor for credit demand. In contrast, factors such as effective tax measures and supporting business environment which includes improved infrastructure, adequate availability of energy, and political stability are much more important considerations in terms of attracting investment. The increase in CRR came at a point of time when larger economies around the world started to recover from the setback of the financial crisis. In view of improvements in their economic activities, a number of these countries increased interest rates as a safeguard against inflationary pressure on the economy.

Factors such as effective tax measures and supporting business environment are more important considerations in terms of attracting investment

Bangladesh Bank, through tightening of monetary policy, expects to put some restraint on bank loans going to unproductive sectors as this had a tendency to contribute to inflationary pressure within the economy. However, such a policy ought to be seen as a short-term measure. Credit expansion in the productive sectors may need to be stimulated in view of the uptake of the export and production-oriented sectors and increased disbursement of industrial term loan in FY2009-10.

Tightening of monetary policy ought to be seen as a short-term measure

Domestic credit experienced an increase of 17.89 per cent in FY2009-10 over FY2008-09. The increase in domestic credit during FY2009-10 could mainly be attributed to other public and private sector credit which increased by 20.8 per cent and 24.2 per cent respectively over this period. Increase in credit to the private sector is also reflected in the increase in term loan and working capital, though a major share of this loan may have gone to finance captive power generation.

Industrial term loan disbursement stood at Tk. 25,875.66 crore in FY2009-10 registering an increase of 29.56 per cent when compared to FY2008-09 (Appendix Table 1.1). Except for foreign banks which reflected a negative growth of 76.7 per cent, all other banks showed an increase in term loan disbursement over FY2009-10 compared to the previous fiscal year. Local private commercial banks (PCBs) posted highest growth in disbursement, of almost 55 per cent, with 46.1 per cent growth in loan recovery over the period under consideration.

The central bank has made disbursement of agricultural credit mandatory for all commercial banks

Disbursement of working capital evinced a significant increase of 31.4 per cent, and the recovery also showed a positive growth of 23.59 per cent in FY2009-10. The state-owned commercial banks (SCBs) registered a negative growth of 10.78 per cent in FY2009-10 in case of working capital disbursement compared to FY2008-09. Foreign banks have recorded the highest growth both in case of disbursement of working capital (72.1 per cent) and recovery (almost by 100 per cent) in FY2009-10 compared to the previous year.

The central bank has made disbursement of agricultural credit mandatory for all commercial banks. In light of this, disbursement of agricultural credit in FY2009-10 stood at Tk. 11,116.88 crore compared to Tk. 9,284.46 crore in FY2008-09, indicating a growth of 19.7 per cent. This was mainly due to the additional allocations of the specialised banks such as Bangladesh Krishi Bank (BKB) and

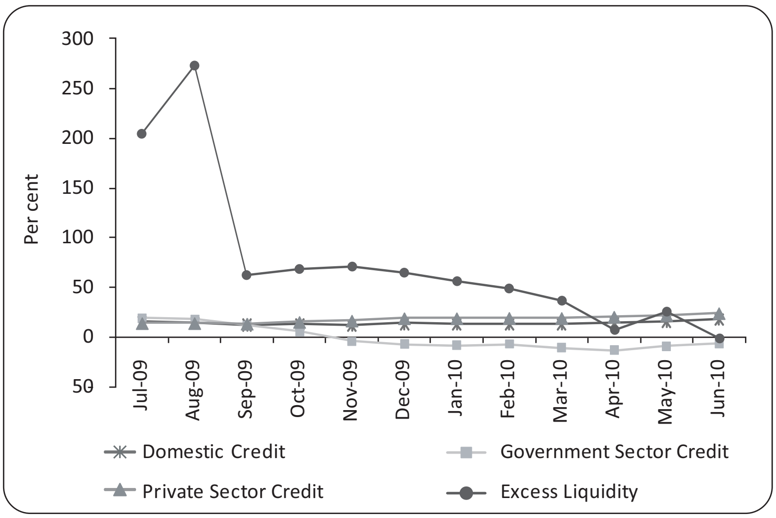
Rajshahi Krishi Unnayan Bank (RAKUB). BKB disbursed a total of Tk. 4,567.17 crore and RAKUB disbursed Tk. 1,060.12 crore, the highest amongst all financial institutions. Crop loan had been highest among all categories of agricultural credit, which contributed to achieve higher food production. Thus, both government and private commercial banks contributed to the enhanced agricultural credit.

Crop loan had been highest among all categories of agricultural credit, which contributed to achieve higher food production

1.5.2 Excess Liquidity

One of the uncomfortable features of the monetary sector in the first few months of FY2009-10 had been the increase of excess liquidity with the scheduled banks which started to increase in FY2008-09. However, during the later months of FY2009-10 the excess liquidity situation eased somewhat primarily because of increased domestic demand. When FY2009-10 is compared with FY2008-09, the growth rate of excess liquidity is negative at (-) 0.8 per cent as opposed to 167.6 per cent in FY2008-09 over FY2007-08. The impact of decline in excess liquidity was reflected in call money rate which went as high as 6.6 per cent in June 2010 compared to 1.7 per cent in June 2009.

Figure 1.12: Growth of Excess Liquidity and Domestic Credit



Source: Estimated from *Major Economic Indicators*, various issues.

Higher growth in domestic credit and lower level of excess liquidity with banks indicate that investment had picked up to some extent after a dull investment scenario during FY2008-09 due to a combination of factors such as anti-corruption drive of the Caretaker Government (CTG), global financial crisis, lack of infrastructural facilities, particularly supply of gas and power, and uncertainties as regards the direction of the country in the near future. Though an increase in private sector credit was observed in FY2009-10 (Figure 1.12), this could be due not only to increase in industrial credit, but also for private consumption, particularly during the festivals.

1.5.3 Loan Default Scenario

In FY2009-10, total classified loan stood at Tk. 23,378.91 crore, registering an increase of 1.8 per cent over FY2008-09. Development financial institutions and foreign banks accounted for an increase of 12.5 per cent and 6.1 per cent respectively in FY2009-10 over the previous fiscal year. Except for the PCBs and SCBs, which were able to make good progress in reducing classified loans by (-) 3.6 per cent and 1.2 per cent respectively during the period under review, none of the other financial institutions were able to show any significant improvement in reducing respective classified loans. In terms of its percentage share in total outstanding loan, net classified loan in all commercial banks has been declining over the last few years. In June 2010 it reached to 1.7 per cent compared to 8.7 per cent in June 2009. On the other hand, the share of total classified loan in total outstanding loan was 12.3 per cent at the end of June 2009. Though it declined to 10.4 per cent at the end of June 2010, the objective of bringing it down to a single digit is yet to be achieved. The high rate of non-performing loan (NPL) with the banks, particularly with the SCBs, reflects the need for significant improvement in services provided by these institutions, in terms of loan quality and efficiency. Evidently, conducting feasibility study of the projects and supervision of loan

Though total classified loan declined to 10.4 per cent at the end of June 2010, the objective of bringing it down to a single digit is yet to be achieved

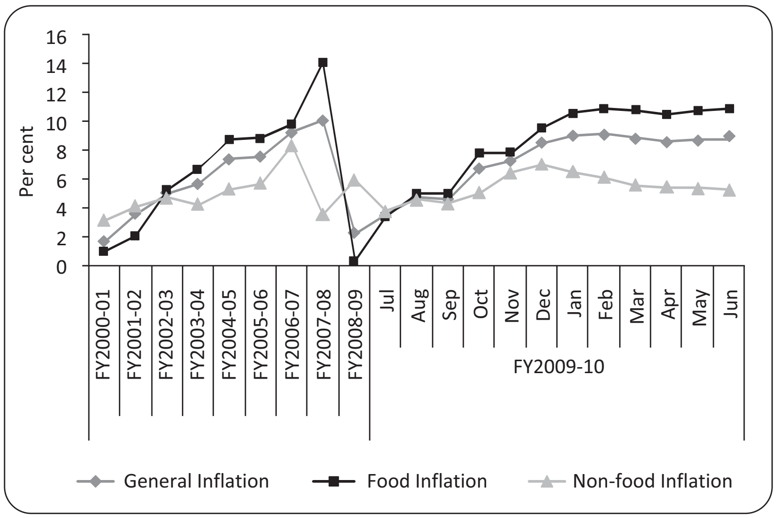
recovery process will have to be significantly strengthened if the amount of NPL is to be reduced. From this perspective, the central bank has instructed the commercial banks to follow up cases of classified loans more closely to correct the existing situation.

1.5.4 Inflation

After a comfortable level of inflation in FY2008-09, the inflationary pressure bounced back once again in FY2009-10

After a comfortable level of inflation in FY2008-09 (thanks to the fall in global commodity prices), the inflationary pressure bounced back once again in FY2009-10. It was increasing almost throughout the fiscal year, and reached at 8.7 per cent in June 2010 compared to 2.3 per cent in June 2009 on a point-to-point basis (Figure 1.13). The 12-month average inflation rate reached to 7.3 per cent in June 2010 as opposed to 6.7 per cent in June 2009 (see Appendix Table 1.1). Food inflation, as always, was above the curve (10.9 per cent on a point-to-point basis, and 8.5 per cent on a 12-month average basis) compared to non-food inflation (5.2 per cent on a point-to-point basis, and 5.5 per cent on a 12-month average basis) in June 2010. Thus, the inflationary trend in FY2009-10 indicates that even though average inflation remained low during the initial months of FY2009-10, the rate of inflation gained pace in the later months. This could have been the result of a number of factors such as implementation of the pay-scale of the government employees, faster rate of ADP implementation during the second half of FY2009-10, continuation of high price of rice (which pushed up food inflation), and high foreign exchange reserves and robust remittance flow into the economy.

Figure 1.13: Point-to-point Inflation Rates



Source: Estimated from BBS (2010a) data.

However, growth in money supply and inflation did not always follow the same direction (Appendix Figure 1.1). Consequently, it is difficult to correlate these two factors, particularly in the absence of any rigorous empirical work towards establishing a relationship between these two.[20] Theoretically, inflation has been associated primarily with interest rate and money supply. Over time, various theoretical models have been developed to rationalise the use of interest rate policies to control inflation rates (Taylor 1993; Svensson 1999). In a bid to facilitate economic growth and control inflation, Bangladesh Bank has been using various tools from time to time, such as repurchase agreement (repo), reverse repo, CRR and SLR. However, striking a balance between inflation and interest rate has always been a challenge for central banks around the globe. Nevertheless, Bangladesh Bank has been pursuing an accommodative monetary policy in line with domestic and international market developments.

Bangladesh Bank has been pursuing an accommodative monetary policy in line with domestic and international market developments

As is known, inflation in Bangladesh is determined mostly by international prices. Though a good harvest of rice is essential for output stability and food security, general price levels tend to rise in tandem with rise in global prices since other

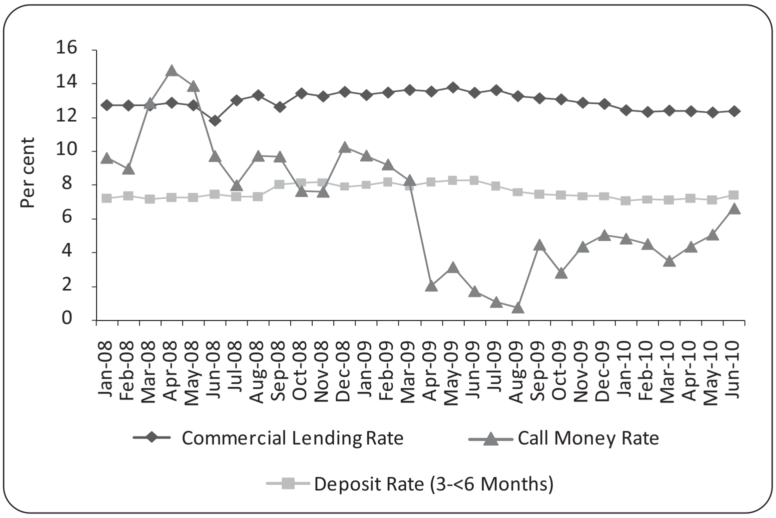
[20] A number of studies have examined various aspects of inflationary situation in Bangladesh (Younus 2009; Ahmed and Mortaza 2005; Mujeri *et al.* 2009). However, these studies have not identified any specific determinants of inflation in Bangladesh.

essential commodities such as wheat, pulses, onion and sugar are mostly imported. Current inflationary pressure tends to be mostly due to supply constraints, and not arising from any significant monetary expansion.

1.5.5 Interest Rate

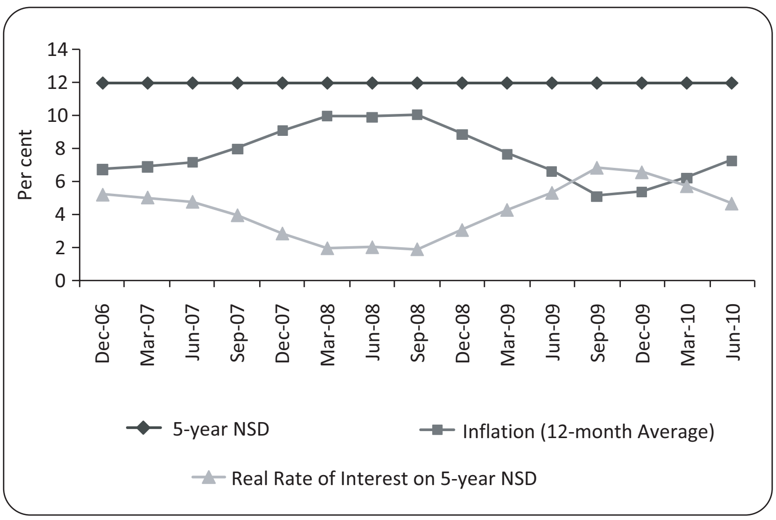
Interest rate has continued to be a debated issue in Bangladesh for quite some time now, since there exists high spread between lending and borrowing rates. In 2008, Bangladesh Bank went as far as to put a cap on the lending rate at 13 per cent. In June 2010, commercial lending rate came down to 12.4 per cent compared to 13.5 per cent in June 2009 (Figure 1.14). Deposit rate had also come down to a 7.4 per cent as of June 2010 compared to 8.3 per cent in June 2009. Though a marginal improvement in terms of reduced interest rate spread was observed in FY2009-10 compared to the previous fiscal, the cut in deposit rate resulted in a shift by small investors to buy more NSD certificates since these guaranteed higher rates of return. NSDs had been a source of good return on funds though the real rate of interest has been on the decline due to inflationary pressure (Figure 1.15). Net sales of NSD certificates increased significantly by about 23 per cent in FY2009-10. Investors also found stock market lucrative since investment in stocks tended to give very high return. The reasons for high interest rate spread in Bangladesh are mainly low efficiency in the banks and high risk of lending. Banking system is yet to be automated fully, and efficiency level in the system is rather low. This increases cost of operation and disbursement and supervision of loans. Besides, since the possibility of loan default is also high, banks are not comfortable to reduce lending rates further which could help narrow down the spread.

Figure 1.14: Lending and Deposit Rates



Source: Estimated from *Major Economic Indicators*, various issues.

Figure 1.15: Real Rate of Interest



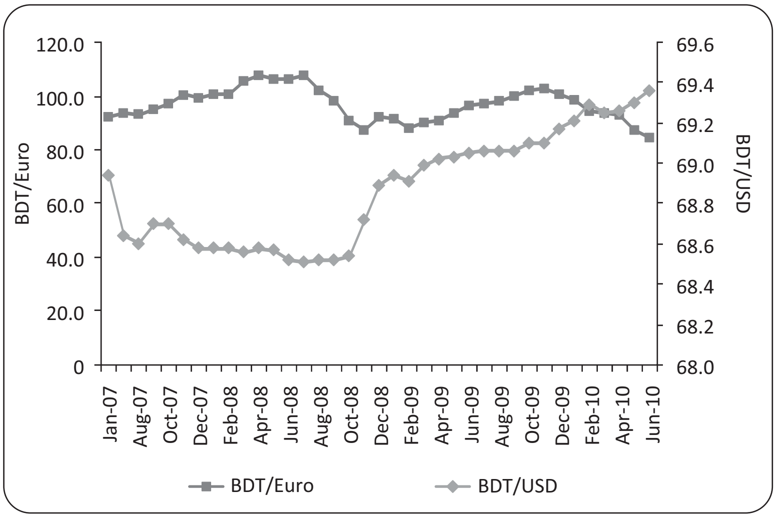
Source: Estimated from *Major Economic Indicators*, various issues.

1.5.6 Exchange Rate

Exchange rate management in Bangladesh context is a difficult task because of the multidimensionality of its impact on the economy and the trade-offs that it entails. Bangladesh has been maintaining a stable exchange rate for a long period. It is often alleged that the policy to maintain stability of exchange rate and protect the benefit of exporters and remitters, may have contributed to higher foreign exchange reserves in Bangladesh in recent years.

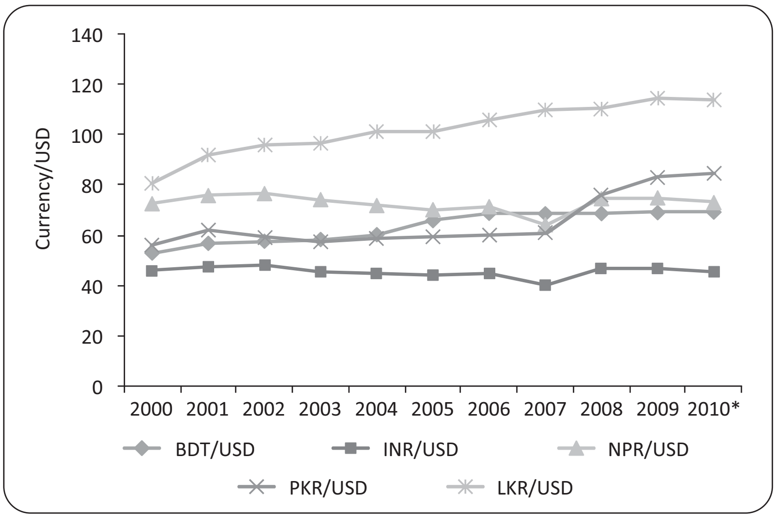
The exchange rate between Bangladesh Taka (BDT) and the United States Dollar (USD) has remained fairly stable in FY2009-10. The BDT depreciated by a small amount against USD to Tk. 69.36 as of June 2010, when compared to Tk. 69.05 in June 2009 (Figure 1.16). There is no Euro/BDT market in Bangladesh and Euro/BDT rate is calculated from the traded rates of USD/BDT. The BDT has appreciated against Euro from Tk. 96.78 in June 2009 to Tk. 84.71 as of June 2010. The BDT has also appreciated against the Indian Rupee (INR), Nepalese Rupee (NPR), Pakistani Rupee (PKR) and Sri Lankan Rupee (LKR) (Figure 1.17). As for the real effective exchange rate (REER) of BDT against USD, it has traditionally been lower than the nominal effective exchange rate (NEER), and there was no exception to this in FY2009-10.

Figure 1.16: Exchange Rates



Source: Estimated from www.onada.com data.

Figure 1.17: Movement of Currencies against USD



Source: Estimated from www.oanda.com data.

Note: *Up to June 2010.

1.5.7 Policy Implications

Monetary sector policies of a country are driven by both domestic and global factors. The purpose of monetary policy in countries such as Bangladesh is not only to achieve growth, but to eradicate poverty and reduce inequality. At present Bangladesh Bank is striving to achieve these objectives through encouraging increased credit to sectors such as agriculture and small and medium enterprises (SMEs). These initiatives are considered to be critical to fulfil the objectives of meeting the needs of those who are lagging behind and are important agents for change in the country. At the same time, the central bank also has a role in helping achieve high growth through higher investment, managing exchange rates to encourage exporters, importers and remitters, utilising foreign exchange reserves prudently, using excess liquidity productively, and containing the inflation growth rate. Along with pursuing the accommodative monetary policy, institutional reforms in the financial sector will also need to be continued. This is needed to instil dynamism and improve efficiency in the market.

Inflation started to pick up in the later part of the fiscal year

The overall performance of the monetary sector has been mixed in FY2009-10. Though inflation rate experienced downward trend in the first few months, it has started to pick up in the later part of the fiscal year. Foreign exchange reserves also reached a record high level and domestic credit had increased significantly. Future monetary policy stance of Bangladesh Bank will have to take measures to keep inflation rate down since the increasing domestic prices, rise in global commodity prices and high foreign exchange reserves may put further pressure on the inflationary situation in the country.

The current inflationary pressure is mainly due to supply side constraints, and hence contractionary monetary policy is likely to have limited impact in terms of containing inflationary trends in the economy. The average inflation for the FY2009-10 was targeted at 6.5 per cent by Bangladesh Bank in its MPS for the period of January-June 2010 (Bangladesh Bank 2010b). Though Bangladesh Bank has stated that the monetary policy stance of the government is to sustain broad-based economic growth and contain inflation within 'tolerable moderate levels,' restraining the rising inflationary trends is likely to prove to be a daunting task in the coming months. It will warrant prudent use of weapons from the government's armoury of monetary management in the short and medium-term, keeping an eye on the fast changing domestic investment scenario and volatilities in the global market.

Contractionary monetary policy is likely to have limited impact in terms of containing inflationary trends in the current situation of the economy

1.6 REAL SECTOR

1.6.1 Agriculture and Food Security

In FY2009-10, five major features were observed with respect to the agriculture sector and food security situation in the country. These were: (i) attainment of self-sufficiency in rice production and highest ever level of production of foodgrains; (ii) improvement in delivery mechanism for public support and agricultural inputs to the farmers; (iii) increase in per capita availability of foodgrains; (iv) vulnerability of *haor* areas due to early flash flood; and (v) dampened enthusiasm of potato growers because of low price.

In FY2009-10, a major feature with respect to the agriculture sector and food security situation was attainment of self-sufficiency in rice production and highest ever level of production of foodgrains

Self-sufficiency in Rice Production

According to the final estimates of the BBS, production of Aus rice in FY2009-10 was 1.7 million metric tonnes (MT), which was 9.8 per cent lower than the actual production in FY2008-09, and 31.4 per cent lower than the target. On the other hand, production of Aman rice in FY2009-10 was 12.2 million MT which was 5.1 per cent higher than the actual production in FY2008-09, but 4.2 per cent lower than the targeted production. Production of Boro rice in FY2009-10 has experienced some negative shocks, but also witnessed some positive developments. Negative shocks included damage to seedlings because of fog and cold at the beginning of the season, damage of 51,000 hectares (ha) of paddy fields in *haor* areas due to early flash flood, and diversion of rice producing land to tobacco production in a number of districts in the northern and western parts of Bangladesh. On the other hand, positive developments included balanced use of fertiliser in response to reduction in administered price of non-urea fertilisers, good sunlight and weather condition[21], and use of relatively young rice seedlings and in lesser number as advocated by agronomists.[22] Despite all the aforesaid factors, total production of Boro rice was 18.3 million MT in FY2009-10, which was 3 per cent higher than FY2008-09, and 3.5 per cent lower than the revised target. Wheat production was 0.9 million MT in FY2009-10 which was 6.1 per cent higher than that of FY2008-09, but 12 per cent lower than the target. Thus, total production of foodgrains (rice and wheat) in FY2009-10 was 33.2 million MT.[23] In

Production of Boro rice in FY2009-10 has experienced some negative shocks, but also witnessed some positive developments

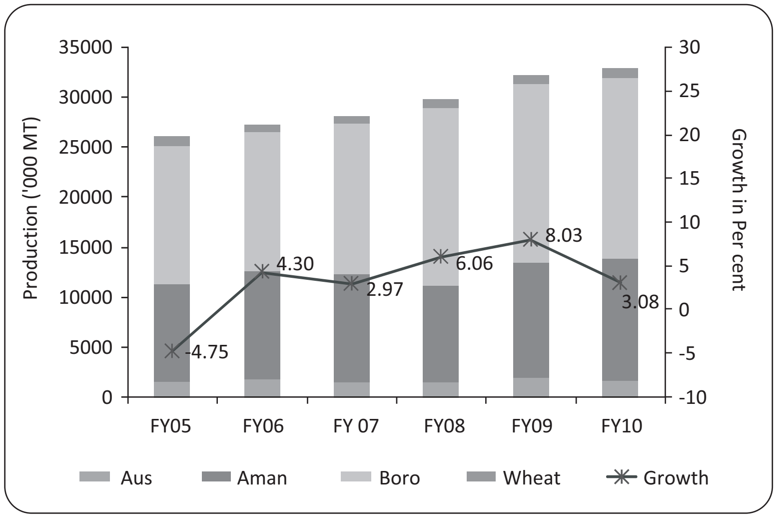
[21]This was helpful to enhance photosynthesis by Boro rice plants which helped attain higher productivity.

[22]The so called system of rice intensification (SRI) which ensures better crop growth and yield.

[23]According to BBS (2009), total production of foodgrains in FY2008-09 was 32.16 million MT, comprising 31.31 million MT of rice (Aus: 1.89 million MT; Aman: 11.61 million MT; Boro: 17.81 million MT), and 0.85 million MT of wheat. In FY2008-09, compared to FY2007-08, production of foodgrains was 8.03 per cent higher while rice production was 8.25 per cent higher.

other words, total rice production (32.3 million) in FY2009-10 was 3 per cent higher than last year, but 6.1 per cent lower than the revised target of FY2009-10. Total production of foodgrains in FY2009-10 is 3.1 per cent (Figure 1.18) higher than that of last fiscal year, but 6.3 per cent lower than the revised target. It may be noted here that the annual compound growth rate in production in the 2000s (FY2001-02 to FY2008-09) was 3.2 per cent for rice and 2.6 per cent for total foodgrains, and negative (-11.3 per cent) for wheat. Continuing rising trend in production in FY2009-10 has led to the highest ever level of foodgrain production in Bangladesh. This has enabled Bangladesh to attain self-sufficiency in rice production in FY2009-10.

Figure 1.18: Estimated Production of Foodgrains in FY2009-10



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

Delivery Mechanism for Public Support and Agricultural Inputs

Introduction of a number of important measures resulted in notable improvement in the transfer mechanism for public support and input delivery to farmers. Measures that were introduced and implemented by the government in FY2009-10 included introduction of Agro-inputs Assistance Cards for farmers, disbursement of diesel subsidy directly to farmer's bank account, free electricity for irrigation to compensate for the early drought in the monsoon season, new mechanism for fertiliser delivery, and collateral-free credit for tenant farmers. The government also continued 20 per cent subsidy for electricity used by irrigation pumps, and raised the amount of agricultural credit for the farmers.

Total production of foodgrains in FY2009-10 is 3.1 per cent higher than that of the last fiscal year

Agro-inputs Assistance Cards

The MoA distributed Agro-inputs Assistance Cards (Krishi Upakaran Sahayata Card) to 18.2 million farmers across the country in FY2009-10. This will from now on be used to support small and medium-sized farmers directly, both in kind and cash. The card contains detailed personal information about the farmers along with their requirement of inputs such as seeds, fertiliser, pesticides, agricultural credit and the provision for irrigation subsidy. It is to keep record of the amount of subsidy given to the farmers in each season as well. The government has provided a unique identity number to each of the cardholders. A national farmers' database is being planned to be set up based on these cards. It was also decided that input subsidy will be delivered to cardholders only through banks. This initiative will be helpful in enhancing efficiency and transparency in the distribution mechanism, and needs to be appreciated.

Input subsidy delivered through banks using Agro-inputs Assistance Cards will be helpful in enhancing efficiency and transparency in the distribution mechanism, and needs to be appreciated

Farmer's Bank Account

As a complementary measure to the Agro-inputs Assistance Card, Bangladesh Bank has directed the SCBs and specialised banks to allow farmers to open accounts with an initial deposit of Tk. 10 to get input subsidies without hassle. Opening of such an account does not require keeping a minimum balance as security, and no one has to identify the account holder either. According to the Bangladesh Bank data more than nine million farmers have opened bank accounts in FY2009-10. Given the large number of people to be covered under this programme, logistical support will need to be expanded considerably.

Subsidy for Diesel and Electricity Used in Irrigation

The initiative to increase subsidy for diesel-operated irrigation system in Boro rice cultivation and continuation of subsidy on electricity for irrigation are commendable measures

The initiative to increase subsidy for diesel-operated irrigation system in Boro rice cultivation and continuation of 20 per cent subsidy on electricity for irrigation are indeed commendable measures. The government has decided to provide diesel subsidy to 9.1 million Boro rice cultivating marginal, small and medium farmers.[24] Accordingly, the government has distributed Tk. 750 each in FY2009-10 to all the deserving farmers through their respective bank accounts.

Subsidy for Agricultural Machinery Purchase

The MoA introduced subsidy for purchase of agricultural machinery to raise productivity and encourage the use of modern equipments. A new project titled *Enhancement of Crop Production through Farm Mechanisation*, with an allocation of Tk. 150 crore, was introduced in FY2009-10. Under the project, farmers of 237 upazilas in 25 districts were to receive 25 per cent subsidy on the cost of buying agricultural machineries (tractors, power tillers, thrashers for rice and wheat, and transplanters) to boost crop production and reduce post-harvest losses. However, the government eventually reduced the allocation for this project and revised this downward to Tk. 15 crore for FY2009-10. Another project to install deep tube-wells (2nd phase) with an estimated cost of Tk. 248 crore was approved in FY2009-10 with a view to irrigate 37,500 ha of land which will help produce an additional 0.19 MT of crops.

A new project titled Enhancement of Crop Production through Farm Mechanisation was introduced in FY2009-10

Distribution and Price of Fertilisers

The MoA implemented a new policy for appointing fertiliser dealers and rearranged the fertiliser distribution system to ensure proper and timely delivery of fertiliser. As per the new policy, one dealer was appointed in each union and each municipality area. In addition, five to nine retailers were appointed for each union who purchased fertilisers from the dealers and then sold those to farmers. Farmers could purchase fertiliser from both dealers and retailers. Following the decline in international prices of non-urea fertilisers, the government refixed prices of triple super phosphate (TSP), muriate of potash (MoP) and diammonium phosphate (DAP) in November 2009.[25] Thanks to the efficacy of the new system, there was no complaint about fertiliser availability in FY2009-10. As is known, international prices of DAP and TSP had increased significantly though the prices of MoP and urea decreased moderately between July 2009 and June 2010.[26] The rising trend in the international prices of urea, TSP and DAP may increase the subsidy burden for the government in view of the substantial financial support that is already being provided by the government. It should be noted in this context that the government has increased the allocation for fertiliser subsidy to Tk. 3,387 crore in the revised budget for FY2009-10.

The MoA implemented a new policy for appointing fertiliser dealers and rearranged the fertiliser distribution system to ensure proper and timely delivery of fertiliser

[24] Amongst the farmers, 8.3 million Boro rice growing small (owning 0.50-2.49 acres of land) and marginal (having 0.05-0.49 acres of land) farmers using diesel for irrigation will get Tk. 800 per head. On the other hand, 0.8 million Boro rice cultivating medium farmers (having 2.50-7.49 acres of land) who have irrigated their land with diesel-operated machines will get Tk. 1,000 per head.

[25] At Tk. 22, Tk. 25, and Tk. 30 per kg respectively from the previous prices of Tk. 40, Tk. 35 and Tk. 45 per kg.

[26] In June 2010, international prices of per MT TSP and DAP were USD 347 and USD 448 respectively, while, MoP and urea were sold at USD 319 and USD 229. Between July 2009 and June 2010, prices of TSP and DAP increased by 55 per cent and 53 per cent respectively, while prices of MoP and urea decreased by 51 per cent and 6 per cent respectively.

Agricultural Credit

The amount of agricultural credit disbursed to the farmers increased significantly in FY2009-10. Total amount of agricultural credit disbursed by commercial and specialised banks was Tk. 11,116.88 crore in FY2009-10 which was 19.7 per cent higher than that of the previous fiscal year (see Section 1.5 for details). An amount of Tk. 500 crore has been made available to the sharecroppers in 150 upazilas as collateral-free loans, at a low interest rate of 10 per cent through a dedicated refinancing scheme with the BRAC.

Food Import and Public Food Distribution Situation

Commercial import of rice was negligible in FY2009-10 but significant increase in import of wheat has increased total import of foodgrains. Bangladesh has traditionally been a net food importing country. External sources of foodgrains comprise of food aid and commercial import.[27] In recent years, commercial import of rice and wheat has been carried out mainly by the private sector. In FY2009-10, commercial import of rice was only 88,100 MT against 0.58 million MT of FY2008-09. During this period, total import of foodgrains and wheat was 3.45 million MT and 3.36 million MT which was respectively 14 per cent and 39.35 per cent higher than that of FY2008-09 (Table 1.4). Increased demand for wheat and wheat products in the country and low level of domestic production explain the underlying reasons for increased import of wheat during this year. It may be recalled here that current wheat production (about 0.9 million MT) was only about 50 per cent of the historically highest production of wheat attained in FY1999-00 (1.8 million MT). Production of wheat has declined in the country due to change in climate, lack of comparative advantage and lack of opportunities for producing alternative crops (maize) with higher return.

Table 1.4: Food Import in FY2008-09 and FY2009-10

('000 MT)

Category of Import	FY2008-09			FY2009-10		
	Rice	Wheat	Total Foodgrains	Rice	Wheat	Total Foodgrains
Food aid	35.0	87.0	122.0	3.6	43.6	47.0
Public commercial import	396.0	295.0	691.0	51.5	457.1	508.0
Private import	187.0	2031.0	2218.0	36.6	2862.0	2899.0
Total	**618.0**	**2413.0**	**3031.0**	**91.7**	**3362.7**	**3454.0**

Source: Food Planning and Monitoring Unit (FPMU), Ministry of Food and Disaster Management, Government of Bangladesh (GoB).

Distribution under PFDS

Total distribution of food under the Public Foodgrain Distribution System (PFDS) decreased due to lower level of distribution under non-priced channel even though distribution under priced channel increased substantially. In FY2009-10, as has been the practice, the government distributed rice and wheat under the PFDS through priced and non-priced (targeted) channels. In FY2009-10, the amount of foodgrains distributed under various PFDS channels was about 1.96 million MT against 2.13 million MT in the previous year (Table 1.5).

Table 1.5: Channel-wise Distribution of Foodgrains in FY2009-10

('000 MT)

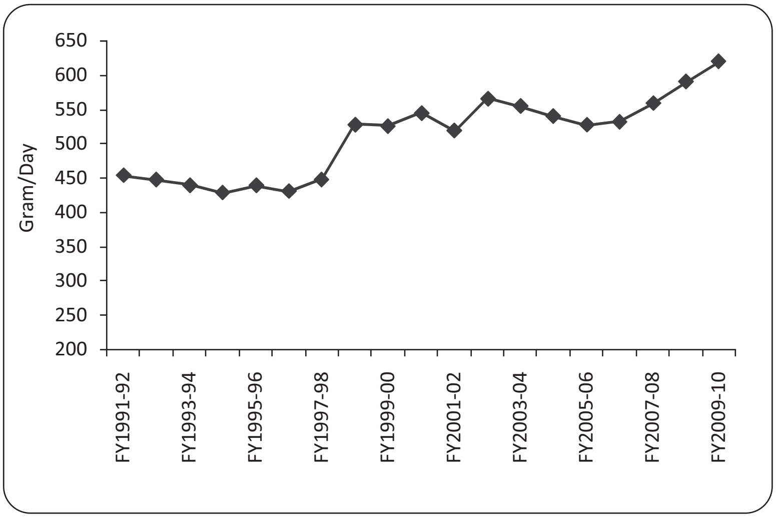
Channel	FY2007-08	FY2008-09	FY2009-10
Priced			
Essential Priority	210	219	246
Other Priority	21	22	21
Large Employee Industries	12	10	15
Open Market Sale (OMS)	268	195	309
Sub-total	*511*	*446*	*591*
Non-priced			
Food for Work (FFW)	154	395	376
Test Relief (TR)	76	368	368
Vulnerable Group Development (VGD)	268	279	272
Vulnerable Group Feeding (VGF)	188	507	249
Gratuitous Relief (GR)	38	43	37
VGF (Relief)	232	-	-
Others	95	92	69
Sub-total	*1051*	*1684*	*1371*
Total	**1562**	**2130**	**1962**

Source: Food Policy Monitoring Unit (FPMU), Ministry of Food and Disaster Management, Government of Bangladesh (GoB).

[27] Food aid comes through public import, but commercial import is carried out by both public and private sectors.

In other words, in FY2009-10 total distribution under PFDS was 7.9 per cent lower than that of the previous year. Distribution through non-priced channel was 18.6 per cent (1.37 million MT) lower than that of the last year. On the other hand, distribution under priced channel in FY2009-10 was 0.59 million MT, which was 32.5 per cent higher than the previous fiscal year. With a view to ensuring food security for the low-income industrial workers, the government sold about 43,050 MT of rice at the subsidised price of Tk. 16/kg to garments and industrial workers in Narayanganj, Gazipur, Narsingdi and Khalispur (in Khulna).

Figure 1.19: Per Capita Availability of Foodgrains



Source: For FY1991-92 to FY2007-08, WFP (2009); for FY2008-09 and FY2009-10, CPD estimates based on data collected from Food Policy Monitoring Unit (FPMU), Bangladesh.

Per Capita Availability of Foodgrains

Improvement in domestic production of rice and increase in import of wheat has led to higher per capita availability of foodgrains in FY2009-10 (Figure 1.19). Per capita availability of foodgrains was 453 gram (gm) per day in FY1991-92 which declined to about 430 gm per day in the mid-1990s, and thereafter gradually increased to 544 gm per day in FY2000-01. It declined again to 519 gm per day in FY2001-02 and showed some fluctuations for several years. Since FY2005-06, per capita availability of foodgrains has been gradually on the rise. According to CPD estimates, it has increased to 590 gm per day in FY2008-09, and to 620 gm per day in FY2009-10. Given such achievement, it appears that time has come to make renewed efforts towards ensuring a nutritionally balanced diet for citizens by fixing cereal production target at the current level and increasing production of other crops. To this end, increase in rice yield will enable the country to release some of the rice producing acreage for production of other crops.

Vulnerability of *Haor* Areas due to Early Flash Flood

According to an estimation by the SPARRSO, about 51,000 ha of Boro rice area was damaged by the flash flood in haor areas

Pre-monsoon heavy rainfall and flash flood damaged Boro rice in *haor* areas and led to increased vulnerability of the people in the affected areas. In early April of 2010, Boro rice in *haor* areas, especially in Sunamganj, Kishoreganj and Netrokona districts, were damaged due to pre-monsoon heavy rainfall and flash flood from upstream hilly lands of the neighbouring country, India. Due to the rise in river water level, flood protection embankments collapsed, and thousands of hectares of Boro rice crop got submerged. According to an estimation by the Bangladesh Space Research and Remote Sensing Organization (SPARRSO), about 51,000 ha of Boro rice area was damaged by the flash flood. *Haor* areas generally tend to be single-cropped. As a consequence, total damage of rice crops by the flash flood will have serious negative impact on the food security situation in those areas. With a view to helping the affected people, the government took a number of initiatives which included postponing credit repayment for a year and providing seeds and fertiliser at subsidised price for the next Boro season. However, apart from these initiatives, the government should also take some medium-term initiatives to minimise production risks in the *haor* areas. To this end, there is a need to develop crop varieties which could be harvested by mid-April. Development of cold-tolerant and early maturing varieties will be needed for diversification. Bangladesh may take help from South Korea in this respect, who has advanced research capacity for the development of cold-tolerant rice varieties. Proper maintenance of the embankments will also help reduce the risk of flood damage. Most importantly, allocations under targeted safety net and employment generation programmes in these areas should be increased.

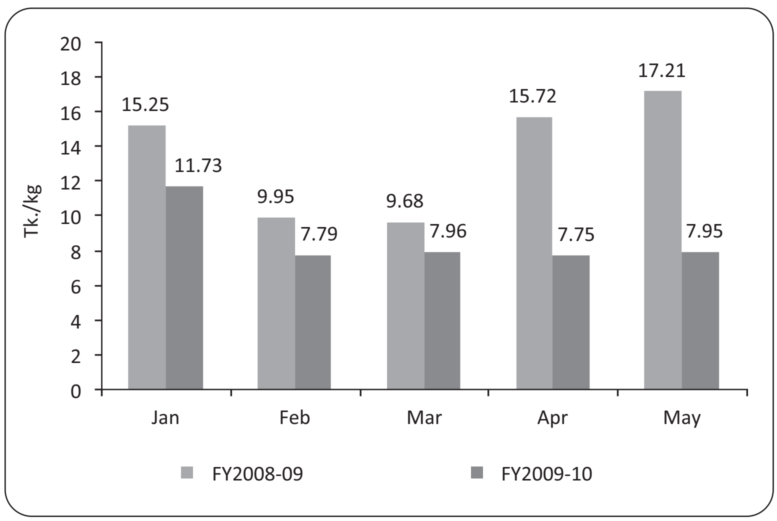
Low Price Discourage Potato Growers

In FY2009-10 Bangladesh recorded highest level of potato production in her history. However, lower levels of price in FY2009-10 which followed the higher prices of the previous year, created a disincentive for the potato growers. According to the BBS, total production of potato in FY2009-10 was 7.93 million MT which was 50.5 per cent higher than that of FY2008-09, and 19.3 per cent higher than that of FY2007-08. It may be noted here that the annual compound growth rate in potato production between FY2001-02 to FY2008-09 was 9.7 per cent. The increase in potato production in FY2009-10 was due to the increase in both acreage and yield. In FY2009-10, area under potato production was 4.35 lakh ha (9.85 per cent higher than that of FY2008-09, and 8.2 per cent higher than that of FY2007-08), while yield was 18.25 MT/ha (37 per cent higher than that of FY2008-09, and 10 per cent higher than that of FY2007-08). High price of potato (about Tk. 30 per kg) prior to the planting time (September-October 2009) induced farmers to increase acreage under potato cultivation. Favourable weather and availability of adequate non-urea fertilisers at subsidised price contributed towards balanced fertiliser use and helped to achieve higher level of potato yield.

Despite the record highest potato production in FY2009-10, low price created a disincentive for the potato growers

In spite of the bumper harvest, potato farmers were rather disappointed. Farm-level price of potato during the harvesting period was much lower in FY2009-10 than the previous year. Average farm-level price of potato in January 2010 was Tk. 11.73 per kg but declined to Tk. 7.79 per kg in February; the price then rose to Tk. 7.96 per kg in March and fell to Tk. 7.75 per kg in April and then again rose somewhat to Tk. 7.95 per kg in May 2010 (Figure 1.20). In contrast, the average farm-level price of potato for the same period was consistently higher last year. It may also be noted here that the average cost of production of potato was between Tk. 10 to Tk. 12 per kg in FY2009-10.

Figure 1.20: Comparison of Farm-level Prices of Potato in Bangladesh: FY2008-09 and FY2009-10



Source: Estimated from Department of Agricultural Marketing (DAM) data.

Lower price aside, inadequate storage capacity also aggravated the situation. Bangladesh has 350 cold storages with a total capacity of about 2.4 million MT. About 4 million MT of potato is usually stored in households for the purpose of sale in the first half of the year. Thus, there was a lack of storage facility for about 1.6 million MT of potato. In FY2009-10, storage capacity emerged as a severe problem. Taking advantage of the emergent situation, cold storage operators increased the tariff for storage from Tk. 220 to Tk. 260 per sack (80 kg).

In order to reduce the existing price risk in potato farming, it is essential to formulate an appropriate policy. There is a cyclical pattern of cultivation and production of potato in Bangladesh. Bumper harvest is normally followed by lower production due to low price, poor storage capacity and inadequate marketing facilities. In this backdrop, the government can do the followings: (i) encourage investors to establish new cold storages in major potato growing areas[28] by providing credit at lower cost, offering tax holiday, and reducing import duty on machineries used in cold storages; (ii) ensure adequate electricity supply in cold storages; and (iii) give priority to potato growing farmers for space management in cold storages. Government could also think of setting up cold storages on PPP basis.

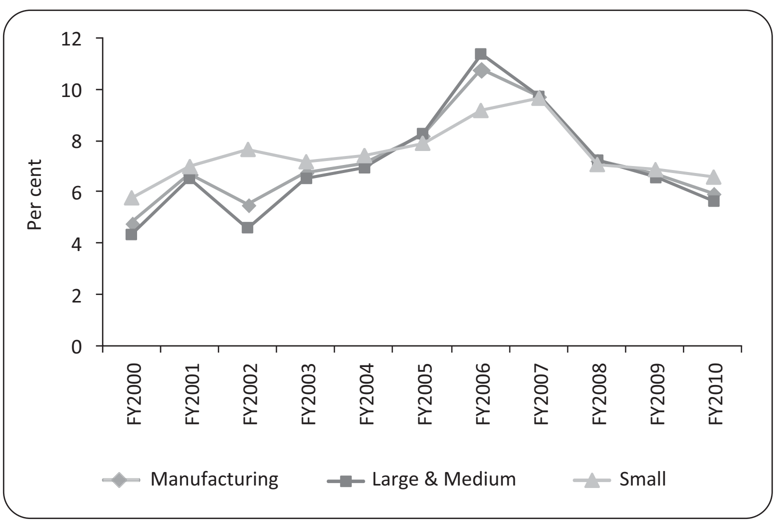
Export potential of potato from Bangladesh to Malaysia, Sri Lanka, Singapore, Thailand and Middle East is quite good

To stimulate export, the government raised cash incentive for potato exporters from the existing level of 10 per cent to 20 per cent, with effect from April 2010. This had a positive impact on potato exports. Potato exports in April 2010 (4,182 MT) was 18 per cent higher than in March 2010. In the February-April period of 2010 Bangladesh exported about 9,000 MT of potato, mainly to Malaysia and Singapore. To encourage potato export, the cash incentive scheme should be continued in the next year. The government could think about introducing the provision of cash incentive to be linked to traceability pre-condition. Thus, it should be made mandatory that identity number of the farmer be put on all potato sacks to be exported. This will help Bangladesh to export potato to supermarkets in the developed countries and fetch higher price. Available information suggests that export potential of potato from Bangladesh to Malaysia, Sri Lanka, Singapore, Thailand and Middle East is quite good.

1.6.2 Industrial Sector

Industrial sector has passed through a turbulent period in FY2009-10 confronting challenges from both domestic and external sources. Due to the lagged impact of the global economic slowdown, particularly on export-oriented sectors, and the continuing shortfall in the supply of energy and power, industrial activities slowed down in FY2009-10. Consequently, manufacturing sector attained its lowest level of growth in FY2009-10 (5.92 per cent) compared to the last seven years (Figure 1.21).

Figure 1.21: Growth of Manufacturing Sector



Source: Estimated from MoF (2010a) data.

Industrial Production

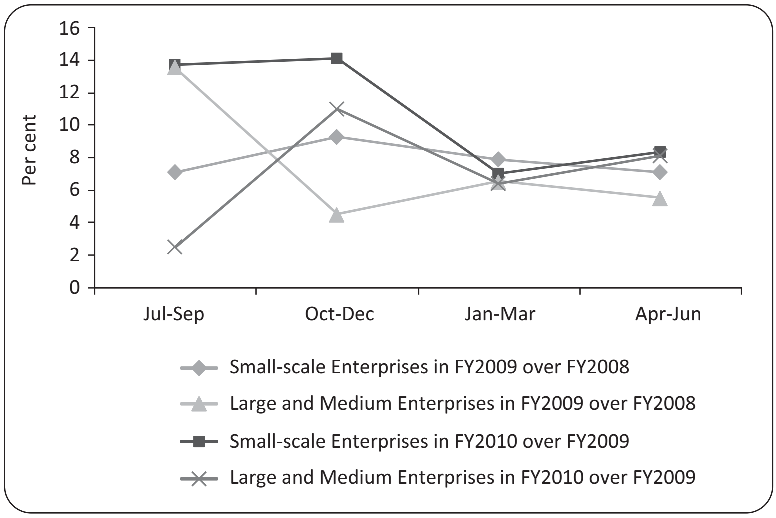
Growth of manufacturing industries in FY2009-10 varied across different sizes of enterprises. According to the *Bangladesh Economic Review 2010*, growth of large and medium-scale manufacturing enterprises was estimated to be 5.6 per cent, which was 0.9 percentage points lower compared to the previous year. Growth of manufacturing enterprises estimated on the basis of monthly data of the quantum index of production (QIP) showed a similar trend.[29] Growth of small-scale enterprises, on the other

[28] It is to be noted that ten major potato growing districts (Bogra, Chandpur, Comilla, Dinajpur, Joypurhat, Munshiganj, Nilphamari, Naogaon, Rajshahi and Rangpur) produce more than 70 per cent of the total potato production in the country.

[29] Large and medium manufacturing enterprises have registered a growth of 6.9 per cent in FY2009-10 which was 0.53 percentage points lower compared to the previous year.

hand, was estimated to be 6.6 per cent which was 0.3 percentage points lower compared to the previous year. However, with a growth rate of 10.7 per cent, the QIP of small-scale enterprises exhibited a significant upward move by 2.9 percentage points. Quarterly movements of QIP of both the categories of industries revealed some fluctuations particularly in the early half of the FY2009-10 (Figure 1.22). This is partly related to the continued slowdown of global demand in the FY2009-10 in view of the financial crisis.

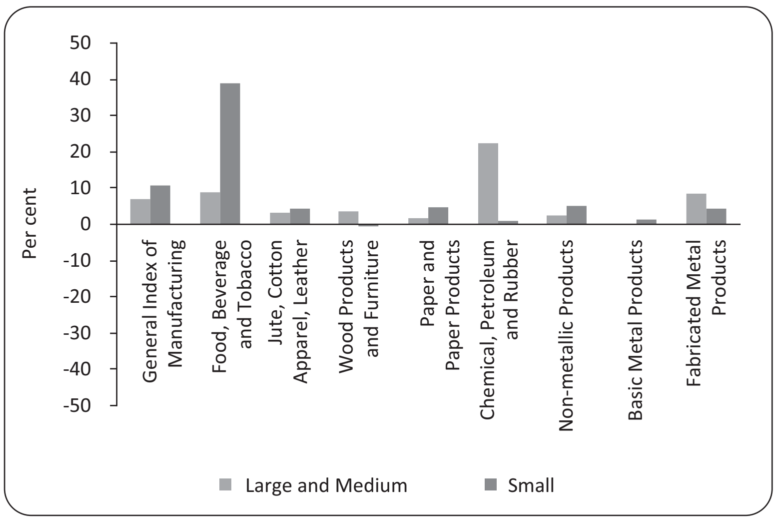
Figure 1.22: Quarterly Changes in QIP for Large and Medium and Small-scale Enterprises



Source: Estimated from *Major Economic Indicators*, various issues.

Growth of large and medium and small enterprises during FY2009-10 was largely influenced by their performances in the crisis-affected international market and the relatively stable domestic market (Figure 1.23). Export-oriented enterprises of these categories have achieved insignificant growth in FY2009-10, particularly industries belonging to the category of jute, textiles, leather and apparels wear. This is corroborated by the weak export performance of knitwear and woven wear apparels in FY2009-10 (posted a rise of 0.84 per cent and 1.6 per cent respectively).[30] Factors such as volatility in the global market prices for cotton, yarn and raw jute, and depreciation of Euro were partly responsible for such slowdown. Performance of domestic market-oriented industries such as food, beverages, tobacco, chemical-related industries and non-metallic products was better in FY2009-10. This was observed both in large and medium and small-scale enterprises. A relatively stable domestic market with modest inflationary pressure and higher domestic demand has contributed to the moderate level attained growth by these industries.

Figure 1.23: Change in QIP for Different Industries: FY2009-10 over FY2008-09



Source: Estimated from *Major Economic Indicators*, various issues.

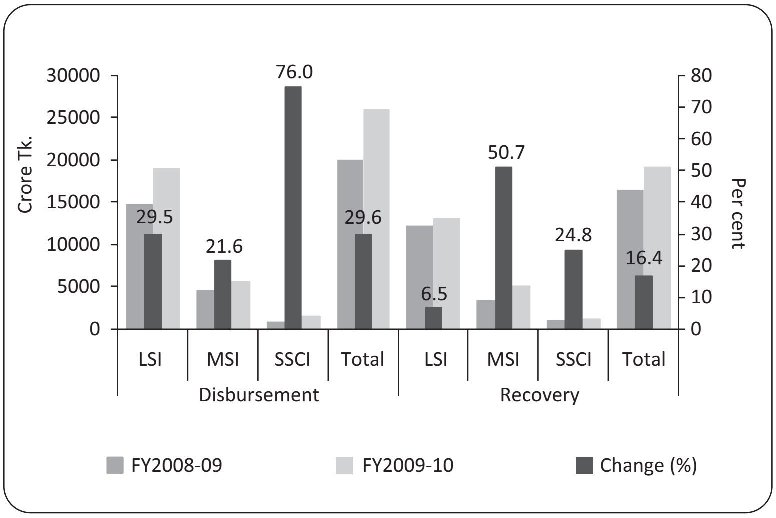
Investment in Manufacturing Sector

The investment trend in the industrial sector can partly be assessed by the disbursement of industrial term loan. In FY2009-10, disbursement of industrial term loan rose by 30 per cent[31] and amounted to Tk. 25,626 crore. Given the moderate growth of the manufacturing sector during FY2009-10, high growth of

[30] However, export performance of jute and jute goods, leather and leather products (not footwear) was relatively better during FY2009-10.

[31] During FY2009-10, total private investment amounted to Tk. 136,280 crore with a growth rate of 12.7 per cent. This growth of private investment is the lowest in the last five years.

Figure 1.24: Disbursement of Industrial Term Loans



Source: Estimated from *Major Economic Indicators*, various issues.

Note: LSI: Large-scale Industries; MSI: Medium-scale Industries; SSCI: Small-scale and Cottage Industries.

industrial term loan portrays entrepreneur's confidence in the upcoming period. This could be because of gradual improvement of global economies in the recent period. Weak investment performance in FY2008-09 (growth rate was -0.9 per cent) was another reason for the relatively high growth rate in the industrial term loan in FY2009-10 (lower reference point). This rise is also partly attributed to the recent drive by the government to enhance financial support to the SMEs. As a result, small-scale credit rose to 76 per cent in FY2009-10 (Figure 1.24).[32] Though recent initiatives of the central bank has contributed to such increase in distribution of small-scale credit, the lending rate for credit facilities is still very high (see Box 1.3).

Box 1.3: Financing the SMEs: Findings from the CPD Field Survey

Financing of SMEs received some impetus this year, thanks to a number of initiatives of the government in support of domestic market-oriented industries. Policies adopted in view of the global economic recession also helped in this respect. Bangladesh Bank had undertaken a number of measures in support of SMEs in FY2009-10 which included establishment of a separate department called the SME and Special Programme Department[33], and preparation of a SME financing guideline called SME Credit Policies and Programme. The guideline focuses on an 'area-based approach' for disbursement of credit by commercial banks[34], and sets a target of Tk. 24,000 crore to be disbursed in 2010.[35] Bangladesh Bank had also organised a roadshow on 'SME Financing, Raising Awareness about Agricultural Credit, Anti-Money Laundering and Encouragement to Send Remittance through Banking Channel' under a campaign titled *Teknaf to Tetulia*. This helped raise awareness among the common citizens about banking facilities available for them.

CPD carried out an area-based rapid assessment to examine the impact of recent initiatives of Bangladesh Bank on financing SMEs. The assessment was carried out in Narayanganj both at bank level (one branch of a SCB and one of a PCB), and at borrowers' level (24 borrowers were interviewed). The survey reveals that branches of both SCB and PCB have, in general, put emphasis on financing SMEs. However, there was serious weakness with regard to complying with the provisions of the central bank guidelines. Major observations emanating from the survey are: (a) higher rate of interest is charged by PCBs; (b) absence of upper ceiling on the interest rate (this can go as high as 17 per cent); (c) ambiguity in the definition of SMEs particularly when applied by the SCBs; (d) inadequate number of SME centres set up by SCBs; and (e) restrictive guidelines designed by the banks for selecting prospective borrowers (e.g. minimum two years of experience, health insurance, fire insurance, trade license, etc.). It was also noted that compliance with the required provisions involved an additional fiscal burden equivalent to 1 to 2.5 per cent of the actual credit disbursed to SMEs.

In order to ensure better accessibility for SMEs, following steps were recommended: (a) ensure strict adherence to the central bank's definition of SMEs; (b) make fixed capital available to SMEs, particularly to newly established enterprises; (c) reduce the rate of interest for SMEs - at least an upper ceiling is necessary; (d) raise awareness among prospective borrowers through establishment of adequate number of SME Centres; (e) ensure appropriate grace period for repayment of loan (e.g. 2-6 months); and (f) employ skilled fieldworkers for building awareness, identifying potential borrowers and monitoring SME credit.

Source: CPD Survey on SME Financing 2010.

[32] The share of small-scale credit in overall disbursement of term loan has increased from 3.9 per cent in FY2008-09 to 5.3 per cent in FY2009-10.

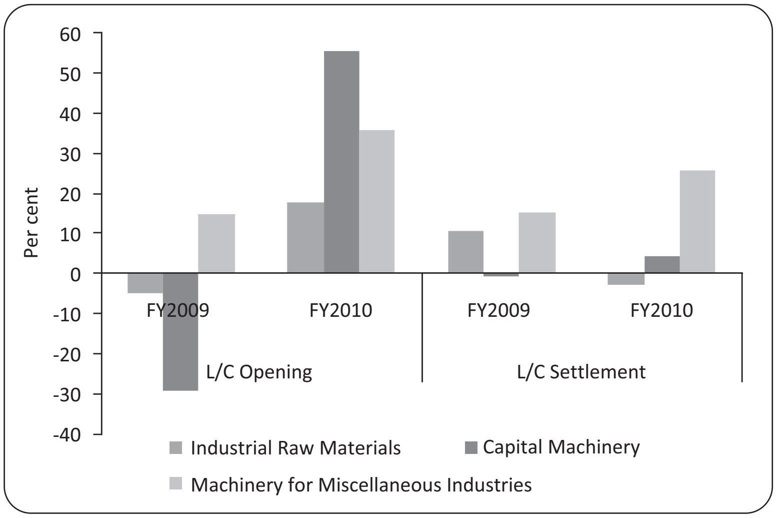
[33] Earlier it was under the Department of Agricultural Credit and Special Programmes.

[34] Other major aspects of the guideline are: clearly specified definition of SMEs, reservation of fund for small enterprises, putting priorities in case of funding to industries and services, financing women-led enterprise at 10 per cent rate of interest, identification of potential sectors for financing in major upazilas of 64 districts, and providing specific monitoring guideline of financing SMEs by Bangladesh Bank.

[35] At least 40 per cent of the total credit disbursement for SMEs is targeted to small enterprises.

Import of intermediate products and capital machineries in FY2009-10 was relatively low compared to that of the previous year, which was indicative of sluggish industrial uptake. However, opening of letters of credit (L/Cs) for importing industrial raw materials, capital machineries and machineries for miscellaneous industries in FY2009-10 was considerably high (Figure 1.25) indicating positive attitude to future prospects.

Figure 1.25: Growth of Opening and Settlement of L/Cs

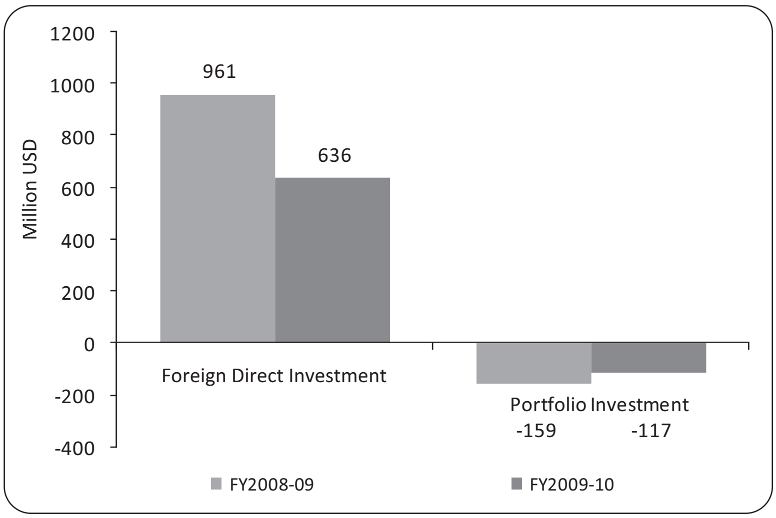


Source: Estimated from *Major Economic Indicators*, various issues.

1.6.3 Foreign Direct Investment and Portfolio Investment

Aggregate foreign direct investment (FDI) inflow was dismally low during FY2009-10. However, higher FDI flow to export processing zones (EPZs) has reinforced the need to address power and infrastructural issues on an urgent basis. Inflow of FDI in FY2009-10 amounted to USD 636 million which was a reduction by 33.8 per cent over the previous year (Figure 1.26). Foreign investment in the Domestic Tariff Areas (DTAs) was largely constrained by weak infrastructural facilities, particularly inadequate supply of electricity and gas. Investment in the EPZs, on the other hand, amounted to USD 220 million during FY2009-10 demonstrating high growth over the previous year (an increase of 50 per cent).[36] While investors are keen to invest in several EPZs such as Dhaka, Chittagong, Adamjee and Karnaphuli (Figure 1.27), they have not been equally keen to invest in the other EPZs owing to lack of infrastructural facilities, poor connectivity with the main seaport, and dearth of skilled workforce in these areas. Portfolio investment in FY2009-10 was negative at (-) USD 117 million. This indicates that a substantial amount of dividend was repatriated and foreign investors have liquidated a part of their assets. Although the share of portfolio investment in the capital market was still very low, at less than 3 per cent of market capitalisation, given the experience of the recent past, the government will have to remain vigilant and sharp, and monitor the stock market on a continuing basis.

Figure 1.26: Net FDI and Portfolio Investment: FY2008-09 and FY2009-10



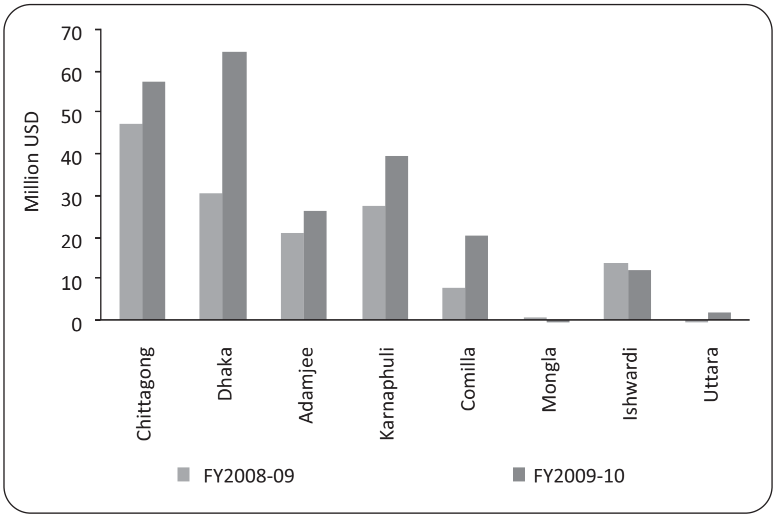
Source: Estimated from *Major Economic Indicators*, various issues.

The power, energy and gas sector, traditionally the major target for FDI flow to Bangladesh, is not being able to attract large amount of FDI over the last few years. This trend continued in FY2009-10 when FDI in this sector amounted to only USD 48 million.[37] The share of this sector in overall FDI flow went down to 7

[36] It may be required to take note of the fact that data on FDI published by various publications by Bangladesh Bank and Bangladesh Export Processing Zone Authority (BEPZA) need to be reconciled (See Box 1.4 for details).

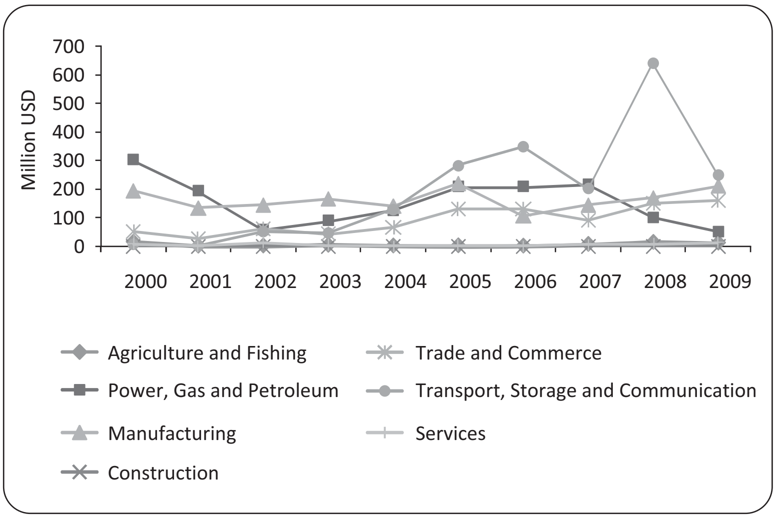
[37] During FY2009-10, the highest amount of FDI was received by transport and communication sector (USD 250.1 million), followed by manufacturing sector (USD 211.3 million). Investment in the construction sector (USD 0.74 million) received increasing attention from foreign investors in recent years.

Figure 1.27: FDI in Different Export Processing Zones



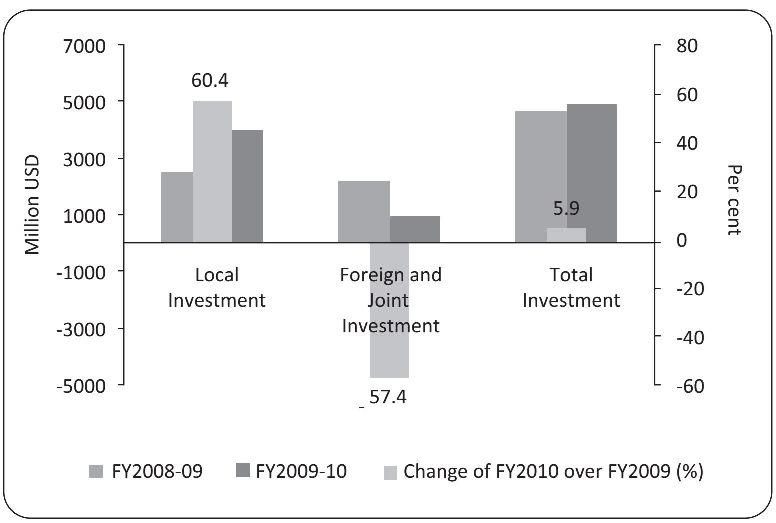
Source: Estimated from Bangladesh Export Processing Zone Authority (BEPZA) data.

Figure 1.28: Sector-wise FDI Inflow in Bangladesh



Source: Estimated from Bangladesh Bank data.

Figure 1.29: Registration of Domestic and Foreign Investment with BoI



Source: Estimated from Board of Investment (BoI) data.

per cent in 2009, which was more than 20 per cent in early part of the decade (Figure 1.28). The roadshows organised in New York and Singapore to attract FDI in the energy sector is yet to generate the expected result in terms of concrete investment proposals. The BoI will need to be more proactive in projecting the opportunities that Bangladesh is able to offer to FDIs. Whilst shortage of power and energy is a cause for lower levels of FDI, indeed, it was crucial that new FDIs in the power and energy sector be given highest attention to stimulate investment in other sectors.

Registration of new investment with the BoI has increased by 6 per cent and reached a total of USD 4.9 billion in FY2009-10 (Figure 1.29). This is mainly attributed to significant rise in the registration of domestic investment (60 per cent); registration of new FDIs, on the other hand, was negative at (-) 57 per cent. However, increased registration of domestic investment and better infrastructural facilities may attract foreign investment in the coming years. Investors from China, Saudi Arab, Hong Kong and South Korea have registered themselves for investment mainly in printing and packaging, tannery and rubber, chemical, and engineering sectors.

It is pertinent to note here that a substantial amount of foreign exchange is going out of the country, on account of FDI, in the form of payment of royalties, profit and dividend, and earnings of oil, gas and power companies. Transfer of income by power generation companies is likely to rise further in the coming years. Net FDI received by Bangladesh during July-December 2010 was indeed negative (- USD 40.7 million) (Table 1.7). Since a number of multinational companies (MNCs), particularly telecom companies, transferred a part of their respective profit in the form of intra-company loan to their subsidiaries, net FDI was likely to be a negative number of larger magnitude. As a matter of fact, the *FDI Act of Bangladesh* does allow repatriation of profit in full amount. It is to be expected that with the rise in cumulative FDI, outflow on account

Box 1.4: FDI Data: Need for Reconciliation

Data on the inflow of FDI to the country is reported and published by the Bangladesh Bank and the BEPZA. One has to recognise that FDI data published by Bangladesh Bank is often confusing and misleading (Table 1.6). FDI data published in the *Major Economic Indicators* under balance of payment did not match with the data presented in the *Monthly Economic Trends*. This happens because of non-reporting of FDI flow to EPZs in the *Major Economic Indicators* published by the GoB. On the other hand, FDI flow published in *Foreign Direct Investment in Bangladesh: Survey Report* has serious discrepancy with the data in Bangladesh Bank's annual publication *Annual Balance of Payments*. Bangladesh Bank may like to review all the relevant documents where FDI flow is reported, and ensure consistency in definition and estimates.

Table 1.6: Differences in FDI-related Data Reported in Different Documents of Bangladesh Bank

(in Million USD)

Component	FDI Survey (A)		Balance of Payment (B)		Difference between (A) and (B) = (C)		Major Economic Indicators (D)	Monthly Economic Trends (E)	Difference between (E) and (D) = (F)
	FY2007-08	FY2008-09	FY2007-08	FY2008-09	FY2007-08	FY2008-09	FY2009-10	FY2009-10	
Total	768.69	960.59	650.19	1034.07	118.5	-73.42	636.00	602.05	-33.95
Equity capital	545.69	535.42	380.52	713.55	165.17	-178.13			
Reinvestment earnings	197.71	336.61	231.88	277.15	-34.17	59.46			
Intra-company loans	25.29	88.56	37.80	43.37	-12.51	45.19			

Source: Estimated from Bangladesh Bank data.

Table 1.7: FDI Inflow and Outward Transfer

(in Million USD)

Component	FY2006-07	FY2007-08	FY2008-09	FY2009-10 (July-December)
FDI Inflow				
A. Total inflow	792.74	768.69	960.59	342.22
Equity	464.50	545.69	535.42	113.47
Reinvested earnings	281.00	197.71	336.61	178.05
Intra-company loans	47.24	25.29	88.56	50.70
Outward Transfer				
B. Total outward transfer	575.83	653.05	879.93	382.96
Royalties and license fees	6.47	7.89	22.66	5.66
Profit and dividends	165.41	173.33	207.39	104.70
Earnings of oil, gas and power companies	403.95	471.83	649.88	272.60
C. Net FDI inflow after deducting outward transfers (A-B)	216.91	115.64	80.66	-40.74

Source: Estimated from Bangladesh Bank data.

of FDI will also rise. Hence it is important to encourage companies to invest their retained surplus in the country. Outward flow arising through 'transfer pricing' also needs to be appropriately monitored. There are indications that this has been on the rise in recent years. The GoB should think about introducing appropriate rules and regulations to address this.

Healthy reserves of over USD 10 billion have allowed Bangladesh Bank to sanction foreign currency loans for investment purposes. Private investors are now allowed to take loan in foreign currency for implementing offshore investment projects, though on a limited scale. The central bank is also thinking of developing a 'Sovereign Wealth Fund' with an initial capital of USD 500 million to provide credit to local investors for investing abroad.[38] However, Bangladesh Bank should apply due diligence in terms of selection of projects and disbursement of credit from this fund.

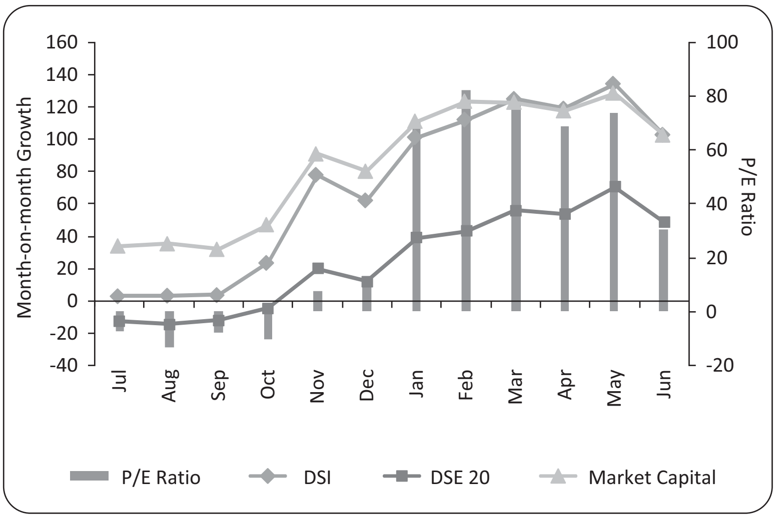
Bangladesh was awarded 'BB-' for long-term and 'B' for short-term by Standard and Poor's and 'Ba3' by Moody's

It is to be noted that Bangladesh has recently come under purview of two sovereign credit rating agencies. Bangladesh was awarded 'BB-' for long-term and 'B' for short-term by *Standard and Poor's* and 'Ba3' by *Moody's*. These ratings are expected to transmit positive signals to the foreign investors.

1.6.4 Capital Market

Slow pace of growth in industrial production over the last few years, particularly during the first half of FY2009-10, has led the capital market to grow significantly. Between June 2009 and June 2010, All Shares Price Index (DSI) registered a growth of 102.83 per cent (index value was 5111.63 at the end of June 2010). DSE 20 index gained 48.5 per cent (index value was 3650.04 at the end of June 2010), and market capitalisation rose by 102.47 per cent (Figure 1.30) (amounting to USD 38.51 billion at the end of June 2010 which was equivalent to about 40 per cent of the GDP). These developments may be attributed to a number of factors. Firstly, the period witnessed the highest number of floating of initial public offerings (IPOs), including a large MNC, the Grameenphone. In all, 21 new IPOs were floated in FY2009-10, which contributed to the depth of the capital market.[39] Secondly, the bullish market attracted a huge number of small investors (in April 2010, total number of Beneficiary Owner (BO) account holders reached about 2.5 million). The number of new BO accounts that were opened in the Dhaka Stock Exchange (DSE) between April 2009 and April 2010 was 0.32 million (corresponding figures for the same period of the previous two years were 0.34 and 0.31 million respectively). Most of these investors were small, with limited knowledge about the equity market and how it works.[40] Some analysts have argued that the market was becoming overheated and investment in the market was becoming increasingly risky (Box 1.5). The sharp rise of price-earning (P/E) ratio has reinforced this argument (P/E ratio for DSE was 29.9 in January 2010, which fell to 24.08 in June 2010; for some companies it was as high as 75 and above).[41]

Figure 1.30: Trends of Major Indicators of Capital Market at DSE



Source: Estimated from Dhaka Stock Exchange (DSE) website data (accessed on 5 August 2010).

FY2009-10 witnessed the highest number of floating of IPOs, including a large MNC, the Grameenphone

[38] Bangladesh Bank in its strategic vision for 2010-2014 has emphasised on setting up such a fund in order to ensure good returns from investment of its resources. However, due attention to liquidity and risk concerns must inform the decision of the Bangladesh Bank in this regard.

[39] With the investiture of Grameenphone, trends with regard to market power, in terms of market capitalisation have changed quite significantly. Although the financial sector contributed more than half of the market share before, now the sector's share has come down to below 40 per cent. Grameenphone has now emerged as a major player, along with banks, in the secondary market.

[40] According to anecdotal information, small investors control around 30-40 per cent of daily trade; institutional investors account for about 30 per cent; and long-term investors are responsible for the rest 30 per cent of daily trade at DSE.

[41] The P/E ratio in the Bombay Stock Exchange (BSE) was found to be stable, and hovered around 19-21 between January 2009 and April 2010.

Box 1.5: Market Efficiency of Dhaka Stock Exchange

In an efficient market, stock prices usually reflect the relevant information concerning the real economy. Macrolevel information and trends with regard to production, inflation, money supply as well as company-level insider information (e.g. expansionary or contractionary production decisions of companies) influence price behaviour of the stocks in the market (Beechey *et al.* 2000). To find out the efficiency in the capital market of Bangladesh, a time series analysis was carried out by using available secondary data. Independent variables of this exercise were monthly data of QIP for general manufacturing, flow of remittances, CPI, M2 and commercial deposit rates (for less than 3 months) for the period from July 2005 to December 2009. One period lag of DGEN (DSE General Index) was considered as the dependent variable taking cognisance of the anticipatory behaviour of the investors in the capital market. Due to lack of availability of information on other real economic variables, particularly QIP and other insider information, data for the latest months could not be used. The results of the estimated model show that none of the variables have strong relationship with lagged value of DGEN, except M2. This is an indication of the inefficiency of the market in the short-run (Table 1.8). An extension of the analysis to examine the long-term relationship also leads to similar conclusions. The findings of this exercise are in line with some of the earlier studies (such as, Ahmed and Imam 2007) on efficiency of the Bangladesh capital market.

Table 1.8: Market Efficiency of DSE

Indicator	OLS		Auto-correlation Adjusted	
	Coefficient	P-value	Coefficient	P-value
Dependent variable	One month lag of DGEN		One month lag of DGEN	
Constant	(-) 5.48	(0.01)	(-) 5.98	(0.08)
Ln (QIP General Manufacturing)	(-) 0.89	(0.02)	(-) 0.24	(0.18)
Ln (Remittance)	0.21	(0.30)	0.01	(0.88)
Ln (CPI)	0.20	(0.00)	0.13	(0.61)
Ln (M2)	1.36	(0.00)	1.24	(0.00)
Ln (Commercial Deposit Rate (less than 3 months))	(-) 0.75	(0.03)	(-) 0.27	(0.40)
Number of observation	65 (Jul 2005 to Dec 2010)		65 (Jul 2005 to Dec 2010)	
R-squared	0.76		0.93	
Durbin-Watson d-statistic (6, 65)	0.34		1.74 (transformed)	

Source: CPD estimates.

The buoyancy in the capital market has given rise to significant volatility in the market. Following the methodology of Rahman and Hossain (2008), volatility was calculated to see the stability of the market both over the short and long-terms. The 'volatility index' for DSI during July 2009 to May 2010 was 1.6 (Table 1.9), which has gradually increased recently (for BSE this index ranges between 1 to 1.3). Such lack of stability and volatility to some extent are also observed for indices such as DGEN, market capitalisation, total trade and total volume in recent times (Figure 1.31). The volatile nature of the market can be explained by various economic and non-economic factors. These include global recession in 2009, offloading of Grameenphone shares, inconsistency in the Securities and Exchange Commission's (SEC) decisions with regard to margin loan facility, face value harmonisation, and apprehensions about capital gains tax (CGT).[42] As is evident from Table 1.10, the high growth of market capitalisation over time, compared to that of the issued capital, confirms rising market volatility owing to accelerated growth on the demand side. To stabilise the market, demand for new shares in the capital market needs to be addressed through offloading of shares of state-owned enterprises (SoEs) (26 SoEs are on the waiting list for offloading), issuance of the proposed infrastructure bonds, and raising of

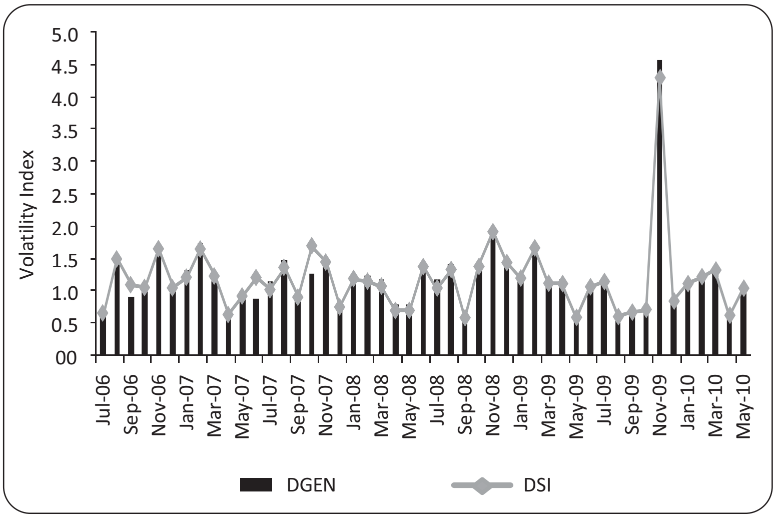
Table 1.9: Inter Temporal Volatility of Major DSE Indicators

Indicator	July 2005 to May 2010	July 2006 to May 2010	July 2007 to May 2010	July 2008 to May 2010	July 2009 to May 2010
Total Trade	15.12	16.05	14.80	14.83	13.08
Total Volume	23.10	23.86	22.15	19.21	16.09
Value in Taka	20.95	22.15	18.61	12.38	15.03
Market Capitalisation	1.02	1.20	1.19	1.23	1.38
DSI	1.14	1.35	1.38	1.48	1.62
DGEN	1.16	1.37	1.43	1.54	1.70

Source: Estimated from Dhaka Stock Exchange (DSE) data.

[42] However, a part of this unusually high level of volatility could also be attributed to the faulty estimation system of the indices followed by DSE.

Figure 1.31: Pattern of Volatility of Major DSE Indices



Source: Estimated from Dhaka Stock Exchange (DSE) data.

Table 1.10: Yearly Growth of Market Capitalisation (Demand Side) and Issued Capital (Supply Side)

Period	Growth of Issued Capital	Growth of Market Capitalisation	Growth of Demand-Supply Gap (Difference between Issued Capital and Market Capitalisation)
June 2007	93.48	119.88	136.04
June 2008	74.35	97.63	109.31
June 2009	59.89	35.09	24.73
June 2010	31.95	102.47	140.25

Source: Estimated from Dhaka Stock Exchange (DSE) data.

equity from the capital market. This could also be helpful for funding of large power projects under the PPPs.

SEC was not always successful in keeping the volatility in the capital market under check. The Commission has tried to correct market fundamentals from time to time by applying various instruments including changing the margin loan ratio and discouraging trade of overvalued shares (through 'over the counter' or 'spot market' trading). There is obviously an urgent need to significantly strengthen SEC's surveillance and monitoring role. The SEC may consider some operational restructuring following the model of Securities and Exchange Board of India (SEBI). It may be noted that the SEBI is directed by a Chairman, usually a person from the reputed public or private sector. 13 different committees (each is made up of 3-19 members) foresee different activities of all stock market operations in India. The SEC should also strengthen its independent research and monitoring capacity. Major regulatory decisions should be made on the basis of a broad-based consultation with concerned stakeholders. There is a need for SEC to more carefully scrutinise and examine the quality of audited reports submitted by the listed companies. Expansion of capital market educational programme up to local levels may be considered by the SEC to raise awareness about the functioning of the stock market. Setting up a separate judiciary mechanism for settlement of disputes in the capital market could help bring more transparency in SEC's operation. In view of the ongoing volatility in market behaviour and the signs of overheating, it is high time that policymakers take concrete steps to address the emerging concerns regarding the stock market of the country. Any foot dragging could prove to be both costly and dangerous.

With demand from both consumers and producers rising, any significant reduction in the power shortage is yet to be observed

1.6.5 Energy

As was the case in FY2008-09, power crisis continued to stand in the way of economic activities and hinder the prospect of higher production and investment in FY2009-10. The government gave highest priority to improve the power situation and undertook a number of immediate and medium-term initiatives to address the emergent problems and improve the situation. However, with demand from both consumers and producers rising, any significant reduction in the power shortage is yet to be observed.

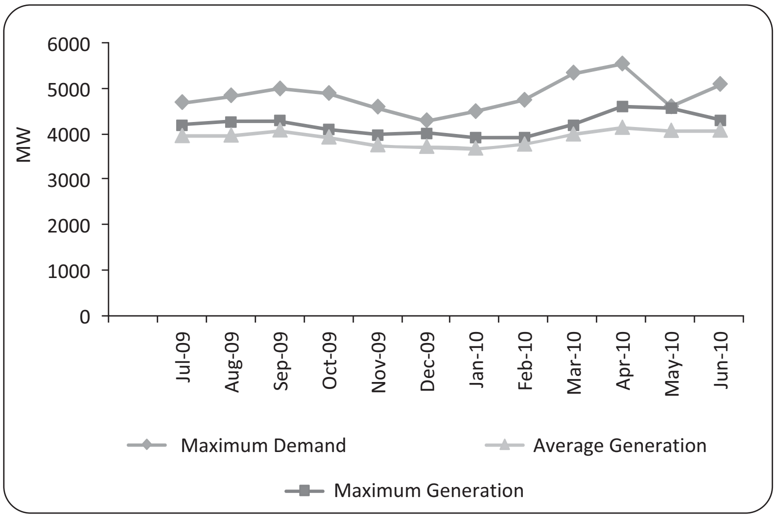
Power Sector

State of the Electricity Generation

Despite a number of new initiatives taken to increase electricity generation of the country, the average generation remained more or less unchanged in FY2009-10.

This is due to firstly, most of the initiatives are yet to be operationalised; secondly, several existing plants were stopped for technical reasons; and thirdly, gas crisis forced some plants to remain underutilised. On the other hand, the demand for electricity evinced a rising trend, particularly in the month of September and then between February and March.[43] From the beginning of April maximum generation has registered some increase; however, average generation did not show a significant improvement over the same period (Figure 1.32).

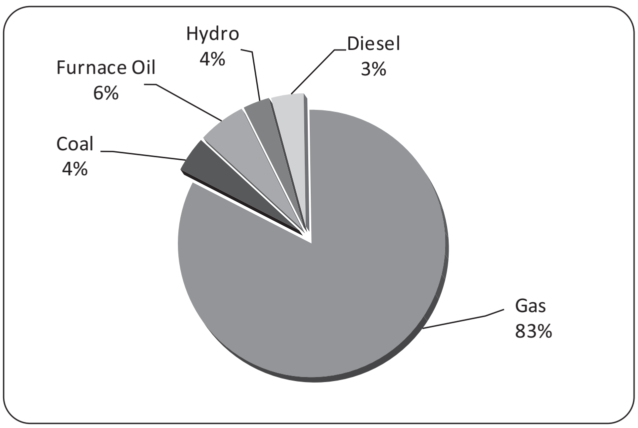
Figure 1.32: Maximum Demand, Maximum Generation and Average Generation of Electricity during FY2009-10



Source: Estimated from Bangladesh Power Development Board (BPDB) data.

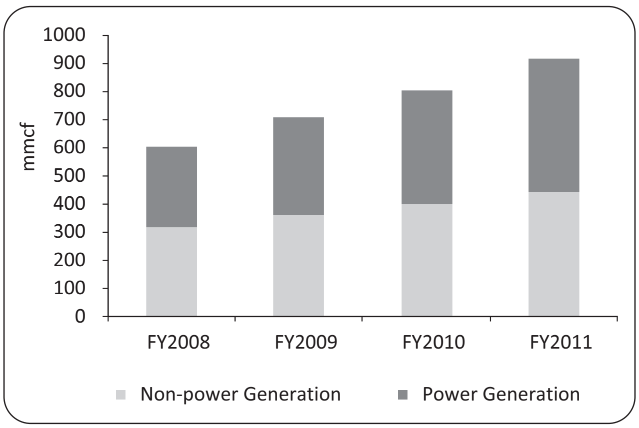
The current electricity crisis was fuelled by increased demand for gas in electricity generation as well as for consumption by other sectors of the economy. The demand of gas for these two purposes increased by 13.5 per cent and 16.8 per cent respectively in FY2009-10 (Figures 1.33A and 1.33B). Slow pace of increase in gas supply and frequent disruption of production in many old plants and transmission lines have also contributed to the crisis. On the other hand, dependence of electricity generation on gas continues to be very high at about 83 per cent. As would be noted, lack of investment in gas extraction and new exploration had contributed to the current gas shortage; no tangible efforts have been taken to explore the coal resources of the country either. In view of this, the government had to resort to costly choices such as quick rental plants to solve the power crisis, with attendant consequences.

Figure 1.33A: Current Use of Fuel for Electricity Generation



Source: Estimated from Bangladesh Power Development Board (BPDB) data.

Figure 1.33B: Projected Gas Demand for Power Generation



Source: Estimated from Petrobangla data.

Challenges of Implementing the Recent Power Plan

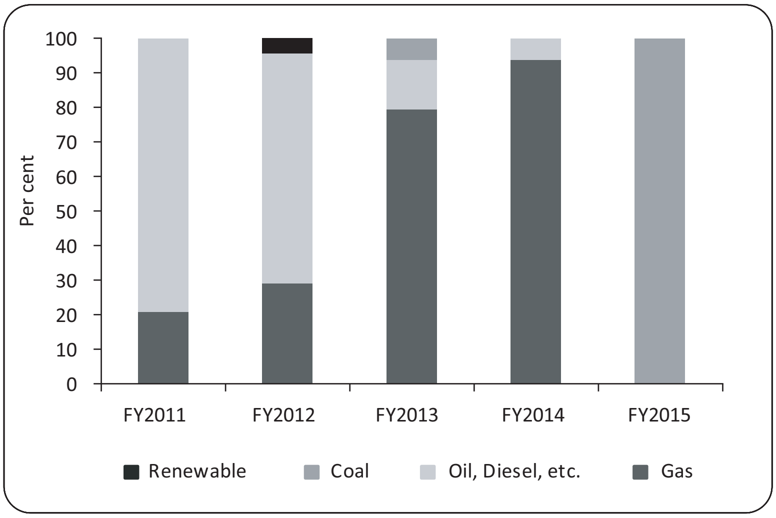
The government has recently formulated a plan for the development of the power sector which will commission 'quick rental' and 'peaking' plants with the participation of both public and private sectors. Under this plan, additional 9,424 mega watt (MW) of electricity is expected to be produced by 2015.[44] During the

[43] These figures do not include the supposite demand that would have been estimated in case of adequate availability.

[44] According to this plan, 790 MW, 920 MW, 2,269 MW, 1,675 MW, 1,170 MW and 2,600 MW of electricity were to be added annually to the national grid between 2010 and 2015.

initial years, i.e. in FY2010-11 and FY2011-12, power is planned to be generated primarily by oil and diesel-fired 'rental,' 'quick rental' and 'peaking' plants; in FY2012-13 and FY2013-14 gas-based power generation should take over; finally, from FY2014-15 coal-fired plants are expected to be implemented. The cost of implementing the plan is estimated to be about USD 12 billion. In the context of shortage of gas supply, the government had to opt for HSD (High Speed Diesel) or HFO (Heavy Fuel Oil)-fired seven 'quick rental' plants, with a total generation capacity of 790 MW in 2010. Gradually, with the increase in gas supply, it is planned to be taking over as fuel for electricity generation for most of the new plants by 2014 (Figure 1.34). In 2015, two coal-fired mega plants, each having a generation capacity of 1,300 MW, under the PPP or independent power producer (IPP) initiative, are expected to be established. Most of the coal to be used for power plants will be imported.

Figure 1.34: Share of Fuel for Electricity Generation during 2011 – 2015



Source: Estimated from Bangladesh Power Development Board (BPDB) data.

The government also signed an agreement with India in January 2010 to import 250 MW of electricity. To facilitate the import of electricity from India, the country needs to install a 45 km long transmission line from the border to its national grid. The estimated installation cost is about Tk. 1,100 crore. Another significant step is the plan to have joint collaboration between Bangladesh Power Development Board (BPDB) and National Thermal Power Corporation (NTPC) of India to install two thermal power plants in Khulna and Chittagong with a capacity of 1,320 MW. Initiatives are also being taken to develop a 2,000 MW nuclear power plant at Rooppur in Pabna district with support from the Russian government. No doubt, implementation of these plans will require substantial funding, careful sequencing of activities and building of the required infrastructure. Many of the related activities will need to be initiated in FY2010-11 with adequate resource allocations in the budget.

Table 1.11: Estimated Fiscal Burden from the Power Generation Plan of the GoB

(in Crore Tk.)

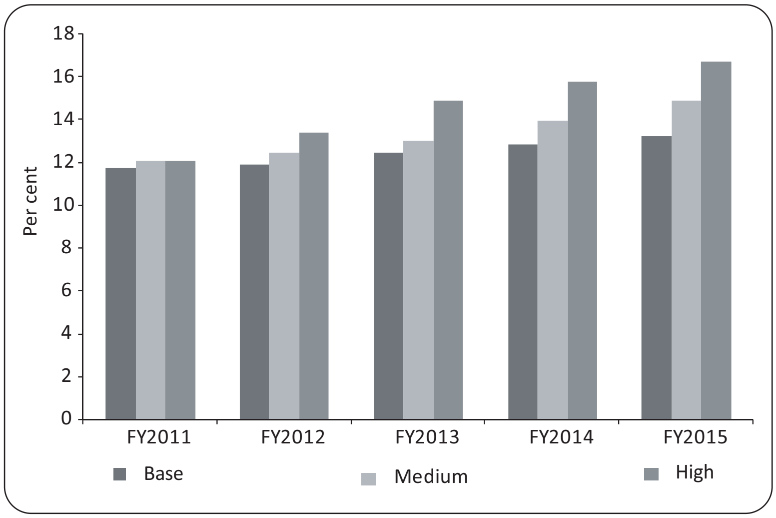
Year	Fiscal Burden[a]	Fiscal Burden[b]	Fiscal Burden[c]
FY2010-11	3775	3570	2505
FY2011-12	5070	4525	3370
FY2012-13	5070	4220	3370
FY2013-14	4605	3550	3065
FY2014-15	4605	3250	3065

Source: CPD estimation.
Note: Production in the proposed Meghnaghat is considered to be 400 MW and the probable starting time for 20 MW capacity (3 yearly) rental plant in Bogra is taken as July 2010.
a. Assuming tariff rate to be increased by 3.66 per cent annually over the next five years;
b. Assuming tariff to rise by 5.75 per cent (average of the past three years) annually for the period;
c. Assuming tariff rate to be increased by 12 per cent annually over the next five years (up to FY2014-15).

The amount of subsidy for power has to be increased by Tk. 2,500 crore to Tk. 4,500 crore annually over the next five years for the implementation of the plan that has been designed and approved by the government. CPD has estimated the tariff burden to be borne by the government for implementing the plan, under three possible scenarios. First, if the tariff remains the same over the next five years (at the present rate of Tk. 3.66 per kilo watt (kw)), the burden will be in the range of Tk. 3,775 crore to Tk. 5,000 crore annually. Second, if the tariff rate rises by 5.75 per cent per year (taking last three years' average) over the next five years, the annual subsidy burden will be to the tune of Tk. 3,200 crore to Tk. 4,500 crore. Third, if tariff rate increases annually by 12 per cent during FY2010-11 to FY2014-15, the subsidy burden will be in the range of Tk. 2,500 crore to Tk. 3,000 crore (Table 1.11).

Another exercise was carried out at CPD to estimate the required growth of electricity generation during the Sixth Five-Year Plan period in order to achieve the projected GDP growth. Results of this exercise reveal that the average annual growth of electricity generation should be in the range of 12.5 per cent to 14.5 per cent to meet the GDP growth targets during FY2010-11 to FY2014-15 (Figure 1.35). The recent power plan of GoB expects annual average growth of electricity generation to be about 26.6 per cent during the period under the Sixth Five-Year Plan. However, it should be kept in mind that it is the net generation capacity, and not the installed capacity that actually matters. Also, frequent disruption in power supply due to malfunctioning of old plants or grids and frequent maintenance work could lower actual availability of power. Another serious problem inhibiting power sector development in Bangladesh is undue delay in the completion of new plants. Moreover, system loss (transmission and distribution) needs to be reduced further. This calls for technical upgradation and efficiency improvement of the existing power plants, grids and transmission lines. Setting up of new plants is also necessary for additional power generation capacity. These measures are essential since the actual demand for electricity will be much higher if the entire population of the country has to be brought under the coverage of electricity. However, the most challenging part of implementing the power plan will evidently concern the ability of the government to manage the required fuels.

Figure 1.35: Required Growth in Electricity Generation to Attain the GDP during Sixth Five-Year Plan Targets



Source: Estimated based on Asaduzzaman and Billah (2008); and BIDS (2010).

Setting up of new plants is also necessary for additional power generation capacity

Reducing System Loss

System loss in power generation, transmission and distribution has been substantially reduced over the last two decades. However, there is still opportunity to reduce further, by some estimates up to another 5 per cent, over the next few years. It is a recognised fact that developing countries do tend to have high system loss in power generation, transmission and distribution. Bangladesh has been no exception in this respect. On a positive note, system loss has come down from about 40 per cent in the 1990s to less than 25 per cent in FY2009-10.[45] Because of system loss alone, the daily electricity loss is estimated to be in the range of 871-952 MW (June 2010), which is equivalent to about 49-54 per cent of the current supply shortage in Bangladesh. An amount of Tk. 6,375 crore to Tk. 8,538 crore could be saved annually had there been no such losses. Measures such as introduction of smart grids, strong enforcement mechanism, conversion of all old meters into digital ones, and obstacle-free electric lines could reduce the loss from the current 21.6-23.6 per cent to about 16.6-18.6 per cent. This could save about 202 MW of electricity per day (more than 10 per cent of the shortage). In other words, Tk. 1,355 crore per annum could be saved in the absence of such losses.

System loss has come down from about 40 per cent in the 1990s to less than 25 per cent in FY2009-10

[45]In the month of May 2010, the overall system loss stood in the range of 21.6 to 23.6 per cent of the total net generation; loss on account of distribution, transmission and 'station use' were about 14.6, 4-5 and 3-4 per cent respectively.

Gas and Coal Sector

Status of the Reserve

The quantum of proven gas reserves in the existing fields is inadequate to satisfy the growing demand of the country in future. Till date, a total of 23 gas fields have been discovered in Bangladesh which has altogether 29.2 trillion cubic feet (tcf) of gas reserves. However, only 15.4 tcf was found to be recoverable. Out of this, 8.4 tcf gas has already been exploited by June 2009, leaving only 7 tcf of recoverable gas for future use. An additional 5.5 tcf gas reserve is expected to be found in the country in future (MoF 2009). All the large proven reservation fields, including Titas, Habiganj and Bibiyana have been in operation for a long period, and do not have much reserve left for future use. Till any large proven and recoverable gas field is discovered, Bangladesh will need to strategise in a manner that ensures optimal use of the proven reserve of only 7 tcf that is left in its fields.

Till date, a total of 23 gas fields have been discovered in Bangladesh which has altogether 29.2 tcf of gas reserves; however, only 15.4 tcf was found to be recoverable

On the other hand, a total of 2,700 million tonnes of coal has been discovered so far in the five coal mines of the north and north-western districts of the country. This reserve is large and equivalent to about 37 tcf gas for energy generation. However, except Barapukuria underground coal mining, coal has confined to remain an untapped resource in Bangladesh. There is thus a need to undertake immediate decision on extraction of coal and generation of coal-based power in the country.

Extraction and Exploration

Increased extraction of gas resources has led to a faster pace of depletion of available gas reserves in the country. This situation, thus, calls for an immediate need for further gas exploration in the remaining blocks and new exploration in the offshore zones of the country. In June 2010, daily shortage of gas in Bangladesh was more than 250 million cubic feet/day (mmcfd). As may be recalled, coal mining at the Barapukuria site was started in September 2005 with the help of the Chinese Government. Till December 2008, about 1.8 million MT of coal has been extracted from the site, which has been primarily used for the Barapukuria thermal power plant of 250 MW. There is no viable alternative for Bangladesh, in the medium to long-run, for power generation other than the exploitation of the country's coal resources. However, issues such as environmental impacts and their mitigation, rehabilitation of the local populace, price of the resources, recruitment of local people, and safety measures for workers, are to be taken care of while making a decision in this regard.

There is no viable alternative for Bangladesh, in the medium to long-run, for power generation other than the exploitation of the country's coal resources

Way Forward

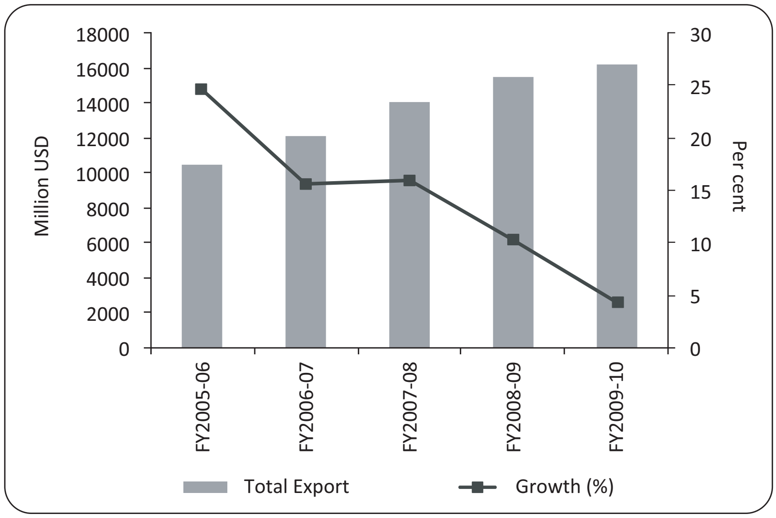
The above discussion on the energy and power sector indicates that there is a need for short and medium-term initiatives to meet the current shortfall. A number of suggestions can be drawn up from the discussion. Some of these may be summarised as follows: (a) implement the plan for gradual increase of power during FY2010-11 to FY2014-15; (b) develop the required fuel supply and storage capacity in the country; (c) ensure timely supply of power from the costly rental plants; (d) reduce the system loss further; (e) finalise the coal policy taking care of interests of the local people, workers and investors; (f) explore gas in the offshore zones and the remaining blocks of the country, and address the disputed issues with India and Myanmar; and (g) generate power through alternative and non-traditional sources, and provide fiscal and monetary incentives to encourage such initiatives.

1.7 EXTERNAL SECTOR

1.7.1 Export

Total export earnings of Bangladesh reached USD 16.2 billion registering a growth of 4.3 per cent in FY2009-10 compared to the 10.3 per cent growth during FY2008-09 (Figure 1.36). In the first two quarters of FY2009-10, performance of the external sector of the country suffered from the negative impact of the recent global financial crisis, as was manifested in the export growth. Exports started to pick up in the third quarter and gained some momentum in the fourth. This trend closely followed the performance of the readymade garments (RMG) sector, the dominant player in the export scenario.

Figure 1.36: Export Scenario of Bangladesh



Source: Estimated from EPB (2010) data.

During FY2009-10, non-RMG sector achieved a remarkable growth against the low export base in FY2008-09. To compare, the RMG sector experienced negative growth till the second quarter of the current fiscal and started to post positive growth momentum from the third quarter and onwards. As global recovery set in, orders for country's apparels also picked up. Consequently, exports rose by 4.5 per cent and 14.7 per cent in the third and fourth quarters respectively (Table 1.12). Total export figures during the first two quarters of FY2009-10 exhibited considerable volatility against the performance record in FY2008-09. However, 9.8 per cent and 19 per cent growth were registered in third and fourth quarters of FY2009-10 respectively, against 6 per cent and (-) 0.6 per cent growth posted in the matched period of FY2008-09. The total export target for FY2009-10 which was set at USD 17.6 billion could not be attained because of the slow pace of growth achievement. The signs are that exports will be able to post robust growth in FY2010-11.

Table 1.12: Quarterly Export Growth in FY2008-09 and FY2009-10

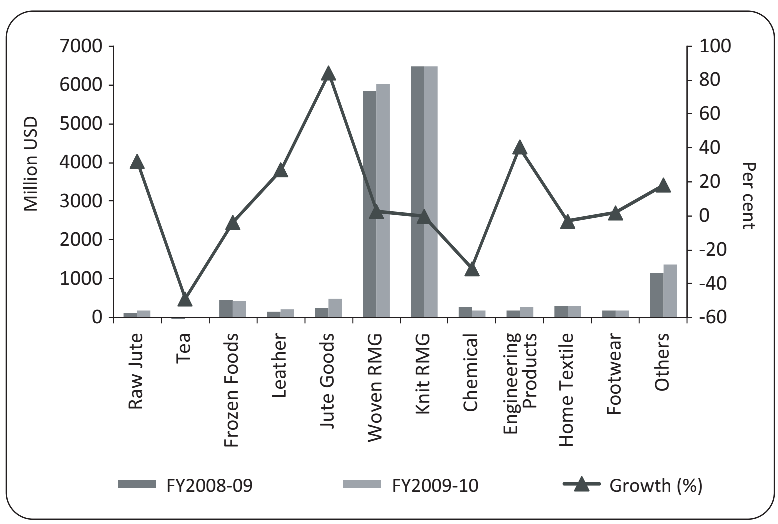
(in Per cent)

Item	FY2008-09					FY2009-10				
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
RMG	44.6	5.4	12.7	3.8	15.4	-9.7	-4.7	4.5	14.7	1.2
Woven	36.7	6.3	9.9	4.0	13.2	-9.7	-5.7	9.5	16.0	2.8
Knit	52.0	4.6	15.8	3.6	17.4	-9.7	-3.8	-0.5	13.6	-0.2
Non-RMG	35.7	-22.2	-16.4	-14.8	-5.8	-18.3	23.7	33.9	36.3	15.6
Total Export	42.4	-1.6	6.0	-0.6	10.3	-11.7	1.0	9.8	19.0	4.2

Source: Estimated from EPB (2010) data.

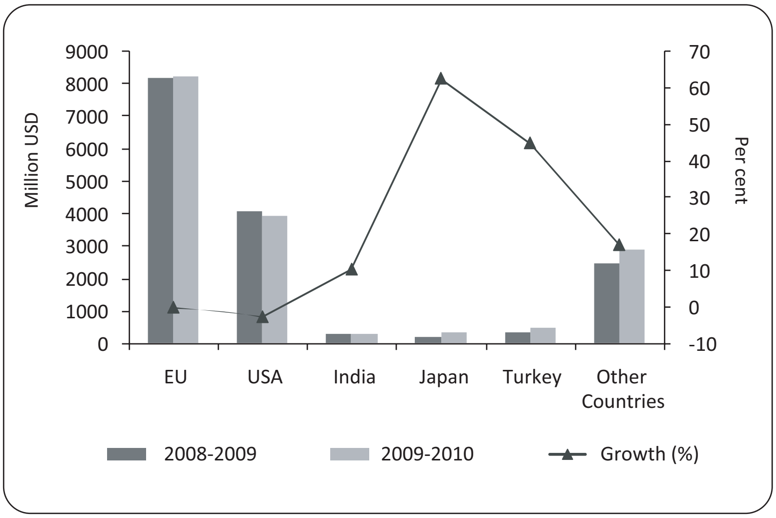
Overall, RMG export posted a 1.2 per cent growth, thanks mainly to the growth of woven wear (2.8 per cent); to contrast growth of knitwear RMG was negative (-0.2 per cent), for the first time in recent years. A number of export items were able to show some degree of buoyancy in FY2009-10 (Figure 1.37). It is important to note that, both raw jute and jute goods export in FY2009-10 has registered a spectacular

Figure 1.37: Export of Major Commodities by Bangladesh: FY2008-09 and FY2009-10



Source: Estimated from EPB (2010) data.

Figure 1.38: Major Markets of Bangladesh and Export Growth



Source: Estimated from EPB (2010) data.

Box 1.6: China as Bangladesh's Competitor in the US Market

Policy changes and stimulus packages to support export-oriented sectors, in view of the global financial crisis, have left their footprints in terms of changes in relative competitive strength in the global market for apparels (Rahman *et al.* 2010). This is demonstrated by Bangladesh's relative performance vis-à-vis China in the US market. US import of top 16 Bangladeshi apparel products (HS 6 digit level) declined by (-) 1.5 per cent during FY2009-10 compared to FY2008-09, whereas China was able to maintain a robust growth of 15 per cent for the same items. An examination at the disaggregated level suggests that China is reverting back to export of lower-end products where Bangladesh has traditionally been strong in the US market. In view of the crisis, China had earlier withdrawn duties on lower-end apparels that she had imposed to discourage exporters of these products and to induce them to go for higher value-added products. China's stimulus package of USD 760 billion included various incentives for exporters of lower-end items which enhanced their competitive strength and allowed them to offer lower prices, and put Bangladesh's exporters of those products under competitive pressure. Bangladesh will need to monitor closely the change in structural composition of apparels export from China, and should take proactive measures to retain her market share in US for these items. Bangladesh will also need to pursue more vigorously for the New Partnership for Trade Development Act 2009 (NPTDA 2009) which has been floated in the US Congress. If passed, this would allow Bangladesh and other Asia-Pacific least developed countries (LDCs) to have the African Growth and Oppotunity Act (AGOA)-parity and duty-free access for all items including apparels. Although Bangladesh has some concern with respect to certain aspects of the Bill, on the whole the country stands to gain significantly, if and when this Bill is passed.

growth of 68.03 per cent reaching USD 736.44 million compared to the set target of USD 438.29 million for FY2009-10.[46]

In terms of market diversification, in FY2009-10 Bangladesh experienced highest growth in the Japanese market (62.5 per cent). The EU and the US continued to remain the largest markets with 50.8 per cent and 24.4 per cent share respectively. The growth in the EU market remained at the same level (marginal growth of 0.1 per cent), while exports in the US declined by (-) 2.5 per cent compared to FY2008-09 (Figure 1.38). In recent years, Bangladesh's export to Turkey has increased significantly. Growth was 44.9 per cent in FY2009-10. Turkey's move towards higher end of the apparels market and the duty-free entry enjoyed by Bangladeshi export products helped to attain this impressive result.[47] Some of the renowned Turkish brands, such as Tema, and other wholesalers are increasing their procurements from Bangladesh. Export items from Bangladesh to Turkey include knitwear, woven garments, raw jute and jute goods, hides and skins, crockery, cutlery and handicrafts.[48]

It goes without saying that Bangladesh should do her best to take advantage of the opportunities emanating from the ongoing global recovery. Domestic policies need to be addressed keeping the interest of the export-oriented sectors in mind. Bangladesh will have to prepare herself to face the pressure from her competitors such as China, India and Vietnam which have taken various stimulus programmes in view of global financial crisis (for details please see Box 1.6). China's Ministry of Industry and Information Technology has already initiated a rural subsidy programme to support the growth of the textile and garment industry. Vietnamese and US officials have met to discuss ways of increasing business between those two, and are putting in place incentives to encourage bilateral trade. It is learnt that about two lakh new jobs will be created in Indonesia for relocating nine Chinese textiles and clothing

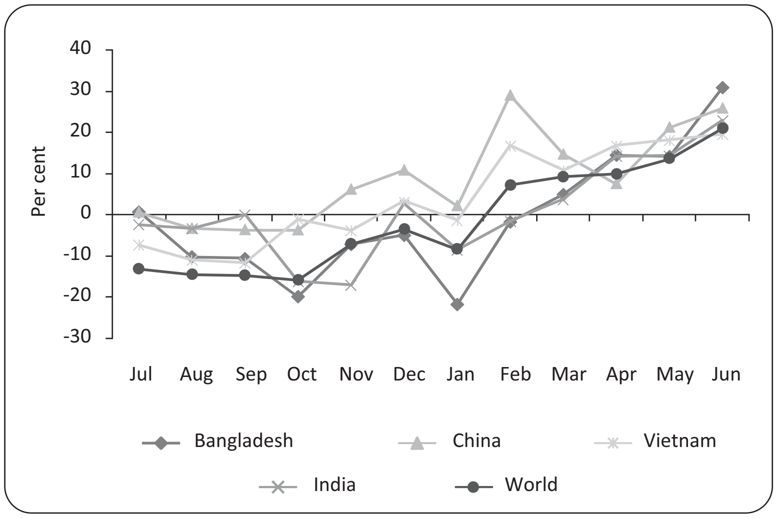
[46]This high growth was underwritten by an increase in both price and volume of export.

[47]Bangladesh receives EU-parity market access in Turkey which allows duty-free access for all items of exports from Bangladesh except for arms.

[48]A part of Bangladesh's exports (mainly apparels) is known to get entry into the EU market via Turkey through their wholesalers.

companies to Central Java (Market Publisher 2010). On the other hand, it has been forecasted that cost of Bangladesh's garment production will rise by 7 per cent following the implementation of the revised minimum wage which envisages an 80 per cent hike in the minimum wage for the country's garment workers (Market Publisher 2010). Bangladeshi entrepreneurs will need to give more emphasis on growth in productivity, product diversification (into higher-end items), and marketing to remain competitive.

Figure 1.39: Growth of US Import of Apparels from World and Some Major Source Countries: FY2009-10 over FY2008-09



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

It is worrisome to note that Bangladesh is losing her US market for RMG to India, China, Vietnam and Indonesia. Her apparels export posted a rise during the second half of the fiscal year (Figure 1.39). However, total apparels export to the US market in FY2009-10 declined marginally by (-) 1.8 per cent compared to FY2008-09. On the other hand, China, India and Vietnam posted a positive growth of 6.8 per cent, 1 per cent and 2.6 per cent respectively, although global import of the US declined by (-) 3.3 per cent over the same period. Cambodia appeared to be the most affected by the global recession, registering a decline of (-) 6.4 per cent during FY2009-10 compared to FY2008-09. In view of the ensuing recovery, Bangladesh should try to take advantage of the rising demand in the US market. Bangladesh must consolidate and strengthen her competitive position vis-à-vis Mexico and Vietnam, so that she is able to become the second largest exporter of apparels in the US, after China.

Some Emerging Concerns

One of the major concerns that afflicted export-oriented apparels sector in FY2009-10 relate to the price of yarn. The unusual hike in yarn price in early FY2009-10 undermined the export competitiveness of RMG significantly. Rise in global cotton prices due to low production in several key cotton-producing countries was the main reason behind this situation. To meet the demand, the GoB decided to allow import of yarn through Benapole land port from India. The situation was aggravated when India imposed an export ban on cotton for an indefinite period in view of low production. As a result, Bangladeshi exporters had to face cost-escalation which strained their competitive strength vis-à-vis cotton producing countries.

The unusual hike in yarn price in early FY2009-10 undermined the export competitiveness of RMG significantly

To mitigate the adverse impact of global recession, the government announced a second stimulus package on 25 November 2009. Key features of the second stimulus package included the followings: (a) providing further incentives on export earnings (at free on board (FOB) prices) from non-traditional export products and in non-primary markets (excluding US, Canada and EU); (b) increasing export incentive by an additional 5 per cent in FY2009-10 for SME exporters (those who exported more than USD 3.5 million)[49]; (c) providing grants at the rate of 10 per cent on paid electricity bills of SMEs which did not have their own captive generators, and this was to be continued till 30 June 2010;

[49] As distinct from the existing 5 per cent incentives, this is to go to the entrepreneurs (and not to backward linkage suppliers of fabrics).

(d) increasing the loan amount from USD 1.5 million to USD 10 million for a single borrower (through consortium of multiple banks and the Export Development Fund; (e) providing cash incentives, at the rate of 5 per cent, to the ship-building and crust leather industries to help diversify exports of these sectors with high potentials. The second stimulus package for export-oriented industries is yet to be implemented in full. There is a need to expedite this, as the delayed implementation of stimulus package will hinder export competitiveness and performance of Bangladeshi entrepreneurs. Timely implementation of the stimulus package will benefit entrepreneurs, especially of small and medium units in the RMG sector, who are having to cope with high costs originating from increased wages and higher costs of raw materials.

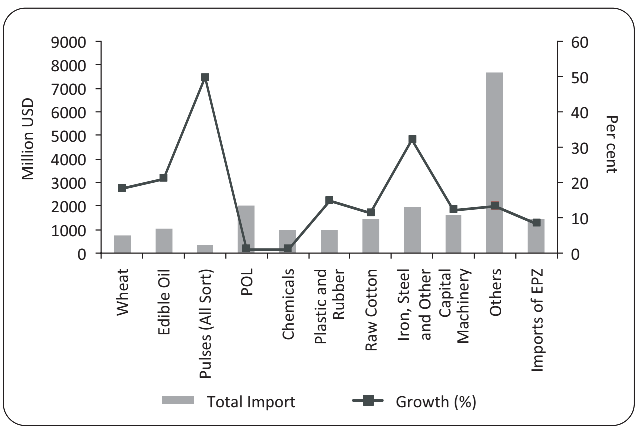
Delayed implementation of stimulus package will hinder export competitiveness and performance of Bangladeshi entrepreneurs

1.7.2 Import

Bangladesh's import experienced sluggish growth in FY2009-10. Total merchandise import of Bangladesh in the year was USD 23.74 billion, which was 5.5 per cent higher compared to FY2008-09. The declining trend dominated imports in the first quarter of the fiscal year with considerable volatility during subsequent two quarters. The last quarter witnessed a reversal of the trends with significant upturn for most of the products other than edible oil and crude petroleum. Import share of petroleum, oil and lubricant (POL) (8.5 per cent of total import) was the highest in total import which was followed by textile and articles (8.4 per cent of the total import); iron and steel, and raw cotton accounted for 6.1 per cent and 6 per cent of total import respectively. Import of foodgrains declined by (-) 5.2 per cent, with rice import falling by (-) 68.5 per cent. Good harvest of rice during FY2009-10, and price stability following high prices in 2007 and 2008 allowed Bangladesh to avoid significant import of rice. In FY2009-10, Bangladesh imported only 0.92 lakh MT of rice, while in the previous year Bangladesh had to import 6.03 lakh MT of rice. Import cost of POL decreased significantly during the first and second quarters, with growth rates of (-) 33.5 per cent and (-) 19.4 per cent respectively when compared with corresponding figures of the previous year. This was mainly because of significant fall in the price of POL from the high levels of previous years. However, due to international oil price hike in the second and third quarters of FY2009-10, import of POL rose by 4 per cent and 110.2 per cent respectively (Figure 1.40A).[50] Import of crude petroleum declined by (-) 8.5 per cent (Figure 1.40B). A 12.3 per cent increase was observed

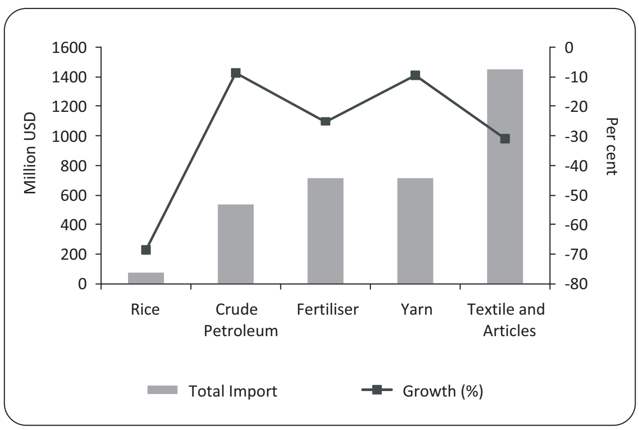
Bangladesh's import experienced sluggish growth in FY2009-10; total merchandise import was 5.5 per cent higher compared to FY2008-09

Figure 1.40A: Import of Some Selected Commodities with Increased Growth



Source: Estimated from Bangladesh Bank data.

Figure 1.40B: Import of Some Selected Commodities with Declined Growth



Source: Estimated from Bangladesh Bank data.

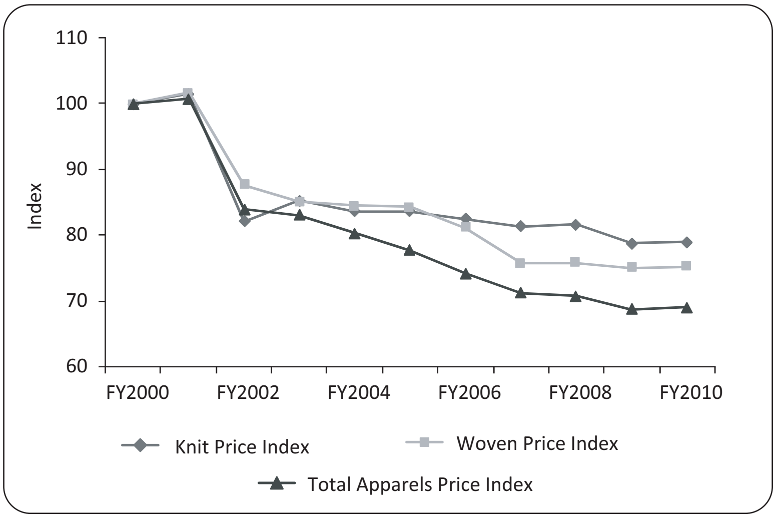
[50]USD 64.6 per barrel in June 2009 to USD 82.3 per barrel in April 2010.

in case of import of capital machineries, which augured well for investment. Even though import payments were negative in the first half of the fiscal, it bounced back in the latter half of the fiscal year in the wake of the global financial recovery. This increase in import is expected to persist in the coming months in view of higher industrial lending, growth prospect of the RMG sector and rising trends in the global commodity prices such as fuel and fertiliser.

Terms of Trade

With the rising global commodity prices (particularly fuel) and falling export prices of major commodities, Bangladesh's Terms of Trade (ToT) in FY2009-10 has worsened further. A decomposition of Bangladesh's export growth of 4.1 per cent in FY2009-10 shows that the growth was mainly volume driven: volume index increased by 4.96 per cent and price index declined by (-) 0.85 per cent. For manufacturing products, volume index increased by 5.2 per cent while price index declined by (-) 0.63 per cent. In case of Bangladesh's major export items, in FY2009-10, export of woven RMG declined by (-) 6.6 per cent in terms of volume, and by (-) 1.8 per cent in terms of price (Figure 1.41). For knit RMG, export volume declined by (-) 10.9 per cent while unit price increased marginally by 0.5 per cent.

Figure 1.41: Trends of Apparel Price Index



Source: Estimated from EPB (2010) data.

In view of the above, ToT declined even further in the recent past. Table 1.13 reveals that in 2008, to import a barrel of crude petroleum, Bangladesh had to export 3.62 dozens of RMG; by 2009, due to falling oil price, this had declined to 1.77 dozens. In 2010, this again increased to 2.94 dozens because of increase in the international oil price and falling export price of RMG. Similarly, to import one ton of rice in 2008, Bangladesh had to export 1.14 tonnes of jute, which declined to 0.98 tonnes in 2009, and further declined to 0.94 tonnes in 2010. Indeed, ToT for leading export items of Bangladesh vis-à-vis her important import items fell significantly in the post-crisis period compared to the pre-crisis period.

Table 1.13: Purchasing Power of Exports

Item	Dozens of RMG				Rise	Rise	Rise	Tonnes of Jute Goods				Rise	Rise	Rise
	2006 (Avg) (a)	2008 (Avg) (b)	2009 (c)	2010 (d)	(in times) b/a	(in times) c/a	(in times) d/a	2006 (Avg) (e)	2008 (Avg) (f)	2009 (g)	2010 (h)	(in times) f/e	(in times) g/e	(in times) h/e
1 barrel of oil (fuel)	2.29	3.62	1.77	2.94	1.60	0.80	1.29	0.11	0.17	0.11	0.13	1.50	0.90	1.19
1 ton of rice	10.76	24.42	16.44	20.60	2.30	1.50	1.91	0.53	1.14	0.98	0.94	2.20	1.80	1.77
1 ton of wheat	6.92	11.86	6.43	7.08	1.70	0.90	1.02	0.34	0.55	0.38	0.32	1.60	1.10	0.95
1 MT of soybean oil	20.75	45.75	24.13	34.00	2.20	1.20	1.64	1.02	2.14	1.44	1.55	2.10	1.40	1.52

Source: Estimated from various sources including Food and Agriculture Organization (FAO), World Bank, and Export Promotion Bureau (EPB).

1.7.3 L/C Opening and Settlement

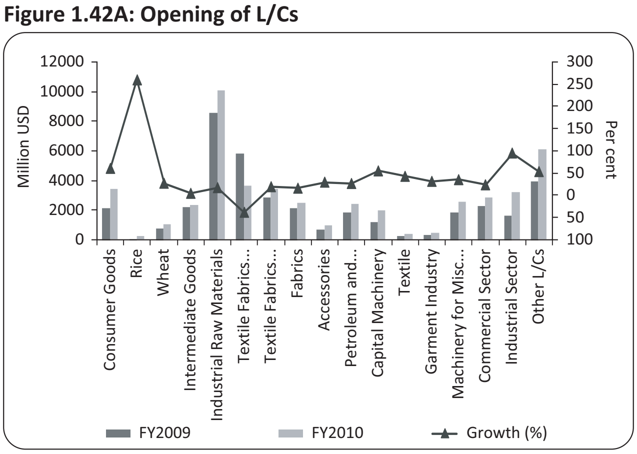
Opening of L/Cs for import have posted a remarkable rise in FY2009-10 and amounted to USD 28.6 billion, registering a growth of 31.5 per cent over FY2008-09. To compare, settlement of L/Cs in FY2009-10 was to the tune of USD 23 billion which was 7.1 per cent higher than that of FY2008-09.

Major share of opening and settlement of L/Cs belonged to industrial raw materials

Major share of opening and settlement of L/Cs belonged to industrial raw materials, with 35.1 per cent (USD 10.06 billion) in case of opening of L/Cs, and 35.8 per cent (USD 8.2 billion) for settlement of L/C. While L/C opening for industrial raw materials rose by 17.6 per cent, settlement of L/Cs declined by (-) 3.1 per cent in FY2009-10 compared to those in FY2008-09.

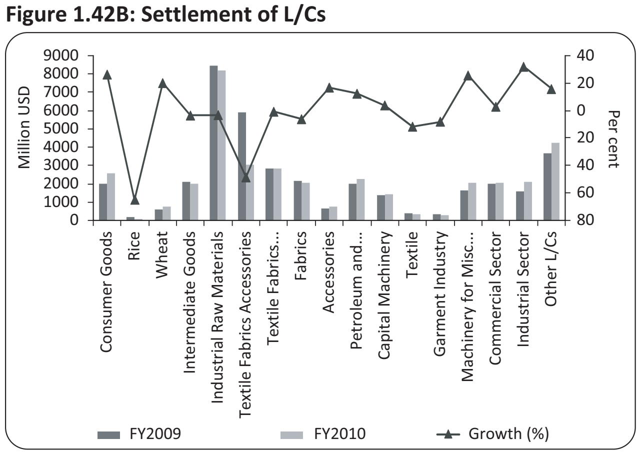
Opening and settlement of L/Cs for consumer goods increased by 60.8 per cent and 26.4 per cent respectively in FY2009-10 over FY2008-09. At a more disaggregated level, decline of L/Cs for rice can also be matched with the declining trend in import. Figures 1.42A and 1.42B indicate lower levels of L/C opening and settlement in FY2009-10. In the period, L/Cs opened for rice was worth USD 184.76 million, which was 259.4 per cent higher (USD 51.4 million) than L/Cs opened in FY2008-09. Settlement of L/Cs declined by (-) 64.6 per cent due to settlement of only USD 80.3 million in FY2009-10 compared to FY2008-09. On the other hand, opening and settlement of L/Cs for import of wheat were up by 27.5 per cent and 20.2 per cent respectively. It is to be noted here that, the volume of total foodgrain import in FY2009-10 increased by 14 per cent; rice import declined by (-) 85.2 per cent and wheat increased 39.4 per cent.

Figure 1.42A: Opening of L/Cs



Source: Estimated from Bangladesh Bank data.

Figure 1.42B: Settlement of L/Cs



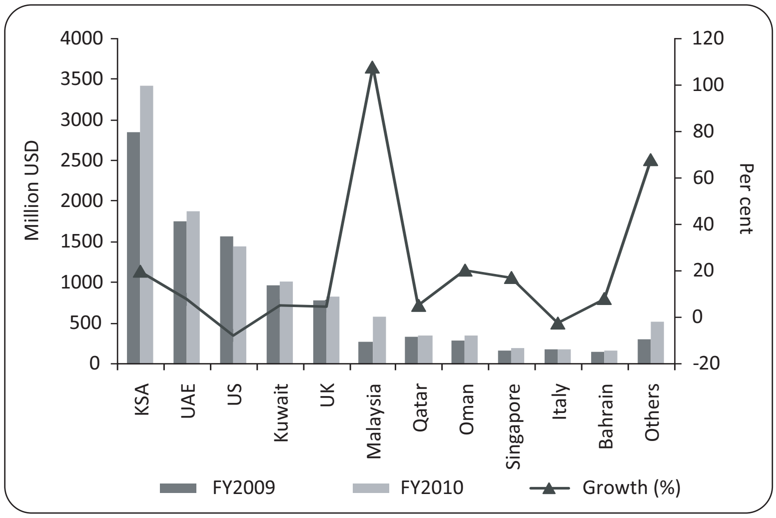
Source: Estimated from Bangladesh Bank data.

L/Cs opened for POL during this period was 26.9 per cent higher than the previous year, while settlement was 12.5 per cent higher. Both opening and settlement of L/Cs for textile fabrics accessories declined by (-) 37.7 per cent and (-) 48.3 respectively. This may have been due to the follow up impact of global financial crisis. During this period, L/C opening of capital machineries experienced a high growth of 55.2 per cent, but settlement of L/Cs posted a marginal growth of 4 per cent. Capital machinery import increased by 12.3 per cent in FY2009-10. For textile and garment industries the growth of L/C opening was 43 per cent and 31.7 respectively. Higher amount of L/Cs indicate a positive news for the economy, however, there could be a drawn down in the reserves if exports do not pick up in a significant manner, as it indicates a substantive investments being taken place in the economy. This is to be kept in mind that the surge of L/C opening will also have impact on the forex reserve.

1.7.4 Remittance Inflow and Overseas Employment

Remittance flow during the first half of FY2009-10 was excellent, though by the second half of the fiscal year growth had slowed down quite significantly. During FY2009-10, remittance earnings reached USD 11 billion, an increase of 13.4 per cent against the high benchmark growth of 22.5 per cent in FY2008-09. In November 2009 remittance flow was highest, at USD 1.05 billion. However, remittance flow started to decline in the second half of the fiscal year. Figure 1.43 shows that Kingdom of Saudi Arabia (KSA) continued to be the major source of remittance contributing 31.2 per cent of the total remittance inflow to Bangladesh. This was followed by the United Arab Emirates (UAE), US and Kuwait (with shares of 17.2, 13.2 and 9.3 per cent respectively).

Figure 1.43: Country-wise Remittance Flow to Bangladesh



Source: Estimated from Bangladesh Bank data.

Outflow of migrant workers declined by 34.3 per cent in FY2009-10 compared to FY2008-09. The monthly average figure of migrants' outflow went down to 27,049 in February FY2009-10; to compare, this was 35,850 in May FY2008-09. Although the number was decreasing, the total stock of migrant workers was on rise. As a result, remittance inflow did not slowdown and experienced robust growth. In 2009, some 475,278 workers went abroad (Table 1.14). Among these workers, the share of professional workers was only 0.30 per cent, an insignificant rise from 0.21 per cent in 2008. The share of skilled workers has come down to 28.9 in FY2009-10 from 32.2 in FY2008-09; on the other hand, the share of semi-skilled and less-skilled workers reached 16 per cent and 54.8 per cent respectively in FY2009-10 from 15.2 per cent and 52.4 per cent respectively in FY2008-09. The recent declaration of governments of the Saudi Arab[51] and Malaysia to recruit 1.4 million workers provide Bangladesh an opportunity to send more migrant workers abroad in the near future. If this does not happen, then rise in remittance flow may be reversed, and Bangladesh could experience negative growth in remittance flow over the subsequent years.

Table 1.14: Share of Classified Migrants from Bangladesh

Year	Labour Outflow	Share of Different Categories of Workers (%)				
		Professional	Skilled	Semi-skilled	Less Skilled	Total
2007	832609	0.08	19.86	22.06	58.00	100.00
2008	875055	0.21	32.16	15.18	52.44	100.00
2009	475278	0.31	28.85	16.03	54.81	100.00

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

In Bangladesh, remittance earnings of households go mostly for consumption purpose, rather than for investment. Recently, a number of initiatives have been taken by government to encourage investment by the migrant workers. Wage Earners' Development Bond for the migrant workers and the *Expatriate Welfare Bank Bill 2010* which was introduced in the parliament to make way for setting up a separate bank for migrant workers, are noble initiatives of the government in this regard. It will need to be ensured that migrants from rural and remote areas can get benefit from these measures. Global labour market is expected to see rising demand in the near and medium-term future. Bangladesh should be

In Bangladesh, remittance earnings of households go mostly for consumption purpose, rather than for investment. Recently, a number of initiatives have been taken by government to encourage investment by the migrant workers

[51]Saudi Arab has declared to recruit 4,500 skilled Bangladeshi workers under a quota system.

prepared to realise the opportunities to be offered by a growing global market. Reduction of cost of migration, upgradation of workers' skill, reduction of cost of money transfer by workers, and investment opportunities for the migrants are some of the issues for policymakers to take up. At the international level, the government has to explore new markets, and bring its diplomatic work into play and expand its network to facilitate employment of Bangladeshi workers.

The demographic dynamics of the developed world is set to create new avenues of employment for foreign workers. Towards this a carefully crafted policy of skills development in emerging areas of demand, many of which are expected to be in medicare and health services, should be undertaken.

1.7.5 Balance of Payment

Trade balance recorded a high deficit of USD 5.2 billion in FY2009-10 compared to USD 4.7 billion in FY2008-09 (Table 1.15). However, this was not as high as the case was in FY2007-08 (USD 5.3 billion). Trade deficit on services account declined to USD 1.2 billion in FY2009-10 from USD 1.6 billion in FY2008-09. Despite a larger trade balance due to increased import, current account surplus recorded an increased amount of USD 3.7 billion in FY2009-10 from USD 2.4 billion in FY2008-09. This was due to a current transfer of USD 11.6 billion of which remittance inflow accounted for USD 11 billion.

Table 1.15: Balance of Payment

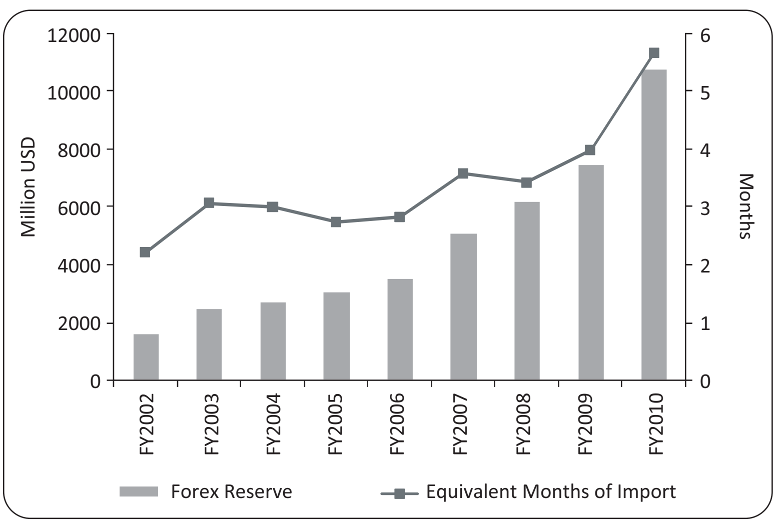
(in Million USD)

Component	FY2008-09	FY2009-10
Trade balance	-4710	-5152
Services	-1616	-1237
Current transfers	10226	11610
Official transfers	72	122
Private transfers	10154	11488
Of which: Workers' remittances	9689	10987
Current account balance	2416	3734
Capital account	451	442
Financial account	-825	-755
Errors and omissions	16	-556
Overall balance	2058	2865

Source: Estimated from Bangladesh Bank data.

Overall, trade balance indicates some deterioration. Export earnings and import payment in FY2008-09 was USD 15.6 billion and USD 20.3 billion respectively. Export earnings increased to 16.2 billion and import payments were even higher, at about USD 21.4 billion in FY2009-10. Accordingly, trade balance deteriorated further in FY2009-10 and reached USD 5.2 billion. Import payment increased because of higher import of edible oil and sugar in FY2009-10 (21.3 per cent and 57.2 respectively). In case of financial account, BOP experienced a net deficit of USD 755 million in FY2009-10 against a deficit of USD 825 million in FY2008-09. Overall balance registered a modest surplus of USD 2.9 billion in FY2009-10 against the record of FY2008-09, which was USD 2.1 billion.

Figure 1.44: Foreign Reserve Trends and Equivalent Months of Import



Source: Estimated from Bangladesh Bank data.

The BOP situation may come under pressure in FY2010-11 if remittance flow fails to maintain the current momentum and import payments go up on account of both higher demand and higher global commodity prices. The situation could aggravate further if exports fail to record significantly high growth in the coming months and years.

1.7.6 Foreign Exchange Reserve

With increased remittance flow, impressive export earnings and lower import payment, foreign exchange reserves reached USD 10.75 billion at the end of June 2009, and posted 43.9 per cent growth compared to FY2008-09. Figure 1.44 depicts the growth in forex reserves and its equivalence in terms of import. Thus, foreign exchange reserve at the end of FY2009-10 was equivalent to 5.7 months of Bangladesh's total import payment. The growing forex reserve will require prudent management both in terms of maintaining a competitive exchange rate between the BDT and other major currencies, and also call for efficient portfolio management of the reserves. About half of the foreign reserves of Bangladesh is kept primarily in USD, about one-seventh is in Euro, and the rest is kept in other currencies (CPD 2010). In view of the falling value of Euro against USD over last few months[52], the issue of prudent management of the growing reserve has become more important. It may be mentioned here that, in view of the current volatility of foreign currencies, some countries including China, India, Mexico, the Philippines, Venezuela and Ecuador are purchasing gold to diversify and consolidate their respective foreign exchange reserves. Careful management of foreign exchange reserves and proactive monitoring of the composition of the currency basket will be required if Bangladesh is to avoid losses arising from the growing volatility in the foreign exchange market.

Increased emphasis on social sector development reflects Bangladesh's commitment towards achieving the MDGs

1.8 SOCIAL SECTOR

Over the years, Bangladesh has undertaken various initiatives in the social sectors to mitigate the poverty situation and address equity concerns. Increased emphasis on social sector development in recent years also reflects Bangladesh's commitment towards achieving the Millennium Development Goals (MDGs) which provide a framework to improve the welfare of people through active policy intervention. As will be recalled, an amount of Tk. 7,745 crore was allocated in the revised budget for FY2009-10 for the line ministries dealing with health, education and technology, women advancement and children affairs, and social safety net (Table 1.16). To compare, this amount was 22 per cent higher than that of the corresponding allocation for FY2008-09.

Table 1.16: Sector-wise Allocation and Expenditure in FY2009-10

(in Crore Tk.)

Sub-sector	RADP Allocation (FY2010)	Utilisation (FY2010)		Utilisation Rate in FY2009 (%)
		Total	Allocation (%)	
Health				
M/O Health and Family Welfare	2814.41	2408.69	86.00	77.00
Education				
M/O Primary and Mass Education	2742.84	2730.43	100.00	97.00
M/O Education	1425.46	1340.22	94.00	96.00
M/O Science and Information & Communication Technology	122.56	112.71	92.00	94.00
Women Advancement and Children Affairs				
M/O Women and Children Affairs	159.56	152.71	96.00	99.00
Social Safety Net				
M/O Social Welfare	75.08	74.11	99.00	59.00
M/O Food and Disaster Management	255.24	239.46	94.00	86.00
M/O Labour and Employment	32.04	29.54	92.00	83.00
M/O Youth and Sports	117.94	112.30	95.00	86.00
Total for All	**7745.13**	**7200.17**	**94.00**	**86.00**

Source: Estimated from IMED (2010).
Note: M/O refers to Ministry of.

1.8.1 Health

86 per cent utilisation of the RADP by the Ministry of Health and Family Welfare (MoHFW) in FY2009-10 presents a fairly positive picture when compared to that of the previous year (77 per cent) and some of the other sectors' performance record in the same year. However, this still lags behind what is needed given the precarious scenario where only about half of the country's population have access to essential medicines. Besides, a growing population also means that demands on the health sector, both in terms of allocation and the quality of service will be on the rise.

[52]Value of Euro against USD has fallen roughly by 16.9 per cent between 1 January and 30 June, 2010.

Table 1.17: Progress under Various Components of the HNPSP during FY2009-10

Selected Components of HNPSP	RADP (Crore Tk.)	Release as % of RADP	Expenditure as % of RADP
Essential Services Delivery	461.0	88.5	82.2
Improved hospital services management	152.0	100.0	87.7
Pre-Service Education	53.2	100.0	99.4
In-Service Training	23.9	75.1	56.7
Micro nutrient supplementation	21.5	93.0	67.6
Maternal, child and reproductive health services delivery	225.0	98.6	67.8
Family planning field services delivery	162.0	93.8	91.4
National Nutrition Programme (NNP)	191.0	95.0	89.1
Physical facilities development	664.5	96.2	89.0
Research and development (health)	2.3	95.7	90.5

Source: Estimated from Ministry of Health and Family Welfare (MoHFW) data.

The Health, Nutrition and Population Sector Programme (HNPSP) is at present the single most important government intervention in the health sector. The project will end in 2011. A review of the programme performance indicates that in FY2009-10, the programme was able to register a mixed performance under various components of the programme (Table 1.17).

As available data suggests, there is an urgent need to raise the quality of implementation of initiatives under the In-Service Training component of the HNPSP. Given the less-than-standard quality of health services, particularly in the rural and remote areas, the need to prepare better trained health professionals cannot be overemphasised. This is also true for the service delivery in case of maternal, child and reproductive health sector for which only 68 per cent of the RADP allocation could be utilised in FY2009-10. If the present trends continue over the coming years, attainment of health-related MDGs by 2015 will come under challenge. In view of the fact that Bangladesh has only five physicians and two nurses per 10,000 people, recruitment of health professionals to fill up the vacant positions in the health sector ought to be given highest priority.[53]

RADP utilisation by the Ministry of Primary and Mass Education and the Ministry of Education in FY2009-10 stood at 100 per cent and 94 per cent respectively

It is encouraging to note that allocation for the health sector (Tk. 8,149 crore) in the budget for FY2010-11 was 17 per cent higher than that made in the previous fiscal. However, an MDG cost estimate by the GoB shows that Bangladesh will need to spend as much as Tk. 17,210.5 crore in FY2010-11 alone to be on the track in terms of achieving the health-related MDGs. This reinforces the need for enhanced government allocation in the sector which could complement household expenditure on health, and also underscores the need to raise efficacy of the service delivery in this regard.

1.8.2 Education

RADP utilisation by the Ministry of Primary and Mass Education and the Ministry of Education in FY2009-10 stood at 100 per cent and 94 per cent respectively. This performance can be attributed to the notable progress registered by various new and ongoing quality enhancement and stipend projects implemented in this period.

FY2009-10 was the first year of extension of the nationwide umbrella programme titled Primary Education Development Programme Second Phase (PEDP II)

As is known, FY2009-10 was the first year of extension of the nationwide umbrella programme titled Primary Education Development Programme Second Phase (PEDP II) which is under implementation by the Ministry of Primary and Mass Education since 2003. The programme will end in June 2011. According to official statistics, about 97 per cent of the allocated budget for FY2009-10 (Tk. 1,694 crore) could be utilised till June 2010.[54] As for cumulative expenditure till the end of FY2009-10, this stood at more than 94 per cent which manifests an impressive utilisation rate for the programme. It is also encouraging to see that the

[53] According to *The Health Bulletin 2009*, published by the MoHFW and released in February 2010, there were 33,000 vacant posts in the public health sector. However, information from various sources suggests that initiatives are underway to recruit 14,000 health professionals, including 4,133 doctors, 2,639 nurses, and 6,391 health assistants.
[54] Utilisation rate for the programme in FY2008-09 was 97.5 per cent.

government has allocated an additional Tk. 1,576 crore for the next fiscal. Given the previous track record, it is hoped that the allocated funds will be successfully spent during the remaining period of the project.

Apart from the PEDP II, the progress with regard to the Reaching Out of School Children (ROSC) project, which is considered to be a significant initiative towards attaining the MDG of ensuring universal primary education for all, has been impressive during the period under review. Available information suggests that expenditure under the project during FY2009-10 was about 97 per cent of the allocated Tk. 110 crore. Furthermore, approximately 92 per cent of the total expenditure was incurred in providing grants and education allowances to learning centers and students.

Table 1.18: Status of Major Education Projects for the Secondary Level in FY2009-10

(in Lakh Tk.)

Name of the Project (Implementation Period)	Total Project Cost	Cumulative Progress (up to June 2010) as % of Total Project Cost	ADP Allocation for FY2009-10	RADP Allocation for FY2009-10	Release as % of RADP Allocation	Expenditure as % of RADP Allocation
Teaching Quality Improvement in Secondary Education Project (01/07/2005 to 30/09/2011)	64471.00	61.24	6500.00	10100.00	100.00	97.32
Secondary Education Sector Development Project (01/01/2007 to 30/06/2013)	79333.00	42.56	6400.00	20450.00	100.00	83.36
Secondary Education Quality and Access Enhancement Project (01/07/2008 to 30/06/2014)	118177.00	27.37	14000.00	24069.00	100.00	93.34
Transformation of Existing Non-government Schools into Model Schools in Selected 306 Upazila Headquarters (01/01/2009 to 31/12/2013)	46577.00	0.03	900.00	6.00	100.00	97.00
Higher Secondary Female Stipend Project (Phase IV) (01/07/2008 to 30/06/2011)	20448.79	63.98	7000.00	9685.00	100.00	99.85
Life Skills Based Reproductive Health Education for In-school Youth and Adolescents through Peer Approach (01/01/2006 to 31/12/2010)	564.00	70.489	100.00	110.00	87.80	87.68
Secondary Education Stipend Programme (01/07/2009 to 30/06/2012)	68793.00	20.42		14100.00	100.00	99.65
Establishment of 11 Secondary Schools and 6 Colleges (Government) in Dhaka Metropolitan City (01/07/2009 to 30/06/2012)	43500.00	0.00				
Capacity Development for Madrasah Education (01/07/2009 to 31/12/2010)	810.00	42.72	789.00	56.09	56.08	

Source: Estimated from Ministry of Education data.

The introduction of the National School Feeding Programme in FY2009-10 was a positive step by the government towards increasing enrolment at the primary level. As has been planned, initially a total of 87 highest poverty-prone upazilas were to be selected based on the new poverty map. It may be noted here that two similar programmes namely Food for Education Programme (2007-2010) and School Feeding Programme (January 2009 to June 2013) are already in operation in some poverty-prone and remote areas of Bangladesh, which are being administered by the government with assistance respectively from the World Food Programme (WFP) and the European Commission (EC). The government is also looking forward to introduce Child Friendly Learning Centers in 209 upazilas in 44 districts. Estimated cost for the project for the period of January 2010 to December 2012 is expected to be Tk. 342.19 crore. It is expected that with such positive attitude of the government towards uplifting the quality of education in the country, it will be possible to achieve relevant MDG targets in time.

The government has given priority to improve enrolment and quality of secondary school students

In addition to various programmes undertaken for quality enhancement in the primary education sector, the government, through the Ministry of Education, has given priority to improve enrolment and quality of secondary school students by both initiating new projects and continuing several ongoing programmes in FY2009-10 (Table 1.18).

According to government data, about 93 per cent of the total RADP allocation for FY2009-10 could be utilised by the end of fiscal year. However, greater importance has been put on the Secondary Education Sector Development Project and the project on Capacity Development for Madrasah Education. Besides this, timely implementation of the work with regard to establishment of secondary schools and colleges in Dhaka city also needs to be ensured as no progress could be made on this project in FY2009-10. On the other hand, progress of the project with regard to stipends for female students at the Higher Secondary level appears to be on track. This project is expected to be a useful means towards eliminating gender divide in the education sector.

One significant step by the government in FY2009-10 was the approval of the National Education Policy 2010

Apart from the above mentioned performance under various components of the education sector, one significant step by the government in FY2009-10 was the approval of the National Education Policy (NEP) 2010 (Box 1.7). The final version of the draft is expected to be adopted by the National Parliament towards the end of 2010. To attain the objective of significantly improving Bangladesh's education system, effective implementation of the NEP will need to be ensured both in terms of its width and breadth.

Box 1.7: National Education Policy 2010

Major Milestones

- 8 April 2009: Setting up of National Education Policy Formulation Committee
- 2 September 2009: Submission of Draft NEP by the Committee
- 31 May 2010: Approval of NEP 2010 by the Cabinet
- Late 2010: Final NEP 2010 to be adopted by the National Parliament

Key Features of the NEP 2010

Pre-primary and Primary Education

- One-year long pre-primary education will be introduced for 5+ children;
- Adivasi (indigenous) teachers and textbooks on Adivasi languages will be arranged so that Adivasi children can learn their respective mother tongues;

(Box 1.7 contd.)

(Box 1.7 contd.)

- Education up to Class VIII will be primary and it will be free, universal and compulsory;
- Students will get stipends on the basis of Class V exam results;
- All students will have the scope to learn their respective religions.

Secondary Education

- Level of secondary education will be from Class IX up to XII;
- At secondary level of general, madrasah and vocational mediums, common curriculum and texts will be followed for Bengali, English, Mathematics, Information Technology (IT) and Bangladesh Studies;
- At the end of Class X, a terminal examination will be held at upazila, municipality and thana level on a common question paper and students will be given stipends on the basis of their results.

Higher Studies

- All three-year degree courses will gradually be turned into four-year Honours courses at all educational institutions;
- *Non-government Teachers Commission* will be formed for teachers' selection in non-government educational institutions and to provide them with trainings;
- To decentralise the National University, its centres will be set up at all divisional headquarters, and later these centres will be turned into approved universities for respective areas.

Vocational and Technical Education

- At the end of Class VIII, students passing the Primary Certificate Examination will be able to opt for vocational education, if they so want;
- To expand vocational and technical education, institutes will be set up in each upazila while numbers of polytechnic institutes, textile institutes and leather institutes will also be increased.

Facilities for Teachers

- To encourage meritorious students take up teaching profession, the issues of dignity and status of teachers will deeply be considered to restructure the system;
- Steps will be taken to enact an *Integrated Education Act* and form a *Permanent Education Commission*.

Source: Draft NEP 2010.

It is also pertinent to note here that allocation for the education sector in the national budget for FY2009-10 accounted for about 2 per cent of GDP. Based on the nature of economic development in countries around the world, there is little doubt with respect to the existence of a strong link between expenditure on education and development of a country. Hence, unless greater financial resources are mobilised and allocated to this vital sector, the goal of developing the required human resources to meet the country's needs will not be achieved. It is, therefore, recommended that investment in education is substantially increased in the years to come.

Progress with regard to most of the cash allowance programmes for the poor and vulnerable had been significantly positive in FY2009-10

1.8.3 Social Safety Net

Safety net programmes are designed to provide subsistence support to the resource-poor and vulnerable groups. With a view to implementing 63 social safety net programmes under the heads of social security and social empowerment, the national budget for FY2009-10 proposed an allocation of Tk. 173.3 crore (2.52 per cent of GDP).[55] Later on, the budget was revised and the amount stood at Tk. 167 crore (2.4 per cent of the revised GDP).

Progress with regard to most of the cash allowance programmes for the poor and vulnerable had been significantly positive in FY2009-10, both in terms of release of the fixed amount of monthly allowance and attainment of the targeted number

[55]This registered more than 25 per cent increase over the revised allocation for the previous year.

of enlisted beneficiaries.[56] Of particular interest in this context is the impressive utilisation rate registered by the line ministries responsible for implementing various social safety net programmes (Table 1.16). One may recall that performance of these ministries was quite disappointing in the previous year.[57] Apart from the regular allocations, a stimulus package worth of USD 725 million for FY2009-10 was announced in June 2009 to strengthen the social safety net programmes in view of the global financial crisis.[58] It may be noted here that the budget for FY2010-11 has proposed to increase the number of these programmes from 63 in FY2009-10 to 82 in FY2010-11 with nine new programmes introduced. To put this into practice, the government has proposed an allocation of Tk. 19,497 crore which is 14.8 per cent of the total budget.

In view of the pervasiveness of both poverty and natural disasters, foodgrain distribution through PFDS is considered by the poor as a critically important support

Public Food Distribution System (PFDS)

Distribution of foodgrains through both monetised and non-monetised channels in FY2009-10 was about 8 per cent lower than that of FY2008-09 (Table 1.19). This appears to be a disquieting performance in view of the fact that the total revised allocation of foodgrains for distribution under PFDS for the period under review (set at 2.68 million MT) was 0.55 million MT higher than previous year's actual distribution. At the end of the fiscal year, actual distribution fell short of target by about 27 per cent, particularly due to the fact that a large part of the allocation under OMS was not required to be distributed (including non-distribution of initially planned one lakh ton of wheat).[59]

In view of the pervasiveness of both poverty and natural disasters in Bangladesh, foodgrain distribution through PFDS is considered by the poor as a critically

Table 1.19: Channel-wise Distribution of Foodgrains in FY2009-10

('000 MT)

Sector	Channel	Revised Budget (FY2009-10)			Cumulative Distribution (1 July 2009 - 30 June 2010)			Distribution of Total Revised Budget (%)		
		Rice	Wheat	Total	Rice	Wheat	Total	Rice	Wheat	Total
Monetised	Essential Priority	157.0	122.0	279.0	152.0	93.7	245.6	96.8	76.8	88.0
	Other Priority	20.0	25.0	45.0	16.7	4.3	21.0	83.4	17.2	46.6
	Large Employers	18.0	4.0	22.0	9.7	5.6	15.3	54.1	139.0	69.5
	OMS, Fair Price Cards, Garments	500.0	100.0	600.0	308.6	0.0	308.6	61.7	0.0	51.4
	Others	0.0	0.0	0.0	0.7	0.0	0.7	N/A	N/A	N/A
	Sub-total	*695.0*	*251.0*	*946.0*	*487.0*	*103.6*	*590.6*	*70.1*	*41.3*	*62.4*
Non-monetised	FFW	200.0	175.0	375.0	265.9	110.2	376.1	132.9	63.0	100.3
	TR	150.0	250.0	400.0	164.8	203.3	368.2	109.9	81.3	92.0
	VGF	550.0	0.0	550.0	248.3	0.1	248.3	45.1	N/A	45.2
	VGD	100.0	165.0	265.0	66.8	205.6	272.4	66.8	124.6	102.8
	GR	64.0	0.0	64.0	37.0	0.0	37.1	57.8	N/A	57.9
	Others	45.0	30.0	75.0	38.8	30.1	68.8	86.1	100.3	91.8
	Sub-total	*1109.0*	*620.0*	*1729.0*	*823.7*	*549.3*	*1373.0*	*74.3*	*88.6*	*79.4*
Grand Total		1804.0	871.0	2675.0	1308.5	652.9	1961.4	72.5	75.0	73.3

Source: Estimated from Food Policy Monitoring Unit (FPMU) data.

56 Available information suggests that utilisation rate for all these programmes ranged between 95-99 per cent of the allocated fund (Source: Department of Social Services, GoB).

57 The Ministries of Food and Disaster Management, Labour and Employment, and Youth and Sports registered 83-86 per cent utilisation of RADP allocation in FY2008-09. On the other hand, Ministry of Social Welfare was able to achieve only 59 per cent utilisation target with regard to total RADP allocation during the same period.

58 The first stimulus package worth USD 500 million was announced by the government on 19 April 2009. The package provided 11 per cent of total allocation for various social safety net programmes.

59 See, Bangladesh Food Situation Report, Vol. 81.

important support towards meeting their daily food intake requirements. However, experience over the years shows that irregularities still exist both during the preparation of beneficiary lists, and the distribution of allowances/foodgrains among the deserving populace. Given the undisputed importance of social safety net programmes in the socioeconomic development of the resource-poor community in Bangladesh, strong vigilance and monitoring by the respective government authorities will have to be ensured throughout the implementation phase to avoid any pilferage or misuse of resources. In this context, GoB should expedite efforts towards creating beneficiary database for various safety net programmes using National ID cards. It may be mentioned here that such a proposal has been put forward by the government in the national budget for FY2010-11.

GoB should expedite efforts towards creating beneficiary database for various safety net programmes using National ID cards

Despite a number of significant improvements made in the social sector in FY2009-10, much remains to be done in view of the reality that majority of the population in Bangladesh still lives below the poverty line. Besides, the already saturated labour market is under pressure to accommodate new entrants. Poor quality of healthcare services are failing to meet people's demand, and education budget as percentage of GDP is still one of the lowest in the South Asian region. Thus, the strategy for future will be to mobilise more resources for social sector and raise efficacy of utilisation of the resources to meet the growing demand of the population.

1.9 OUTLOOK FOR FY2010-11

Growth and Investment Outlook

Encouraged by the upturn in the post-crisis global economy with its favourable impact on external sector performance, and in light of the envisaged steps to mobilise domestic resources, stimulate sectoral growth and a number of short-term measures to partially solve the ongoing power crisis, the GDP growth target for FY2010-11 was initially set at 6.7 per cent. In view of the attained GDP growth of 5.83 per cent in FY2009-10, this target is rather ambitious although underachievement in the growth figure in FY2009-10 (5.8 per cent as against 6 per cent) would mean that the proposed growth rate will need to be achieved on a relatively low base. Attainment of this target will hinge on many factors and would require a robust performance in all the critical sectors of the economy. Projections of sectoral GDP growth targets for FY2009-10 made by the government are not available. However, CPD has carried out an exercise to project the sectoral GDP growth targets on the basis of the aggregate GDP target of about 6 per cent, past experiences, recent benchmarks, and the current context (Table 1.20).

Table 1.20: Projection of Sectoral Growth Targets for FY2010-11

(in Per cent)

Sector	FY2009-10	FY2010-11*
Agriculture	4.7	4.6
Industry	6.0	8.5
Services	6.4	6.8
GDP	5.8	6.7

Source: CPD projection and estimation based on BBS (2010b).
Note: *Sectoral growth rates are projected in view of the GDP growth target.

As has been noted earlier, good agricultural production and resilient and robust export performance were the highlights of FY2009-10. If the current policy support is continued and there is no major natural disaster, a near 4.6 per cent growth in the agricultural sector is likely to be achieved in FY2010-11.

Good agricultural production and resilient and robust export performance were the highlights of FY2009-10

The average growth rate of the industrial sector during the past decade (FY2000-01 to FY2009-10) has been about 7.4 per cent. The last time a 'more-than-six-and- half-per-cent' growth was achieved in the industrial sector was in FY2005-06 (6.6 per cent), when the manufacturing sector contributed about 40 per cent of the incremental GDP. Similar level of performance in FY2010-11 would require that the industry sector grows at least by 8.5 per cent. The achievement of GDP target for FY2010-11 will largely depend on the envisaged contribution by the manufacturing sector.

Investment target suggests that the government is expecting an increase in the investment rate in FY2010-11

Historically, the services sector of the country has been able to demonstrate a steady performance in the backdrop of the moderate achievements in the real sectors. On average, the services sector posted a growth of 6.1 per cent per year during FY2000-01 to FY2009-10. Given the expected performance of the other two major sectors, it is likely that the services sector will be able to achieve a higher than average growth rate in the forthcoming year.

Investment target, as stated in the budget, suggests that the government is expecting an increase in the investment rate (as a percentage of GDP) from 25 per cent in FY2009-10 to 26.4 per cent in FY2010-11 (Table 1.21). A significant rise in public investment (in terms of ADP) may imply a stagnant share of private investment as a percentage of GDP in FY2010-11. This could be an indication of lack of growth in private investment or a priori acceptance of less than full delivery of the ADP.

Table 1.21: Medium Term Macroeconomic Outlook of Bangladesh Economy: FY2009-10 – FY2012-13

Indicator	Actual	Projection				
	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
Output						
Real Growth (%)	5.8	6.7	7.2	7.6	8.0	8.0
Inflation (12-month Annual Average) (%)	7.3	6.5	6.3	6.1	6.0	6.0
Gross Investment (% of GDP)	25.0	26.4	28.4	30.0	31.6	32.0
ICOR	4.3	3.9	3.9	3.9	3.9	4.0
Government Accounts (% of GDP)						
Total Revenue	10.8	11.9	12.5	13.1	13.6	14.1
Tax	9.0	9.7	10.2	10.8	11.3	11.8
Non-Tax	1.7	2.2	2.3	2.3	2.3	2.3
Total Expenditure	13.8	16.9	17.2	17.4	17.8	18.1
Current Expenditure	10.3	12.0	11.9	11.8	11.7	11.5
ADP Expenditure	3.5	4.9	5.3	5.6	6.1	6.6
Overall Balance (excluding Grants)	-3.0	-5.0	-4.7	-4.3	-4.2	-4.0
Financing	3.0	5.0	4.7	4.3	4.2	4.0
Domestic Financing	1.9	3.0	2.6	2.3	2.2	2.1
Banking System	-0.3	2.0	1.8	1.7	1.7	1.7
Non-banking System	2.2	1.0	0.8	0.6	0.5	0.4
Net Foreign Financing	1.1	2.0	2.1	2.0	2.0	1.9
Money and Credit (% Change)						
Net Domestic Assets	18.8	14.8	15.5	15.8	16.5	16.5
Credit to Private Sector	24.2	18.2	18.5	18.5	19.0	19.5
Broad Money (M2)	22.4	16.2	16.3	15.9	15.8	15.8
Balance of Payments						
Export (% Change)	4.1	15.0	16.0	16.5	17.0	17.2
Import (% Change)	4.1	16.0	17.5	18.0	18.5	18.7
Remittances (bln USD)	11.0	14.0	17.1	20.8	25.5	31.4
Remittances (% Change)	13.4	27.3	22.1	21.6	22.6	23.1
Current Account Balance (% of GDP)	3.7	3.6	3.3	3.0	2.7	2.3
Forex Reserve (bln USD)	10.8	11.0	12.0	12.5	13.0	14.5
Forex Reserve (Months of Imports)	4.9	4.4	4.0	3.5	3.0	2.7
Exchange Rate (Tk./USD)	69.5	70.2	70.7	71.2	71.5	71.9

Source: Medium Term Macroeconomic Framework (MTMF).

The ICOR has been projected to decrease to 3.9 in FY2010-11. This implies that some acceleration in the capital productivity has been anticipated. In order to achieve the targeted growth rate, investment, particularly private sector investment, has to increase significantly. The role of the much hyped PPP will continue to remain a critically defining factor in mobilising investible resources in the coming year.

Medium Term Macroeconomic Outlook

According to the projections of the new MTMF for the period between FY2010-11 and FY2014-15, the Bangladesh economy will grow between 6.7 and 7.2 per cent during FY2010-11 and FY2011-12 respectively

According to the projections of the new MTMF for the period between FY2010-11 and FY2014-15, the Bangladesh economy will grow between 6.7 and 7.2 per cent during FY2010-11 and FY2011-12 respectively. The GDP growth rate is expected to reach at 8 per cent in FY2013-14. The MTMF also makes projections for inflation rate at 6.5 per cent in FY2010-11, which is expected to decelerate further and remain stable at 6 per cent in FY2013-14. Higher domestic production is required to achieve this target, particularly in view of the rising global demand for food and rising global prices anticipated in the coming year. Containing inflationary pressure will be critical to achieving the MTMF targets.

The MTMF also forecasts that the budget deficit will come down gradually to 4 per cent of GDP by FY2014-15. This is based on the assumption that the current public expenditure will remain stable and that revenue mobilisation will steadily improve, particularly the tax revenue component. This will not be easy. It is hoped that reforms in tax laws will result in significant improvement in revenue collection. The government also intends to boost public investment significantly over the medium term, to reach 6.6 per cent of the GDP by FY2014-15. The other goals of the MTMF include lowering the dependence on domestic sources for deficit financing and keeping the deficit low by restraining reliance on foreign assistance.

The projected monetary aggregates do not reflect the required credit flow as has been planned for financing the fiscal deficit

A conservative monetary expansion is forecasted for FY2010-11 with contraction of M2 growth. However, the projected monetary aggregates do not reflect the required credit flow as has been planned for financing the fiscal deficit. It may be recalled here that the CPD had earlier suggested a moderately expansionary monetary policy stance given the current economic situation. Projections of credit flow and fiscal deficit indicate that the growth in M2 could be higher than anticipated. Hence, if credit to the private sector is increased, there could be a reduction of credit growth in the public sector. This indicates a potential mismatch with the proposed expansionary fiscal policy. Notably, growth of M2 is expected to slowdown further after the end of FY2014-15 compared to FY2010-11.

To achieve the MTMF targets, exports have to increase to USD 35.8 billion by FY2014-15 from the current level of USD 16.2 billion

To a large extent, the performance of the external sector will depend on the dynamics of the global market and the nature of the economic recovery. Targets for external sector have been kept at moderate levels. To achieve the MTMF targets, exports have to increase to USD 35.8 billion by FY2014-15 from the current level of USD 16.2 billion. Efforts towards both product and market diversification are needed to attain these targets. Given the recent slowdown in remittance inflow and overseas employment, the target to receive remittances of USD 31.4 billion by FY2014-15 appears to be rather optimistic. Much will depend on whether Bangladesh is able to achieve significant levels of market and product diversification. Equally, skill-mix will also have to be significantly improved if the ambitious remittance targets are to be achieved. By any measure, the tasks at hand are formidable and challenging.

1.10 CONCLUDING REMARKS

Bangladesh was able to take advantage of the global recovery that kept her balances robust and exchange rate stable

If maintaining macroeconomic stability at a time of great economic uncertainties, consequent to the global economic crisis, ought to be considered as one of the most important performance indicators of the economy in FY2009-10, then by and large Bangladesh economy has fared rather well. As the review of key macroeconomic indicators presented in the preceding sections testifies, country's growth was admirable by the standards of most other developing countries, and both domestic economy and external sector had performed well. Efforts to mobilise higher domestic resources through more intensive tax efforts succeeded in raising the tax-GDP ratio, and timely delivery of adequate and subsidised inputs for farmers was rewarded with higher crops output. Bangladesh was able to take advantage of the global recovery that kept her balances robust and exchange rate stable. This is not to say that the economy did not confront any pressure. Continuing power shortage undermined growth prospects and investment, and there was pressure on the domestic labour market in view of lower migration figures. Mounting inflationary pressure was also a major concern. Overall macroeconomic stability witnessed in FY2009-10 was not able to harness growth momentum since in the latter half, lagged response of the global financial crisis started to have adverse impact on the economy, particularly on the external sector. Growth prospects in FY2009-10 thus could not live up to the early promise.

Economic management in FY2010-11 will inherit many of the weaknesses that informed the macroeconomic management in FY2009-10

Economic management in FY2010-11 will inherit many of the weaknesses that informed the macroeconomic management in FY2009-10. Three key areas that will need to be addressed on an urgent basis relate to significant enhancement of the delivery capacity of the government, particularly in such areas as power generation and infrastructure development, attracting investments through PPPs, and maintaining a restraint on the gathering inflationary momentum. Delay in finalising policies, which in turn impedes their implementation, is increasingly proving not to be only financially costly, but is also having adverse impact on private sector investment. The achieved targets of FY2009-10 will need to be seen in the context of the medium-term planning framework and targets, and since FY2010-11 will be the first year of the Sixth Five-Year Plan and the ten-year Perspective Plan, this will call for better coordination and better coherence between short and medium-term policies in FY2010-11.

Implementation of the public expenditure plan, particularly the ADP component, will decide whether the projected 6.7 per cent growth in FY2010-11 will be achieved or not

Implementation of the public expenditure plan, particularly the ADP component, will decide whether the projected 6.7 per cent growth in FY2010-11 will be achieved or not. Higher domestic resource mobilisation and efficient management of fiscal deficit in a non-inflationary manner will be the key to achieving the forecasted growth. The twin objectives of maintaining macroeconomic stability and translating this into higher growth can be met only by a well-crafted supply-side management policy, which will boost production and take care of distributive justice and equity consideration. Indeed, the inflationary momentum may induce policymakers to resolve the attendant tension between growth and stability in favour of the latter. This, as is known, has its downside. The often conflicting interests of producers and consumers will have to be appropriately balanced through adequate incentives to farmers and producers, and improved system of delivery, better stock management, timely import, efforts to reduce the margin between wholesale and retail price and import and retail price, and an efficient safety net programme.

Taking advantage of the opportunities of global economic recovery must be seen as a cornerstone of macroeconomic policies to be pursued in FY2010-11. The balance of payment may, however, come under some pressure as imports pick up, but much will depend on how export and remittance perform. If either of these two fails to deliver the expected outcome, this pressure may increase. If this be the case, maintaining exchange rate stability at a time of inflationary pressure in the global commodity market will be a challenge. The situation may aggravate in view of higher demand of fuel import which could go up significantly in the backdrop of the fuel-intensive power generation projects that are being implemented at present. In anticipation of this the government may look out for additional foreign resources. It will be advisable if these are accessed in the form of budgetary support to maintain the required policy space at a time of heightened tension between conflicting policy choices.

Private sector, the dominant player in investment accounting for about 80 per cent of total investment, will be the key to achieving the growth target in FY2010-11. Whilst the renewed interest of private investment in the equity market ought to be seen as a good indicator, oversight institutions, particularly SEC, should be vigilant against any player trying to manipulate the market. This cautionary note is all the more pertinent because of the market trends and signs of overheating visible in the market towards the end of FY2009-10 and beginning of FY2010-11. Prudent policies will need to be pursued so that the stock market's primary role remains to be an avenue to raise equity and not to serve as a casino, signs of which are only too visible at this point in time. Highest efforts should be exerted by policymakers to mobilise the excess liquidity in the system towards productive investment. Lack of innovative thinking and approach could cost the country and the economy dearly, and put the current macroeconomic stability under threat. This is a risk that the Bangladesh economy can hardly afford.

Lack of innovative thinking and approach could cost the country and the economy dearly, and put the current macroeconomic stability under threat. This is a risk that the Bangladesh economy can hardly afford

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CHAPTER 1

APPENDIX TABLE AND FIGURE

Appendix Table 1.1: Summary of Monetary Sector Variables in FY2009-10

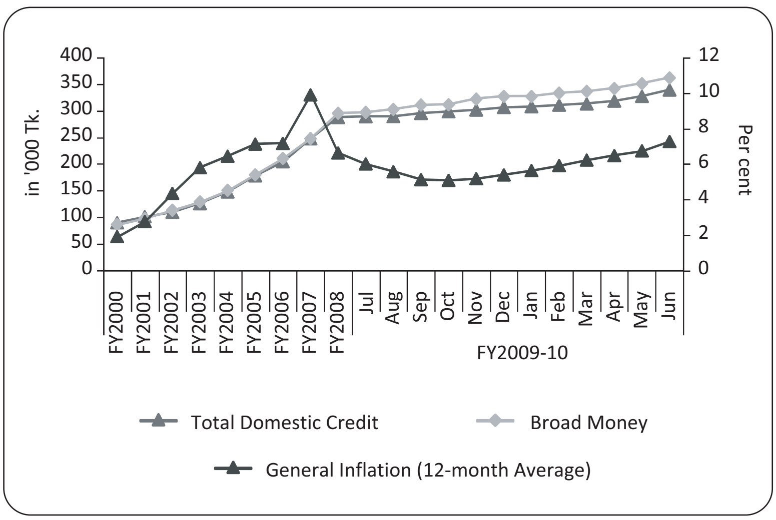
(in Per cent)

Indicator	FY2008-09		FY2009-10	
Inflation rates (June)				
- Point-to-point	2.25		8.70	
- 12-month average	6.66		7.31	
Growth in money supply (end of the period)				
- Broad money (M2) (end of June)	19.17	(296499.80)	22.44	(363031.20)
- Reserve money (end of June)	31.45	(69390.10)	16.03	(80510.30)
- Demand deposit (end of June)	14.02	(30236.50)	37.65	(41621.80)
- Time deposit (end of June)	21.42	(230073.00)	19.55	(275042.80)
- Excess liquidity (end of June)	167.64	(34762.08)	-0.76	(34498.73)
Growth in credit (end of June)				
- Domestic credit	16.03	(288552.40)	17.89	(340176.10)
- Credit to government sector	24.04	(58185.10)	-6.52	(54392.30)
- Credit to other public sector	6.94	(12439.70)	20.77	(15023.00)
- Credit to private sector	14.62	(217927.50)	24.24	(270760.80)
Growth in agricultural credit (end of June)				
- Disbursement	-10.66	(934.35)	31.42	(1227.91)
- Recovery	50.95	(935.61)	14.48	(1071.08)
Growth in industrial credit (July-June)				
- Term loan (disbursement)	-0.88	(19972.69)	29.56	(25875.66)
- Working capital (disbursement)	12.67	(45028.28)	31.41	(59171.95)
Percentage share of classified loan to total outstanding (June)	10.50		8.67	
Percentage share of net classified loan (June)	2.45		1.67	
Interest rates (end of the period)				
- Lending rate (June)	13.46		12.37	
- Deposit rate (June)	8.26		7.40	
- Spread (June)	5.20		4.97	
- Call money rate (June)	1.71		6.62	
Exchange rate (period average)				
BDT/USD (June)	69.05		69.36	
BDT/EURO (June)	96.78		84.71	
BDT/INR (June)	1.45		1.49	

Source: Estimated from Bangladesh Bank (2010a) and *Major Economic Trends*, various issues.

Note: Figures in parentheses refer to amount in Crore Taka.

Appendix Figure 1.1: Total Domestic Credit, Broad Money and Inflation (12-month Average)



Source: Estimated from Bangladesh Bank (2010a) data.

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CPD IRBD 2010: State of the Bangladesh Economy in FY2009-10*
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**CPD IRBD 2010 Team alone remains responsible for the contents of this report. The Expert Group Members do not carry any responsibility in this regard.*