Bangladesh Economy in FY2022–23

Interim Review of Macroeconomic Performance

Prepared under CPD's programme on

Independent Review of Bangladesh's Development (IRBD)

CENTRE FOR POLICY DIALOGUE

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The views expressed in this volume are those of the CPD IRBD 2023 Team members and do not necessarily reflect the views of the CPD.

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The CPD IRBD 2023 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

Contents

List of Tables, Annex Tables and Figures

Tables

Annex Tables

Figures

Acronyms

ADP	Annual Development Programme
ADR	Advance-Deposit Ratio
AIT	Advance Income Tax
AT	Advance Tax
AT	Additional Tax
B.O.P	Balance Of Payments
BAPEX	Bangladesh Petroleum Exploration and Production Company
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladeshi Taka
BFIU	Bangladesh Financial Intelligence Unit
BPC	Bangladesh Petroleum Corporation
BPDB	Bangladesh Power Development Board
CIID	Customs Intelligence and Investigation Directorate
CPD	Centre for Policy Dialogue
CPI	Consumer Price Index
ECF	Extended Credit Facility
EFD	Electronic Fiscal Devices
EFF	Extended Fund Facility
ENDS	Electronic Nicotine Delivery Systems
EPZ	Export Processing Zone
EU	European Union
FCB	Foreign Commercial Banks
FDI	Foreign Direct Investment
FY	Fiscal Year
GDP	Gross Domestic Product
GHG	Greenhouse Gas

GoB	Government of Bangladesh
HFO	Heavy Fuel Oil
HIES	Household Income and Expenditure Survey
HSD	High-Speed Diesel
IB	Islami Banks
IDCOL	Infrastructure Development Company Limited
IMED	Implementation Monitoring and Evaluation Division
IMF	International Monetary Fund
IPP	Independent Power Producers
ITES	IT-Enabled Services
L/C	Letter Of Credit
LDC	Least Developed Country
LNG	Liquefied Natural Gas
Mcf	Million cubic feet
Mmcfd	Million standard cubic feet per day
MoEWOE	Ministry of Expatriates' Welfare and Overseas Employment
MoF	Ministry of Finance
MoFA	Ministry of Foreign Affairs
MoP	Ministry of Planning
MoPEMR	Ministry of Power Energy and Mineral Resources
MW	Mega Watt
NBR	National Board of Revenue
NDC	Nationally Determined Contribution
NEER	Nominal Effective Exchange Rate
NER	Nominal Exchange Rate
NGO	Non-government Organisation
NPLs	Non-performing Loans
NSD	National Savings Directorate
OECD	Organisation for Economic Co-operation and Development
OMS	Open Market Sales
PCB	Private Commercial Banks
PVs	Photovoltaics
QRR	Quick Rental Power Plant
RD	Regulatory Duty
REER	Real Effective Exchange Rate
RMG	Readymade Garment
SB	Specialised Bank
SCB	State-Owned Commercial Banks
SD	Supplementary Duty

SDC	Sales Data Counter
SDG	Sustainable Development Goal
SREDA	Sustainable And Renewable Energy Development Authority
TCB	Trading Corporation of Bangladesh
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TTI	Total Tax Incidence
US	United States
USA	United States of America
USD	US Dollar
VAT	Value Added Tax
VGF	Vulnerable Group Feeding
WHO	World Health Organization

Chapter 1

State of the Bangladesh Economy in FY2022–23 *(Third Reading)*

1.1 INTRODUCTION

The assessment of key macroeconomic correlates of Bangladesh being carried out by the CPD as part of its flagship IRBD programme comes at a crucial juncture in the country's development journey. The measures required to correct some of the long-standing as also the newly emerging disquieting trends informing the management of the economy warrants in depth analysis to arrive at possible solutions. As is known, the Bangladesh economy had to face formidable difficulties owing to the adverse fallouts of the COVID-19 pandemic. At a time when the economy was coming out of the worst impacts of the pandemic, the situation was exacerbated by the Russia-Ukraine war which started in late February 2022 and was manifested in high global commodity prices, high imported inflation, and supply chain disruptions. While these exogenous factors have definitely left their footprints, embedded structural weaknesses, sub-optimal policies, lax policy implementation, lack of good governance, and inability to implement the required reforms have compounded the difficulties facing macroeconomic management in recent times. In July 2022, CPD had cautioned that these weaknesses would aggravate the pressure points in managing the Bangladesh economy (CPD, 2022).

Indeed, the Bangladesh economy has remained under considerable pressure throughout the first three quarters of FY2023. This was manifested through, inter alia, subdued momentum in revenue mobilisation and consequent shrinking of the fiscal space, high reliance on borrowings from the central bank for financing budget deficit, tightened liquidity position of scheduled banks, high prices of essentials, deteriorating external sector balance and foreign exchange reserve (CPD,2023). In view of these challenges, the Bangladesh government has resorted to a 42-month International Monetary Fund (IMF) supported programme under the Extended Credit Facility (ECF) and Extended Fund Facility (EFF) in an attempt to restore macroeconomic stability.[1] As IMF itself mentions, 'Bangladesh would risk falling into a subpar equilibrium of low growth, low investment, and weak human development, if left to restore macroeconomic stability on its own' (IMF, 2023, p.5). Furthermore, to meet the large climate financing requirements, the government in parallel sought support from the Resilience and Sustainability Facility (RSF)[2] of the IMF. Bangladesh has also sought budget support of USD 500 million from the World Bank in April 2023.

The timeline of the IMF programme coincides with the preparatory phase of Bangladesh's LDC graduation and the second half of the period to attain the SDGs. Given the juxtaposition of current developments and upcoming milestones, it is critically important to focus on consolidating the gains of the past, restoring macroeconomic stability, and adjusting to new realities taking the growth and stability trade-offs into cognisance. It is also to be noted that the IMF programme is being implemented on the eve of presentation of the FY2023-24 budget and when the country is preparing for its next national elections.

As experience shows, any attempt to restore macroeconomic stability under a predetermined set of conditions inevitably entails some hard choices and limits the options available for policy manoeuvring. The below examples could be useful to highlight this point.

1. If maintaining fiscal balance via lowering the budget deficit is the policy objective, then exploring new avenues of revenue mobilisation or reducing public expenditure might be unpopular for a

[1]The key objectives of the ECF/EFF arrangement are to restore macroeconomic stability and prevent disruptive adjustment (i.e., strict demand and import management measures which are disproportionately affecting the poor and the vulnerable and are likely to adversely impact medium-term growth prospects if they remain in place). The ECF/EFF programme is also expected to induce momentum in implementing source of the overdue macroeconomic reforms.

[2]The programme objective of the RSF is to improve the climate investment potential of Bangladesh.

political government. Also, continued bank borrowing to finance the growing budget deficit may crowd out private investment.

2. If improving the external sector balance is considered, then pursuing a free-floating exchange rate regime may entail inflationary implications. On the other hand, maintaining a managed exchange rate regime may not bode well for the foreign exchange reserve situation.
3. As a way of containing inflation, if a market-based interest rate is pursued, then it will imply higher cost of funds for the businesses. Counter inflationary measures such as providing direct fiscal support to the vulnerable groups via social safety nets may contradict the objective of maintaining a healthy fiscal balance.
4. Similarly, providing subsidy on agriculture and allocations for public procurement to ensure food security may not go hand in hand with the objective of maintaining fiscal balance. The subsidy required to ensure food security will depend on the import price of agricultural inputs, which, in turn, will be impacted by the exchange rate regime and global commodity prices.

Such intertwined nature of policy options calls for a concerted and co-ordinated effort towards macroeconomic management. At the same time, it raises further questions regarding how the very concept of macroeconomic stability should be perceived. Past experiences from the developing countries show that stabilisation packages prescribed by the multilateral agencies share many common elements. However, there are divergences in the results of such packages (Abbott, Andersen and Tarp, 2010; Taylor, 1988).

In this backdrop, the present report identified four sets of critical issues which should receive heightened attention in the current policy discourse, particularly from the macroeconomic management viewpoint. These are: maintaining fiscal balance, improving external sector equilibrium, containing inflation, and ensuring food security. While this report acknowledges the presence of several other critical issues, the aforementioned four were consciously focused upon given their significance in restoring macroeconomic stability, disciplining macroeconomic management, and identifying development priorities. Each of the selected four blocks of issues takes note of the IMF conditionalities (e.g., subsidy management, reserve estimation and milestones, market alignment) and their implications, data-related concerns etc. Furthermore, findings from recent nationally representative surveys such as HIES and LFS have been made use of as required.

1.2 FISCAL BALANCE OF BANGLADESH: SIX KEY AREAS OF POLICY INTERESTS

The fiscal framework of Bangladesh has shown signs of considerable stress all through the ongoing FY2023. This has been manifested in, inter alia, subdued growth in revenue mobilisation, slow implementation of the annual development programme (ADP), and increased reliance on bank borrowings to finance budget deficit—particularly from the central bank. The government also had to resort to an IMF-supported programme in the backdrop of discernible macroeconomic instabilities. The key objectives of this support programme include enhancement of revenue mobilisation, reduction of NSD certificate issuance, containment of subsidies, and increase of public expenditure efficiency with fiscal and institutional reforms. It must also be mentioned in this regard that the IMF programme comes with a set of time-bound milestones and conditionalities; the extent of availability of the support will hinge on Bangladesh's ability to meet those. Such conditionalities, on the one hand, will provide some form of policy predictiveness. On the other side, these will entail some hard choices on the part of the policymakers. In this backdrop, the present chapter spotlights some key areas that require urgent policy attention.

1.2.1 Major Observations on the Fiscal Framework during FY2023

Targets of revenue mobilisation for FY2023 will be missed by a large margin.

The revenue mobilisation scenario in FY2023 appears to be quite dismal. According to the Ministry of Finance (MoF) data, during July-February of FY2023, total revenue collection decreased by (-) 0.1 per cent over the corresponding period of FY2022. However, the targeted growth of total revenue for the entire fiscal year was 29.5 per cent. This implies that an unprecedented 98.3 per cent growth will be required during March-June of FY2023 if the target of revenue mobilisation is to be achieved. According to the MoF data, revenue collected by the National Board of Revenue (NBR) decreased by (-) 1.3 per cent during the July-February period of FY2023.[3] Since NBR is tasked to mobilise more than 85 per cent of the total revenue envelope, this state of collection undoubtedly points towards a large shortfall in revenue earnings (i.e., the gap between targeted and actual revenue mobilisation) at the end of the fiscal year. Indeed, CPD in March 2023 projected that the total revenue shortfall (including tax and non-tax) at the end of FY2023 would be approximately BDT 75,000 crore (CPD, 2023). Hence, it can be said with certainty that it is not possible to attain the ambitious revenue mobilisation targets set out in the national budget for FY2023 as well as the IMF conditionality.

Full utilisation of the budgetary allocations remains elusive.

The inability to deliver on the programmed budgetary allocation has continued in FY2023. During the first eight months of FY2023, only 37.6 per cent of the total budgetary allocations could be utilised. The corresponding figure for FY2022 was 38.3 per cent. Alarmingly, annual development programme (ADP) expenditure fell both in terms of monetary value and implementation rate during the aforementioned period as far as the MoF data is concerned.[4] The utilisation rate of non-ADP expenditure rose albeit significantly, from 47.5 per cent during July-February FY2022 to 47.9 per cent during July-February FY2023—indicating a 15 per cent growth. This was driven primarily by increases in expenditure owing to interest payments, subsidies, incentives, and current transfers. Due to the depreciation of the Bangladeshi Taka (BDT), the expenditure incurred for interest payments is likely to face upward pressure during the remainder of FY2023.

While the budget deficit widened, the composition of deficit financing has become a more problematic issue.

According to the MoF data, in the first eight months of FY2023, the budget deficit (excluding grants) reached BDT 21,201 crore compared to the budget surplus of BDT 2,937 crore in the corresponding period of FY2022. Net sales of National Savings Directorate (NSD) certificates decreased by (-) 63.4 per cent during the July-February FY2023 period thanks to reduced interest rates and additional regulatory requirements, including the obligation to provide income tax return submission receipts. Net borrowing from the banking sector, including the Bangladesh

[3]Curiously, as per NBR data, revenue collected by NBR increased by 8.9 per cent during the July-February period of FY2023 compared to the corresponding period of FY2022.

[4]According to data from Implementation Monitoring and Evaluation Division (IMED) of the Ministry of Planning, ADP implementation rate was 32.3 per cent during July-February of FY2023. IMED also provides more updated data for up to April FY2023. According to this, the ADP implementation rate during July-April FY2023 was 46.7 per cent—the second lowest in the last decade.

Bank, increased by nearly 70 per cent during the aforementioned period.[5] Net foreign financing has declined by (-) 24.8 per cent during the first eight months of FY2023, and the government has sought increased budget support from multiple development partners for FY2023.

1.2.2 Six Key Areas of Policy Interests

NBR will need to identify new sources to mobilise the required revenue

Enhanced economic activities will induce natural growth in revenue collection. To find out its extent, an OLS estimation was carried out. The model considered is provided in the following equation.[6]

$$\text{Log Tax revenue} = \alpha + \beta_1 \text{ Log GDP} + \beta_2 \text{ Log Import} + \beta_3 \text{ Inflation rate} + \varepsilon$$

From the estimation, it was found that a one per cent increase in real GDP and import will increase the tax revenue collection by 0.59 per cent and 0.65 per cent, respectively; the coefficient values are positive and statistically significant (Annex Table 1.1). On the other hand, the coefficient for inflation is found to be negative (-0.02) and statistically significant. This implies that a one per cent increase in inflation will result in a decrease in tax revenue collection by 0.02 per cent (Annex Table 1.1). As have been reported in several media outlets, targeted GDP growth and anticipated inflation in the upcoming FY2024 are 7.5 per cent and 6.0 per cent, respectively. Also, IMF (2023) projected that imports would increase by 14.2 per cent in FY2024. If these values are taken into consideration, then using the aforesaid coefficients, it can be forecasted that the tax revenue collection in FY2024 will increase by 13.5 per cent. As previous experience shows, growth targets of revenue mobilisation for a particular fiscal year are set considering the revised budget figures of the previous fiscal year. However, if the actual collection of the previous fiscal year is taken into account, then the growth targets for the following year become much higher. This ultimately contributes towards a considerable amount of revenue shortfall. If the potential shortfall in tax revenue is considered, the likely target will be expected to generate around 37-40 per cent growth. This implies that a natural course of action will not work for the government, particularly with respect to the NBR. Hence, it can be unambiguously stated that without new sources, the revenue shortfall will remain very high and will constrain the fiscal space significantly. As has been reported in the media, the government is planning to, inter alia, raise taxes on cigarettes, introduce some form of a carbon tax, impose a minimum tax on individuals who will file tax returns even if they do not have taxable income, increase capital gains tax, impose VAT on mobile phone at the manufacturing stage, etc. More potential sources of revenue collection, such as property tax, inheritance tax, and taxes on digital economic activities, can be explored,[7] not to mention going for better enforcement to deal with tax avoidance and corruption in the system.

Strategising rationalisation (gradual withdrawal) of tax exemption provisions will need to be objective

CPD has long been urging the need for rationalisation of tax exemptions which have become rampant over recent years. As part of IMF conditionalities, reduction of exemptions in the areas of income tax, VAT, and customs will have to be carried out. The extent and sequencing of the

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[5]The MoF data does not show how much money was borrowed from the Bangladesh Bank. However, according to Bangladesh Bank statistics, the government's net borrowing from the central bank during the July-February period of FY2023 stood at BDT 54,501.2 crore. The corresponding figure for FY2022 was negative BDT (-) 11,130.5 crore.

[6]Using data from Bangladesh Economic Review, the model considered the FY1993-FY2020 period.

[7]See Bhattacharya (2023) and Rahman (2023) to this end.

withdrawals will be key in balancing the needs of meeting the conditionalities and supporting domestic industries. There are many debates that inform the discourse concerning the provision of tax exemptions. In an ideal situation, all types of tax exemptions should respond to well-defined and clearly articulated policy objectives. However, in reality, this is often not the case. In some instances, certain exemptions benefit only the target groups instead of the whole society. In some cases, the exemptions may have been beneficial at the time of their introduction but, over time, lost their relevance in the wake of declining social returns. Many tax exemptions are introduced to appease various interest groups rather than to meet actual needs. This results in significant efficiency loss. In Bangladesh, many exemptions are not time-bound, and those that have time limits keep getting extended. Thus, a medium-term plan and timeline to phase out the various tax exemptions have emerged as an exigency. The next budget should lay out an action plan to this end. Some fundamental questions ought to inform this phasing-out process: whether new or existing sectors should be prioritised; whether export-oriented or domestic market-oriented industries should be prioritised. Whether households or businesses should be prioritised? The policy related to the rationalisation of tax exemption provisions should not be left to the vested interest groups and should prioritise small and medium businesses and general people.

The guiding principles behind the austerity measures should be clear

The government has already taken some austerity measures, which include expenditure cuts across the sectors and not undertaking new expenditures. In the FY2023 ADP, projects were divided into A, B, and C categories based on priority to ensure proper utilisation of limited resources. The A-category projects were planned to be implemented as usual, while up to 75 per cent of the allocation for the B-category projects could be spent. All C-category projects were put on hold. However, some of these restrictions were relaxed later. Whether the proposed categorisation was followed in view of the austerity measures remains a question. An account of cost savings owing to the categorisation of ADP projects and subsequent implementation can be provided in the FY2024 budget to bring some clarity. CPD, in December 2022, urged the government to prioritise the implementation of all foreign-funded projects in view of the foreign currency crisis. At the same time, projects which are closer to completion also needed to be prioritised (CPD, 2022). An incentive mechanism, following a carrot-and-stick principle, could be introduced to facilitate the timely implementation of ADP projects. It needs to be ensured that project costs are not abnormally inflated, citing the devaluation of the BDT as a reason. Finally, the austerity measures should be taken in a way that the impact on the social safety net, health and education sectors, agriculture, and small and medium enterprises (SMEs) is less onerous.

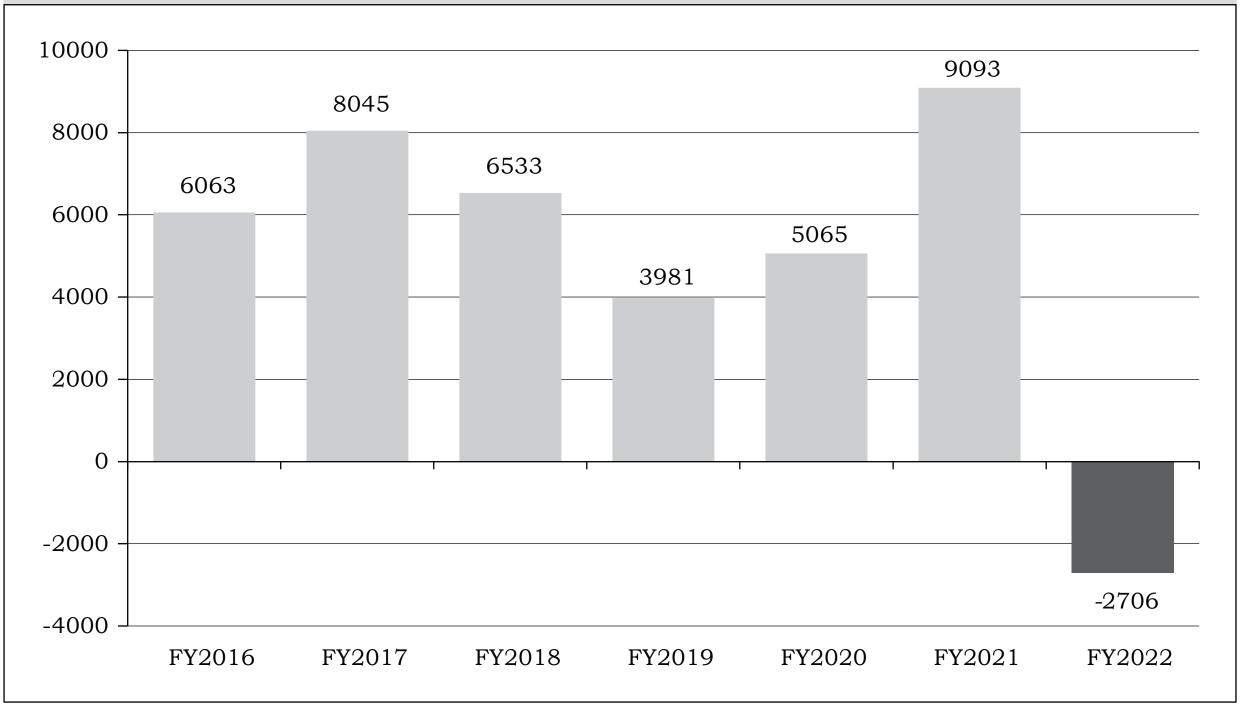
Prioritisation, pacing, and consideration of distributional impacts will be key in case of subsidy management

Adequate subsidies in the agricultural sector, particularly for fertilisers and pesticides, will need to be ensured. As the international commodity prices have come down, budgetary allocation for agriculture and food should be lower than the ongoing fiscal year; and hence, should not be a major concern. Indeed, a review of the agricultural subsidies will be necessary to see if such incentives can be extended beyond foodgrains and to other promising rising areas of agriculture, particularly in view of the ongoing commercialisation of agriculture. Food subsidy, if required, may be increased to expand public food distribution in the backdrop of high prices of essentials which should be directed towards the disadvantaged population groups in need. The current provisions of the fiscal incentives towards exports and remittances should be maintained to start with. However, exit plans will need to be formulated in both cases. For example, if the exchange rate is made market-based, the resultant depreciation should cover the fiscal incentives provided now. This is also true for export subsidies. While allocating the budget, the possible impact of a future depreciation of BDT needs to be taken into cognisance.

The most critical policy decisions in the areas of subsidy will need to be in the energy and power sectors. If the periodic formula-based price adjustment mechanism for petroleum products is adopted as per IMF suggestion, then no subsidy will be required for Bangladesh Petroleum Corporation (BPC). To this end, there is a need to review the tariff and tax structure. An institutional audit of BPC should be carried out to ensure transparency and accountability. Currently, of the retail selling prices of diesel (BDT 109/litre) and octane (BDT 130/litre), the government collects about 17–18 per cent as customs duty, VAT, advance income tax and advance tax. According to media reports, the government is considering the withdrawal of advance tax (5 per cent). However, this may not have an impact on the retail price as paid advance tax at the import stage is adjusted with the VAT collected at the domestic stage. According to CPD's estimation based on available information, BPC is likely to make profits to the tune of about BDT 5 per litre from selling a litre of diesel and about BDT 13 per litre from selling a litre of octane. So, there may be an opportunity to reduce petroleum prices between BDT 5-10/litre. It is to be noted that the windfall gain made by the BPC comes at the price of consumers' reduction in purchasing power. Indeed, BPC's total profit in the last seven years (FY2016–2022) was about BDT 43,804 crore. After paying BDT 7,727 crore as income tax to the government, the total net profit of BPC over the said period (FY2016–2022) was BDT 36,074 crore (Figure 1.1). Being a monopoly in the sector and as it is a state-own enterprise, penalising the citizens of the country cannot be justified. As the government may opt for a periodic formula-based price adjustment mechanism for petroleum products, the pricing mechanism, tax policy, and profits should be analysed publicly, objectively and transparently. Indeed, the government is also collecting additional revenues from the windfall gains of BPC as

Figure 1.1

Net profit of BPC after tax in the last seven years *(in crore/BDT)*



Source: Audit Reports of BPC.

VAT and income tax. The windfall gains of a (state-owned) monopoly should not be considered as 'value-added' on which VAT is to be imposed. Also, income tax is collected from the profit originating from the windfall gains of BPC. Indeed, with reduced prices of petroleum products, the demand for subsidies for the power sector will also decline.

The subsidy on power cannot be phased out overnight, given the inflationary effect of the power price rise.[8] Power sector subsidies should be rationalised not only by the upward revisions of electricity prices but also reducing the burden of capacity payments provided to IPPs and quick rentals. At the same time, the energy mix for power production and the associated deals in the power and energy sector will have to be scrutinised further. There must be a pathway to phase out of the costly quick rental power plants. The next national budget for FY2024 should refrain from making budgetary allocations for subsidies (or loans) to other state-owned enterprises.

A rethinking regarding the classification of social safety net programmes (SSNPs) is necessary if their expansion, both in terms of coverage and rates, is to be carried out in a transparent and meaningful way

Valid concerns remain regarding the transparency of SSNP implementation. Publicly available data only shows targeted coverage and allocation but never the actual implementation figures, which hinders comprehensive evaluation and understanding of their impact. One matter of contention is the inclusion of loosely related programmes that inflate the total number of SSNPs and the concerned budgetary allocations. While it can be argued that fringe elements need to be included to make a comprehensive list, the inclusion of completely unrelated programmes (e.g., pension for retired government officials, agriculture subsidies, various credit programmes, infrastructure projects, etc.) raises questions as to whether the intention was to inflate the statistics in the first place.

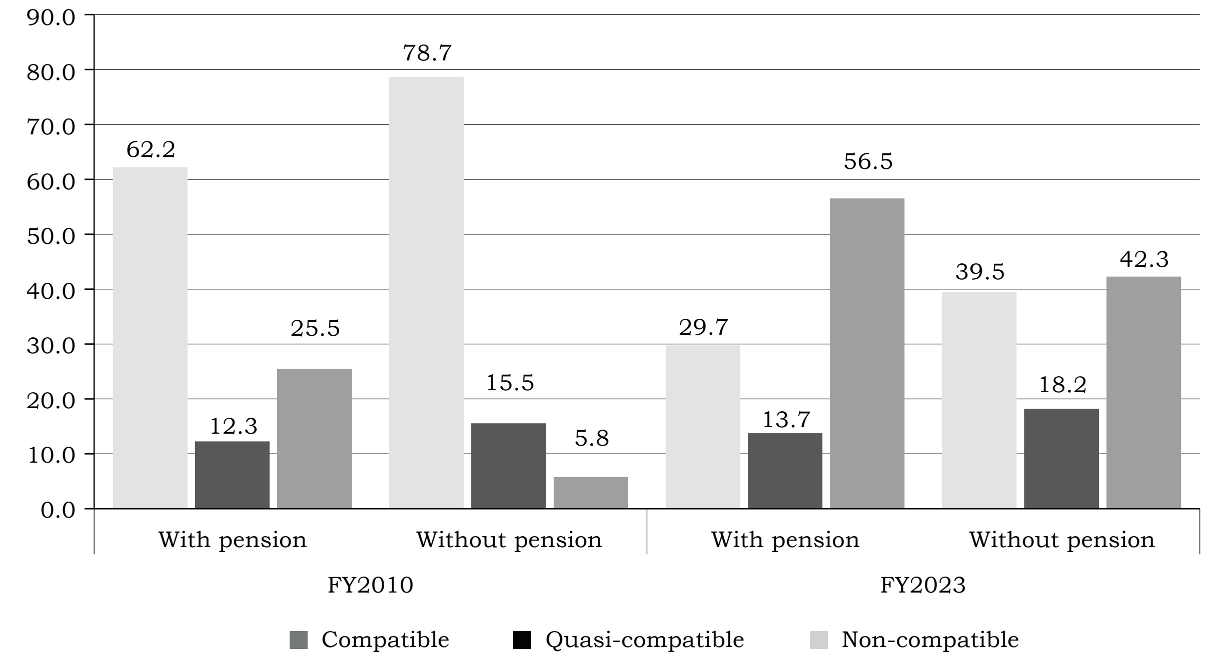
In this context, CPD has classified the different SSNPs for FY2010 and FY2023 into three categories viz. compatible (i.e., the SSNPs that should naturally be included in the aggregate list), quasi-compatible (i.e., those that fall somewhere in the 'grey' area), and non-compatible (i.e., those that should be excluded from the SSNP list). In FY2010, the number of compatible, quasi-compatible, and non-compatible SSNPs was 40, 17 and 10, respectively. The corresponding numbers for FY2023 increased to 57, 29 and 29, respectively. As can be seen from Figure 1.2, compatible SSNPs constituted 62.2 per cent of the total SSNP budget in FY2010, whereas the corresponding share was 29.7 per cent in FY2023. In contrast, the share of non-compatible programmes in the total SSNP budget increased from 25.5 per cent in FY2010 to 56.5 per cent in FY2023. If pension for retired government employees is not considered, then the situation becomes even worse—the share of non-compatible programmes rising from 5.8 per cent in FY2010 to 42.3 per cent in FY2023. Indeed, the allocation for the compatible SSNPs as per cent of GDP declined from 1.6 per cent of GDP in FY2010 to 0.8 per cent of GDP in FY2023. As a share of the total national budget, this declined from 9.5 per cent in FY2010 to 5.0 per cent in FY2023.

Within the non-compatible programmes, a change of composition can also be observed. In FY2010, the non-compatible SSNPs mostly consisted of disaster management, construction, pension, and agriculture-centric programmes. On top of such programmes, the SSNP budget of FY2023 included several non-compatible programmes which are related to credit support and COVID-19 recovery, which are expected to be mostly discontinued in the budget for FY2024. CPD recommends that the incremental SSNP budget be made for the compatible programmes in FY2024 that directly benefit the disadvantaged population groups.

[8]As reported in the media, the removal of subsidies from the power sector will result in a 65 per cent increase in retail electricity price (Sharebiz, 2023).

Figure 1.2

Composition of SSNP budget *(in per cent)*



Source: Authors' calculation from MoF data.

If the government continues to borrow from the central bank, it will further deteriorate the macroeconomic discipline.

It can be argued that the government can run a perpetual budget deficit, paying interest accrued on the growing debt load simply by issuing new debt. However, this is far from reality, as the government is bound by a number of constraints (Hamilton and Flavin, 1986). Both governments and central banks face structural constraints that limit their financing possibilities; going beyond a certain limit may result in explosive debt growth or serious inflationary problems (Leone, 1991). A cross-country literature survey reveals that country practices vary when it comes to limiting the central bank's credit to the government. A universal golden rule or limit is perhaps elusive. However, many countries have put legislative limits to this end. Most countries cap credit, overdrafts, or advances to less than 10 per cent or, at best 20 per cent of the government revenue in the previous fiscal year. Alternative relative measures are also applied by a few countries to limit government borrowing from the central bank, for instance, 5 per cent of government expenditure in Costa Rica or 12 per cent of the monetary base in Argentina (Jácome et al., 2012). As of February 2023, the government's borrowing from the central bank stood at BDT 54,501 crore (Bangladesh Bank, 2023). If media reports are taken into consideration, then this figure reached as high as BDT 74,393 crore in April 2023 (New Age, 2023; The Business Standard, 2023). A comparison between the aforementioned thresholds and the actual government borrowing from the Bangladesh Bank is presented in Table 1.1. The government's borrowing from the central bank surpassed all the thresholds for each criterion by a considerable margin. Indeed, it is apprehended that during the last quarter of the fiscal year, government borrowing will increase further (as it happens every year) as the demand for financing the budget deficit tends to rise. With limited funding available from other sources (i.e., foreign borrowing, non-bank borrowing and borrowing from commercial banks), the government will continue to borrow from the central bank if no discipline is applied.

Curiously, the central bank has not made any clear policy stance to this end. Given that borrowing from the central bank is high-powered money, it has an inflationary impact on the economy. Applying the money multiplier (5.15 as of March 2023), the borrowing from the central bank so far (as of April 2023) may have created about gross new money to the tune of BDT 383,124 crore. Thanks to net sales of foreign exchange (resulting in a decline in foreign exchange reserve), the net foreign assets declined, which helped to keep the broad money growth in check. However, the central bank is no longer in a position to continue such release of foreign exchange reserves. Indeed, the government will need to build up foreign exchange reserves in the coming months, including throughout FY2024, which will release more money in the market. At the same time, in FY2024, there is an apprehension that borrowing from the central bank to finance the budget deficit may continue, particularly if the interest rates remain administrative. Hence, continuing borrowing from the central bank will surely create a higher flow of money supply and hence, create inflationary pressure. This inflationary impact, in turn, may deteriorate the balance of payments scenario by creating more aggregate demand. It will also be critical for the government to mobilise the foreign-funded budgetary support under negotiation with several multilateral funding agencies.

Table 1.1

Government borrowing from Bangladesh Bank (thresholds vs actual)

Threshold criteria	Threshold values for Bangladesh	Govt borrowing from Bangladesh Bank		Overshoot	
		As of Feb 2023	As of Apr 2023	As of Feb 2023	As of Apr 2023
	In crore BDT			*In per cent*	
10 per cent of total revenue in the previous fiscal year	33,437	54,501	74,393	63.0	122.5
20 per cent of total revenue in the previous fiscal year	66,874	54,501	74,393	(-)18.5	11.2
5 per cent of public expenditure	25,910a	54,501	74,393	110.4	187.1
12 per cent of the monetary base	41,263b	54,501	74,393	32.1	80.3

Source: Author's calculation based on MoF and Bangladesh Bank data.
Note: a: FY2022 value, b: As of March 2023.

1.3 TAMING INFLATION: HARD CHOICES TO BE MADE

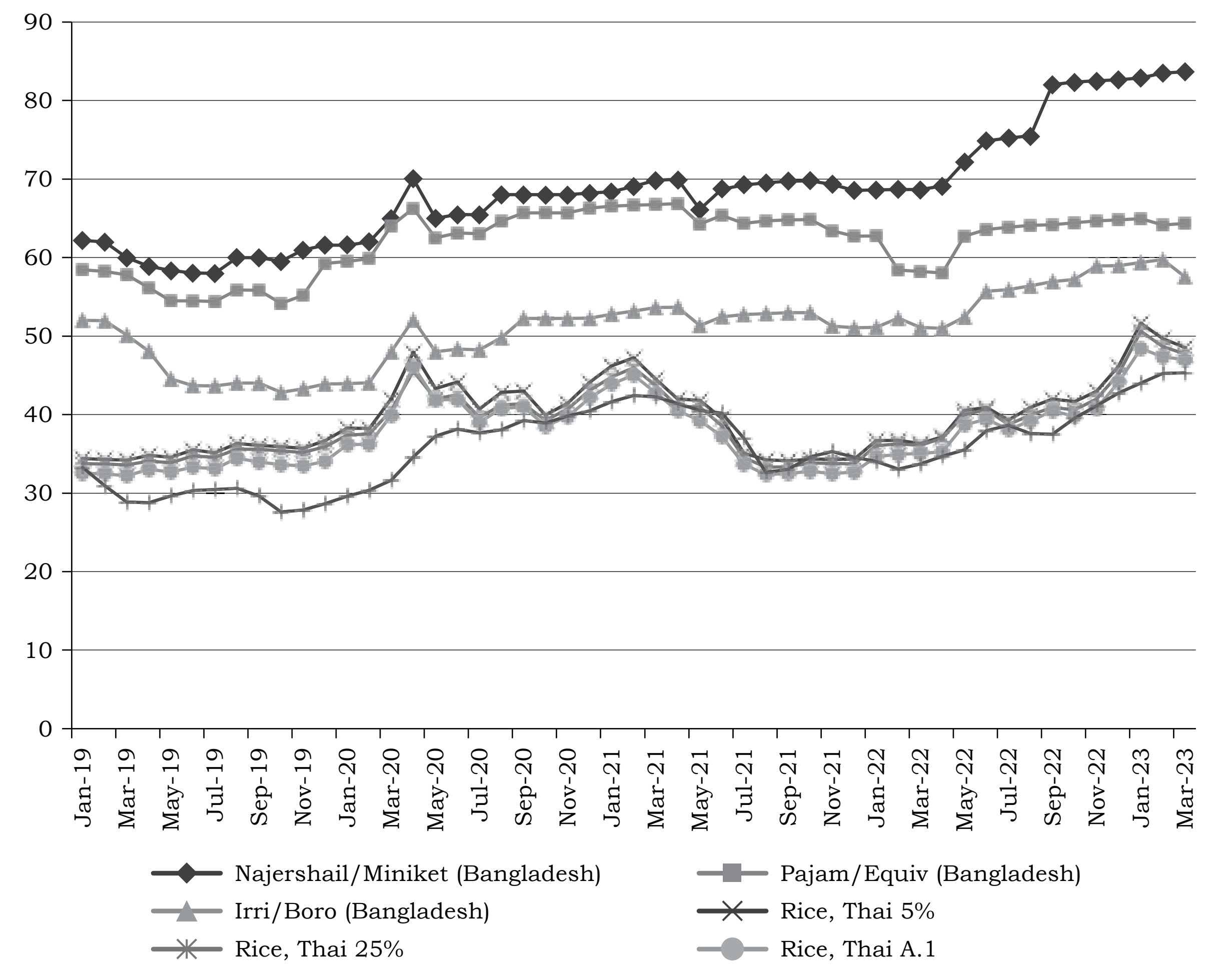
The persistent inflation crisis remains a major pressure point as far as managing the Bangladesh economy in the current context. This is evident through surge in prices observed since June 2020, following the onset of the pandemic. Despite minor fluctuations, high inflation has persisted the recent time. According to the Bangladesh Bureau of Statistics (BBS) inflation has soared to 9.24 per cent in April 2023, surpassing the government's projected rate of 5.6 per cent for FY2023, as stated in the Budget Speech and Bangladesh Bank's 7.5 per cent as projected in central bank's Monetary Policy Statement for January – June 2023. As the surging inflation continues to be a significant pain-point for Bangladesh economy, identifying the sources of inflation is crucial for prudent policymaking.

High prices are not fully an external phenomenon

The policymakers are attributing high prices to exogenous factors since Bangladesh relies on imports of fuel and a number of other essential commodities. However, the increased global prices of these items, coupled with the rising costs of transportation and logistics due to global inflation, also have an impact on locally produced goods. Also, this pass-through effect is only observed during price increases, while the consumers are not able to reap the benefits when the global prices experience a decline. Importers argue that their current stocks were purchased at higher prices, preventing them from immediately lowering prices in response to a drop in global prices. They can only sell products at a lower price once their old stocks are cleared, and new stocks are imported at the new and lower prices. If this argument is logical, then the reverse should also hold – when commodities are imported at cheaper prices, these should also be sold at lower prices till old stocks are depleted, even if there is a price hike in the international market. As a general rule, this is not the case. When international prices rise, importers immediately raise prices, even for their old stock. Currently, importers are attributing the increased cost of imported goods to the expensive USD compared to the BDT. Lack of competitive environment,

Figure 1.3

Price of Rice in Bangladesh and international markets *(in BDT per kg)*



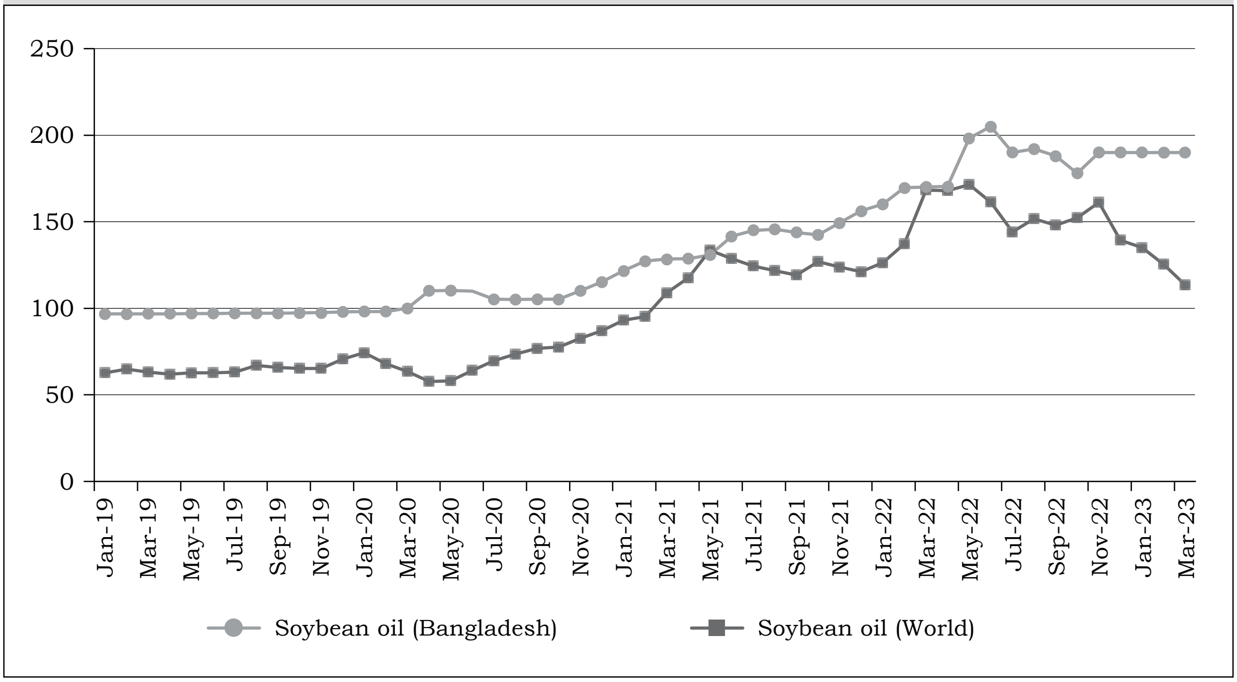
Source: Authors' illustration based on data from Bangladesh Bureau of Statistics and World Bank.

market syndication, absence of necessary monitoring and lax enforcement of existing laws by institutions concerned are key factors in this connection. This is related to the presence of an imperfect market mechanism, where market rules fail to operate optimally, has contributed to this inflationary trend. The government attempts to periodically reduce duties on particular commodities, but traders argue that this does not help narrow the gap caused by the sharp depreciation of the Taka in recent months.

To better understand the situation, price differences between local and international markets of a few commodities such as rice, soybean oil, sugar and beef have been mentioned below. An international comparative analysis reveals that the prices for basic food products in Bangladesh exhibit no decline, despite a decrease in international prices. Furthermore, the data indicates that certain essential food items show a persistent tendency to exceed global prices. Among these four commodities, rice and beef are primarily domestically produced, while soybean oil and sugar are predominantly imported. However, it has been observed that the cost of all these commodities in Bangladesh remains high compared to the global market prices. The price of three common types of rice have been consistently higher than price of both Thai and Vietnamese rice (Figure 1.3). The price of soyabean oil has been falling in the international market from November 2022 to March 2023, whereas there has been no decrease in the price of soyabean oil in the local market during the same period (Figure 1.4). The price of sugar in March 2023 was BDT 124 per kilogramme (kg) in Bangladesh, but only BDT 85 per kg in the US market, BDT 46 per kg in the world market, and BDT 36 per kg in EU market. Even if we consider transport costs, import tariffs, and other trade-related expenses, the differences in prices appear to be high (Figure 1.5). The international price of beef decreased from July 2022 to December 2022, whereas the price of the item in Bangladesh increased during the same time. As of March 2023, the price of beef per kg in Bangladesh was BDT 180 higher than the price of beef per kg in the world market (Figure 1.6).

Figure 1.4

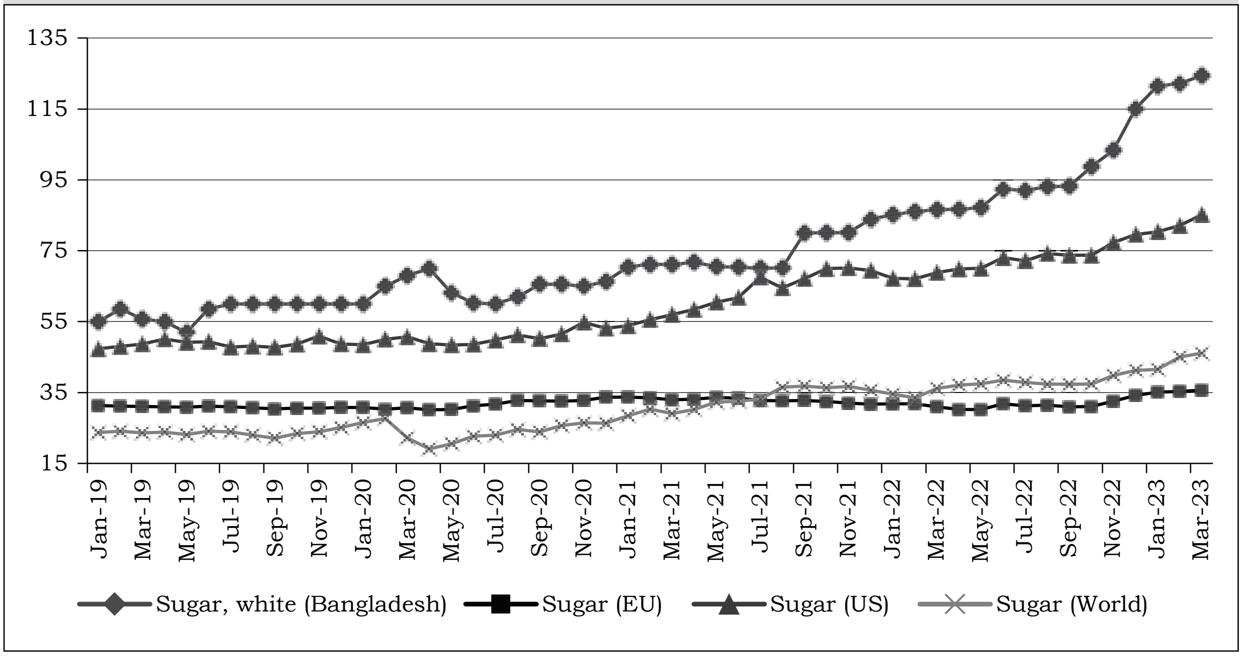
Price of Soybean oil in Bangladesh and international markets *(in BDT per litre)*



Source: Authors' illustration based on data from Bangladesh Bureau of Statistics (BBS 2023) and World Bank.

Figure 1.5

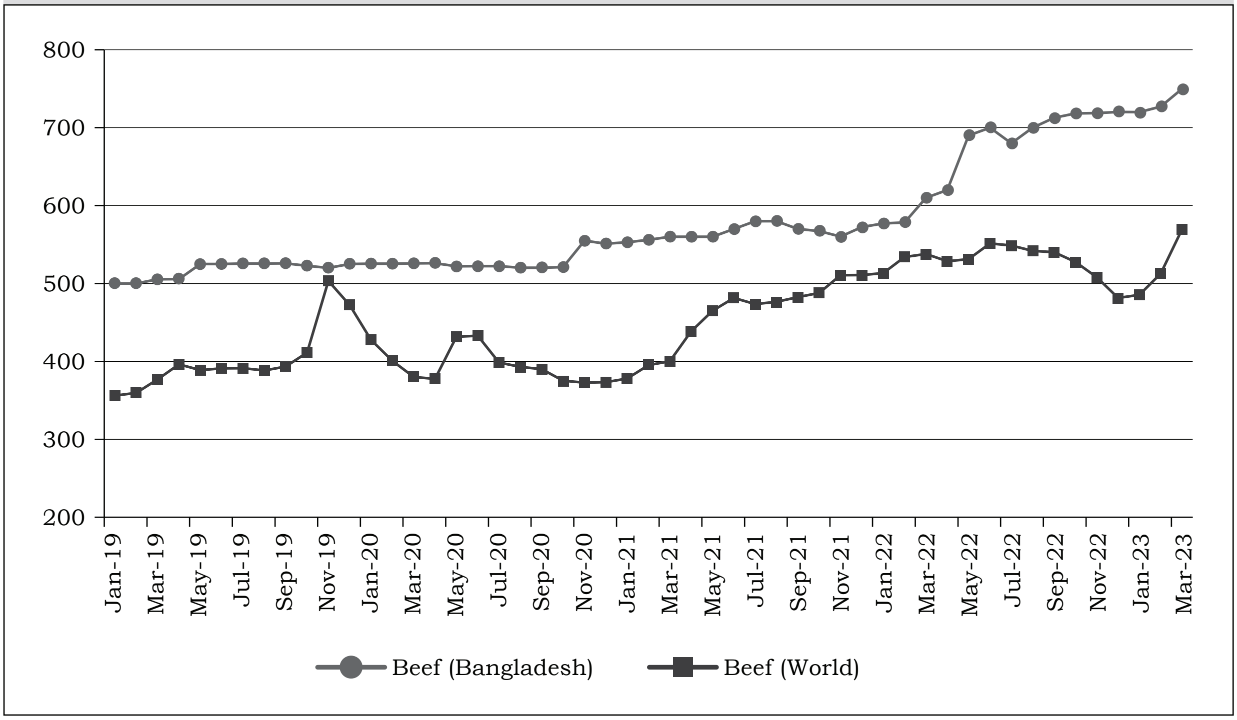
Price of Sugar in Bangladesh and international markets *(in BDT per kg)*



Source: Authors' illustration based on data from Bangladesh Bureau of Statistics and World Bank.

Figure 1.6

Price of Beef in Bangladesh and international markets *(in BDT per KG)*



Source: Authors' illustration based on data from Bangladesh Bureau of Statistics and World Bank.

Policy measures are inadequate to tame inflation as the real reason for price hike is not recognised by policymakers.

The notion that global prices rather than domestic factors have raised domestic inflation has influenced the policy measures taken by the government. Hence, domestic policy interventions to rein in inflation had hardly worked till now. A few policy shortcomings are highlighted here.

First, various policy tools deployed by the policymakers have failed to attain their objectives. This is observed in many cases. The most obvious case is the issue of interest rate which has been fixed by the Bangladesh Bank. In order to curb the current inflation, various central banks worldwide have made use of interest rates as a means to regulate credit expansion and contain consumer demand. This approach has yielded positive outcomes not only in advanced countries like the USA and countries within the European Union (EU), but also in developing countries such as India, where interest rates were raised. The lending rate is fixed at 9 per cent since April 2020. This makes the borrowing rate cheaper as inflation rate is higher than lending rate. Recently, the central bank has raised the interest rate on consumer loans from 9 per cent to 12 per cent. However, it is noteworthy that the interest rate cap on other types of loans, has remained unchanged at 9 per cent. Regrettably, policymakers face persistent opposition from entrepreneurs whenever interest rates are proposed to be increased. Their resistance is further bolstered by recent surge in production costs resulting from higher energy prices, which they argue would undermine their competitiveness. However, competitiveness is contingent upon multiple factors, including the business environment, efficacy of institutions and the state of overall good governance. These elements are crucial for enhancing productivity and efficiency of the private sector, initiating level playing field, creating competitive environment and in the end facilitating cost reductions. By addressing these concerns, the remaining issues can be resolved. Unfortunately, economic decisions in Bangladesh are frequently influenced by non-economic factors. A lack of significant monetary policy shift has led to an ineffective attempt to curb inflation in Bangladesh. The Bangladesh Bank raised its key interest rate - the repurchase agreement (repo) in May 2022 from 4.75 to 5 and then gradually to 5.5, 5.75 and 6 at various points in time till March 2023 - to contain price pressures. However, this did not generate the expected impact in terms of reduced inflationary pressure (Table 1.2).

Table 1.2

Repo, reverse repo, and call money lending/borrowing rate

Period	Repo	Reverse Repo	Weighted average monthly call money lending/borrowing rate
Jan-22	4.75	4.00	2.43
Feb-22	4.75	4.00	2.80
Mar-22	4.75	4.00	2.66
Apr-22	4.75	4.00	4.58
May-22	5.00	4.00	4.73
Jun-22	5.50	4.00	4.88
Jul-22	5.50	4.00	5.34
Aug-22	5.50	4.00	5.49
Sep-22	5.50	4.00	5.53
Oct-22	5.75	4.00	5.79
Nov-22	5.75	4.00	5.80

(Table 1.2 contd.)

(Table 1.2 contd.)

Period	Repo	Reverse Repo	Weighted average monthly call money lending/borrowing rate
Nov-22	5.75	4.00	5.80
Dec-22	5.75	4.00	5.80
Jan-23	6.00	4.25	6.66
Feb-23	6.00	4.25	6.15
Mar-23	6.00	4.25	6.03

Source: CPD compilation based on data from Bangladesh Bank.

Second, several imported items face high duties and taxes. The NBR relies on indirect taxes for meeting its target of revenue collection. There was hardly any attempt to reduce these duties and taxes albeit for a limited period (Table 1.3).

Table 1.3

Import tariff on essential food items

	HS Code	Description	Unit	TTI
1	2012090	Fresh Or Chilled, Other Cuts Of Bovine Meat With Bone In, Nes	KGM	58.60
2	2012010	Fresh Or Chilled, Other Cuts Of Bovine Meat With Bone In, Wrapped/Canned up to 2.5 kg	KGM	89.32
3	2042290	Fresh Or Chilled Other Cuts Of Meat Of Sheep, With Bone In, Nes	KGM	58.60
4	2071410	Frozen Cuts And Offal Of Chicken, Wrapped/ Canned up to 2.5 kg	KGM	89.32
5	3021990	Fish...ruhi, katla,......,pangash, karp & alike, excl. wrapped/canned up to 2.5kg Other	KGM	58.60
6	3028919	Hilsha fish (EXCL.wrapped/canned up to 2.5 kg)	KGM	89.32
7	4012010	Milk & Cream Of>1%But<=6%Fat,Not Concentrated Or Sweetened, Wrap./Cann. Up to 2.5 kg	KGM	58.60
8	4021010	Milk & Cream In Powder Forms<=1.5%Fat,Con... Or Sweet., In Reta. Pk. up to 2.5kg	KGM	89.32
9	4021091	Milk and cream in solid forms of =<1.5% fat imported by vat reg. Milk and milk produce	KGM	37.00
10	4021099	Milk and cream in powder excl. Powder, grnules or other solid from and imported vat regg	KGM	37.00
11	7020019	Tomatoes, Fresh, Nes	KGM	58.60
12	7031019	Onions, Fresh Or Chilled, Nes	KGM	10.00
13	7032090	Garlic, Fresh Or Chilled, Nes	KGM	7.00
14	8041019	Dates, Fresh, Nes	KGM	10.00
15	9041190	Pepper, Neither Crushed Nor Ground, Nes	KGM	58.60
16	9083190	Cardamoms: Neither Crushed Nor Ground. EXCL. Wrapped/canned up to 2.5 Kg	KGM	58.60

(Table 1.3 contd.)

(Table 1.3 contd.)

	HS Code	Description	Unit	TTI
17	9093190	Seeds of Cumin: Neither crushed or ground EXCL. Wrapped/canned up to 2.5 Kg	KGM	58.60
18	9101190	Ginger: Neither Crushed or ground EXCL. Wrapped/canned up to 2.5 Kg	KGM	10.00
19	9103090	Turmeric (Curcuma), Nes	KGM	10.00
20	10059090	Other Maize, Excluding wrapped/canned up to 2.5 kg	KGM	2.00
21	10062000	Husked (Brown) Rice	KGM	62.50
22	10063011	Semi-Milled Or Wholly Milled Rice	KGM	85.00
23	11081200	Maize (Corn) Starch	KGM	67.00
24	15111010	Crude palm oil imported by VAT registered edible oil refinery industries	KGM	32.00
25	15119090	Palm Oil (Excl. Crude) & Its Fractns....Nes. Incld. Refined Palm Oil	KGM	20.00
26	15132900	Refined Palm Kernel/Babassu Oil & Fractions, Not Chem. Modified	KGM	55.00
27	25010020	Salt (other than pure sodium chlo.)...solution ..salt boulder for crushing & salt in bulk	KGM	89.32

Source: CPD compilation based on data from National Board of Revenue.

Third, the ongoing fiscal year has presented substantial challenges for revenue collection due to diminishing business profits, leading to a decline in direct tax contributions. Furthermore, reduced imports have resulted in a decrease in customs tariffs. Another source of government funding is investments in national savings certificates which has declined drastically for several reasons including ceiling on NSD purchase by individuals, and reduction of savings by low-income groups due to increased cost of living. As a result of consistently low levels of domestic resource mobilisation through taxation, the government is increasingly relying on the central bank to obtain additional funds. The increased borrowing of high-powered money has the potential to fuel inflationary pressure. This may have serious macroeconomic implications (please see Section 2 of this report).

Fourth, though an important source of imported inflation in Bangladesh is high fuel prices, the skyrocketing inflation has been further worsened by frequent energy price hikes in the country. From early November 2021 till recent times, various fuel types have witnessed upward adjustments. Even though the global fuel prices are on a downward trend, one does not see this reflection of this low prices in Bangladesh. Given IMF loan equivalent to USD 4.7 billion f the government is under pressure to withdraw all types of subsidies. Consequently, increased costs due to subsidy withdrawal will be passed on to consumers, further burdening their cost of living. Despite profits made by Bangladesh Petroleum Corporation (BPC) during periods of low global energy prices, particularly between FY2015 and FY2022, the common people did not reap the benefits. This is because the government controls and determines energy prices in Bangladesh, leaving consumers vulnerable to the decisions of policymakers. In early August 2022, despite the decline in global fuel prices, the government raised prices for various l types of fuel. Ironically, when global energy prices rise, the government adjusts prices accordingly, but consumers do not enjoy the same benefits when global prices decrease because the government does not lower prices in line with global trends. In 2016, energy prices were only slightly reduced despite a significant decline in global prices. Therefore, consumers could not benefit from the profits made by BPC due to lower global prices of fuel in the past. One sees a similarity in the way private sector and the government behave, vis-à-vis the consumers.

Fifth, structural problems are also responsible for the price hike. Lack of strict enforcement of competition laws gives rise to unfair practices. In the absence of a pricing system that is based on transparency and takes strong stance to eliminate the involvement of middlemen in the supply chain, prices cannot be controlled with only monetary and fiscal tools.

Synchronised measures are needed to tackle persistent inflationary pressure.

To mitigate the impact of inflation and provide support to those in need, it is of utmost importance that the government implements a range of measures. These should encompass direct cash support for individuals living in poverty including the new poor, augmenting allowances within social safety net programmes, enforcing stronger social protection measures for low-income families, and introducing tailored stimulus packages to aid small businesses during these challenging times.

It is crucial to establish an integrated policy framework that facilitates the co-ordination of fiscal and monetary policies, thus ensuring their efficacy. It is also necessary to address non-economic and distortionary practices in the market to bring down prices. This necessitates the implementation of bold and coordinated measures.

The Bangladesh Competition Commission should strengthen its role and take proactive measures. This includes establishing a comprehensive database, conducting regular surveillance of dominant market players' activities, closely scrutinising market manipulation, and promptly taking necessary actions. To effectively address monopolies and promote fair competition, the Competition Act of 2012 needs to be updated with explicit anti-trust provisions and clear penalties for those who violate those. Additionally, rigorous monitoring and supervision are essential for efficient market management, ensuring that commodity prices remain under control.

1.4 EXTERNAL SECTOR: MANAGING RISKS, COMBATING HEADWINDS

14.1 The Context: An Unprecedented Scenario

A significant part of the ongoing macroeconomic challenges facing the Bangladesh economy originates in the formidable difficulties facing the external sector of the country and the nature of current trends in the external sector balances which have emerged as a major concern for the policymakers. Accordingly, the likelihood of success of coming out of the current situation also lie, to a large extent, in whether the policymakers are able to manage the attendant risks and tackle the headwinds confronting the country's external economy and external balances. When the increasingly open and globalising economy of Bangladesh came under pressure immediately after the start of the Russia-Ukraine war, the prevailing comfort zone came under pressure. As is known, Bangladesh has been able to maintain strong external sector balances over the recent past years. Even in years of depressed export performance or low remittance growth, external balances tended to remain stable, allowing policymakers considerable policy flexibility and manoeuvrability. Regrettably, Bangladesh's policymakers failed to appreciate the likely consequences of the war – induced external shocks on the economy and could not adequately anticipate the adverse impacts these could have on the country's overall macroeconomic management.

One sign of the lack of the aforesaid appreciation is that the FY2023 budget was formulated in a business as usual manner- the GDP growth was planned at 7.5 per cent, and the inflation target was set at 5.6 per cent; the pressure on import payments, reserves, exchange rate and external sector balances was not forecasted with analytical rigor and the policy acumen that these deserved, even though the tell-tale signs of this was becoming increasingly evident for some time even before the budget was formulated. Thus, the current external sector scenario reflects both the ramifications of the external shocks as also the failure of domestic policymaking at a critically important juncture of Bangladesh's development journey. True, as the fiscal year FY2023 moved on, policymakers were compelled to resort to various fire-fighting measures to contain the adverse impacts that afflicted the economy: the taka was allowed to significantly depreciate since the central bank was no more able to sustain the managed float regime at the prevailing state; imports were selectively curtailed; L/C margins were raised, whilst the central bank supported import of essentials albeit at depreciated but managed exchange rate. Private sector found it difficult to open L/Cs for imports of both consumers' and producers' goods and this disrupted the supply chain of many commodities, leading to supply shortages and fuelling demand-push high prices. Because of high commodity prices, resulting in rising subsidies, policymakers had to raise domestic administered prices of a number of essentials to ease the subsidy pressure. This led to rising prices of many essential items, leading to erosion of purchasing power. Public expenditure had to be curtailed also because domestic resource mobilisation through custom duties and VAT was also under-performing at a time when imports were coming down and lower government expenditure (e.g., in case of ADP implementation) resulted in lower VAT collection.

All these had adverse impact on private sector investment whose share has been stagnating (as a percentage of GDP), led to lower than planned private sector credit uptake and resulted in lower GDP growth projections for FY2023 (at 6.03 per cent compared to the earlier set target of 7.5 per cent for FY2023). The actual inflation turned out to be about 9.0 per cent instead of the projected 5.6 per cent. Thus, the weak external sector performance and the consequent imbalances had a knock-on-negative implications for the overall performance of the domestic economy of Bangladesh. In the end, Bangladesh had to resort to IMF programme which came with a number of quantitative milestones and qualitative conditionalities. In short, the impacts of the external shock, weak resilience capacity to deal with shocks, muted policy response and embedded weaknesses and fault lines in the economy created a vicious cycle which underpins the current challenging macroeconomic scenario.

In view of the above, Bangladesh's macroeconomic stability will critically hinge, as was noted, to a large extent, on how successfully the external sector regains its lost stability, to what extent the balance of payments situation improves, how the economy will adjust to the market aligned exchange rate regime (towards a unified market determined rate) and the capacity of economy to arrest the fall in forex reserves. Restoration of external sector stability will help improve macroeconomic management and arrest the dreaded twin trends of falling GDP with high inflation –a precursor of stagflation. A reversal of the current scenario will help restore investor confidence, give relief to consumers and help the economy regain its growth momentum. This is the key challenge facing the policymakers as the budget for FY2024 is presented before the Parliament on June 1, 2023.

The next section examines the current external sector trends in FY2023 and makes an attempt to capture the drivers of the movements of the relevant correlates. The third section comes up with a number of measures to restore external sector stability over the immediate and medium term.

1.4.2 The Current External Sector Trends: Disquieting and Disturbing

Export sector performance has been rather muted, with adverse implications for net export earnings

Bangladesh's external sector performance over the first 9-10 months of FY2023 has been lacklustre. Growth of export earnings during July-April, FY2023 was 5.4 per cent compared to the corresponding period of FY2022; this was indeed 3.5 per cent lower than the strategic target for the corresponding period. It is obvious that the strategic growth target for FY2023, set at 11.5 per cent , is not going to be achieved—exports will need to rise by 41.4 per cent in the remaining two months (May and June) of FY2023 over the corresponding period of FY2022 if the strategic export target for FY 2023 (which was set at USD 58.0 billion) was to be attained, an impossible task.

It is to be noted that, if over this period (July-April of FY2023) RMG export earnings were 9.1 per cent higher, the earnings from non-RMG exports were (-) 11.1 per cent lower than the corresponding period of FY2022. The significantly low growth of exports in April at (-) 16.5 per cent, with export of RMG falling by about 16.1 per cent transmits a truly disturbing signal. If the RMG export target of 11.0 per cent is to be attained, exports will have to rise by 19.4 per cent over the next two months (May and June) compared to the corresponding period of FY2022; this is not going to be achieved. Interestingly, analysis of price trends of RMG products in key markets of the US and the EU indicates a rise in average prices: average price of apparels (per dozen) in the US went up by 23.3 per cent in July-March period of FY2023 compared to corresponding period of FY2022 (however, the volume has decreased by 17.6 per cent, indicating a slump in demand). The average price of apparels in the EU also went up by 24.8 per cent (per 100kg) over the same period (with the volume also rising by 9.8 per cent). The significant depreciation of the BDT should have enhanced export competitiveness of apparels (as also other items of exports from Bangladesh) in the global market. The rising price should also have helped. It is in this backdrop that the slow growth of RMG exports and the recent fall in export earnings from the RMG sector have emerged as a matter of concern. The accumulated risks of lack of export and market diversification are showing up in export performance of recent times.

The negative growth of non-RMG exports has an adverse implication for net exports and the forex reserves. Since domestic value addition for RMG is about 55-60 per cent, whilst that of non-RMG items varies in the range of between 80 and 95 per cent, the compositional aspect of recent export performance has an adverse impact on growth of net domestic value retention, net export, and forex reserves. Policymakers should take note of this.

Table 1.4

Terms of Trade taking RMG price per 100kg as reference (EU)

Commodities	**Units**	**FY 22 (July-March) Average**	**FY 23 (July-March) Average**
Cotton, A Index	kg	602.96	745.65
Rice, Thai A.1	mt	4.07	4.05
Wheat, US HRW	mt	4.32	4.46
Palm oil	mt	1.20	1.85
Soybean oil	mt	1.05	1.22
Crude oil, average	bbl	19.38	20.38
Liquefied natural gas, Japan	mmbtu	117.15	88.32

Source: Author's estimation based on The Pink Sheet and Eurostat.

There are signs of improvements in terms of trade, but depressed demand in major markets has emerged as a concern

If the purchasing power of RMG is taken as a reference point, it is seen that Bangladesh's terms of trade has somewhat improved, both in the EU and in the US markets if measured against most of the commodities, excepting for LNG (Table 1.4 and Table 1.5). This should have a positive impact on trade balance in the BoP. However, as was noted export performance over recent months has been particularly disturbing and the (depressed) demand side impacts have started to be felt in a strong way as FY2023 draws to a close. The significant decline in the quantity of RMG items in the US market is particularly disquieting.

Table 1.5

Terms of Trade taking RMG price per dozen as reference US

Commodities	Units	FY 22 (July-March) Average	FY 23 (July-March) Average
Cotton, A Index	kg	15.45	21.14
Rice, Thai A.1	mt	0.10	0.11
Wheat, US HRW	mt	0.11	0.13
Palm oil	mt	0.03	0.05
Soybean oil	mt	0.027	0.035
Crude oil, average	bbl	0.50	0.58
Liquefied natural gas, Japan	mmbtu	3.00	2.50

Source: Author's estimation based on The Pink Sheet and USITC.

Import payments have come down both owing to policy interventions and because of falling global commodity prices, but the bill will likely go up if the economy is to regain growth momentum

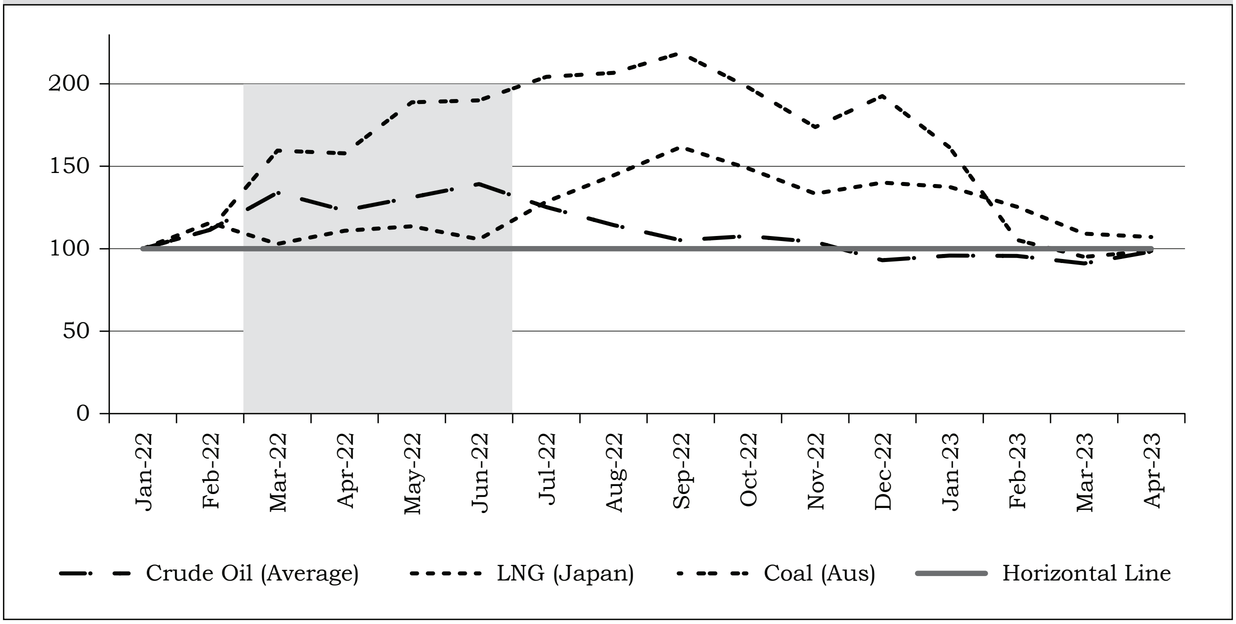
Imports during the first nine months (July-March) of FY2023 was more than USD 8.3 billion dollar less than corresponding period of FY2022 i.e. lower by 12.4 per cent (for EPZ this was 19.6 per cent lower compared to the corresponding period of the previous year). In quantitative terms, import payments have declined by about USD 7.6 billion during July-March FY2023 compared to the corresponding period of FY2022 (the matched figures are USD 61.5 billion and USD 53.9 billion). What is to be noted in this connection is that all key components of imports have demonstrated negative trends: intermediate goods (-14.7 per cent); RMG related goods (-19.6 per cent); capital goods (-17.8 per cent) including capital machineries (-11.9 per cent). Demand-side factors (depressed demand, in part because of high prices) may have played a role. However, the policy of selective import restrictions, difficulties in accessing foreign currency to open L/Cs and dampening effect of a significantly depreciated Taka have played no less an important role in this backdrop. Supply chain disruption and the adverse impact domestic investment in the end has contributed to the lower GDP growth. If the economy is to regain its growth momentum import payments will go up (IMF projects a 14.2 per cent rise in import in FY2024), creating pressure on trade and current account balance if export and remittance earnings do not rise in tandem.

Global Price Trends

One comforting development is that global commodity prices are showing downward trend from their peak of April-June 2022; at present prices of majority of the commodities are lower than pre-Ukraine-Russia war levels. The only exceptions are the prices of LNG and wheat (Figures 1.7, 1.8,

Figure 1.7

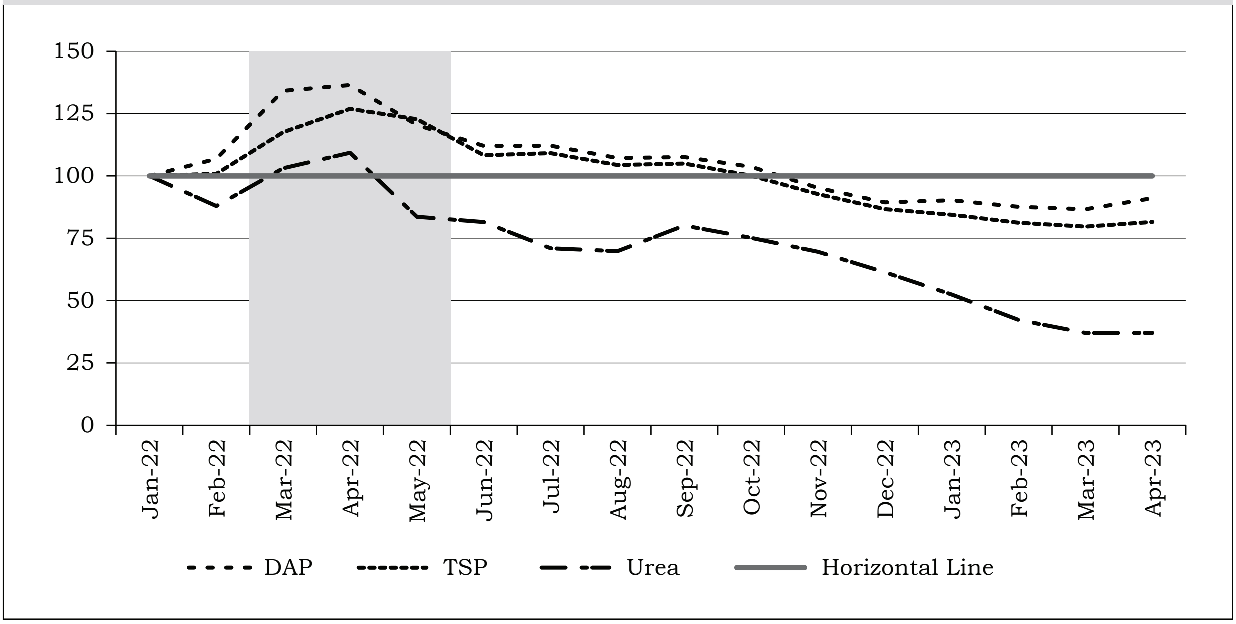
Fuel (Crude Oil, LNG, Coal) price trends since January 2022



Source: The Pink Sheet, World Bank.
Note: Prices in January 2022 or the base price is assumed to be 100 for the ease of comparison.
Shaded region represents the four months starting from start of Russia-Ukraine war in February 2022.

Figure 1.8

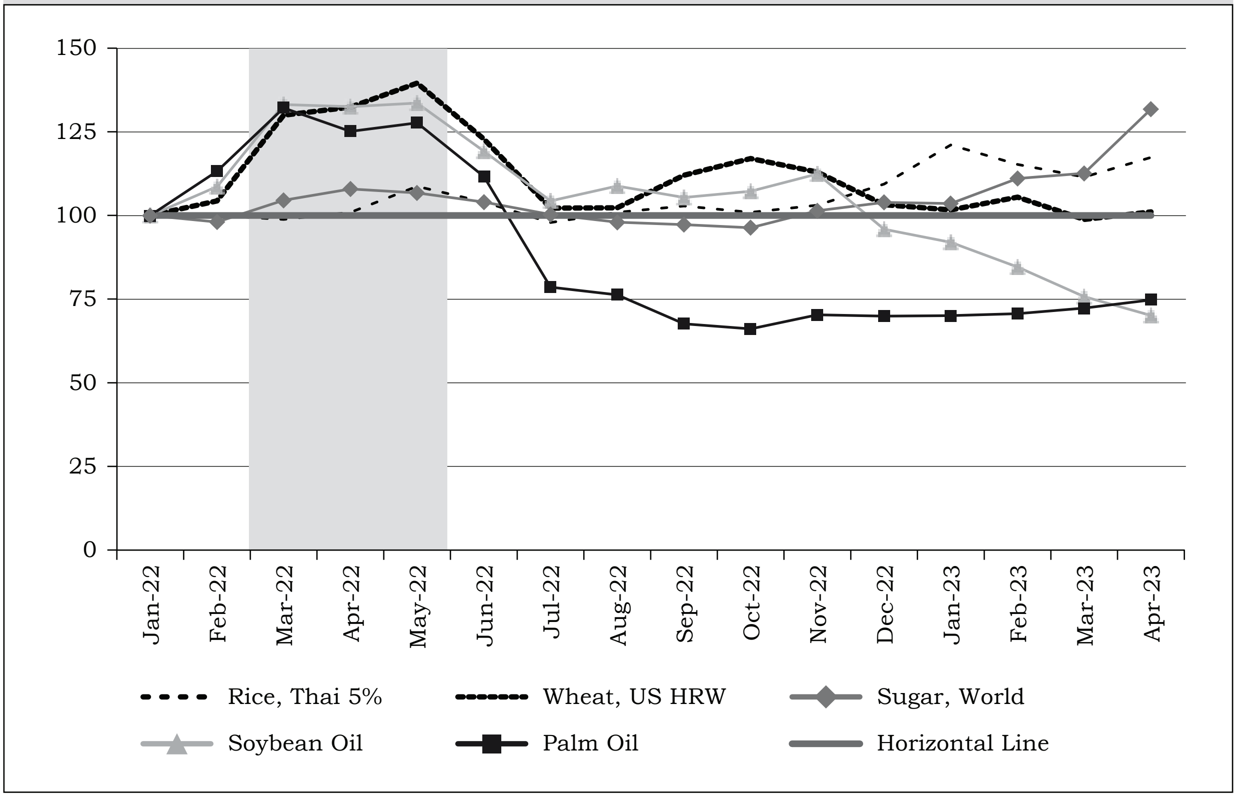
Fertiliser (DAP, TSP, Urea) price trends since January 2022



Source: The Pink Sheet, World Bank.
Note: Prices in January 2022 or the base price is assumed to be 100 for the ease of comparison.
Shaded region represents the three months starting from start of Russia-Ukraine war in February 2022.

Figure 1.9

Food grains (Rice, Sugar, Wheat) and Edible Oil (Soybean, Palm) price trends since January 2022



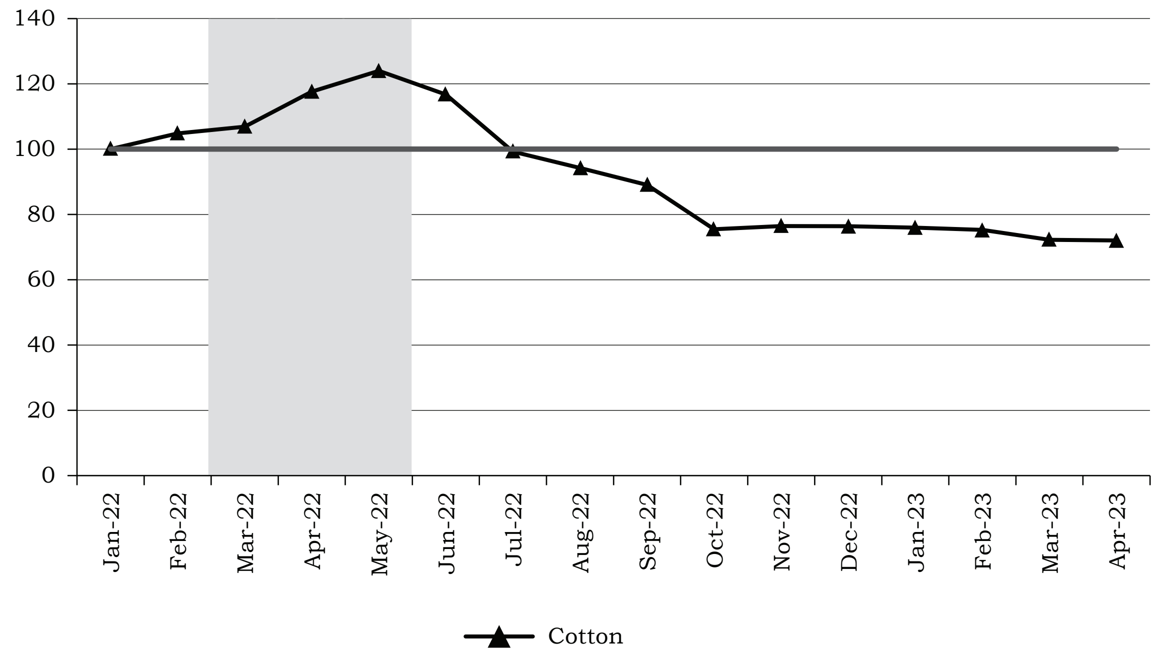
Source: The Pink Sheet, World Bank.
Note: Prices in January 2022 or the base price is assumed to be 100 for the ease of comparison.
Shaded region represents the three months starting from start of Russia-Ukraine war in February 2022.

1.9 and 1.10). Thus, the decline in value terms in import payments does not necessarily reflect a proportionate decrease of imports in quantitative terms, a good sign. However, because of the growing dependence of Bangladesh on LNG imports, the rise in prices of this critically important import item does not augur well for Bangladesh.

The trends in remittance flows do not match the growing number of migrant workers leaving for overseas job markets and consequently the trends in sources of remittance flows raise serious concerns

One disquieting development of recent times relates to remittance flows. Remittance earnings has risen by only 2.4 per cent during July-April, FY2023 compared to the corresponding period of FY2022. Even in April of this year (a time of traditionally high flow of remittance on occasion of Eid ul Fitr), remittance flow was 16.3 per cent lower in 2023 compared to the corresponding month of 2022. Three factors are to be kept in mind in this context. The number of people going abroad for work during the first 10 months of FY2023 was significantly high at 9.22 lakh; majority of these people went to the Gulf countries, but the remittance flows from this region did not match this rising number. Secondly, The USA has replaced Saudi Arabia as the foremost source of remittance in this period. CPD has drawn attention to this new phenomenon in its previous IRBD. In spite of 12.3 lac people going to Saudi Arabia during January 2021–April 2023 (56.9 per cent of the total of 21.5 lakh during this period), the remittance from Saudi Arabia has come down from USD

Figure 1.10
Cotton price trends since January 2022



Source: The Pink Sheet, World Bank.
Note: Prices in January 2022 or the base price is assumed to be 100 for the ease of comparison.
Shaded region represents the three months starting from start of Russia-Ukraine war in February 2022.

3.86 billion in FY2022 (July–April) to USD 3.04 billion in FY2023 (July–April) while that from the USA increased from USD 2.87 billion to USD 3.05 billion over the corresponding period. To note, the share of migrant workers travelling to the USA in this period was negligible. Remittance from Oman (USD 628.8 million and USD 849.9 million over the corresponding period of FY2023 and FY2022), declined by 26.0 per cent and that from Kuwait (USD 1322.2 million and USD 1384.8 million) declined by 4.5 per cent in spite of 43.9 thousand and 31.5 thousand migrant workers travelling between January 2021 and April 2023 respectively to these two countries.

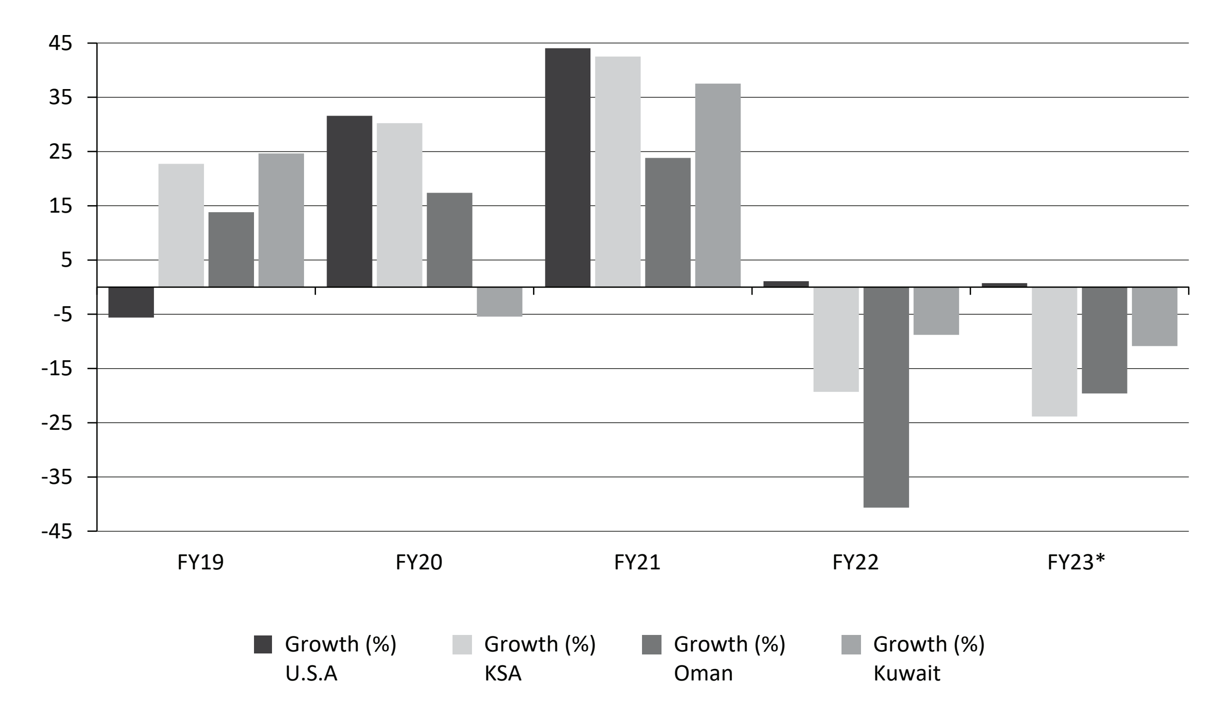
The overall slow growth of remittance flows and relative decline in remittances from some countries in the Middle-East, as is discernible from Figure 1.11, merits careful investigation. The likelihood of transfer through hundi/hawala as also repatriation of money to take advantage of incentives provided for remittance flows and the scope of whitening of black money taken out of the country illegally via the remittance route should come under proper scrutiny by concerned authorities, and appropriate steps ought to be taken to deal with the emergent scenario.

Trade and Current Account Balances are showing some improvement, but Financial Account Balance has emerged as the villain of the piece. Consequently, the fall in reserves has persisted

The fall in import payments has helped improve the balance of trade significantly, from (-) USD 25.0 billion in FY2022 (July–March) to (-) USD 14.6 billion in FY2023 (July–March). The current account balance has also registered some improvement, from USD (-) 14.3 billion to (-) USD 3.6 billion over the corresponding period, a decline of about USD 10.7 billion. However, the gross

Figure 1.11

Growth rate of remittance from selected countries: FY2019–FY2023



Source: Author's estimation based on Bangladesh Bank.
Note: *FY2023 figures compare growth rate of remittance flows from selected countries for July-April period of the fiscal year.

reserves have come down from USD 44.1 billion to USD 31.1 billion between FY2022 (March 2022) and FY2023 (March 2023), by about USD 13.0 billion. If this trend continues it will lead to a highly risky situation (not to mention that according to the IMF estimates the net reserves were about USD 24.0 billion).

The villain in the piece as far as forex reserves are concerned appears to be the balance in the financial account. The major driving force in this regard is the significant deterioration in the balance, from USD (+) 11.9 billion to USD (-) 2.2 billion, a fall of about USD 14.1 billion. If the trend cannot be arrested the pressure on reserves will lead to serious difficulties with import payment, debt servicing and exacerbate macro-economic challenges.

1.4.3 Suggested Policy Measures

Bring transparency in external sector earnings data and deal with illegal transfers.

Can slowdown in export earnings be explained only by the demand side factors? The IMF has recently raised the question about the mismatch between the amount of what should have been earnings from exports and the earnings that were actually repatriated. The central bank has come up with an explanation in recent times as regards this mismatch, but this need to be looked at more closely. There is also a significant difference between the EPB export earnings figures and Bangladesh Bank figures which has been persisting for a long period. In recent times, the Bangladesh Bank has also unearthed a number of anomalies with regard to under invoicing in exports and both over (for purposes of illicit money transfer) and under invoicing (to avoid customs duties) in case of imports. This needs to be looked into carefully to improve the trade balance and consequently the reserve situation. Why the services export target for FY2023 (at USD 9.0 billion) was set at only 2.2 per cent higher than the previous year also raises a question. It appears that a large part of the earnings from services export remains unaccounted for in the balance of payments record. The authorities concerned should take urgent steps for repatriation of services earnings through formal channel. Introduction of PayPal may be considered in this connection. By all possibility, a large part of remittances is being channelled through the hundi/hawla channels. This must be tackled through demand side and supply side measures including enforcement of current-laws and signing of bilateral treaties with concerned countries.

Take steps to improve Finance Account Balance to Improve Overall Balance and reverse the falling forex reserves trend

In this backdrop, both the short and medium-term measures will be required to reverse the situation. Several steps will need to be undertaken to ease the pressure on reserves and reclaim external sector stability. The balance of (other) investment component of Finance Balance has emerged as a major concern in view of the disquieting reserves scenario, declining in the first nine months from (+) USD 10.4 billion to (-) USD 3.5 billion, a fall of about USD 13.9 billion –medium to long-term loans declined by about USD 1.6 billion, while the departure in trade credit (net) was to the tune of USD 2.5 billion, of DMBC and NBDC (net) was about USD 4.0 billion and in case of other short term loan (net) was about USD 4.0 billion; liabilities has increased by USD 3.5 billion. Interest on trade credit, which was received at almost zero, had gone up to 6–7 per cent (in the backdrop of uncertainties about reserves and payments capacities) and traders had tried to repay the credit as soon as possible, leading to the significantly high negative figure.

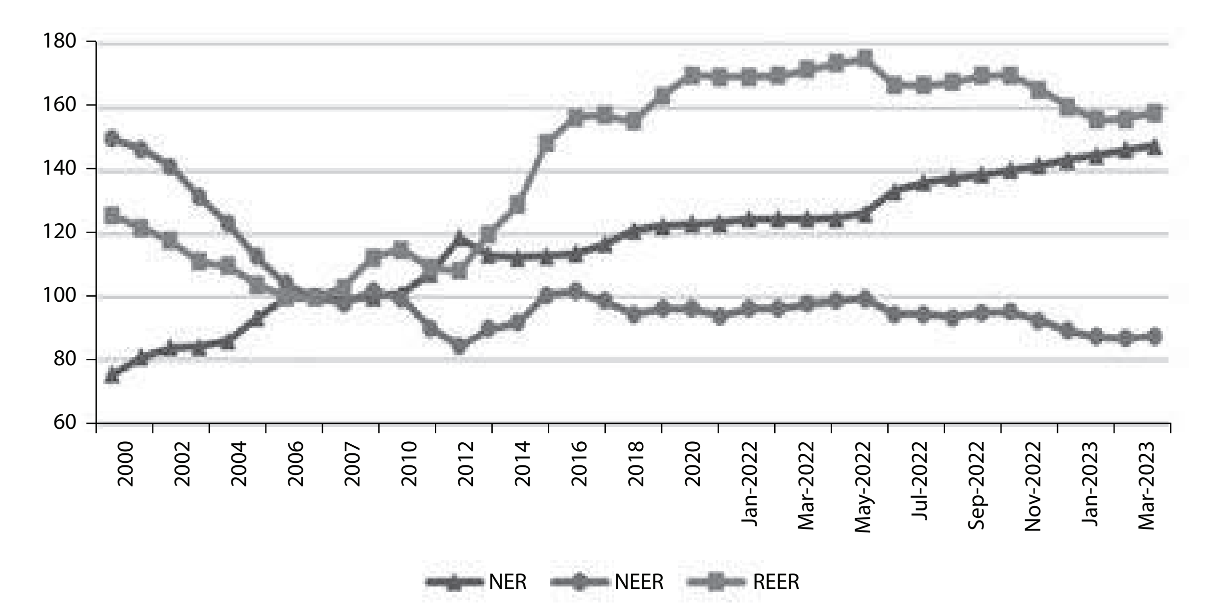
Why is error and omission, at USD (-) 2596 so high when this was only USD (-) 697.0 million in FY2022 also needs to be looked into carefully.

Every effort should be taken to mobilise foreign funds and expedite the disbursement of loans in the pipeline. The GoB has negotiated significant loan amount with the World Bank, ADB and other development partners, both as budgetary support and for project implementation. Foreign funded projects in the ADP and in the aid pipeline should be prioritised for implementation. The Bangladesh Bank is shedding its disbursement of trade credit from the Export Debt Fund (EDF), which, on the one hand, will help improve the overall reserves situation and, on the other hand, help meet the IMF-set target of forex reserves for June 2023 at (USD 24.46 billion; the target for December 2023 is USD 26.81 billion). However, support to exporters, through the newly created credit line and other measures of support must be ensured to deal with the likely shortfall in supply of trade credit against demand, at a time when Bangladesh is having to reduce the size of EDF significantly to protect net forex reserves.

The medium-term target should be to attract higher amount of FDI. In recent years, a large part of the FDI has been on an account of reinvested profit when net new flow of FDI has been very low. The SEZs could be a game changer in this connection. However, the service promised under the One Stop Service Act of 2018 must be offered and overall cost of doing business and business environment (including dispute resolution mechanisms) must be put in place on an urgent basis.

Move towards market aligned exchange rate must be carefully monitored and the monetary policy will need to be well coordinated with fiscal policies. However, major disruptions in

Figure 1.12
REER vs NER vs NEER in Bangladesh



Source: Based on Bruegel.

currently prevailing exchange rates is not anticipated as market corrections have already taken place, to a significant extent

The IMF programme requires Bangladesh to move towards a unified exchange rate policy, by moving away the current multiple exchange rates (selling rate by the Bangladesh Bank, inter-bank exchange rate, rate for L/C opening, export repatriation rate, rate applicable for remittances) to a single rate.

Our analysis indicates that, already the significant depreciation of taka is having an impact and the difference between REER and NER has come down quite significantly in recent times (Figure 1.12).

CPD has carried out an exercise based on a Dynamic OLS model[9] to examine the misalignment between the REER[10] and equilibrium REER (EREER)[11] and estimated what would be the range of the nominal exchange rate (BDT/ USD) if the two were to be aligned. The model indicates that the REER (in December 2022) was misaligned to the extent of 3.4 per cent from the EREER. Accordingly, the nominal market-based exchange rate, if an alignment is reached, would be in the range of BDT 105 to 116 per USD (considering 95 per cent confidence interval). As was noted, the

[9]The EREER was estimated using a Dynamic OLS model with a fixed lead and lag of 1. The model used the REER as the dependent variable and Productivity Proxy (GDP/Capita), Government Consumption Expenditure, Net Foreign Asset, Remittance and Trade Openness as independent variables. REER was extracted from Bruegel and the other variables were extracted from World Development Indicators. Results of our estimations correspond with the Balassa Samuelson effect. The output table is given in Annex Table 4.1.

[10]REER: Real Effective Exchange Rate.

[11]EREER: Equilibrium Real Effective Exchange Rate.

gap between the REER and NER is closing down in recent months. Actual exchange rate of BDT will, however, depend on various factors including the extent of intervention by the Bangladesh Bank in the forex market, export and remittance performance, demand for imports and global commodity prices, capital and financial flows. Also, the estimates are based on 2022 figures; there has been some developments in the forex exchange market since then. However, the indications are that if a move is taken towards a single exchange rate, the forex market is currently in a position to adjust to it without significant disruption. The central bank should undertake rigorous analysis and take decisions in this regard based on evidence and data and closely monitor the exchange rate movement.

1.5 FOOD SECURITY DURING THE PERIOD OF MACROECONOMIC INSTABILITY

1.5.1 Introduction

Food security in net-food importing countries is likely to be adversely affected during macroeconomic instability (e.g., high inflation, currency devaluation, or economic recession). Bangladesh, for having macroeconomic instability during FY2023, may experience food security-related challenges during this period. It is to be noted that food security has two macroeconomic determinants – (a) food supply (i.e., availability) and (b) households' demand for food (i.e., access). The former depends on the abundance of per capita food supplies from domestic production, stocks, and imports (Pescatori, et.al., 2021). Lack of food grain availability negatively and significantly impacts food price inflation in both the short and long run. Increased volatility of commodity prices is likely to weigh on increased volatility in food production and food inflation (IMF, 2023). Small farmers and poor consumers in developing countries get affected due to high inflation as poor people spend a major portion of their income on food consumption (Samal et al., 2022). The purchasing power of the consumers determines how much food security the consumers would avail during the period of macroeconomic instability. This section aims to review the state of food security in Bangladesh during the macroeconomic crisis that Bangladesh is currently experiencing and to identify reasons behind this and possible way out in order to better manage the food security situation.

1.5.2 State of Food Supply during Macroeconomic Instability

State of country's food self-sufficiency

Bangladesh's state of food self-sufficiency—mainly domestic production of rice and wheat, needs to be analysed first as it largely determines the level of the country's food security. After the official announcement of food self-sufficiency in 2000 (Bokhtiar & Samsuzzaman, 2023), over the years, the demand for the import of rice and wheat has decelerated. Despite the positive development, the import of rice and wheat did not stop; rather, it has continued intermittently (Table 1.6).

Table 1.6

Production and import of rice & wheat (in '000' m. tonnes) and average growth rate per year

Fiscal Year	Production				Imports			
	Rice ('000' m. tonnes)	Δ Rice annual growth	Wheat ('000' m. tonnes)	Δ Wheat annual growth	Rice ('000' m. tonnes)	Δ Rice annual growth	Wheat ('000' m. tonnes)	Δ Wheat annual growth
FY2000	23067	7.4	1840	8.9	433	391.2	1,671	26.4
FY2005	25157	-3.9	976	-22.1	1295	61.7	2078	4.6

(Table 1.6 contd.)

(Table 1.6 contd.)

Fiscal Year	Production				Imports			
	Rice ('000' m. tonnes)	Δ Rice annual growth	Wheat ('000' m. tonnes)	Δ Wheat annual growth	Rice ('000' m. tonnes)	Δ Rice annual growth	Wheat ('000' m. tonnes)	Δ Wheat annual growth
FY2010	32257	3.0	969	14.1	93.0	-84.6	3364	38.7
FY2015	34710	1.0	1348	3.6	1490.0	297.3	3784	40.6
FY2019	36391	0.3	1017	-7.4	206.0	-94.7	5629	-4.3
FY2020	36604	0.6	1029	1.2	4.3	-97.9	6435	14.3
FY2021	39644	8.3	1299	26.2	1359.0	31507.0	5343	-17.0
FY2022	39481	-0.4	1226	-5.6	987.0	-27.4	892	-83.3

Source: FPMU database; Note: Import includes GoB commercial import, GoB import for public stock, private import, and food aid; gradually, food aid is decreasing, and during the last decade, it accounted for around 1 per cent of total import.

The per capita food availability is found to be higher than per capita food demand, although it has significantly dropped in FY2022 (Table 1.7). In other words, the official announcement of food self-sufficiency still seems 'elusive'. The Ukraine-Russia war had made the 'self-sufficiency' claim weaker. Due to war, the country has experienced multiple macroeconomic challenges which negatively impact domestic production and capacity to import (Table 1.6). Hence, the food security challenges need to be handled by the government from the perspective of a 'net food importing country'.

Table 1.7

Per capita availability against per capita demand (consumption as a proxy of demand)

Fiscal year	Per capita availability (gram/day)			Per capita consumption (gram/day)		
	Total	Rice	Wheat	Total	Rice	Wheat
FY1997	430	384	46	502	447	55
FY2000	522	453	70	591	530	61
FY2005	529	471	57	626	568	58
FY2010	614	535	79	674	598	76
FY2015	634	548	87	709	609	101
FY2020	687	564	123	723	592	131
FY2021	834	718	97	726	592	135
FY2022	653	576	76	709	601	108

Source: Author's calculation based on the FPMU data on PCA and index mundi for PCC.

Food Production and Import: Factors Behind the Trend

The production, import and availability of foodgrains had a mixed trend during the pre-pandemic period. However, the trend is negative in the post-pandemic period. The per capita availability of rice and wheat has significantly decreased during the post-pandemic period. Compared to the pre-pandemic period, wheat's per capita availability is much lower during the post-pandemic period. A significant drop in wheat imports due to high wheat prices caused by an interruption in the global supply chain due to the Ukraine-Russia war and less availability of dollars for importing the required amount of wheat were the main reasons behind the low per capita availability of wheat (Table 1.8).

A number of factors are found to be responsible for low food availability during the post-pandemic period. These include– (a) the high price of wheat in the international market due to limited availability of wheat; (b) devaluation of the BDT against USD, which made import costlier; and (c) limited domestic supply of fertilisers due to lack of gas supply.

Table 1.8

State and growth in food production, import and availability

Product	Fiscal year	production		Import		Per capita availability	
		In '000' m. tonnes	% Changes	In '000' m. tonnes	% Changes	Gram/day	% Changes
Rice	FY2019	36391	0.3	206.0	-94.7	528	-9.7
	FY2020	36604	0.6	4.3	-97.9	564	6.8
	FY2021	39644	8.3	1,359.0	31507.0	718	27.3
	FY2022	39481	-0.4	987.0	-27.4	576	-19.8
Wheat	FY2019	1017	-8.0	5,629.0	-4.3	106	-5.4
	FY2020	1029	1.2	6,435.0	14.3	123	16.0
	FY2021	1299	20.8	5,343.0	-17.0	97	-21.1
	FY2022	1226	-6.0	892.0	-83.3	76	-21.6

Source: Author's calculation based on FPMU database.

a. High price of wheat in the global market

In Bangladesh, wheat and rice are considered complementary food products – fluctuation of global supply and price of one product directly affect the supply and price of another. During the post-pandemic period, the majority of food products have experienced a price rise. Among those, wheat supply has significantly dropped mainly due to the Ukraine-Russia war, which consequently shot up the wheat price in the international market (Table 1.9) – almost double compared to the pre-pandemic level. As a result, the local market has confronted shortages of wheat and a rise in the prices of wheat and rice. Hence, food availability during the post-pandemic period has confronted challenges.

Table 1.9

Per capita availability against per capita demand (consumption as a proxy of demand)

Product	Quantity	2019	2020	2021	2022	Av. yearly % change (2019 and 2022)
Tea, avg 3 auctions	($/kg)	2.6	2.7	2.7	3.1	6.3
Coconut oil	($/mt)	735.7	1010.4	1636.3	1634.6	40.7
Groundnuts	($/mt)	1337.8	1838.7	1555.0	1568.1	5.7
Fish meal	($/mt)	1448.0	1432.7	1480.9	1595.6	3.4
Groundnut oil	($/mt)	1407.4	1697.8	2075.1	2202.6	18.8
Palm oil	($/mt)	601.4	751.8	1130.6	1276.0	37.4
Soybean oil	($/mt)	765.4	837.8	1385.4	1666.8	39.3
Maize	($/mt)	170.1	165.5	259.5	318.8	29.2
Rice, Thai 5%	($/mt)	418.0	496.8	458.3	436.8	1.5
Rice, Thai 25%	($/mt)	410.4	481.8	448.3	429.7	1.6

(Table 1.9 contd.)

(Table 1.9 contd.)

Product	Quantity	2019	2020	2021	2022	Av. yearly % change (2019 and 2022)
Rice, Thai A.1	($/mt)	393.5	474.6	436.1	417.7	2.1
Rice, Viet Namese 5%	($/mt)	351.9	428.0	446.3	404.5	5.0
Wheat, US SRW	($/mt)	211.3	227.7	281.7	381.9	26.9
Wheat, US HRW	($/mt)	201.7	231.6	315.2	430.0	37.7
Sugar, world	($/kg)	0.3	0.3	0.4	0.4	15.2

Source: The World Bank.

b. Shortages of supply of fertiliser

The fertiliser supply has significantly reduced in 2022 and is likely to be less in 2023. This is mainly because of less fertilisers imports during the said periods, though production has increased (Table 1.10). Moreover, domestic production of fertilisers is likely to be curtailed mainly in 2023 because of less supply of gas for the state–owned fertilisers companies. Given the limited availability of foreign exchange, there was a constraint in allocating funds to import fertilisers. To reduce the subsidy burden, the government has revised the fertilisers price—the decision would reduce the subsidy burden by an amount of BDT 7,000 crore. However, such a move would not ensure a rise in fertilisers supply unless the necessary amount of foreign exchange is allocated for meeting the gaps in domestic requirements for fertilisers.

Table 1.10

Fertiliser production and imports (thousand m. tonnes)

Year	Production	Import	Total
FY2019	904	4225	5129
FY2020	924	4798	5772
FY2022	1725	3220	4945

Source: FPMU database.

c. Depletion of Foreign Exchange Reserve and Devaluation of BDT against USD

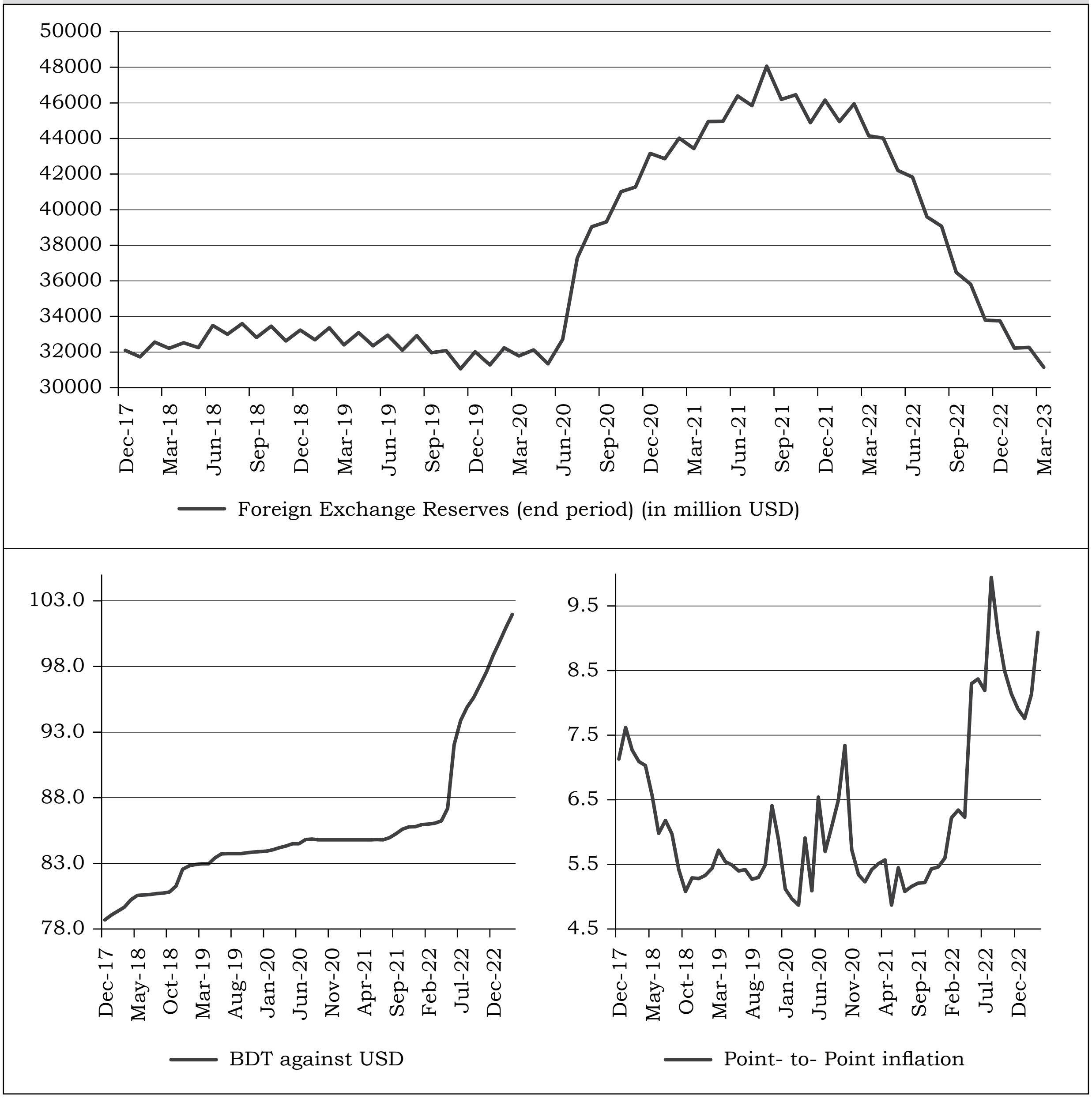
The gradual depletion of foreign exchange reserves has multiple impacts on food security-related issues (Figure 1.13 (a b c)). This has reduced the capacity to import essential food items as well as raw materials, including fertilisers, pesticides and other items required for food production. On the other hand, the depletion of the reserve has further weakened the local currency against major foreign currencies, including the USD. Hence, the import of cost for food and food-related materials has increased. Overall, the current exchange rate and inflation spike have made food imports dearer.

d. Regression Analysis on Determinants of Food Import

A regression analysis has been carried out in order to identify the relationship between the import of food grains with the import price of rice and wheat, food inflation, exchange rate (BDT/USD)

Figure 1.13

Trend of the exchange rate, food inflation and foreign reserve



Source: Author's analysis based on the Bangladesh Bank.

and foreign exchange reserve, (Table 1.11).[12] It is identified that all the variables are stationary at first difference except import of food and inflation which were stationary at level form. Therefore, the ARDL model was fit to identify the long-run equilibrium among the variables. It is found that the coefficient of the foreign reserve is significantly negatively associated with the import of food.

[12]The model includes the import of food as a dependent variable, whereas the import price of rice and wheat, food inflation, the exchange rate (BDT/USD), and foreign exchange reserve as independent variables. Monthly data of different variables are used from the period of January 2014 to December 2022. Data are converted into logarithmic form in order to have the same data unit for different types of variables.

In order to identify the long-run equilibrium among the variables, the bound test has been estimated. The results in Table 1.12 indicate that the F statistics (20.45) are higher and T statistics (-10.81) are lower than their I(0) regressors which suggest rejecting the null hypothesis of no equilibrium. Therefore, there is at least one cointegrating relationship in the long run.

Table 1.11

Results of ARDL regression

Log of import	**Coefficient**	**P>t (significance level)**
	Log of import	
L1.	-0.07	0.46
Log of import price of rice	0.79	0.37
Log of import price of wheat	2.30	0.06*
Log of food inflation	0.54	0.20
Log of exchange rate	8.05	0.52
Log of reserve	-7.24	0.01**
Constant	-3.54	0.63

Source: Authors' estimate.

Note: *indicates significance at a 10 per cent level and **indicates significance at a 5 per cent significance level.

Table 1.12

Results of bound test to indicate long run equilibrium

Regressors		**Critical values**	
[I_0]	L_1	2.26	-2.57
[I_1]	L_1	3.35	-3.86
[I_0]	L_05	2.62	-2.86
[I_1]	L_05	3.79	-4.19
[I_0]	L_025	2.96	-3.13
[I_1]	L_025	4.18	-4.46
[I_0]	L_01	3.41	-3.43
[I_1]	L_01	4.68	-4.79
		accept if F < I(0) & Reject if vice versa	accept if t > I(0) & Reject if vice versa
		F	T
Calculated values		***20.45***	***-10.81***

Source: Authors' analysis based on the data from FPMU and Bangladesh Bank.

The above table suggests that food import (dependent variable) is cointegrated with at least one variable. In order to identify the cointegrating equation, the error correction model is estimated in table 1.13. The model postulates that a high speed of positive adjustment is expected toward equilibrium, and the error correction term is significant. Only the import price of wheat is found to be cointegrated in the long run, whereas in the short run, causality is found with the import of food with the import price of wheat and the foreign reserve. The lag and difference operator of wheat prices and foreign reserves also cause food import in the short run.

Table 1.13
Results of ARDL regression

D. ln imp	**Coefficient**	**P>t**
Adjustment parameter (speed of adjustment)		
Ln imp		
L1.	-1.07	0.00
Long run equation		
Log of import price of rice	0.74	0.37
Log of import price of wheat	-0.82	0.01
Log of inflation (food)	0.50	0.20
Log of exchange rate	0.34	0.88
Log of foreign reserve	0.69	0.12
Short run equation		
Long of import price of wheat		
D1.	3.18	0.01
LD.	0.72	0.55
L2D.	-3.69	0.00
Log of exchange rate		
D1.	7.69	0.55
LD.	-21.38	0.11
L2D.	-21.35	0.12
Log of foreign reserve		
D1.	-7.97	0.00
LD.	-7.30	0.01
_cons	-3.54	0.63

Source: Authors' estimate.

According to the diagnostic test of Durbin Watson autocorrelation test, normality and heteroscedasticity, the model has no serial correlation, and data is normally distributed and heteroscedastic. In terms of CUSUM stability test, the model deviates from its upper and lower range values in the short run but converges to the equilibrium within the upper and lower bound range.

e. Food Availability for the Target Groups: Public Food Stock

The reduced availability of food during 2022 has pushed the government to take proactive measures for raising public food stock. The public food stock has significantly increased during the post-pandemic period, particularly in 2022 (Table 1.14 and Table 1.15), which is likely to continue in 2023. A part of the public food stock was based on domestic procurement of rice and wheat, while a major part of the stock was direct import by the government. Because of the faulty pricing policy for the public procurement of rice as well as the non-transparent procurement process, the domestic procurement of rice could not reach the target. Hence, the potential for domestic procurement could not meet the target, which ultimately affects the food security of the targeted population – i.e., poor, vulnerable and other targeted groups.

Table 1.14
Year wise (end of June) Closing Public Food Stock

Fiscal year	Rice	Wheat	Total	Average growth in rice stock	Average growth in wheat stock
	('000 m. tonnes)				
FY2001	422	445	867	-15.3	-16.8
FY2002	500	444	944		
FY2003	525	146	671		
FY2004	723	116	839		
FY2005	163	146	308		
FY2006	568	167	735	-6.5	-8.5
FY2007	436	168	604		
FY2008	825	174	999		
FY2009	930	216	1145		
FY2010	421	110	531		
FY2011	569	311	880	16.7	2.1
FY2012	939	311	1250		
FY2013	715	306	1021		
FY2014	734	419	1153		
FY2015	949	337	1287		
FY2016	458	397	855		
FY2017	123	256	378	26.9	-4.7
FY2018	963	353	1315		
FY2019	1256	418	1674		
FY2020	838	350	1188		
FY2021	1056	411	1467		
FY2022	1197	286	1483		

Source: FPMU Database.

Table 1.15

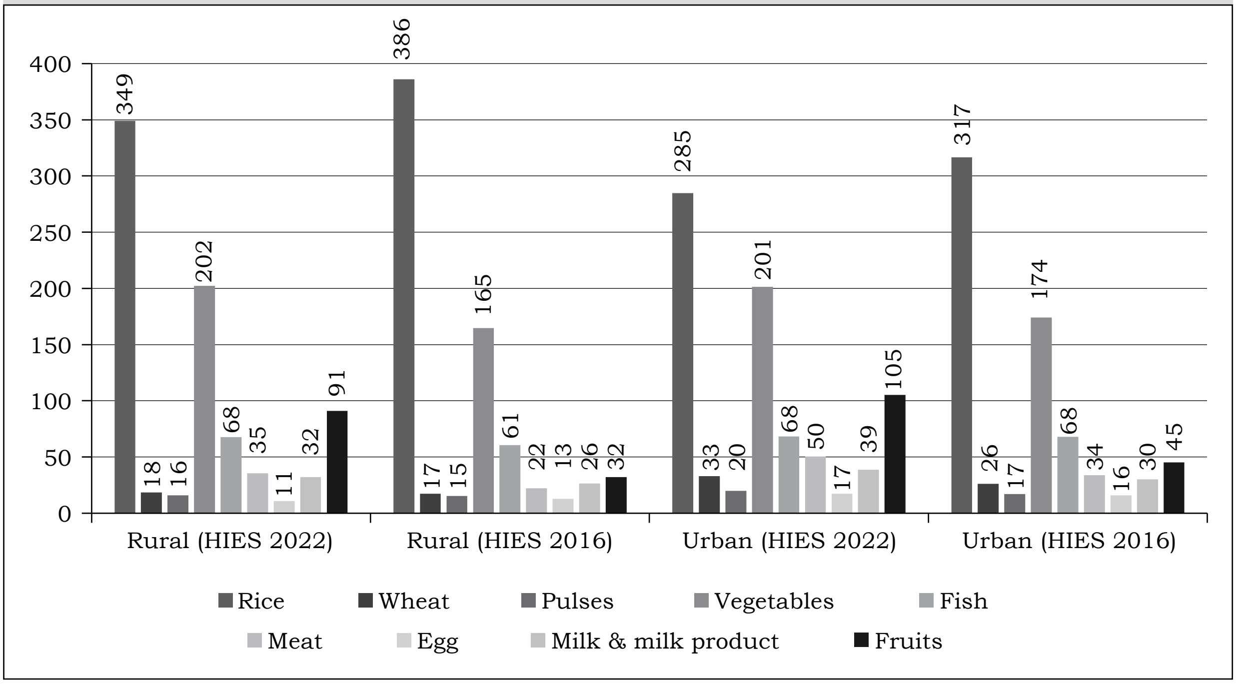
Domestic procurement of Aman and Boro rice and wheat

Year	Aman						Boro						Wheat	
	Target '000' metric tonnes			Actual '000' metric tonnes			Target '000' metric tonnes			Actual '000' metric tonnes			'000' metric tonnes	'000' metric tonnes
	Paddy	Rice	in Rice	Paddy	Rice	in Rice	Paddy	Rice	in Rice	Paddy	Rice	in Rice	Target	Actual
2000	73	200	250	54	199	236	154	500	600	134	513	600	250	211
2005	37	175	200	0	163	163	39	978	1000	20	919	931	50	1
2010	150	200	302	0	14	15	150	1050	1147	9	557	563	50	48
2015	-	320	320	0	320	320	100	1035	1100	71	1024	1070	250	205
2019	-	800	800	0	800	800	400	1150	1410	400	1000	150	50	44
2020	600	400	800	241	156	316	800	1000	1670	238	565	720	1000	103
2021	200	650	783	12	75	83	650	1235	1749	362	1060	1319	100	103
2022	300	500	700	0	12	12	-	-	-	-	-	-	-	-

Source: FPMU database.

Figure 1.14

Comparison of the per capita consumption (gram per day)



Source: BBS.

1.5.3 Household's demand for food during macroeconomic instability

As discussed, household demand for food reduces during the time of macroeconomic instability as a rise in inflation causes a reduction in a household's purchasing capacity. Hence, the household demand for food is likely to be adversely affected during the post-pandemic macroeconomic instability in Bangladesh. According to the Household Income and Expenditure Survey (HIES) 2022, households' food and non-food consumption expenditures have increased compared to that in HIES 2016. However, the consumption of rice has declined in 2022 while the consumption of wheat has marginally increased (Figure 1.14). In other words, households have experienced changes in the consumption pattern where consumption of non-rice and non-food has been getting more important in overall household expenditure.

Household's expenditure for food consumption

Household's expenditure for food consumption (in real term) has significantly deteriorated during 2022 compared to that in 2016 (Table 1.16). Household's expenditure for food did not rise in commensurate with their rise in real income. In other words, households are forced to spend a substantial amount of their income on non-food items. Out of the incremental rise in real income of BDT 3317 per household per month, less than one-third of that household's income is spent on food consumption. Households seem to be in a state of vulnerability from a food security point of view.

Table 1.16

Comparison of the income of the household in nominal and real terms

Year	Income		Food expenditure		Share of food expenditure of total household's income	
	Nominal	Real	Nominal	Real	Nominal	Real
2022	32,422.0	10,589.0	14,003.0	4,207.0	43.2	39.7
2016	15,988.0	7,272.0	7,354.0	3,132.0	45.9	43.1

Source: Author's calculation based on BBS.

Social Safety net Programmes for the Target Groups during Macroeconomic Instability

Given the weak purchasing capacity during the period of high inflation, it is important to continue the SSNPs for the target groups extensively. The food assistance-related programmes cover around 4.24 crore people. Programmes are targeted at vulnerable women, VGF, GR, hill tract people, OMS, food for work, and different types of relief. The programmes are related to food assistance, whereas the government provide food as grants or for work. Most vulnerable households who are less resilient during economic crises are covered under OMS, TR, and Food for Work programmes. In 2022, the government distributed rice and wheat at subsidised prices among one crore families registered under TCB. It is interesting to note that most of the programmes did not experience any major changes in coverage during 2022 and 2023; rather, the coverage has declined in a few programmes (such as VGF and OMS in 2023) (Table 1.17). Due to the rise in the cost of food, the budget allocation has partially increased in some of the programmes (even decreased in a few programmes, FFP in 2023). Besides, there are allegations of lack of efficiency in selecting

Table 1.17

PFD allocation for different target groups

Food support programmes	Beneficiaries (persons in lakh)			Budget (in crore BDT)		
	RFY2021	RFY2022	BFY2023	RFY2021	RFY2022	BFY2023
Vulnerable Women Benefit (VWB) Programme	10.4	10.4	10.4	1840.1	1838.5	1840.3
Vulnerable Group Feeding (VGF)	200.2	180.0	180.0	941.2	962.0	991.1
Gratuitous Relief (Food)	26.3	32.0	33.0	242.6	572.6	589.9
Food Assistance in Ctg-HTA	2.8	2.3	2.9	318.2	347.6	365.3
Food For Work (FFW))	0.0	9.6	9.8	0.0	826.4	876.3
Open Market Sales (OMS)	20.0	54.0	37.4	949.0	1943.6	1720.1
Food friendly Programme	62.5	62.5	62.5	2891.0	2816.7	2543.9
Food Subsidy (Others)	-	-	-	1389.3	1584.6	1700.8
Relief Goods	59.1	80.3	82.9	185.0	185.0	190.0
Relief Works (Flood, Drought, Cyclone and Others)	36.0	4.8	4.8	91.0	181.0	81.0
Ration for Shaheed (Martyred) Family and Honourable Injured Heroic Freedom Fighters	0.3	0.3	0.3	65	70	70

Source: MoF.

beneficiaries for the family card programme, including the problem of ‘exclusion-inclusion biases’ in the programme beneficiaries. According to Moazzem and Shibly (2023), the old age allowance and vulnerable women group (widow) support programmes have a leakage of 30 and 33 per cent, respectively. Proper beneficiary targeting would cover an additional 45 lakh eligible old age and widow non-beneficiaries.

Coverage of PFDS

The distribution of rice and wheat under PFDS, particularly through OMS, FFP, and other programmes, increased during FY2022 (Table 1.18). This rise in the distribution of food has partially increased the availability of food for the target groups. However, this rise in food distribution does not necessarily mean a rise in access to a number of potential beneficiaries. Government capacity to spend for PFDS is another important issue during the period of limited fiscal space. Figure 1.15 shows a 20.5 per cent rise in food subsidy from BDT 4,172 crore in FY2021 to BDT 5,026 crore in FY2022. Without having the fiscal space, the rise in budget for PFDS-related expenditures and thereby ensuring more coverage is difficult.

Table 1.18

Public food distribution *(in ‘000 m. tonnes)*

Year	Rice		Wheat	
	Distribution	% changes	Distribution	% changes
FY2015	1220	-3.3	619	-35.4
FY2016	1512	23.9	552	-10.8
FY2017	1610	6.5	631	14.3
FY2018	1702	5.7	408	-35.3
FY2019	2145	26.0	448	9.8
FY2020	2208	2.9	569	27.0
FY2021	1862	-15.7	590	3.7
FY2022	2250	20.8	636	7.8

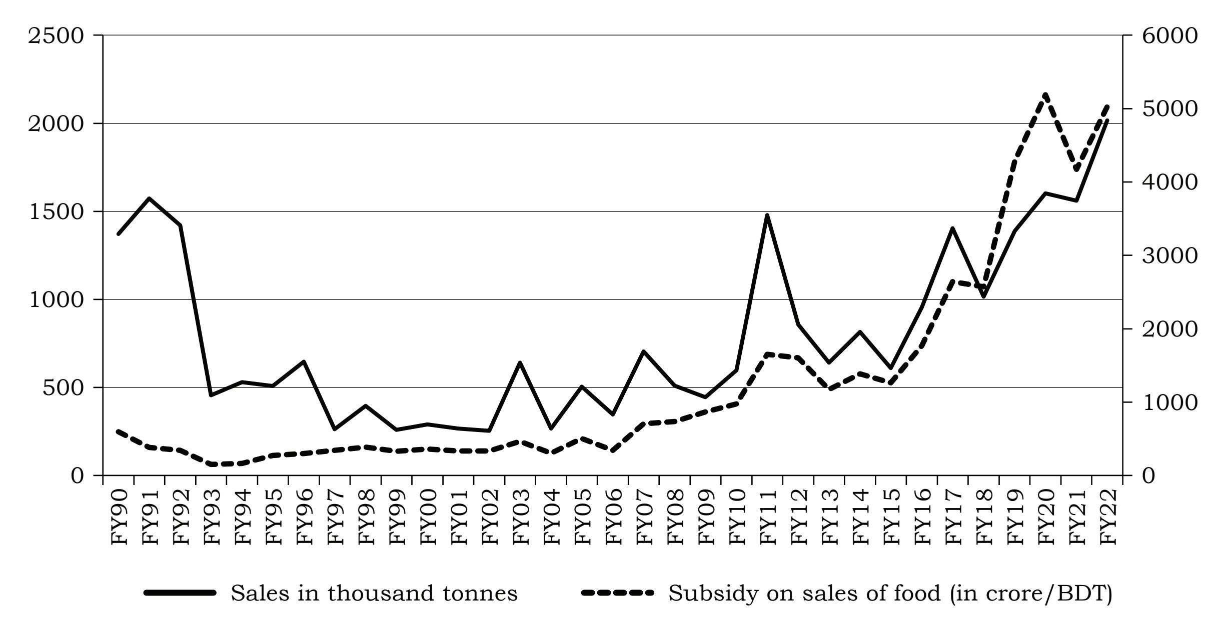
Source: CPD compilation based on data from National Board of Revenue.

Rise in Energy Prices and Its Implications on Food Security

The rise in energy prices to adjust the energy related subsidy as per meeting the conditionality of IMF is a faulty step. In fact, energy related subsidies could be reduced without raising energy prices by revising the pricing of electricity purchases from independent power producers. Because of the faulty step, farmers need to pay higher irrigation charges which would ultimately increase the harvest price of rice and wheat. A similar attempt is going to be made by setting a market-based pricing for the retail tariff of electricity, as per IMF conditionality. Without proper adjustment of the power purchase agreement, market-based pricing would deprive the consumers, including the farmers.

Figure 1.15

Subsidy for sales of foodgrain and distribution amount by sales



Source: Author's calculation based on FPMU database.

1.5.4 Conclusion: Addressing the Concerns of Food Security during the Period of Macroeconomic Instability

Addressing the concerns of food production

The government needs to ensure a rise in food production to ensure food security through better food availability and reduce volatility in food prices in the domestic market. It is important to keep the irrigation cost lower by reducing electricity costs or replacing diesel-based irrigation with solar-based irrigation. Hence, farmers should get subsidised rates for electricity usage for irrigation. Similarly, subsidies for fertilisers and mechanisation need to continue- it is expected that government will not make any attempt to revise the prices of fertilisers and farm machinery. A necessary allocation needs to be made to procure rice and wheat to cover the increased demand for PFDS. In this context, the necessary foreign exchange needs to be allocated for the import of essential food items, particularly rice, and wheat. It is found that other South Asian countries have taken different measures to address the food production related concerns (Annex Table 1.3).

Addressing the concerns of food demand

Containing food inflation is highly important with a view to reducing the pressure of declining the real income of the households. In this context, stability in the exchange rate (BDT against USD) and maintaining a stable forex reserve could partly help reducing the volatility in the import of food grains. The SSNP has yet to raise the coverage during the crisis period, although that is highly essential. A rise in PFDS could ensure the higher availability of foodgrains for existing beneficiaries, but it cannot ensure higher access to potential beneficiaries. In this context, a rise in subsidy allocation for SSNPs, particularly PFDS, is required. Better targeting and reducing the leakages and wastages could substantially increase the potentiality to raise access to the beneficiaries. Bold measures are required in order to ensure transparency and accountability in the SSNPs, particularly OMS operations. Despite having fiscal difficulties, the government needs to create fiscal space to ensure universal food security. It is expected that the next budget will take measures towards that direction. It is found that other South Asian countries have taken different measures to address the food demand and supply related concerns (Annex 1).

1.6 CONCLUSIONS

In view of the emergent scenario and keeping in perspective the upcoming national budget, there is no doubt that the primary task before the policymakers is to restore macroeconomic stability. The targets to be set for the macroeconomic (and fiscal) framework for FY2024 will need to take cognisance of the current realities. The mistakes while preparing the FY2023 budget – that is, setting the targets for major macroeconomic correlates in an unrealistic manner – must not be repeated. While the fiscal and budgetary measures are expected to be the centre of discussions in the coming days, it is critical that the government and the central bank ensure the complementarity between fiscal and monetary policies. The policy measures must prioritise the interests of the small and medium entrepreneurs and common citizens while withstanding the pressure of the vested interest groups. Keeping the IMF conditionalities in perspective and national interests in mind, reform measures should be initiated and expedited. However, the pacing, sequencing and phasing of these reform measures should be well-planned and transparent. Proper enforcement of laws and regulations against bank loan defaulters must be ensured. Instead of incentivising illicit financial flows and illegally earned money through direct and indirect measures, strict administrative steps and punishment should be imposed as per existing laws. The Bangladesh economy is at a crossroads and passing through the most difficult time in recent history. This must be recognised and addressed by appropriate policy tools.

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ANNEX

Annex Table 1.1

Impact of GDP, import and inflation on tax revenue collection

Sample: 1993-2020

Included Observations: 28

Methodology: Ordinary Least Square (OLS)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOGGDP	0.592189	0.251361	2.355928	0.0270
LOGIMPORT	0.652748	0.168807	3.866829	0.0007
INFLATION_RATE	-0.018458	0.005576	-3.310186	0.0029
C	-1.319364	0.411887	-3.203216	0.0038
R-squared	0.981431	Mean dependent var	–	2.649789
Adjusted R-squared	0.979110	S.D. dependent var	–	0.477879

Source: Authors compilation.

Annex Table 1.2

Output table

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Productivity Proxy	0.734	0.160	4.576	0.002
Govt. Cons. Exp.	-0.245	0.129	-1.884	0.100
Net Foreign Asset	-0.488	0.666	-5.236	0.001
Remittance	-0.100	0.029	-3.332	0.012
Trade Openness	-0.212	0.049	-4.289	0.003
Constant	8.680	1.578	5.498	0.001
R-squared	0.997	Mean dependent var	–	4.821
Adjusted R-squared	0.992	S.D. dependent var	–	0.165

Source: Authors compilation.

Annex Table 1.3

Measures taken by Nepal and Cambodia during the pandemic and post-pandemic period

Countries	Issues	Measures were taken after a pandemic
Nepal	SSNPs	Ensuring the uninterrupted supply of essential commodities, supporting smallholder farmers, strengthening market systems, and enhancing social safety nets. Implemented cash transfer programmes, including targeted food assistance and provided subsidies to vulnerable households and smallholder farmers affected by the pandemic.
	Stockpiles	Emergency food stockpiles to ensure the availability of essential commodities during crises.
	Localisation	Strengthening local food systems to reduce reliance on external supply chains during the pandemic. This involved promoting local production, facilitating farmers' access to markets, supporting farmer cooperatives, and enhancing storage and processing infrastructure.
Cambodia	COVID-19 Economic Stimulus Package	Measures to support agriculture, such as providing subsidised loans, agricultural inputs, and technical assistance to farmers
	Market Support and Price Stability	Market monitoring and interventions to stabilise food prices and smoothening the supply chains
	Promotion of Urban Agriculture	Encouraging the cultivation of vegetables, herbs, and small livestock within the urban area
	Strengthening Food Processing and Storage	Improvement of post-harvest infrastructure, including food processing and storage facilities
	SSNPs	Cash transfer programmes, subsidised food distribution, and nutritional support have been implemented.

Source: Authors compilation.

Chapter 2

CPD's Recommendations for the National Budget FY2023-24 *(Second Reading)*

Weathering the Storm, Containing the Risks

2.1 INTRODUCTION

The national budget for FY2023-24 (FY2024) will be the last budget prepared by the incumbent government prior to the upcoming national elections. It is being prepared amidst a number of disquieting developments – both at the global and domestic fronts. The Bangladesh development narrative, with its impressive success in terms of economic performance and commendable progress in terms of key socio-economic indicators, have come under scrutiny in view of the developments of recent times. The challenge facing the economy is to restore macroeconomic stability, consolidate the gains of the past, and adjust to new realities keeping the growth and stability trade-off in the perspective. The upcoming FY2024 budget will need to address these attendant concerns amid election-related uncertainties. This will require renewed efforts towards raising the quality of macro-fiscal planning and management which, in turn, will require some hard choices on the part of the policymakers.

In this backdrop, the present report focuses on six areas: a) macroeconomic management; b) fiscal framework; c) prices of commodities; d) subsidies; e) health and education; and f) environmental concerns. This report highlights some of the key challenges in these areas which require immediate and heightened policy attention, particularly from the macro-fiscal management viewpoint, using the latest available data from official and credible international sources. Finally, this report puts forward a set of recommendations which might be considered by the policymakers while formulating the national budget for FY2024. The analyses and recommendations presented by this report may also inform the electoral debates subsequent to the national budget.

2.2 KEY TRENDS IN MACROECONOMIC CORRELATES

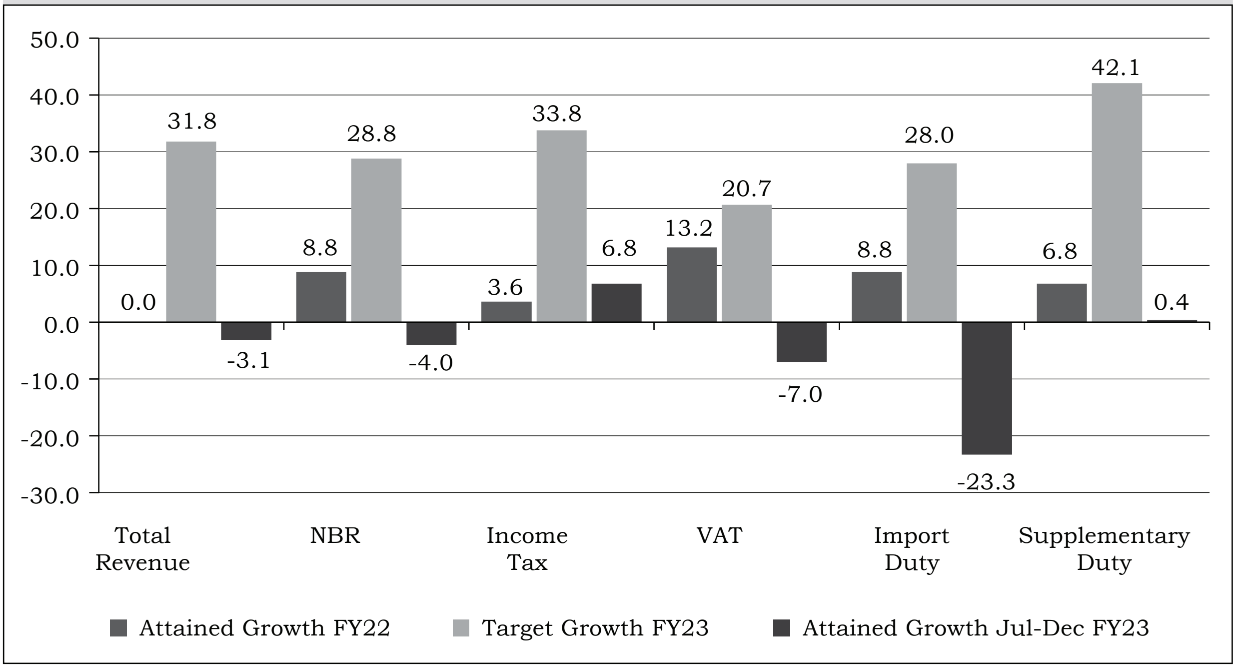
As FY2023 commenced its journey in July 2022, it became evident that the Bangladesh economy would be under severe stress. At a time when the economy was coming out of the worst impacts of COVID-19, the adverse consequences of global price hikes following the war in Ukraine began to be felt on various correlates of the Bangladesh economy. The Centre for Policy Dialogue (CPD), in July 2022, had cautioned that the emergent macroeconomic pressure would not be short-term in nature and would be exacerbated by embedded structural weaknesses. Macroeconomic instability has remained endemic and a matter of great concern throughout the ongoing fiscal year of FY2023. While adverse impacts of economic headwinds, currency pressure and soaring commodity prices have started to recede in most Asian economies, as the economies took measures to adjust to the new normal, the Bangladesh scenario remained distanced. Indeed, the headline macroeconomic trends in the country evince cautionary signals. As the government prepares to present the national budget for the upcoming FY2024, it is important to acknowledge the changing trends of macroeconomic correlates and identify the elements of the emerging tensions and pursue a co-ordinated policy package. It needs also be recognised that Bangladesh is currently under an IMF programme, which would call for undertaking adjustments in the macroeconomic targets and defining some of the critical policy choices.

Shrinking fiscal space in the backdrop of a lack of momentum in revenue mobilisation

Total revenue collection declined by (-) 3.1 per cent during the first half of FY2023, driven primarily by the reduced tax collection by the NBR (Figure 2.1). It is rather surprising that despite the rising commodity prices and substantial depreciation of the Bangladeshi Taka (BDT), the collection of value added tax (VAT) was substantially lower in the stated period compared to the previous year. While NBR has kept trying to boost revenue collection, a number of factors have militated against its declared objectives. From the very outset, the government took a cautionary approach towards spending budgetary allocations for the ADP projects. This was perhaps one of the reasons for the

Figure 2.1

Revenue mobilisation growth by sources *(in per cent)*



Source: Estimated from Monthly Report on Fiscal Position: December 2022 (Fiscal Year 2022-23), MoF.

reduced revenue collection. However, the key reason is more likely to be the slowing economic activities resulting in limited revenue collection since no significant proactive administrative and institutional measures were undertaken. The tightening of imports not only reduced the scope for indirect tax collection at the external stage but also hampered production for the domestic market and consequently led to lowered tax collection at the local level. It is more likely that the IMF's condition (as part of the quantitative performance criteria and indicative targets for the first two reviews) to generate BDT 3,456.5 billion in FY2023 as tax revenue would remain unmet.

Budget deficit financing relied highly on borrowings from the central bank

Shrinking fiscal space arising from lower revenue mobilisation has forced the government to go for restraining public expenditure. In spite of this, the budget deficit remained higher in the first half of FY2023 compared to FY2022. More importantly, the government's options for financing of budget deficit were limited to borrowing from the central bank. Foreign financing (both loan and grants components) did not make any significant improvement, while net sales of NSD certificates was negative as encashment exceeded new sales (to the tune of (-) BDT 3,065 crore), implying that the government borrowed less than what it repaid. Gross sales of NSD certificates declined (by BDT 12,836 crore during the first seven months of FY2023), while repayments increased (by BDT 2,395 crore). More stringent administrative measures (such as the requirement to present income tax return certificates for purchasing NSD certificates), lowered interest rates, dissaving, and the reduced ability of middle-income investors to save in the backdrop of declining purchasing power have contributed to this scenario in all likelihood.

Since cash-strapped scheduled banks were unable to provide loans, the government was compelled to resort to the central bank to finance the budget deficit. According to the Bangladesh Bank data, the government borrowed about BDT 51,266 crore from the central bank during the first half of

FY2023 and repaid about BDT 20,735 crore in net terms to the scheduled banks. On the other hand, it is also to be noted that the central bank also retracted a substantial amount of BDT from the market as it sold a substantial amount of foreign exchange during this fiscal year (USD 10.5 billion as of 15 March 2023). As a result, both broad money supply and reserve money growth rates are within the programmed limits. However, continued borrowing from the central bank will not be advisable as it may lead to added inflationary pressure. Regrettably, in view of the current trends, the government may not have many options as the budget deficit and its financing demand is set to rise during the latter months of the fiscal year.

The liquidity position of scheduled banks tightened amid deteriorating financial sector governance According to the Bangladesh Bank data, during the first seven months, overall liquidity in the banking system had declined sharply (by BDT 66,581 crore). Indeed, the Islami banks as a group could not meet the total minimum liquidity requirement by the end of January 2023 (Table 2.1). Significant malgovernance and lack of prudential management were the reasons. Bangladesh Bank introduced a new tool to extend liquidity support to cash-strapped Islami banks, namely Mudarabah Liquidity Support (MLS), with a view to cushioning the banks' ailing financial health. The space also declined sharply for state-owned commercial banks and private commercial banks (as groups) as well. At the same time, with declining purchasing power and lowered propensity to save, currency in circulation outside banks increased by 24.1 per cent by the end of January 2023 (to the tune of BDT 51,216 crore).

Table 2.1

Excess liquidity by bank types *(crore BDT)*

End of Month	SCB	PCB	IB	FCB	SB	All Banks
June 2022	79,430	76,376	21,792	25,743	82	203,424
October 2022	61,970	64,657	10,420	32,394	115	169,556
January 2023	51,387	55,554	(2,218)	32,051	69	136,842

Source: Bangladesh Bank.

Note: 1. SCB – State-owned commercial banks, PCB – Private commercial banks, IB – Islami banks, FCB – Foreign commercial banks, SB – Specialised banks.
2. Figure in the parenthesis implies a negative number.

It has now emerged as an urgency that the central bank intervenes to change the current system of administered interest rates and embraces a market-based interest rate regime. The central bank has committed to IMF to adopt an interest rate corridor system with a view to enhancing monetary operations by the end of July 2023. Indeed, CPD has been arguing for some time that the central bank should opt for a market-determined interest rate regime in view of rising inflation and the tight liquidity situation. Recently, Moody's, one of the most reputed global rating agencies, downgraded its outlook for the sector in Bangladesh from 'stable' to 'negative'. The issue of establishing good governance in the banking sector of Bangladesh and pursuing the needed reforms to this end is long overdue. Indeed, the central bank and MoF are committed to the IMF to implement three major reform activities in this regard. These are: (i) Bangladesh Bank completes the pilot risk-based supervision action plan to establish risk-based banking supervision by the end of June 2023; (ii) MoF submits to the Parliament the Bank Companies (Amendment) Act 2020 and the Finance Companies Act 2020, drafted in line with the best practices, to upgrade legal and regulatory framework by the end of September 2023; and (iii) Bangladesh Bank publishes banks' distressed assets in the annual financial stability report to support resolution of non-performing loans (NPL) and take measures to enhance transparency by the end of June 2023.[1] These reforms should be carried out in an unbiased professional manner ignoring the pressure from vested groups and keeping the best interest of the banking sector in mind. Besides, urgent steps must be taken to expedite legal steps against financial misappropriations in the banking sector and the wilful defaulters. One recalls here that CPD has been urging for setting up an independent Banking Commission, which would be mandated to propose a set of actions that would then be implemented in a time-bound manner.

Despite some relief at the global level, there is no respite from rising commodity prices

Headline inflation at the global level has begun to ease. According to the Organisation for Economic Co-operation and Development (OECD) data, headline inflation in G-20 countries is expected to decline from 8.1 per cent in 2022 to 5.9 per cent in 2023, while in G-7 countries, it is predicted to decline from 6.4 per cent in 2022 to 4.4 per cent in 2023. Indeed, as is presented in Figure 2.2, according to World Bank Commodity Price data, international prices of 10 major selected imported commodities for Bangladesh recorded significant declines. Regrettably, the falling global commodity prices were not reflected in commodity prices in Bangladesh domestic market. It is true that during this period, BDT also experienced a record depreciation (about 17.3 per cent, according to the Bangladesh Bank data). Also, the government made significant upward adjustments to the prices of petroleum products and electricity, which may have contributed to the upward pressure of commodity prices in Bangladesh. However, considering all relevant factors, it is hard to justify the high level of prices in the country. Weak market and supply chain management, manipulation in the market, syndication, lax enforcement of laws and regulations and weak institutional capacities have combined to lead to this situation.

The government is committed to IMF to adopt a periodic formula-based price adjustment mechanism for petroleum products by the end of December 2023. As the government prepares for this major policy reform, it is critically important that this exercise is carried out in an inclusive and transparent manner. The policy agenda must include an institutional efficiency audit of the monopoly operations of the Bangladesh Petroleum Corporation (BPC) and other state-owned entities associated with contracts, import and distribution. The prevailing tax structure applied at the import stage for these critical intermediate, and final products will need to be adjusted in line with the government's overall tariff policy and cross-country practices.

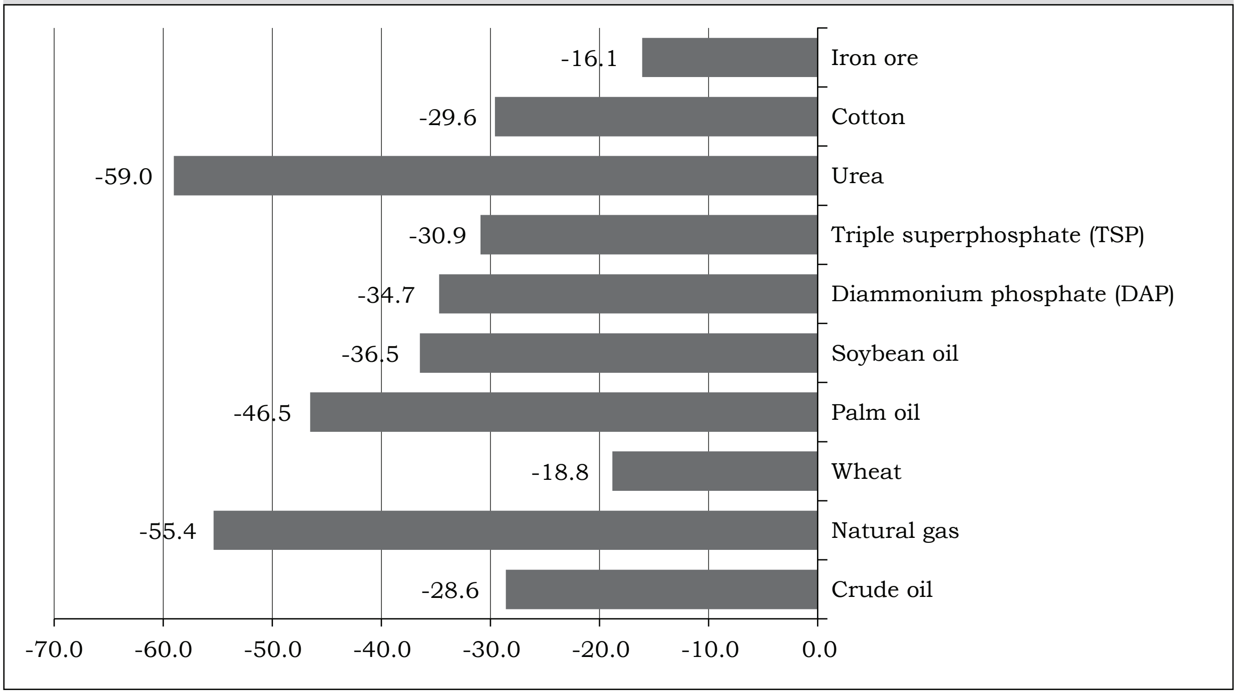
Despite tightening imports, balance of payments remains at risk

The sharp deterioration in the balance of payments resulting in a drastic decline in foreign exchange reserves and significant depreciation of the BDT is one of the most distressing signals witnessed by the Bangladesh economy in recent past years. During the first seven months of FY2023, the deficit in overall balance reached USD 7.4 billion. Over the last months, there has been a conscious effort to curb imports along with the significant depreciation of BDT. Payments for merchandise import shipment declined by (-) 5.7 per cent during the July-January period of FY2023. Opening of letter of credit (L/C) also declined by (-) 22.5 per cent during the first half of FY2023. On the other hand, after recording an impressive growth of 34.4 per cent in FY2022, the export earnings continued to grow in FY2023 amid the fragile global environment. During the July–February period of FY2023, the growth of export earnings was 9.6 per cent (Table 2.2). However, this is solely driven by the growth attained by the RMG products (14.1 per cent). It is a worrying sign to find that combined export earnings from non-RMG products have come down by (-) 9.9 per cent. It is surprising to

[1]The NPL in Bangladesh continued to be high. Indeed, if the Basel III requirements are applied, the NPL will be significantly higher.

Figure 2.2

Growth rates in selected global commodity prices between February 2023 and March 2022 (the beginning of war in Ukraine) *(in per cent)*



Source: World Bank Commodity Price Data.

Note: (1) Crude oil, average spot price of Brent, Dubai and West Texas Intermediate, equally weighed; (2) Natural gas index (Laspeyres), average of Europe, US and Japan (LNG), weights based on 5-year average consumption volumes; (3) Wheat (U.S.), no. 2 hard red winter Gulf export price; (4) Palm oil (Malaysia), RBD, FOB Malaysia Ports; (5) Soybean oil, Dutch Soyoil Crude Degummed, EXW Dutch Mills; (6) DAP, spot, f.o.b. US Gulf; (7) TSP, spot, import US Gulf; (8) Urea, (Ukraine), prill spot f.o.b.; (9) Cotton (Cotton Outlook 'CotlookA index'), middling 1-3/32 inch, traded in Far East; and, (10) Iron ore (any origin) fines, spot price, c.f.r. China.

Table 2.2

Growth rates of export earnings *(in per cent)*

Product	Growth Target FY23	Achieved Growth Jul–Feb FY23	Required Growth Mar–Jun FY23
RMG	**9.8**	**14.1**	**2.1**
Knit	10.3	13.2	4.9
Woven	9.3	15.1	-1.0
Non RMG	**18.3**	**-9.9**	**75.6**
Raw Jute	11.0	-10.6	55.7
Leather	18.9	-14.6	84.6
Home Textiles	22.1	-22.5	92.6
Frozen & Live Fish	19.0	-21.7	150.4
Pharmaceuticals	21.8	-8.8	90.6
Other non-RMG	17.4	-6.1	66.4
Total Export	**11.4**	**9.6**	**14.7**

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

find that the sharp depreciation of BDT, which should have enhanced their competitive strength significantly, had failed to be realised in export terms. This is even more surprising in view of the fact that unlike the RMG, where the local value addition is relatively low, in the case of these products, domestic value addition is notably higher.

Remittance inflow continued to remain in positive terrain, albeit demonstrating a lower growth, recording a 4.3 per cent growth during the July–February period of FY2023. At the same time, the growth of overseas migration was far more impressive—about 27.5 per cent. Indeed, the average number of Bangladeshi workers going abroad per month was 91,741 during the first eight months of FY2023, an unprecedented number, which was 71,957 during the corresponding period of FY2022. In this backdrop, apprehensions about an increasing inflow of remittance through informal channels have been gaining traction in recent times. Curiously, despite having a large surge in overseas employment of Bangladeshi workers going to middle eastern countries, remittance inflow from this region has failed to correspond to the rising number of migrant workers. Other possible sources of foreign exchange inflow also do not evince any significant positive picture. Despite improvement in the implementation of the project aid component of ADP in BDT terms, foreign aid inflow was lower in FY2023. Indeed, in USD terms, net foreign aid declined by (-) 12.2 per cent during the first seven months of FY2023. Apparently, the required emphasis was not given as regards higher utilisation of the committed foreign aid. While net foreign direct investment (FDI) posted a small positive growth (4.1 per cent), concerns remain in the area of (net) trade credit as this component of the balance of payments was found to be significantly negative ((-) 2.8 billion). In the context of the balance of payments scenario, the financial account has emerged as a key concern, and all the elements here will need to be kept under constant scrutiny and monitoring.

In view of the deficit in the overall balance of payments, the foreign exchange reserves declined by USD 10.5 billion (as of 22 March 2023) during this fiscal year. According to the IMF conditionalities, the Bangladesh Bank will need to compile and report official reserve assets as per the Balance of Payment Manual of the IMF (Sixth Edition) definition to improve transparency and reporting standards. This will have to be done by the end of June 2023, to which the Bangladesh Bank has agreed. It is likely that following this revision, it will be clear that the central bank will not have much room to pump foreign exchange and may have no other option but to allow BDT to depreciate as the ongoing pressure on the balance of payments is likely to continue. Indeed, the risks manifested in external sector correlates are far from over. Since global prices have come down in recent months, it will help the government ease some of the prevailing import restrictions in the coming months. However, since the amount of deferred payments from both the public and private sectors is rather high, the pressure on the balance of payments is set to continue over the foreseeable future. It needs to be noted that the Bangladesh Bank will need to pursue a market-determined exchange rate for official foreign exchange transactions to enhance foreign exchange flexibility as part of IMF conditionalities by the end of June 2023. CPD has been arguing for a gradual move towards a market-determined exchange rate regime for quite some time now. This is already happening, although the way the exchange rate has taken the heat has hardly left anytime or space for the external sector to adjust. Now belatedly, the Bangladesh Bank has reacted to the reality, and it will need to go further. Indeed, the central bank should immediately opt for a market-determined exchange rate without further delay. It should also undertake an in-depth study as regards its ramifications on debt servicing, inflation and the balance of payments and strategise as regards flanking measures that will need to be undertaken.

Take preparation towards macroeconomic management in difficult times

The aforesaid trends in macroeconomic correlates suggest that the pressure points in the economy will continue over the coming months. The government in the past has tried to blame the war in

Ukraine and the subsequent volatility in the global economy for the current situation. However, the crises in the Bangladesh economy accumulated over the years and were rooted in weaknesses in domestic policies, lack of good governance and inability to implement the needed reforms. Indeed, as the global economic situation is improving and global commodity prices are now coming down, there is hardly any room to blame the global volatility for the ongoing challenges confronting the Bangladesh economy.

As policymakers focus on the macroeconomic situation and policies, the implications for the general people and enterprises can and should not be ignored. The distress in the macroeconomic situation had a far-reaching negative impact on the development pathway of Bangladesh. In FY2023, the general people, particularly the fixed-income earning and low-income population groups, experienced significant erosion of purchasing power, impacting their well-being. They are compelled to opt for lower levels of consumption, depleting savings and curtailing expenses for education and health. The import restrictions have forced many enterprises to operate at significantly lower levels of capacity. The impact of import restrictions, along with the rising cost of doing business and the lower purchasing power of consumers, will have a long-term detrimental impact on business profitability and consumer welfare. The consequent impact on aggregate demand will have a negative knock-on impact on investment demand. Evidently, such negative consequences are much higher for smaller enterprises, be it in the manufacturing or in services sectors. Indeed, many enterprises may find it difficult to survive, and the economy may suffer from significant disinvestment.

If the macroeconomic instability continues, attracting fresh private investment will be difficult. The lower fiscal space has already forced the government to cut back on subsidies and overall public investment. The government's capacity to raise public expenditure on education, health and social safety net programmes will be limited in view of the shrinking fiscal space. The government will need to reprioritise public expenditure and opt for targeted fiscal measures. The national budget for FY2024 will need to be cognisant of this.

It is hard to predict the extent of the impact on the economy as data for the real economy is either unavailable or unreliable. Bangladesh Bureau of Statistics (BBS) is expected to publish quarterly GDP estimates following the conditionality of the IMF beginning from the end of December 2023. The labour force data should also be made available at the earliest. This will help the policymakers assess the economic situation better and make informed policy decisions. This is particularly needed since the GDP data is often unsatisfactory. BBS has also recently conducted a household income and expenditure survey. However, how far the recent loss of purchasing power of the people arising from drastic price rises is captured in the survey will need to be considered.

Macroeconomic management in the coming months will be challenging. Policymakers will need to make hard choices. The fiscal, monetary and institutional policies will need to be reinforcing in nature. Macroeconomic management should be informed by the following three objectives: stability, discipline and consolidation. First, restoring macroeconomic stability should be the anchor of the macroeconomic policy stance. To this end, the government should immediately pursue market-based interest rates and exchange rates. Stabilising the prices of the essential commodities would require economic (e.g., tax and duty relief) and institutional (e.g., market monitoring and ensuring a competitive environment and enforcement of laws and regulations). Social protection measures for the low-income and fixed-income earning population groups should be given priority to ride over these turbulent times. Second, the government should make its best efforts to establish discipline in public expenditure by prioritising and ensuring good value for money. Also, discipline needs to be ensured in the banking sector by establishing good governance. The government should also closely examine the debt situation, which IMF has also emphasised. Debt management will call for consideration from both fiscal and external sector perspectives. The recent exchange rate fall would require much higher foreign debt servicing payments in BDT terms. Third, the government needs to consolidate domestic resource mobilisation and foreign exchange inflow. To this end, the utmost emphasis would be required to curb tax evasion and illicit financial flows. The foreign exchange inflow in all forms, be it export earnings, remittances through the official channels, foreign aid (commitment and utilisation), foreign grants for NGOs, and FDI, should be encouraged without exception. And lastly, policy formulation and implementation should be free from the capture of vested interest groups. The needs of the disadvantaged population groups will need to be met through adequate support programmes and speedy implementation of such declared initiatives as the 'family card'.

2.3 FISCAL FRAMEWORK

Whether the fiscal framework of FY2023 was designed considering the correct set of assumptions remains a critically important question. While the economy was already reeling under immense pressure due to the ramifications of the COVID-19 pandemic, the situation on the eve of presentation of FY2023 budget was exacerbated by the rising pent up demand and price hike in global commodity market consequent to the advent of Russia-Ukraine war in late February 2022. Regrettably, FY2023 budget failed to take cognisance of the emerging scenario and the new realities that should have informed budget design and fiscal-public expenditure proposals. This resulted in a fiscal framework that was rather formulaic in nature and driven by business-as-usual considerations, i.e., lofty targets were set that had a high probability of missing their marks by a considerable margin at the end of the fiscal year. As the halfway marks become available, it is safe to anticipate that the probable will become the reality as the current fiscal year reaches the finishing line. Drawing lessons from this experience, the design and fiscal targets of the upcoming FY2024 should be set in a realistic manner, taking cognisance of the current macroeconomic trends—both domestic and external.

The issue of realistic target setting could take the case of revenue mobilisation as a key reference point. For instance, while proposing the budget for FY2023, the targeted growth of revenue earnings was set at 11.3 per cent over the revised budgetary target of FY2022. However, if the realised revenue mobilisation of FY2022 is considered, the growth target for FY2023 actually turns out to be almost threefold, at 31.8 per cent. As it so happens, according to the Ministry of Finance (MoF) data, revenue mobilisation decreased by (-) 3.1 per cent during the first six months (July-December) of FY2023. This implies that if the annual growth target of 31.8 per cent is to be achieved, then revenue earnings will need to increase by an unrealistic 67.4 per cent over the remainder (second half) of FY2023. Revenue mobilised by the National Board of Revenue (NBR), which accounts for about 85 per cent of the total targeted resource envelope, decreased by (-) 4.0 per cent during the July-December period of FY2023.[2] The decline in NBR tax collection can be primarily attributed to the fall in VAT and import duty collection. This, perhaps, is a reflection of the various import-related restrictions imposed by the government in view of the ongoing foreign currency crisis. On the other hand, this in all likelihood, is also indicative of a possible slowdown in

[2]Curiously, data provided by the NBR itself posts a 11.0 per cent growth during the July-December period of FY2023. It may be noted that the July-December FY2023 tax collection figure reported by the NBR surpasses the MoF figure by about BDT 4,400 crore. Also, the two agencies reported widely different figures as regards the tax collected by the NBR during July-December FY2022. Indeed, it is this figure of FY2022 which is the primary reason for the divergence. MoF reported that BDT 146,859 crore was collected by NBR during the July-December FY2022 period whereas the figure reported by NBR for the same period is BDT 131,035 crore. As a result, the growth figure reported by NBR appears to be much higher than the MoF figure.

economic activities. If this indeed be the case, then any significant increase in revenue mobilisation over the short term is highly unlikely.

If the current trend of revenue mobilisation persists, a large shortfall (i.e., the gap between the revenue mobilisation target and actual attainment) at the end of FY2023 will become inevitable. In December 2022, CPD came up with the projection that the total revenue[3] shortfall in FY2023 is likely to be BDT 64,000 crore (CPD, 2022). Taking advantage of the latest available data from both MoF and NBR, and considering the trends of other macroeconomic correlates, we now project that the revenue shortfall at the end of FY2023 could reach approximately BDT 75,000 crore, with total revenue collection being about BDT 358,000 crore. In this connection, it must be noted that the IMF has projected the total revenue mobilisation of FY2023 and FY2024 to be nearly BDT 387,600 crore and BDT 454,900 crore, respectively. If the aforementioned CPD projection holds and the IMF projection for FY2024 is to be achieved, then total revenue mobilisation in FY2024 will need to grow by about 27 per cent—a daunting task indeed. Furthermore, as a quantitative performance criterion to avail of the IMF loan facility, the floor of tax revenue collection at the end of FY2023 has been set at BDT 345,630 crore. This clearly illustrates that the government has an uphill battle in the area of revenue mobilisation for both current and upcoming fiscal years if it wants to avail of the future instalments of the IMF loan.

The failure to utilise planned budgetary allocations has been a regular feature in Bangladesh's fiscal framework. Regrettably, this trend has continued in FY2023. According to the MoF data, total public expenditure recorded a paltry growth of 1.3 per cent during the July-December period of FY2023 (Table 2.3). The most alarming fact in this regard is that the annual development programme (ADP) expenditure recorded a negative (-) 4.9 per cent growth during the aforementioned period.[4] Whether it is due to limited resource availability owing to the fall in revenue mobilisation, the inability to implement the large number of projects, or is a result of the austerity measures taken by the government remains a critical question in this backdrop. ADP and non-ADP expenditures will need to increase by 41.5 per cent and 48.0 per cent, respectively, over the remainder of FY2023, to reach the programmatic public expenditure targets.

Table 2.3

Growth of public expenditure components *(in per cent)*

Component	Target FY22	Actual FY22	Target FY23	Jul-Dec FY22	Jul-Dec FY23	Required Jan-Jun FY23
a. Total expenditure	31.4	12.8	30.9	8.7	1.3	45.2
a.1 ADP expenditure	41.1	16.5	32.2	2.3	-4.9	41.5
a.2 Non-ADP expenditure	26.3	10.8	30.1	10.7	3.0	48.0

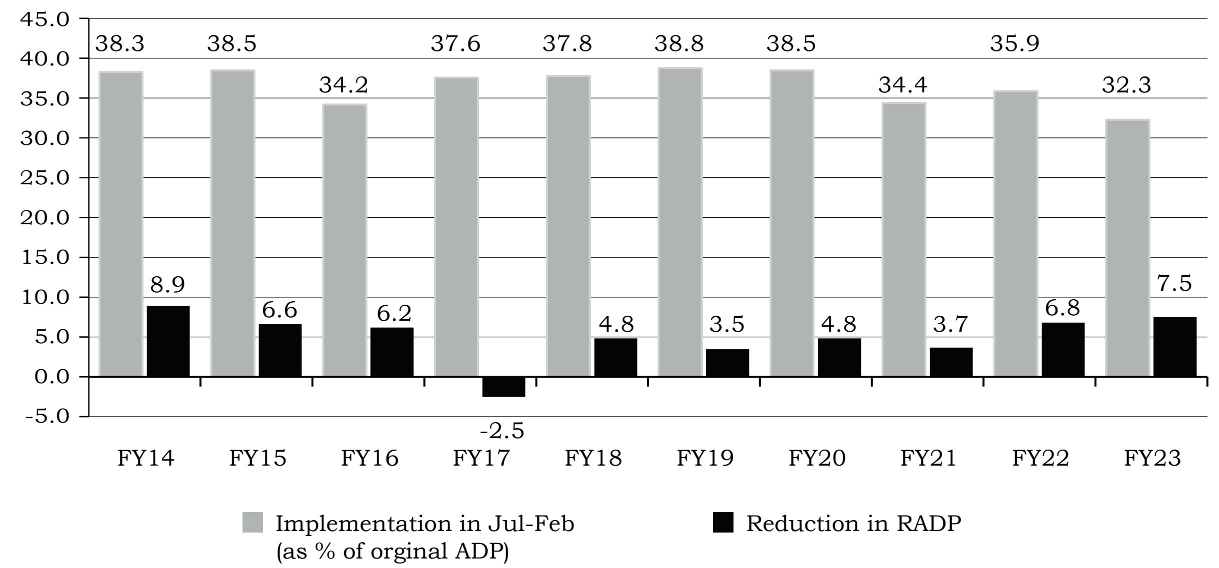
Source: Calculated from MoF data.

[3]Total revenue is composed of both tax and non-tax revenue. Tax revenue, in turn, includes NBR tax revenue and non-NBR tax revenue.

[4]The discrepancy in data reporting is observed once again in this case. According to the data from Implementation Monitoring and Evaluation Division (IMED) of Ministry of Planning, ADP expenditure increased by 7.3 per cent during July-December of FY2023.

Figure 2.3

ADP implementation scenario and reduction in RADP (*in per cent)*



Source: Calculated from IMED data.
Note: In the case of a reduction in ADP, a negative sign implies an increase in allocation.

The data available from the Implementation Monitoring and Evaluation Division (IMED) gives a more updated picture as regards the ADP implementation scenario. During the first eight months of FY2023 (July-February), actual expenditure on account of ADP implementation was 32.3 per cent of the originally planned allocation of BDT 246,066 crore which is the lowest in the last decade (Figure 3.1). The utilisation of project aid (35.7 per cent) was marginally higher than the corresponding period of FY2022 and was in line with the trend of last three-four years. It was the Power Division that primarily drove the utilisation of project aid (PA). The utilisation of the local resource (BDT) component (30.2 per cent) was the lowest since FY2014. Of the top ten ministries/ divisions with a combined share of 72.5 per cent of the total ADP allocation for FY2023, four were not able to utilise their respective allocations at the average level. These are the Ministry of Science and Technology, Ministry of Primary and Mass Education, Health Services Division and Secondary and Higher Education Division. In this connection, it must be mentioned that in the budget speech for FY2023, ensuring timely completion of projects in education and health sectors was identified to be one of the major challenges for FY2023.

In view of the slow pace of implementation, a number of major government sectors (e.g., Education, Transportation and Communication, Health, and Power and Energy) were subjected to significant reduction in the revised ADP (RADP) for FY2023. The ADP for FY2023 was slashed by BDT 18,500 crore (or 7.5 per cent) (Figure 2.3) which brought the size down to BDT 227,566 crore. The reduction was fully on account of the PA component with the BDT (taka) component remaining unchanged. This appears to be rather counterintuitive for two reasons: first, the rate of implementation of the PA component was better than that of the taka component, and second, in view of the ongoing foreign currency crisis, 'utilising funds available through foreign assistance', should have been given highest priority as mentioned in the budget speech.

Given the shortfall in revenue collection, inability to spend budgetary allocations could give policymakers some 'relief'. As a consequence, the level of budget deficit may not become a major concern in FY2023. However, this trade-off, as CPD has repeatedly pointed out, is a false relief brought with significant macroeconomic costs. Along with this, the composition of deficit financing should trigger some reasons for concern. Comparing the July-December period of FY2023 to the corresponding period of FY2022, the government's reliance on borrowing from the banking system has seen some rise. At the same time, due to lower net sales of national savings certificates, net non-bank borrowing has increased rather slowly. Given the persistent inflationary pressure in the economy, the government may need to continue to proactively borrow from non-banking sources in the coming days. However, as mentioned in the previous section, whether it will be possible remains a concern.

In light of the preceding discussion, the following suggestions are placed before the policymakers to take into account while formulating the national budget for FY2024:

- The personal income tax (PIT) structure in the FY2023 budget has remained mostly unchanged from the one introduced in FY2021. CPD has argued that lowering of the highest tax rate (from 30 per cent to 25 per cent) went against the idea of tax equity. In the FY2024 budget, the maximum tax rate should be restored to 30 per cent for highest cohort of earners.
- Given the increased pressure of the commodity price hike, particularly those of food items, the tax-free income threshold for personal income should be increased to BDT 3.50 lakh. As an alternative, in order to give the low-income earners some respite, the second PIT slab, which is 5 per cent for an additional BDT 1 lakh, should be raised to BDT 3 lakh.
- In the FY2023 budget, the rate of investment tax rebate was fixed at 15 per cent on the eligible amount. This means that higher taxpayers, i.e., top earners receive higher tax rebate benefits, whereas those with annual income below BDT 15 lakh are not eligible to get any additional tax benefits. The withdrawal of this provision needs to be considered in the FY2024 budget.
- The FY2023 budget also increased the allowable ceiling of perquisite from BDT 5.5 lakh to BDT 10 lakh. Accordingly, individuals with annual income ranging between BDT 16.5 lakh and BDT 30 lakh will receive additional tax benefits of up to BDT 112,500 per year. This is another instance where the tax policies favour high-income groups. The FY2024 budget may consider eliminating this clause.
- All ad-hoc provisions of tax incentives should be stopped from FY2024. The NBR needs to be selective and careful in the next fiscal year as more demand for incentives will be lined up in view of current economic situation. Proper cost-benefit analysis must be conducted before coming up with new provisions. 'Sunset clauses' should be introduced in case of existing provisions. There should also be a medium-term plan and timeline as regards phasing out the various tax exemptions. Stakeholder consultations should be an integral part of formulating this plan. An analysis of revenue forgone owing to the various tax exemptions should be provided in the next budget. This will draw much-needed political attention to this burning issue.
- In the FY2023 budget, a new provision (Section 19F: Special Tax Treatment in respect of undisclosed offshore assets) was added to the Income Tax Ordinance 1984 to mainstream money earned and asset acquired abroad into the economy. According to the provision, no authority, including the income tax authority, shall raise any question as to the source of any asset located abroad if a taxpayer pays tax on such asset. This opportunity was to be in force for the full FY2023 period. Such an initiative is ethically unacceptable, will discourage honest taxpayers, and has traditionally did not generate the intended revenue which justified its introduction in the first place. CPD strongly feels that this provision should be discontinued, and no such incentive finds its place in FY2024 budget.
- Provisions such as Section 16H, Section 19BBBBB, and Section 19DD are still in place to legalise undisclosed income and assets under the Income Tax Ordinance, 1984. These should be discontinued from the next fiscal year.

- Since the income tax exemptions for 28 IT-enabled services (ITES) are set to come to an end in FY2024, a thorough examination of the incentives should be undertaken with a view to (a) selection for continuation of incentives, (b) introduction of sunset clause and (c) identify opportunities for imposition of taxes on e-commerce and digital services.
- The moratorium on e-commerce taxation, introduced in WTO in 1998, is set to come to an end (by 2024 or 13th WTO Ministerial Conference – MC13, whichever is earlier if no agreement is reached in the WTO in this regard). The government should take adequate preparation to (a) proactively participate in the WTO discussions and (b) identify tax measures if and when the moratorium comes to an end.
- Ambiguities in current tax laws (service code 99.60) in defining e-commerce activities should be removed to enhance the scope and opportunities of revenue mobilisation.
- To collect VAT at the local stage, NBR could install only 4,595 electronic fiscal devices (EFD) / sales data counter (SDC) machines at existing businesses against the target to reach the 10,000 mark by June 2022. Presenting the national budget for FY2023, the Finance Minister stated the plan to reach the target of installing 10,000 EFDs by June 2023. The government plans to install another 300,000 EFDs over the next five years, which is expected to yield an additional revenue of BDT 10,500 crore, with an initial 60,000 planned for FY2024. The NBR needs to aggressively pursue this target.
- The NBR should launch at the earliest, a comprehensive online payment system for VAT, income tax and customs together with an interface with iBAS++ and ensure harmonisation and taxpayer data sharing across various wings of the NBR as has been envisaged in the PFM Action Plan 2018-23. The data-sharing issue has also been raised by the IMF.
- As per data from international sources, the larger part of Bangladesh's illicit financial outflows are on account of trade mispricing. The Transfer Pricing Cell (TPC) of NBR, Bangladesh Financial Intelligence Unit (BFIU) and Customs Intelligence and Investigation Directorate (CIID) should work closely to deal with trade-based money laundering. For effective implementation of the responsibility of the TPC, the national budget for FY2024 should ensure adequate allocation for technical and human resources and forensic investigation capacities of the aforesaid entities.
- The upcoming national budget must focus on generating revenue from specialised sources, particularly expediting the realisation of contested revenue claims[5] through the Alternative Dispute Resolution (ADR) mechanism. Steps should be taken to expedite the resolution of pending tax-related cases in tax tribunals and courts.
- Priorities for public spending ought to be set out clearly in the FY2024 budget. The design of the budgetary framework should take cognisance of the rising cost of essentials. In order to do this, appropriate attention should be paid to food production, social safety net programmes (including public works programmes), subsidies for agriculture, energy and power sectors, as well as the health and education sectors. Supporting the marginalised groups should be the central focus of subsidy management.
- Prior government directives to reduce 'unnecessary and luxury' public spending (such as the purchase of government vehicles and international travel) should be reintroduced.
- The ADP for FY2024 should be carefully designed with a view to containing the budget deficit. A political government may find it tempting to take on new development initiatives in the run-up to the upcoming election by adopting a populist stance. The budget for FY2024 should, however, refrain from any ostentatious public spending in the backdrop of the macroeconomic challenges facing the economy.
- The government should give priority to implementing all foreign-funded ADP projects in light of the current foreign exchange situation. The government should give higher priority to

[5]Regrettably, up to date data as regards this is not available on public domain. However, according to the NBR Annual Report 2019–2020, contested revenue claims in FY2020 amounted to more than BDT 126,600 crore.

implementing projects that are nearly finished (about 90-95 per cent completion rate in June 2023).

- Projects that had a 10 per cent or lower implementation rate up till end-FY2023 should be deprioritised. 'Carryover projects' that have a maximum implementation rate of less than 30 per cent up till end-FY2023 should be re-examined to justify continuation.
- The government should form an independent commission to assess the rising costs of public infrastructure projects. Concrete steps should be taken to ensure good governance in implementation of public infrastructure projects in particular. As a first step, the government must make all development project proformas (DPPs) available to the public for review and comments. To do this, the government should also think about undertaking a comprehensive assessment of public expenditures as early as possible.

2.4 PRICE OF ESSENTIALS BEYOND PEOPLE'S REACH

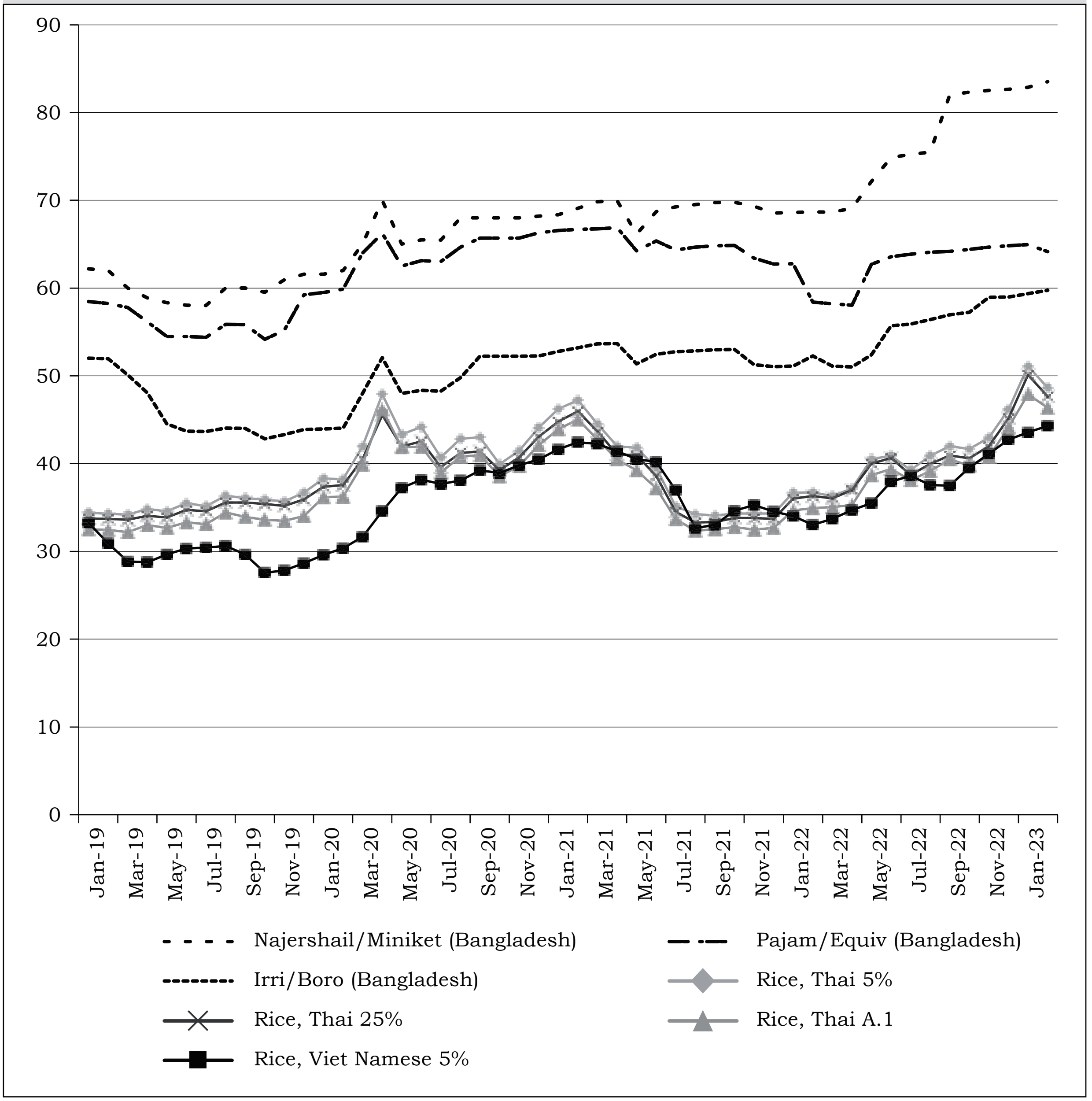
Inflationary pressures have been building in Bangladesh even before the situation in Ukraine began. Recent sharp swings in energy costs have made matters worse in Bangladesh. The continued price growth is due in part to domestic reasons including market distortion by a small number of dominant firms and lax regulation. There are a number of essentials that are more expensive in Bangladesh than in other developing or industrialised countries. Low-income families are fighting to make ends meet as the cost of living continues to rise. Many families, including minimum wage earners across all sectors, are struggling to make ends meet.

Analysis reveals that at least 28 imported essential food items, currently face a high incidence of tax. These include: fresh or chilled, other cuts of bovine meat with bone; fresh or chilled boneless bovine meat, wrapped/canned up to 2.5 kg; fresh or chilled other cuts of meat of sheep, with bone; frozen cuts and offal of chicken, wrapped/canned up to 2.5 kg; fish (Ruhi, Katla, Pangash, Karp & alike), excluding wrapped/canned up to 2.5kg; Hilsha fish (excluding wrapped/canned up to 2.5 kg); milk & cream of greater than 1 per cent but less than or equal to 6 per cent fat, not concentrated or sweetened, wrapped/canned up to 2.5 kg; milk & cream in powder forms less than or equal to 1.5 per cent fat, concentrated or sweetened, in retail packing up to 2.5kg; milk and cream in solid forms of less than or equal to 1.5 per cent fat imported by vat registration milk and milk product; milk and cream in powder excluding powder, granules or other solid from and imported vat registered companies; milk and cream in powder excluding powder, granules or other solid from and imported vat registered companies; tomatoes, fresh; onions, fresh or chilled; garlic, fresh or chilled; dates, fresh; pepper, neither crushed nor ground; cardamoms: neither crushed or ground, excluding wrapped/canned up to 2.5 kg; seeds of cumin: neither crushed or ground, excluding wrapped/canned up to 2.5 kg; ginger: neither crushed or ground, excluding wrapped/canned up to 2.5 kg; turmeric (curcuma); other maize, excluding wrapped/canned up to 2.5 kg; husked (brown) rice; semi-milled or wholly milled rice; maize (corn) starch; crude palm oil imported by vat registered edible oil refinery industries; palm oil (excluding crude) & its fractions, not else specified, including refined palm oil; refined palm kernel/babassu oil & fractions, not chemically modified; salt (other than pure sodium chloride) solution, salt boulder for crushing & salt in bulk; sugars, pure (excluding glucose, etc.); sugar ethers and salts, etc. (National Board of Revenue 2022). In the backdrop of the soaring inflation, the National Board of Revenue (NBR) should reduce the duties and taxes, both at import and domestic levels, for essential commodities to provide some respite to consumers with low and limited income.

High inflation has revealed the inherent weakness in the government's domestic resource mobilisation approach which is largely dependent on revenue collection from indirect taxes. It is likely that if inflation continues at the present rate, the government may be compelled to withdraw indirect taxes on essential items. Thus, fiscal policy which is highly dependent on indirect taxes propagates economic inequality in society and forces the government to trade-off revenue generation in the face of high inflation. It is urgently required to increase revenue collection from direct taxation and reduce dependence on indirect taxes, especially since Bangladesh is now poised to graduate from the Least Developed Countries (LDC) group.

Figure 2.4

Price of Rice in Bangladesh and international markets *(in BDT per kg)*



Source: Authors' illustration based on data from Bangladesh Bureau of Statistics and World Bank.

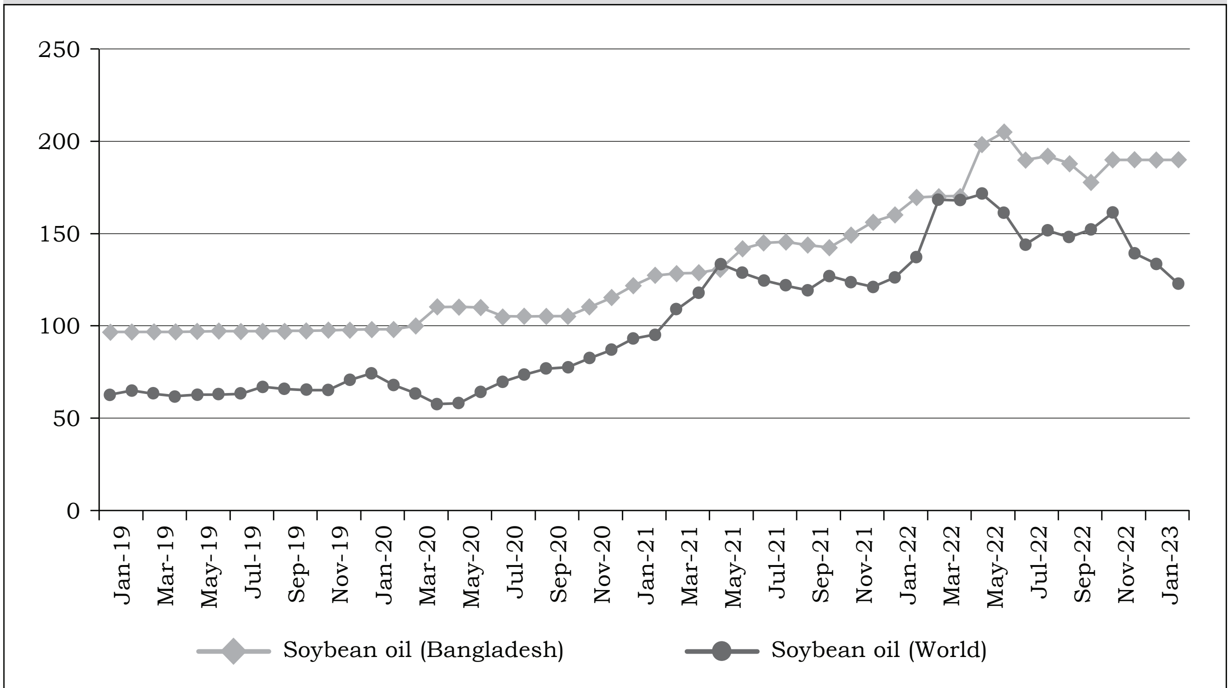
International comparison of prices shows that the price of essential food items does not fall in Bangladesh, even when the international prices fall. Additionally, the data also shows that the price of some essential food items remain consistently over the international prices.

For brevity of exposition, we highlight the difference in domestic and international prices of four food items: rice, soybean oil, sugar, and beef. Out of these four, rice and beef are mainly produced domestically, whereas soybean oil and sugar are mainly imported. Nevertheless, we find that the price of all four items in Bangladesh is consistently higher than the international prices. Figure 2.4 shows that the price of three common types of rice have been consistently higher than price of both Thai and Vietnamese rice.

Figure 2.5 shows that the price of soybean oil has been falling the international market from November 2022 to February 2023, whereas there has been no decrease in the price of soybean oil in the local market during the same period.

Figure 2.5

Price of Soybean oil in Bangladesh and international markets *(in BDT per litre)*



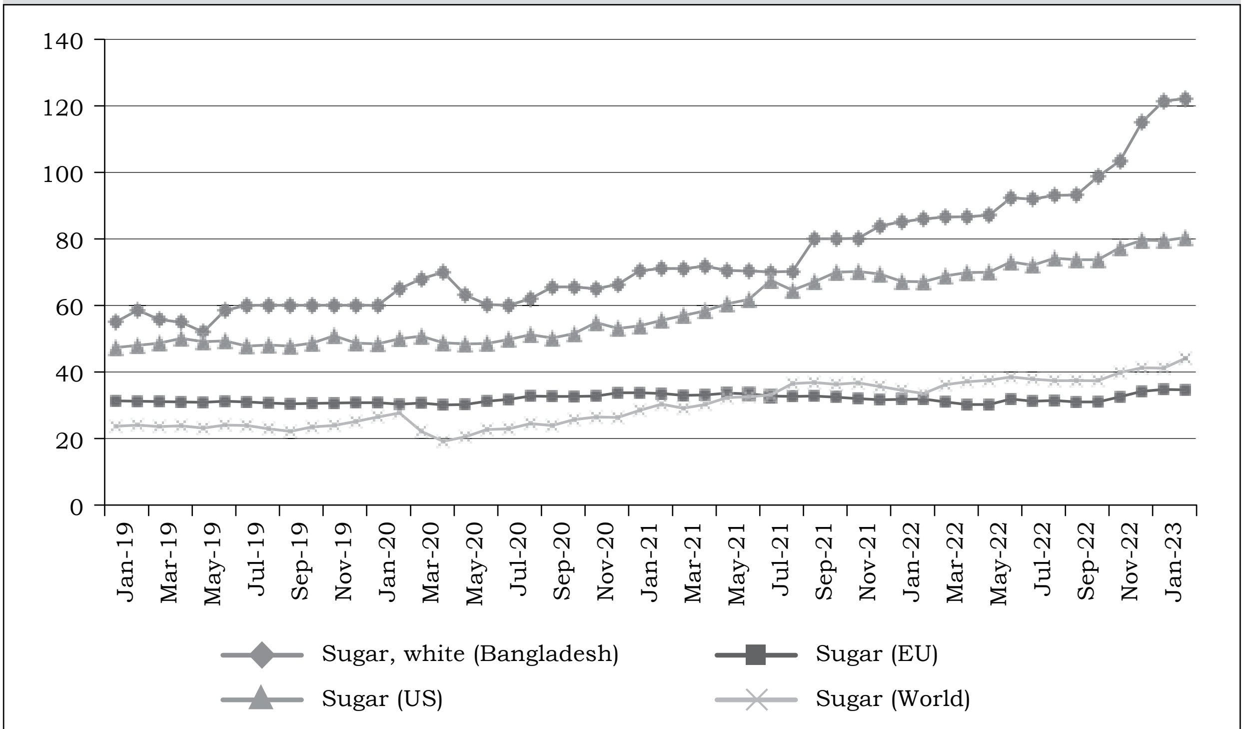
Source: Authors' illustration based on data from Bangladesh Bureau of Statistics and World Bank.

Figure 2.6 shows that the price of sugar in February 2023 was BDT 122 per kg in Bangladesh, but only BDT 80 per kg in the US market, BDT 44 per kg in the world market, and BDT 35 per kg in EU market. Even if we consider transport costs, import tariffs, and other trade-related expenses, such high differences in prices appear to be odd.

Finally, Figure 2.7 shows that the international price of beef decreased from July 2022 to December 2022, whereas the price of beef in Bangladesh increased during the same time. As of February 2023, the price of beef per kg in Bangladesh was BDT 225 higher than the price of beef per kg in the world market.

Figure 2.6

Price of Sugar in Bangladesh and international markets *(in BDT per kg)*



Source: Author's illustration based on data from Bangladesh Bureau of Statistics and World Bank.

These numbers indicate that the inflation prevailing in Bangladesh at present may not necessarily be imported inflation, as is commonly presumed. On the contrary, the inflation in Bangladesh appears to be a largely domestic phenomenon.

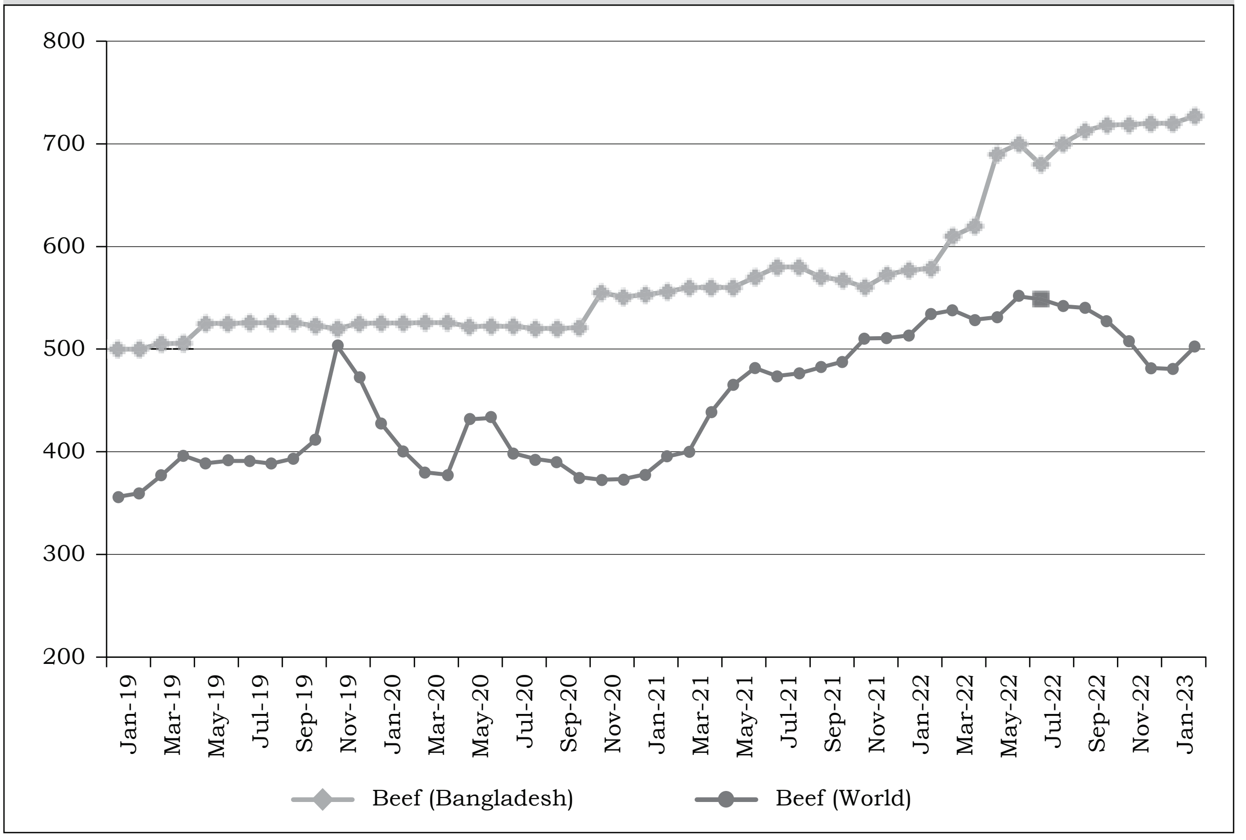
As a result of these price increases, the cost of living has increased rapidly causing immense suffering to low income and fixed income households. Figure 2.8 shows that the average monthly food expenses for a household of 4 individuals in Dhaka city have increased continuously during 2019 to 2023. The average monthly cost of consuming a compromised diet for a household of 4 individuals increased from BDT 4,712 in February 2019 to BDT 7,131 in February 2023, and the average monthly cost of consuming a regular diet for a household of 4 individuals increased from BDT 15,705 in February 2019 to BDT 22,664 in February 2023.

Figure 2.8: Average monthly food expenses for a household of 4 individuals in Dhaka city (in BDT) Source: i) Authors' calculations based on data from Bangladesh Urban Socioeconomic Assessment Survey 2019 (BBS 2020), Bangladesh Household Income and Expenditure Survey 2016 (BBS 2019), and Trading Corporation of Bangladesh (TCB 2022).

A simple comparison shows that the percentage change in the price of essential food items was significantly higher than the officially reported food inflation. Figure 2.9 shows that the 12 month average food inflation in February 2023 was 8.08 per cent, whereas the percentage change in the price of essential food items in the same period was 25.37 per cent.

Figure 2.7

Price of Beef in Bangladesh and international markets *(in BDT per kg)*



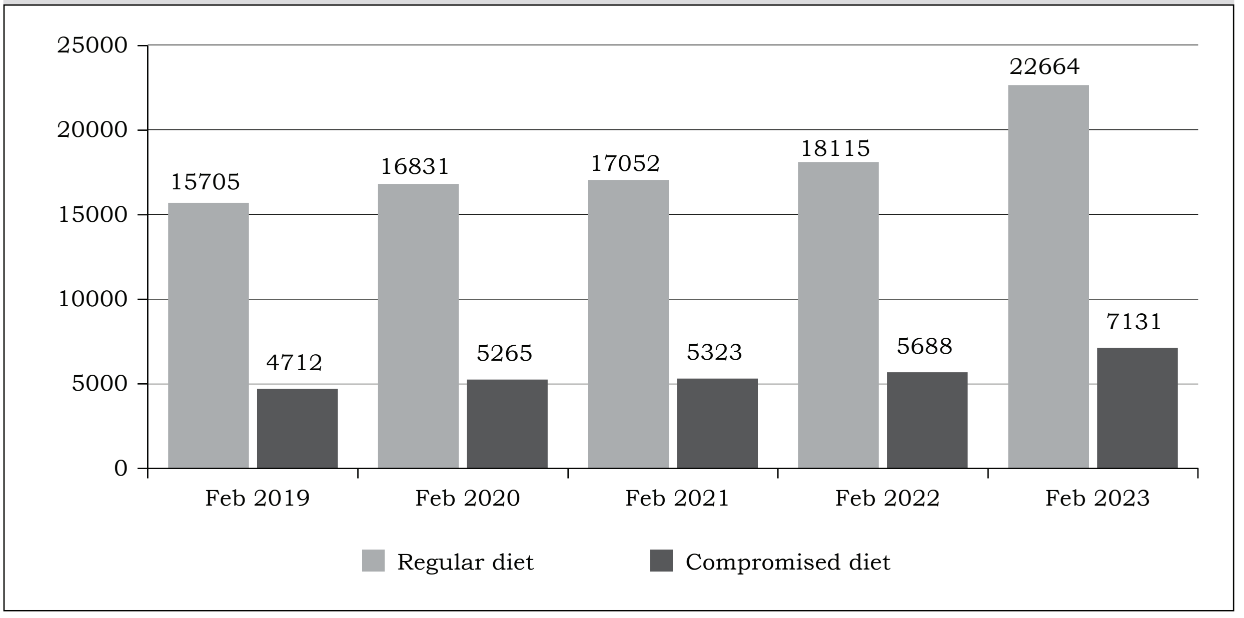
Source: Authors' illustration based on data from Bangladesh Bureau of Statistics and World Bank.

In view of the above, the following suggestions are put forward for consideration of policymakers for controlling the price of essentials in the upcoming budget of FY2023:

- The Minimum Wage Board should consider increasing the minimum wages in all industries so that workers earning minimum wages may at least afford basic food. Private sector corporations should consider a higher salary increment in 2022, given that a 5 per cent increment of salary in the face of double-digit price hikes is compelling workers to seriously compromise their standard of living.
- Government should carefully examine the duty and tax structures of the essential commodities, both at import and domestic levels, and make downward adjustments with a view to provide some respite to low and limited income-earning consumers. The increased price level of most of the other commodities should be able to compensate for the potential revenue loss to this end.
- Tax-free income threshold for personal income should be raised to BDT 3.50 lakh in view of the added pressure of the rising food inflation and income erosion induced by the pandemic. The next slab for personal income tax, which is 5 per cent for an additional BDT 1 lakh, should be increased to BDT 3 lakh to provide a cushion for the middle-income earners.
- Government should extend the scope of direct cash/kind assistance programmes for low-income population groups.

Figure 2.8

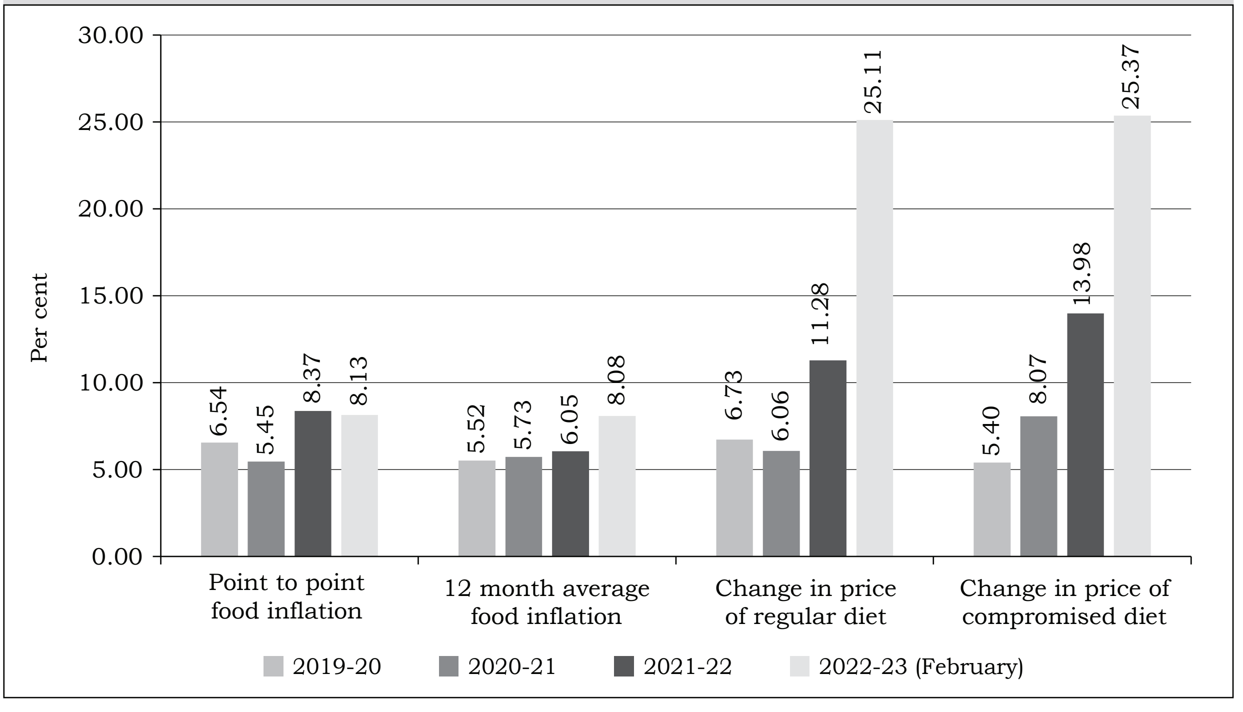
Average monthly food expenses for a household of 4 individuals in Dhaka city *(in BDT)*



Source: i) Authors' calculations based on data from Bangladesh Urban Socioeconomic Assessment Survey 2019, Bangladesh Household Income and Expenditure Survey 2016, and Trading Corporation of Bangladesh.

Figure 2.9

Food inflation versus change in price of essential food items



Source: CPD illustration based on data from Bangladesh Bank and Trading Corporation of Bangladesh.

- Volume of essential commodities sold through the open market sales (OMS) should be increased. Government should set higher targets for foodgrains procurement and food distribution programmes. To this end, adequate resources should be allocated in the FY2023 budget. Furthermore, the distribution of these commodities must be managed efficiently and without corruption so that only the eligible can obtain the essential items at lower prices.
- Competition Commission's role should be strengthened. Required skilled professionals should be hired to this end, particularly with a view to monitoring markets for essential commodities on a regular basis. The Commission should create a database, monitor the operations of prominent market players on a regular basis, investigate market control and manipulation (if any), and take appropriate actions. An adequate budget should be earmarked for the Commission to perform these duties. To this end, the Ministry of Commerce should also work in tandem with the Commission. The Bangladesh Competition Commission should adopt a strong stance against cartels and a zero-tolerance policy towards collusive practices. Furthermore, the Competition Act 2012 should be revised to directly address monopolies and include specific anti-trust clauses, along with concrete penalties for violators.
- Government should provide additional support for subsidised credit programmes for the agriculture sector (both crop and non-crop) to incentivise production during the next fiscal year.
- Government should continue providing stimulus to the small and medium enterprises to help them survive the difficult times.

2.5 SUBSIDY RATIONALISATION AND MANAGEMENT IN MAJOR SECTORS

The subsidy expenditure of the government has skyrocketed within a short period of time and has become a major concern in view of limited fiscal space. In the national budget FY 2022–23, total subsidy expenditure is projected to be BDT 82,745 crore, which is about 1.9 per cent of GDP (Table 2.4). Between FY2015–16 and FY2022–23, the subsidy expenditure increased by about five times (494.3 per cent). The subsidy is distributed in three forms— (a) cash loan, (b) subsidy, and (c) fiscal incentives. Rise of cash loans to Bangladesh Power Development Board (PDB), subsidy to gas and cash incentives to agriculture and remittances are the main areas which caused such a rise in subsidy expenditure in recent years. Hence, the government has made specific commitments with regard to subsidy rationalisation and management as part of meeting the loan conditionality set by the IMF. This section discusses the current state of subsidy in main economic activities/sectors,

Table 2.4
Total subsidy *(in Billion BDT and as % of government expenditure)*

Items	Subsidy (BDT in billion)							
	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Cash loan	29.07	51.73	35.52	113.41	128.86	110.49	133.73	
Subsidy	10.86	29.43	50.20	91.44	76.86	89.57	208.00	
Fiscal incentives	99.31	80.05	96.81	118.17	213.54	182.56	260.25	
Total subsidy	139.24	161,21.00	182.53	323.02	419.26	382.62	601.98	**827.45**
% of government expenditure	5.80	6.00	5.67	8.25	10.14	8.22	10.15	**12.20**
% of GDP								**1.90**

Source: Based on Ministry of Finance.

initiatives undertaken for subsidy rationalisation and management and possible alternative ways to address those issues.

2.5.1 Subsidy in the Power and Energy Sector

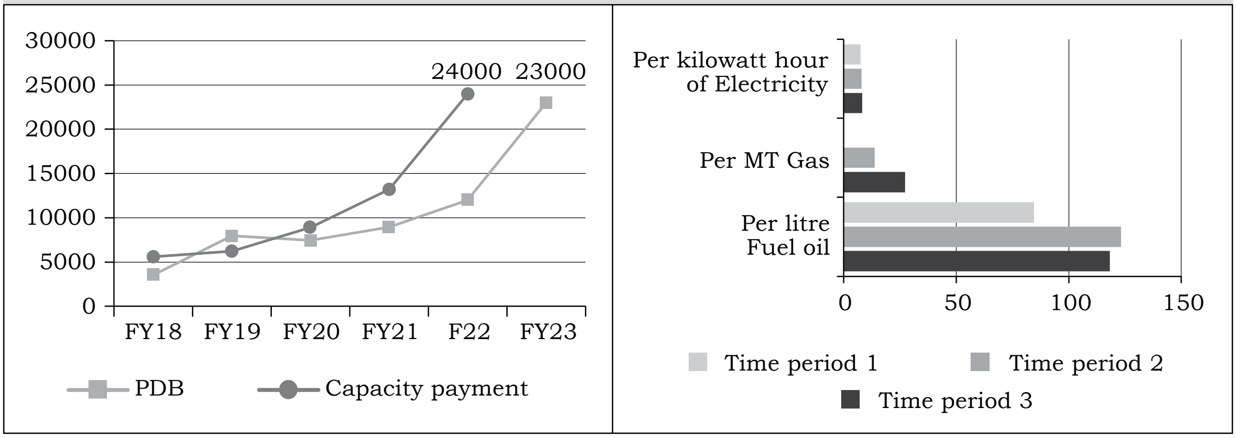
The power and energy sector is the government's biggest subsidy expenditure shareholder (40 per cent of the total subsidy allocation in FY2022–23). Within this sector, the power sector gets the lion's share of the distribution (79.3 per cent of total allocation for the sector). During the budget of FY2022–23, a subsidy of BDT 17,000 crore was proposed for the power sector, which has been revised upward to BDT 23,000 in the revised budget for FY2022–23. In addition to that, imported LNG has been subsidised for several years. In the budget for FY2022–23, BDT 6,000 crore was proposed for importing LNG. An additional subsidy of BDT 5,000 crore was requested but was not approved in the cabinet. There is no subsidy allocated for imported petroleum (Table 2.5). It is to be noted that a part of the expenses related to generating electricity or importing petroleum and LNG have been passed on to the consumers as adjustment of tariffs through the administered process.

Table 2.5
Subsidy in power and LNG in last fiscal years

	Power (Crore BDT)	LNG (Crore BDT)	Petroleum (Crore BDT)	Share of the power sector in total subsidy (Per cent)	Share of LNG sector in total subsidy (Per cent)
RFY22	12,000.00	6,000.00	0.00	35.12	17.56
PFY23	17,000.00	6,000.00	0.00	30.21	10.66
RFY23	23,000.00	6,000.00	0.00	31.47	8.21

Source: MTMPS 2022–23 to 2024–25, The Business Standard.

Figure 2.10
Trend of subsidy and capacity payment in the power sector and change of tariff[6] *(in BDT crore)*



Source: MTMPS 2022-23 to 2024-25, The Business Standard, BERC, BPC and MPEMR.

[6]In case of power tariff January, February and March 2023 have been considered as time period 1, 2 and 3 respectively. In case of gas tariff June 2022 and January 2023 have been considered as time period 1 and 2 respectively.
In case of fuel oil tariff October 2008, 10 September 2022 and 30 September 2022 have been considered as time period 1, 2 and 3 respectively.

The high amount of subsidy that the BPDB claims for the power sector is based on the argument of rising import price of raw materials such as— HSD, HFO and LNG, and their higher transmission and distribution costs to the power plants. However, a large part of the subsidy burden is caused due to excess power generation capacity and resultant capacity payment to the independent power producers (IPPs). Figure 2.10 postulates the trend of subsidy provided in the power sector and capacity payment to the IPPs. The trend of capacity payment and subsidy shows almost a parallel increasing trend indicating how the positive growth in capacity payment induces higher subsidy in the power sector (Figure2.10).[7]

The subsidy in the LNG sector is mainly due to the import of expensive LNG from the spot market. Bangladesh's government has resumed LNG import from the international market and intends to import even more LNG in future.[8] Even though the price in the global market shows a downward trend, the LNG import at a higher amount to meet the gas shortages will cause a higher subsidy burden. A part of the high expenses has been met by passing it on to the consumers at a high retail price of LNG/gas. The subsidy burden could be eased significantly if domestic gas exploration onshore and offshore was being prioritised by Petrobangla.

In the budget for FY2022–23, no subsidy was allocated for petroleum products. However, the Bangladesh Petroleum Corporation (BPC) requested a subsidy of BDT 19,358 crore at a later stage which is not accepted with the argument that it is making a profit on petroleum products (e.g. diesel) after the recent adjustment of tariff at the retail level.

To ease the subsidy pressure in the power and energy sector, the government has gradually increased the retail price of electricity, gas and fuel. This initiative aligns with the government's commitment to comply with the IMF condition of slowly moving towards market-based tariff rates for petroleum products. As part of this initiative, a number of times tariffs have been adjusted during the current fiscal year. The government has hiked fuel oil prices by 42.5 per cent to 51.6 per cent during August 2022. It increased gas prices by 179 per cent for industries effective 1 February 2023. During January-March 2023, the electricity price was hiked three times by 15 per cent (5 per cent each month) by government executive orders. According to an estimate by the finance ministry, subsidy expenditure is reduced by BDT 23,105 crores through those initiatives. Unlike Bangladesh, India follows a market-based price-setting mechanism in case of energy price. Figure 2.11 shows the overall tariff trends in Kolkata (India) and Dhaka (Bangladesh) for diesel and petrol since January 2022. Following the market-based rates, diesel and petrol prices fluctuated in Kolkata. However, after the adjustment of tariffs, a sharp jump in both diesel and petrol prices can be observed in Bangladesh. The petrol price in Dhaka is higher than that of Kolkata while the gap in diesel price has reduced significantly and the prices in both cities are almost similar.[9]

In order to ease the pressure of the subsidy burden, the following initiatives could be undertaken by concerned departments of the Ministry of Power Energy and Mineral Resources (MoPEMR).

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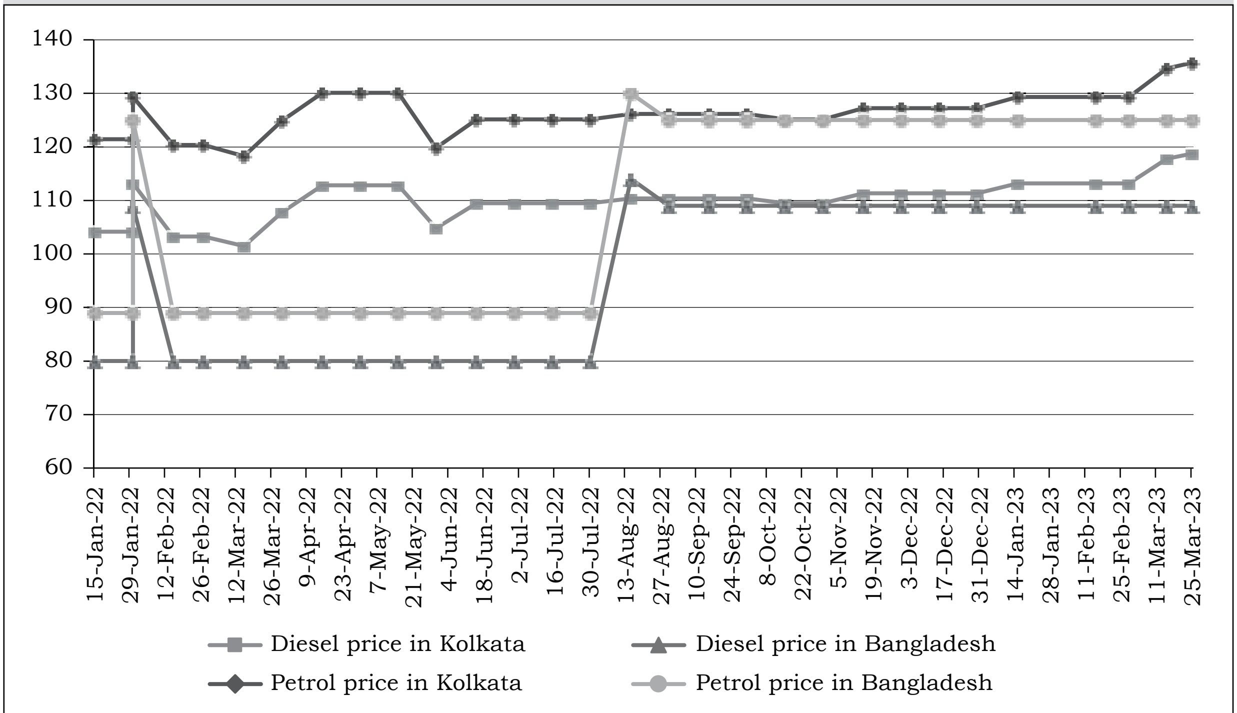
[7]In case of power tariff January, February and March 2023 have been considered as time period 1, 2 and 3 respectively. In case of gas tariff June 2022 and January 2023 have been considered as time period 1 and 2 respectively.
In case of fuel oil tariff October 2008, 10 September 2022 and 30 September 2022 have been considered as time period 1, 2 and 3 respectively.

[8]The government has approved the purchase of 12 LNG cargoes from the spot market until June, 2023 and the first shipment will arrive in April, 2023. In upcoming months, Petrobangla eyes up to four cargos to maintain the daily supply of 3,000 million cubic feet.

[9]https://www.thedailystar.net/news/bangladesh/news/govt-aims-save-tk-20000-crore-3196371.

Figure 2.11

Difference between the diesel and petrol price in Kolkata and Bangladesh



Source: NDTV and BPC website.

1) Subsidy of the power sector should be rationalised by reducing the burden of capacity payment provided to IPPs and QRRs: The government should gradually step out of the vicious cycle of capacity payment to the IPPs and QRRs through signing/renewing agreements under 'no electricity, no pay' clause. Moreover, expensive fuel-based power plants, outdated power plants, low-efficiency power plants, and QRRs should be gradually phased out to ease the pressure of the subsidy burden.

2) A market-based price-setting mechanism should be introduced in the power and energy sector: According to the IMF, introducing a periodic formula-based fuel price adjustment mechanism will help ensure no structural subsidies for petroleum products. India long ago had transited from Administered Pricing Mechanism (APM) to Market Determined Pricing Mechanism (MDPM) through the phase-in period approach. As the energy prices at global market is gradually declining, and domestic petroleum companies are now in surplus, it is the right time to introduce a periodic formula-based fuel price adjustment mechanism. The BPC should start market-determined price-setting mechanism for petroleum prices from July 2023. The price can be monitored and adjusted on a monthly basis in accordance to the global energy market.

3) Budget allocation should be provided on a priority basis for domestic gas exploration: The national budget of the ongoing fiscal year neither has projects relating to gas exploration nor includes an allocation for intensive gas exploration and expedited work plan. The Bangladesh Petroleum Exploration and Production Company (Bapex) plans to add up to 300 million cubic feet of gas per day to the national grid by 2023 through its short-term exploration programme by drilling 22 wells in designated areas as well as in areas of other production companies. The ongoing exploration programme must be implemented at the earliest with necessary fiscal support. The upcoming national budget must include an allocation for the exploration of natural gas as a solution to LNG subsidy.

4) Promoting clean energy could ultimately help the power and energy sector out of the subsidy burden: Existing fiscal and monetary policies are highly discriminatory in promoting renewable energy in the country. Promoting clean energy in Bangladesh will not be possible unless fossil-fuel-based energy infrastructure is not discouraged by withdrawing fiscal and budgetary support (e.g., carbon tax, carbon cap). This transformation towards clean energy can only occur by providing fiscal and budgetary support to renewable energy producers through tax breaks, subsidies and cash incentives. Hence, the government needs to take measures such as reduction of custom duty and VAT on renewable energy-related technologies and types of machinery, and even subsiding clean energy-based projects and initiatives to create a level playing field. The Renewable Energy Policy 2008 provides renewable energy project investors in public and private sectors exemption from corporate income tax for 5 years. They should be provided 10 years of tax holiday as fiscal support.

2.5.2 Fiscal Incentives for the Export Sector

In the national budget for FY2022–23, significant fiscal incentives were allocated for the export sector, like those in earlier fiscal years. The number of items eligible for different export cash incentives increased to 43 this year. Among them, eight items were given 20 per cent cash incentives, six were given 15 per cent cash incentives, and one was given 12 per cent cash incentives (Annex Table 5.1). RMG products were made eligible for multiple kinds of cash incentives: a) 5 per cent if product exported with locally procured raw materials; b) 4 per cent if raw materials were imported for the exported products; c) an additional 4 per cent if exported to non-traditional markets that include all the countries except the EU, Canada, the UK and the US; d) 1 per cent additional cash incentive for all the RMG product. Besides, all the exporting products were made eligible for 1 per cent cash subsidy.

Fiscal incentives for export products and jute goods have been consistently increasing in line with the rise in the export of different export products. During FY2021–22, a total of BDT 9,000 crore (including for Jute) was spent as incentive to the export sector (according to Ministry of Finance). Given the overwhelming dominance of RMG products in the overall structure of export, the majority share of export cash incentives was allocated to the RMG sector. Majority of export cash incentives have been in effect without any specific time period over a long period. Uncertainty remains over the real effectiveness of these incentives in promoting the export of these products in traditional and non-traditional markets (such as a negative relation between cash incentives and export performance for Nepal found by Paudel et al., 2020). Moreover, cash incentives only for targeted potential RMG and non-RMG products need to be considered to promote export diversification. Hence, a major overhauling in the structure of cash incentives for the export sector is needed, targeting the future outlook of the country's export. Under the current circumstance, the government could consider the following recommendations for the allocation of export subsidies in the upcoming budget:

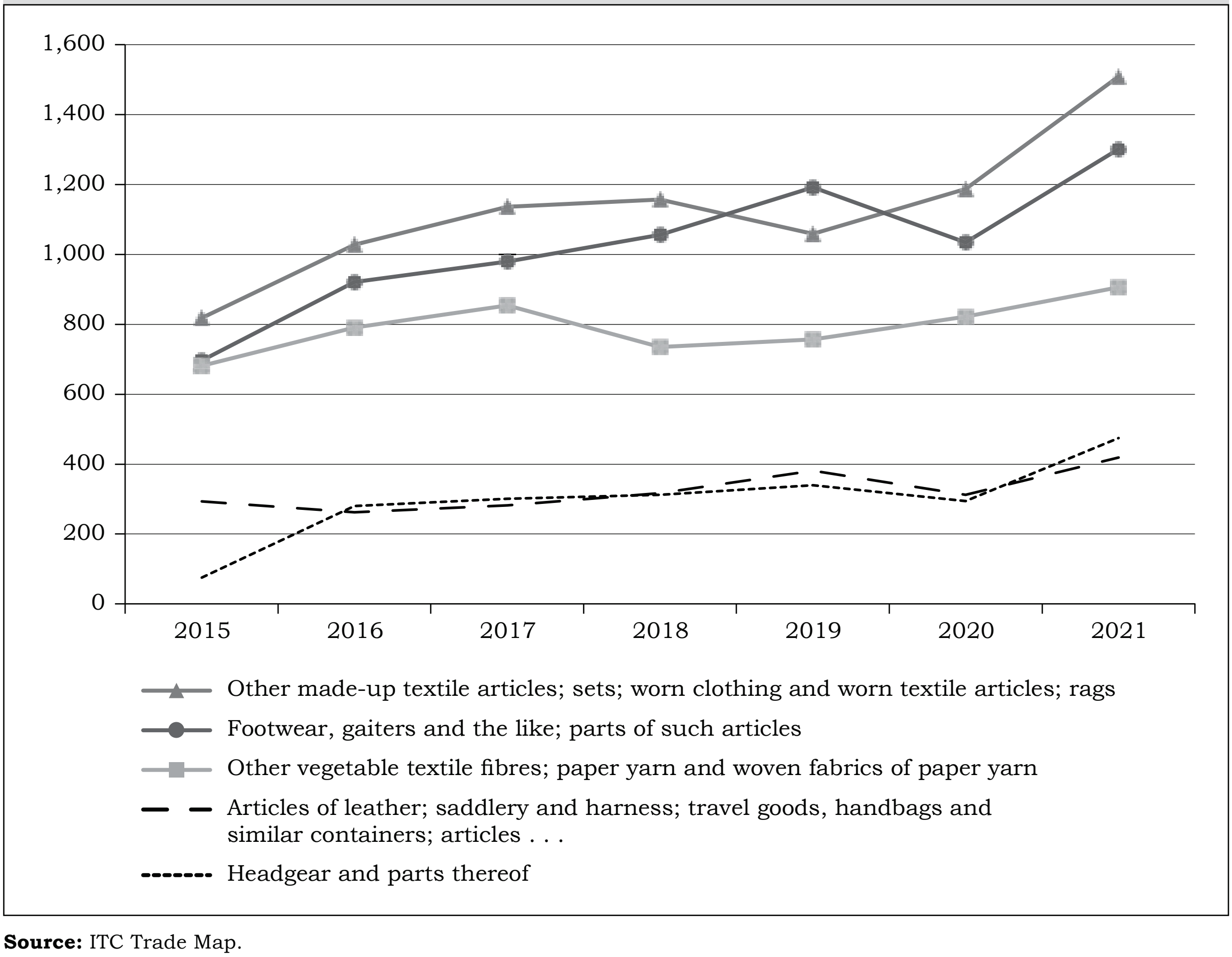
1) A detailed study on the assessment of the effectiveness of cash incentives for export needs to be undertaken: The Ministry of Commerce, with the support of the Bangladesh Trade and Tariff Commission, should undertake a detailed study to assess the effectiveness of cash incentives for export products. Such a study should help assess whether the cash incentives were able to achieve the targets, identify the demand for existing cash incentives, and identify the requirement for cash incentives for new and emerging products. It will also assist in redistributing the cash incentives for promoting intra-RMG and non-RMG diversification.

2) Give more priority to non-RMG sectors for providing export cash incentives: Although the rate of cash incentive for RMG is lower than the many non-RMG products, given that RMG industry exports the highest amount, the sector also gets the highest amount of cash incentives. Besides RMG sector enjoys other fiscal and non-fiscal benefits. In view of promoting export diversification, the national budget for FY2023–24 may consider shifting a portion of RMG cash incentives to non-RMG products that have higher export potential. Figure 2.12 shows the export trend some of the top-growing non-RMG sectors in recent times.

3) Allocate more subsidies for non-cotton textiles: The increase in global demand for blended fabrics and apparel at the consumer level has led to an increase in the demand for non-cotton textiles as well. However, Bangladeshi textile still has a limited capacity to produce non-cotton textiles (manmade fibre, synthetic fibre, polyester, etc.). As a result, woven apparel makers need to depend on imports to meet around 60 per cent of the demand for non-cotton fabrics. The budget of the current fiscal year (FY2022–23) did not allocate any dedicated subsidy for non-cotton fabrics. Providing special cash incentives for exporting non-cotton products in the national budget for FY2023–24 would enhance export outside cotton-based products.

Figure 2.12

Export trend of some key non-RMG product *(in million USD)*



Source: ITC Trade Map.

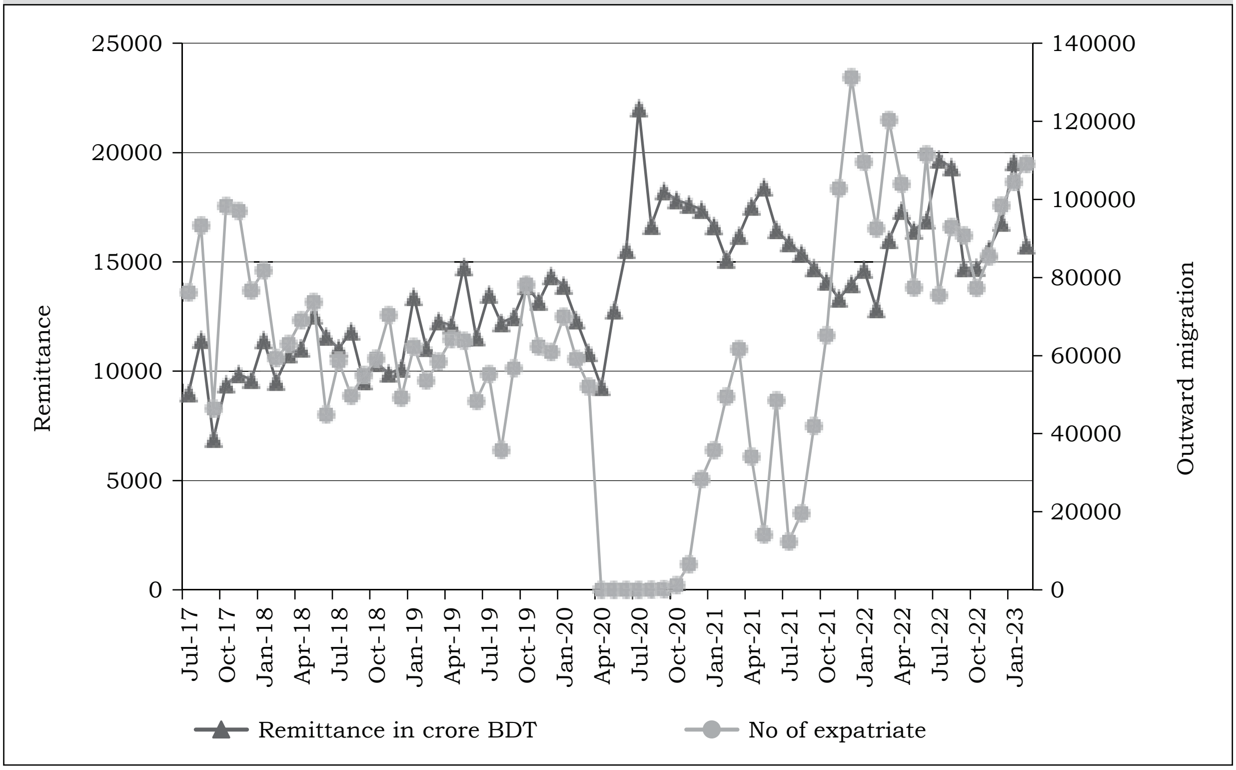
4) Find out strategies to gradually withdraw traditional cash incentives for export: After Bangladesh graduates from the LDC category in 2026, it cannot provide cash incentives for export in its current form as per World Trade Organization (WTO) rule. Hence, the government needs to gradually reduce subsidies from the export sector to let it be prepared for the post-LDC scenario. While direct export subsidy gradually needs to be reduced, at the same time, innovative incentive schemes (such as subsidy for skill and technology upgradation, active labour market programmes, social safety net programmes, health insurance and support for ease of doing business etc.) needs to prioritise for supporting the export industry.

2.5.3 Cash incentive for Inward Remittance

The government introduced cash incentives in FY2019–20 to enhance the inward flow of remittance. [10] Over the years, the amount of cash incentives has been on the rise because of the rising inward flow of remittance in the country—from BDT 30.6 billion in FY 2020 to BDT 50 billion in FY2021–22. Since a record number of workers have immigrated in FY2022–23 (up to February 2023) and will continue in the coming months, the resulting rise in the flow of remittance in the formal channel would push for further requirements of cash incentives. However, the trend shows that the inward

Figure 2.13

Remittance earnings (in crore BDT) and outward migration



Source: Author's calculation based on data from Bangladesh Bank.

[10] To encourage the remitters, the government introduced 2.0 per cent cash incentives over remitted earnings through formal channel during July, 2019. Later in January, 2022, the government has raised the rate of incentives by 0.5 percentage points to 2.5 per cent. Additionally, the government has withdrawn the mandatory provision for submitting the supporting documents particularly documents validate earning abroad against remittances exceeding the amount of USD 5,000 (MoF, 2022a).

flow of remittance in every month has remained within a limit indicating a part of the remittance is likely to be sent to the country through the informal channel (Figure 2.13). While this informal flow partly reduces the pressure of cash incentives, but the formal channel deprives of getting the highly essential foreign currency. Hence, it is important to ensure the flow of remittance through formal banking channels in full in order to contribute to strengthening the country's forex reserve.

Since the introduction of cash incentives on workers' remittances in FY2019–2020, the government has spent a total of BDT 15,442 crore. However, the disbursement would be high if a part of the remittance is not channelled informally. According to the national dailies, the Criminal Investigation Department (CID) has found that hundi traders laundered BDT 75,000 crore in 2021 through different mobile financial service operators. This amount of hundi stands at around 35.7 per cent of the remitted amount through the formal channels. The central bank has taken some measures to prevent hundi transactions while law enforcement agencies have initiated legal actions against hundi traders. A high margin in the exchange rate between USD and BDT pushed the workers to use the informal channel. Hence, reducing the gap between the official and informal exchange rates needs to be considered.

The government may consider the following budget recommendations as part of subsidy rationalisation and subsidy management.

1) Introduce the market-based exchange rate with a view to reducing the exchange rate gaps: The government may consider introducing market-based exchange rates between USD and BDT. At present exchange rate against USD is BDT 113 (as of 25 March 2023), while the remittance exchange rate is BDT 107 (as of 22 March 2023). Such a measure would reduce the demand for cash incentives for inward remittance as the exchange rate would be considerably higher—above the 2.5 per cent cash incentives provided at present. This would reduce the demand for using the informal channel to remit forex abroad.

2) Preventing the hundi business by strengthening operations in the banking channel as well by the Police: The hundi business takes place in broad daylight where the illegal agents are known to the community. The central bank, commercial banks and law enforcement agencies should work hard to trace, track and identify these agents and hand them over to law enforcement agencies. It has been observed that the remittance inflow in 2022 and 2023 has decreased from Saudi Arabia, Kuwait, Oman, Bahrain, and Malaysia compared to the earlier years (FY2019 to FY2021). Perhaps this can be related due to the hundi transactions in those countries. Therefore, the Bangladesh Bank and other government organisations related to the prevention of anti-laundering must be more vigilant in tracking and prosecuting hundi operators. The central bank has anti-money laundering guidelines to detect and prevent this activity, which should be strictly implemented.

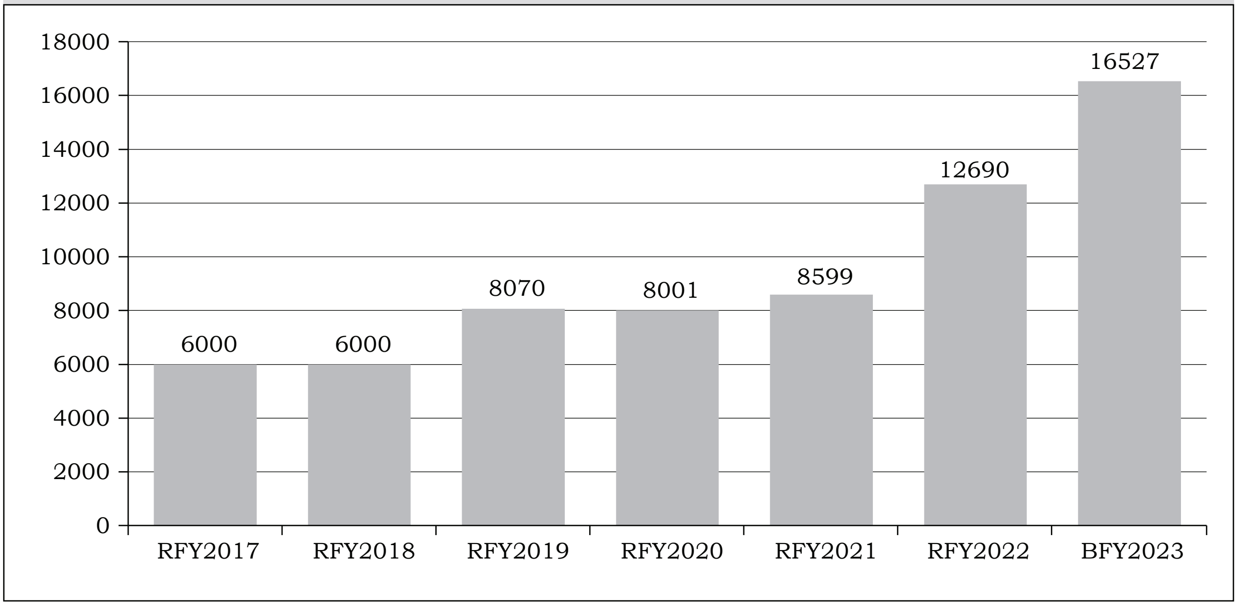
3) Proactive role of embassy and consulate at migrant destination countries: The government has an established network in foreign countries where a number of labour attaché are available for ensuring the welfare of the migrant workers. In this regard, labour attaché can play a proactive role in terms of encouraging migrant workers to remit money through formal channels. Necessary allocations should be made for the Ministry of Foreign Affairs and Ministry of Expatriates' Welfare and Overseas Employment (MoEWOE) to increase the number of labour attaché or to take initiatives to source services from private agencies to meet the demand of the migrant workers in the destination countries. The services will include awareness against the hundi transaction and promoting formal remittance channels, and benefits for migrant workers for remitting money through formal channels.

2.5.4 Subsidy in Agriculture

The agriculture sector has been one of the biggest subsidy recipients in the national budget. For the current fiscal year (FY2022–23), a total of BDT 16,527 crore was proposed as subsidy for the agriculture sector, which was not only BDT 4,000 crore higher than the previous year's (FY2021–22) revised allocation but also the highest ever budget allocation for agriculture subsidy (Figure 2.14). In fact, despite this highest allocation for subsidy—in view of the increased import cost of fertiliser—the allocated amount was found to be inadequate. According to media reports, an additional BDT 40,247 crore was required to fulfil the subsidy requirement for fertiliser.[11] However, only an additional BDT 10,000 crore was allocated against the increased demand in the revised budget of the current fiscal year (FY2022–23)—which took the total allocation to BDT 26,527 crore.

Figure 2.14

Allocation of subsidy for agriculture sector *(in BDT crore)*



Source: Ministry of Finance.

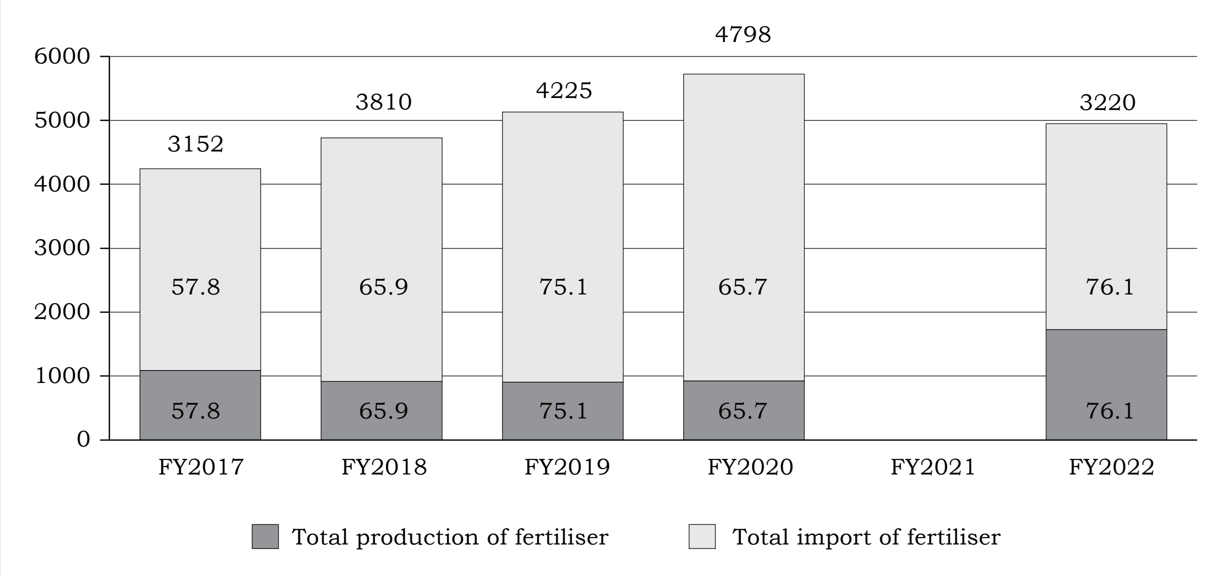
As usual, the lion's share of the agriculture subsidy was allocated for fertiliser. In addition, the current fiscal year's (FY2022–23) budget proposed to continue providing incentives for agriculture mechanisation, rehabilitation aid, rebate on the electricity bills for the electricity use in irrigation pumps (20 per cent), subsidised interest rate credit for farmers (at 4 per cent interest), and cash incentive for export of agriculture products (20 per cent).

However, continuing the same subsidy facilities for the upcoming fiscal year (FY2023–2024) could be challenging. This would be mainly because of- a) the looming limited fiscal space in view of lower than the targeted revenue income in the current fiscal year; b) high pressure on foreign reserve; c) increased cost of import, including the increase in the US dollar price; and d) rising inflation, etc. In view of the shortage of gas supply, the public fertiliser companies (i.e., Shahjalal Fertiliser Company) have stopped their operation lately. On the other hand, the increase in the import cost

[11]https://www.tbsnews.net/economy/subsidy-burden-balloons-war-604090

Figure 2.15

Total (in '000' mt) and share of import and production of fertiliser in Bangladesh



Source: Based on FPMU website data.

has led to a decrease in the amount of fertiliser imported. Hence, after a consecutive rise in recent years, the fertiliser supply fell during FY2021–22 (Figure 2.15).

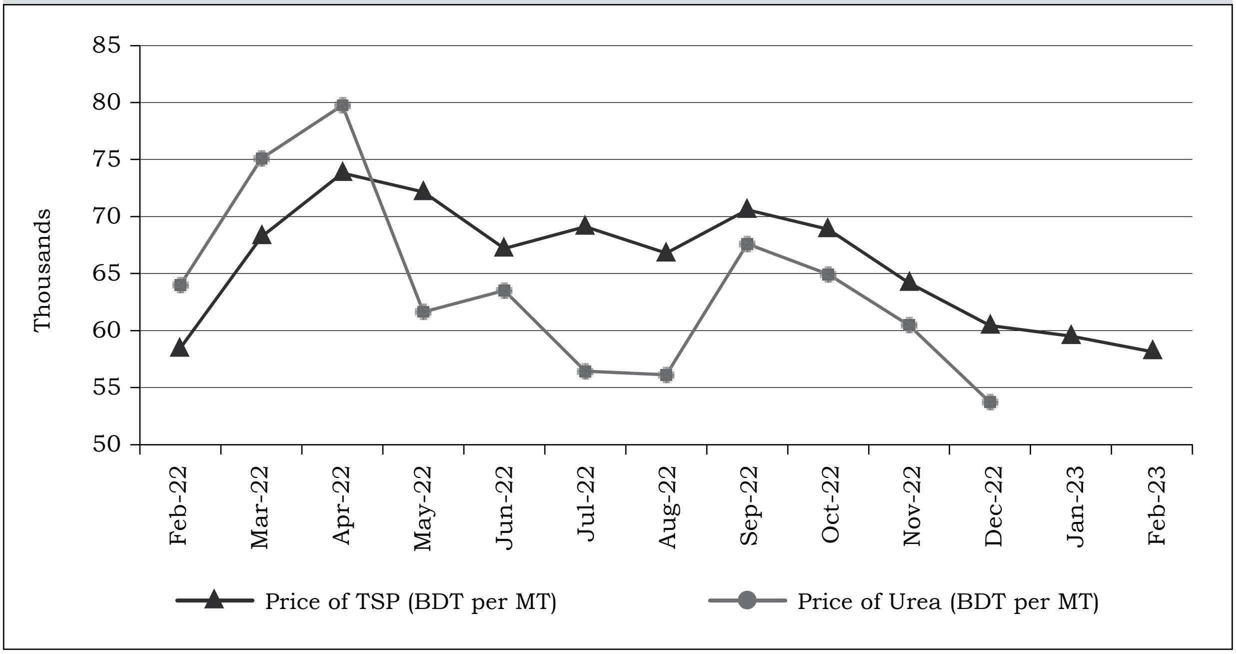
Amid this challenging time, the following recommendations can be considered by the government for the upcoming budget in the area of agriculture subsidy:

1) Continue providing higher subsidy for fertiliser: Irrespective of the current fiscal space status and other challenges, the fertiliser subsidy must be continued in the FY2023–24 to ensure food production gets the utmost priority in a time of uncertainty over the global food supply. Despite fiscal pressure (of the additional spending for fertiliser subsidy in the current fiscal year against limited allocation), the extent of the burden for subsidising fertiliser in the upcoming fiscal year (FY2023–24) is expected to be slightly less than the current fiscal year. The reasons include- a) the recent decreasing trend of the price of fertilisers in the international market (despite an increase in the price of the US dollar) (Figure 2.16); b) the government has already increased the price of Urea by BDT 6 per kilogram in August 2022 (both at dealer and farmer levels); and c) the decrease in requirement of subsidies in other sectors, mainly in the energy sector (as per conditions set by IMF).

2) Go for more effective subsidy management: While the subsidy needs to be there for fertiliser, proper subsidy management can ease the fiscal burden and yield more benefits. Some of the areas need particular attention: a) the strengthening of market monitoring mechanism must be ensured in view of continuous allegations that farmers in many places are being unable to buy fertilisers at a subsidised price (Also reflected partly in Figure 2.17); b) higher allocation should be considered on promoting the use of balanced fertiliser so that the misuse of fertiliser gets decreased along with increases in the production (the Figure 2.18 indicates that share of the supply of fertiliser is still higher for urea alone); c) continue allocating a sizable share of fund for agricultural research targeting decrease the use of fertiliser and increase the use of technologies to enhance production. Source: DAE.

Figure 2.16

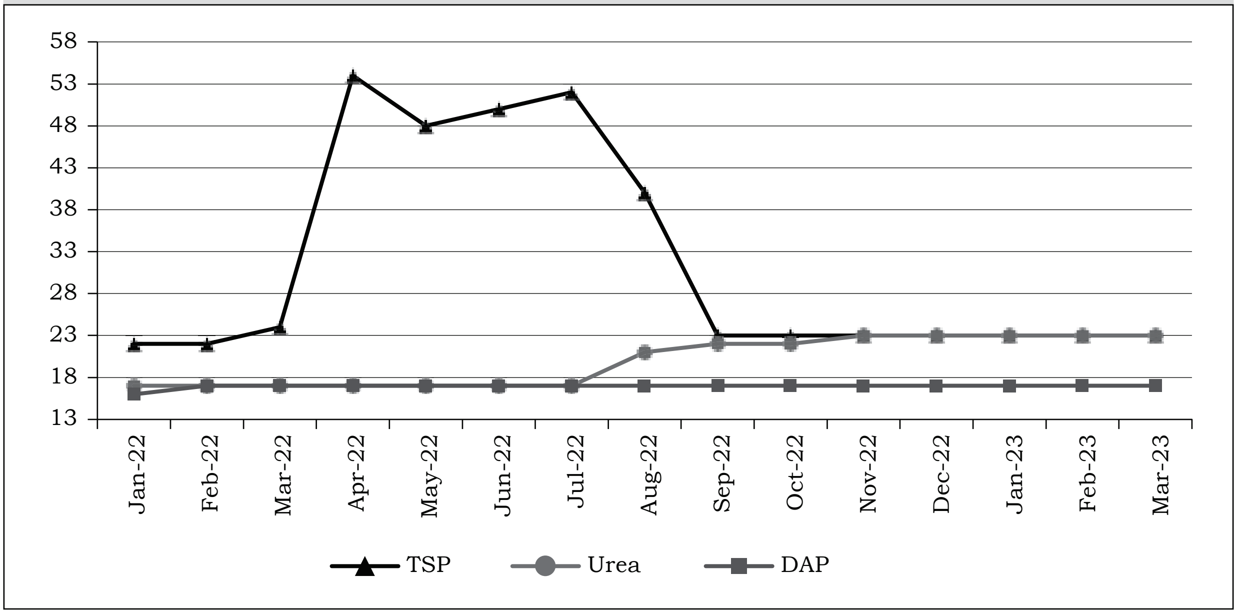
Global monthly price of fertilisers *(BDT per MT)*



Source: Based on World Bank.

Figure 2.17

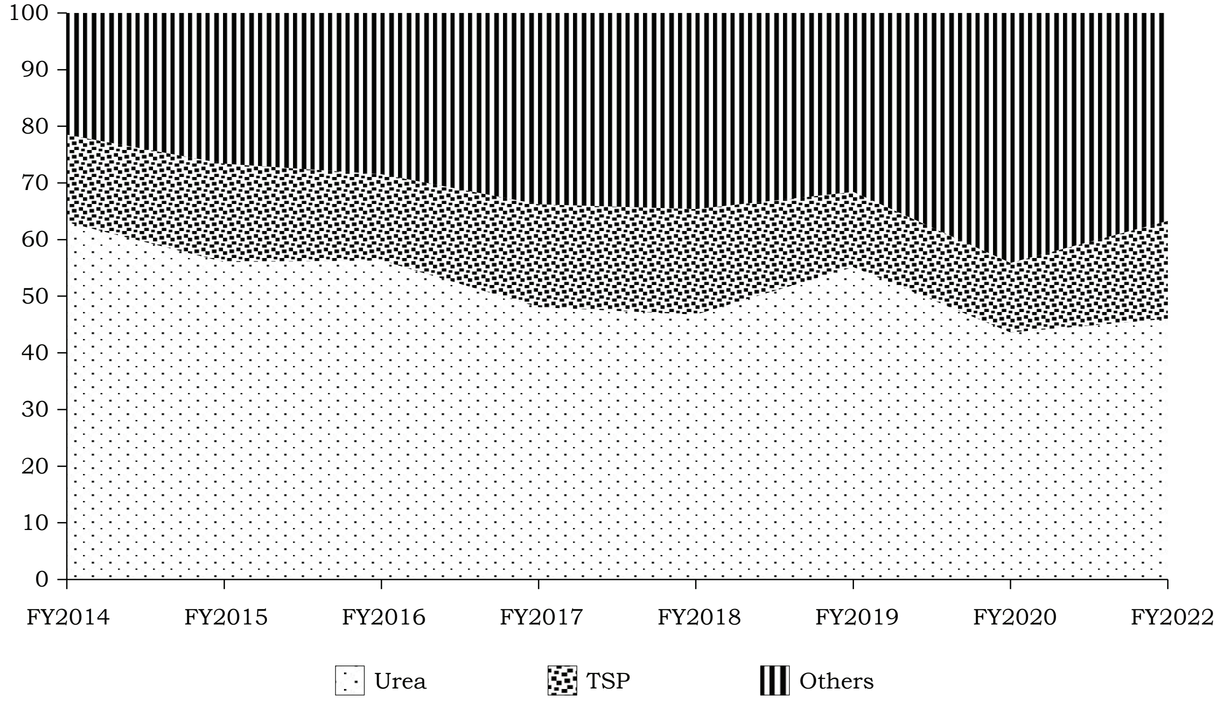
National average monthly price of fertiliser *(Tk per KG)*



Source: DAE.

Figure 2.18

Share of market supply of different fertilisers (domestic production + import)



Source: FPMU.

3) Pursue scope of quick transformation to solar-based irrigation system from diesel-based irrigation system: Although the current fiscal year's budget enabled the facility of subsidised electricity price for irrigation, it could be difficult to carry on providing this subsidy in the coming year. Moreover, the government needs to comply with the conditionality of the IMF of lifting subsidy from diesel price. Hence, a distinct focus needs to be made on the quickest transformation of solar-based irrigation systems from diesel-based irrigation. In this regard, the target of transforming 200 diesel-based irrigation by 2023 to solar-based ones should be ensured. More importantly, a plan needs to take to transform 1.34 million diesel-based power pumps into solar-based ones by 2030.

2.6 FISCAL POLICY FOR MAXIMISING SOCIAL WELFARE

Fiscal policy is an important tool for correcting market failures and maximising social welfare. In a free market equilibrium, merit goods are under-produced and under-consumed. This deprives society of the positive externalities that are associated with merit goods. Hence the production and consumption of merit goods need to be encouraged through government interventions to maximise social welfare. Two of the most important merit goods are health and education. Often these are neglected sectors in developing and low-income countries. Analysis of the past fiscal policies of Bangladesh shows that neither health nor education have received any importance in the national budget.

2.6.1 Protecting public health through fiscal policy

The total budget allocation for the health sector increased only by 13 per cent, from BDT 32,731 in FY22 to BDT 36,864 in FY23, which was lower than the 14 per cent average annual increase in total budget allocation for the health sector between FY2011 and FY2022.

Allocation for the health sector as a share of the total budget has increased from 5.42 per cent in FY22 to 5.44 per cent in FY23. However, this was lower than the allocation of 6.18 per cent of budget in FY2010 when there was no pandemic. Actual expenditure increased by 24 per cent from BDT 17,513 crore in FY20 to BDT 21,647 crore in FY21. In Bangladesh, the budget allocation for the health sector has been less than 1 per cent of Gross Domestic Product (GDP) for the past 13 years indicating that healthcare was never a priority sector for the government. On the contrary, in 2017 at least 30 Least Developed Countries (LDCs) spent more than 1 per cent of GDP on health (World Bank, 2022). On top of this, out-of-pocket expenditure on health in Bangladesh is not only the highest in South Asia, but also increasing over time.

In this context, it is necessary to not only increase the budget allocation and budget utilisation of the health sector, but also implement a number of fiscal measures to promote improved public health and in turn maximise welfare for society. In the following exposition, fiscal measures for a few selected items are suggested.

Tax on tobacco and related products

In Bangladesh, the cigarette industry's pricing encourages purchase of relatively cheaper cigarettes. The complicated tiered tobacco tax framework supports differential pricing. Such differential pricing defeats the intended purpose of taxation as a tool for achieving beneficial public health outcomes. Hence Bangladesh's tobacco tax structure needs to be streamlined. Cigarette affordability should be reduced as a result of tax-induced price increases. For tobacco and tobacco-related products, the government should eliminate the tiers of taxation and replace them with a single system. Additionally, a specific tax, which is fixed per pack, should be implemented instead of an ad valorem tax, which is determined as a percentage of retail price. The government will find it much easier to administer a uniform specific excise system of taxes on tobacco. It would also let the government relinquish jurisdiction over the administration of cigarette recommended retail price (RRPs), which is putting strain on the tax authorities. The government lacks the resources to monitor and enforce RRPs across the country. The cigarette industry capitalises on this lack of monitoring to maximise their profits. Hence, it is suggested that the government lets the market establish the relevant price and collect tax revenue through a sufficiently high uniform specific tax that is unrelated to the tobacco product's price and only reliant on the number of sales.

We propose a uniform specific excise duty of BDT 10 per cigarette stick on all cigarettes to be implemented in FY2024 (Table 2.6). Such a uniform specific tax on all cigarettes should be increased by at least BDT 5 per stick each year, to account for annual inflation and income growth.

In line with the proposed tax structure for cigarettes, the tax structure for Bidi, Jarda, and Gul should also be reformed. This will protect low-income groups from health hazards and reduce the burden of health expenditure on the government. Instead of the current tier classification of Bidi into filtered and non-filtered, and additional groupings based on the size of the pack, we propose specific excise tax of BDT 3 per stick for all Bidi to be implemented in FY2024 and allow the price of Bidi to be determined by the market (Table 2.7). Such a uniform specific tax on all Bidi should be increased by at least BDT 1 each year, to account for annual inflation and income growth.

Table 2.6
Proposed tax structure for cigarettes *(per pack of 10 cigarettes)*

	Current tax structure for cigarettes in FY23					CPD's recommendation				
	Retail price		SD				Retail price		Specific excise duty	
Tier	Pack of 10 (in BDT)	Per stick (in BDT)	Per pack of 10 (in per cent)	Per pack of 10 (in BDT)	Per stick (in BDT)	Tier	Per pack of 10 (in BDT)	Per stick (in BDT)	Per pack of 10 (in BDT)	Per stick (in BDT)
Low	40+	4.00	57	22.80	2.28	Universal	Market based	Market based	100	10
Medium	65+	6.50	65	42.25	4.22					
High	111+	11.10	65	72.15	7.21					
Premium	142+	14.20	65	92.30	9.23					

Source: CPD compilation data from the Ministry of Finance.

Finally, the existing tax structure on Jarda and Gul should also be reformulated in cognisance of the severe health risks posed by the long-term consumption of such items. We propose a BDT 6 specific excise duty on per gram (gm) of Jarda and Gul to be implemented in FY2024, and to allow the price of Jarda and Gul to be determined by the market (Table 2.8). Such a specific tax on Jarda and Gul should be increased by at least BDT 1 each year, to account for annual inflation and income growth.

Table 2.7
Proposed tax structure for Bidi

	Current tax structure in FY2023					Proposed tax structure in FY2024				
	Retail price		SD				Retail price		Specific excise duty	
Type of bidi	Per pack (in BDT)	Per stick (in BDT)	Per pack (in per cent)	Per pack (in BDT)	Per stick (in BDT)	Type of bidi	Per pack (in BDT)	Per stick	Per pack (in BDT)	Per stick (in BDT)
Non-filtered 25 stick handmade bidi	18.00	0.72	30	5.40	0.22	All	Market based	Market based	75.00	3
Non-filtered 12 stick handmade bidi	9.00	1.33	30	2.70	0.23				36.00	
Non-filtered 8 stick handmade bidi	6.00	1.33	30	1.80	0.23				24.00	
Filtered 20 stick handmade bidi	19.00	1.05	40	7.60	0.38				60.00	
Filtered 10 stick handmade bidi	10.00	1.00	40	4.00	0.40				30.00	

Source: CPD compilation data from the Ministry of Finance.

Table 2.8

Proposed tax structure for Jarda and Gul

	Current tax structure in FY2023					Proposed tax structure in FY2024				
	Retail price		SD				Retail price		Specific excise duty	
Type of product	Per 10gm (in BDT)	Per gm (in BDT)	Per 10 gm (in per cent)	Per 10 gm (in BDT)	Per gm (in BDT)	Type of product	Per 10gm (in BDT)	Per gm (in BDT)	Per 10gm (in BDT)	Per gm (in BDT)
10gm jarda	40.0	4.0	55	22.0	2.2	10gm jarda	Market based	Market based	60.0	6.0
10gm gul	20.0	2.0	55	11.0	1.1	10gm gul				

Source: CPD compilation data from the Ministry of Finance.

The Health Development Surcharge Management Policy 2017 states that 1 per cent surcharge must be charged from tobacco companies in Bangladesh which is also in accordance to the WHO Framework Convention on Tobacco Control (FCTC) to which Bangladesh is a ratified member (NTCC, 2017). The Statutory Regulatory Order (SRO) by Bangladesh government further details the proper utilisation of the fund accrued through the Health Development Surcharge. CPD believes the Health Development Surcharge must be increased further to empower the National Tobacco Control Cell (NTCC) in furthering the objectives and meeting the goal of a tobacco free Bangladesh by 2040. In this connection, we propose (Table 2.9) that that the Health Development Surcharge on cigarettes and other tobacco products to be increased from 1 per cent to 5 per cent, and the VAT on cigarettes and other tobacco products to be increased from 15 per cent to 20 cent in FY2024.

Table 2.9

Proposed Health Development Surcharge and VAT on cigarettes and other tobacco products

	Health Development Surcharge (in per cent)	VAT (in per cent)	Health Development Surcharge (in per cent)	VAT (in per cent)
Cigarettes	1	15	5	20
Bidi	1	15	5	20
Jarda	1	15	5	20
Gul	1	15	5	20

Source: CPD compilation.

CPD believes that to achieve a tobacco free Bangladesh by 2040, corporate taxes should be increased incrementally. On the contrary we find that the effective tax rate of the largest tobacco company in Bangladesh decreased by around 1 percentage point in 2022 (British American Tobacco Bangladesh, 2022). In the budget for FY2023, companies manufacturing tobacco products were subject 45 per cent corporate tax, which was the same rate of corporate tax as non-publicly traded mobile operator companies. Since companies manufacturing tobacco products are directly causing severe public health hazards, it is necessary to ensure that such companies pay corporate tax at a rate which is above the corporate tax rate for all other types of companies.

Therefore, in addition to the aforementioned tax reforms, we also propose that the corporate tax on all companies manufacturing tobacco products, such as cigarette, bidi, chewing tobacco, jarda, and gul, to be increased from 45 per cent in FY2023 to 50 per cent in FY2024, and the associated surcharge to be increased from 2.5 per cent in FY2023 to 5 per cent in FY2024 (Table 2.10).

Table 2.10

Corporate tax on tobacco product manufacturing companies

Type of company	Current tax structure in FY2023		Proposed tax structure for FY2024		Proposed tax structure for FY2026	
	Corporate tax (in per cent)	Surcharge (in per cent)	Corporate tax (in per cent)	Surcharge (in per cent)	Corporate tax (in per cent)	Surcharge (in per cent)
All companies manufacturing tobacco products, such as cigarette, bidi, chewing tobacco, jarda, and gul	45.0	2.5	50.0	5.0	55.0	7.5

Source: CPD compilation data from the Ministry of Finance.

In order to achieve the government's long-term goal of a tobacco-free Bangladesh, we also propose that the corporate tax on all on all companies manufacturing tobacco products, such as cigarette, bidi, chewing tobacco, jarda, to be increased to 55 per cent, and the associated surcharge to be increased to 7.5 per cent, in 2026 when Bangladesh graduates from the LDC group.

According to the latest report on national estimates of land use and production of Drugs and Narcotics from the Yearbook of Agricultural Statistics 2021, the tobacco industry used 99600.24 acres of fertile cultivable land to produce tobacco leaf in Bangladesh (BBS, 2022). The tobacco companies in Bangladesh are exploiting favourable agricultural policies to produce tobacco leaf in massive quantities and export it to other countries where such production of tobacco leaf is more restricted. The export of tobacco leaf from Bangladesh has almost doubled from 272 crore BDT in 2021 to 559 crore BDT in 2022 for one of the largest tobacco market shareholders of Bangladesh (British American Tobacco Bangladesh, 2022).

The local market of Bangladesh is experiencing a huge price hike of basic necessities such as rice, wheat and other food items. Since inflation has been severely cutting into the lives of marginalised people, it is important to acknowledge the opportunity cost of such high level of tobacco leaf production in Bangladesh. The government has unequivocally declared several times to utilise every inch of arable land in the country to ensure food security. However, in reality we find that vast quantity of arable land is being used for tobacco cultivation each year.

If 99600.24 acres of land which is currently being used for tobacco leaf production was used for Boro rice cultivation, assuming the average yield rate is independent of geographical location and technical knowledge of farmers, then 167,434.39 metric tonnes (MT) of additional Boro rice could be produced to meet the local demand. This additional quantity of Boro rice produced could meet the demand of additional 12.50 lakh people for a whole year. Alternatively, if the land was used for wheat production, then 133012.603 MT of additional wheat could be produced to meet the local demand. Similarly, the additional 133012.60 MT of wheat production could sustain the wheat demand of additional 1 crore 84 lakh people for a whole year. This is vital for a country which has a population of more than 165 million and is a net food importing country. Hence substituting the production of tobacco leaf with more productive major crops can reduce the stress on food imports. CPD believes the 25 per cent tax waived for tobacco companies operating at Export Processing Zones (EPZs) must be reinstated in FY2024.

Tobacco taxation policy will remain ineffective if we do not regulate the operations of the industry in the greater space of our society. The overall message behind such high tariffs must be so well-defined and precise that it must be reflected in every realm of social space. If the overall atmosphere is conducive to the tobacco companies, then high tax rates will fall short of achieving the primary goal. For instance, allowing the e-commerce site 'Buy Here Now' to sell cigarettes online, sponsoring targeted events, and the National Board of Revenue (NBR) providing social recognition to tobacco companies and individuals related to the trade for amount of tax paid.

The business model of the tobacco industry is to innovate continuously and be one step ahead of the policy makers. The topic of e-cigarette is missing from the mainstream discussion of tobacco control. Electronic nicotine delivery systems (ENDS), of which electronic cigarettes are a common type, are devices that heat a liquid to create an aerosol that is inhaled by the user. The liquid contains nicotine and other chemicals that may be toxic to people's health (WHO). People passively exposed to e-cigarettes aerosol absorb nicotine (measured as cotinine), with one study showing levels comparable to passive smokers of conventional cigarettes. There is little research on direct health effects, but one study shows short-term pulmonary effects and evidence of cytotoxicity in animal and human in vitro test systems. (Marques & Sanz, 2021)

The demand for e-cigarette is rising at an alarming rate in Bangladesh. According to the data from Tobacconomics, there's a 6.7 per cent adults of the country has used e-cigarettes (Tobacconomics, n.d.). The entire experience of nicotine consumption has been made more convenient by e-cigarettes. The innovation of e-cigarettes aimed to substitute all the qualities or attributes of cigarettes that were detested in society. For example, e-cigarettes avoid the foul smell of conventional cigarettes by utilising different artificially flavoured liquids to entice new customers. CPD believes there is no reason why e-cigarette or ENDS should not be treated in the same way as tobacco companies under the tax laws. CPD believes rather than imposing a complete ban on e-cigarettes or ENDS, the government can regulate the market and impose high taxes to discourage their consumption and generate revenue for the government.

A hard tax for soft drinks

Carbonated soft drinks and energy drinks are a significant health concern in Bangladesh. Such beverages have a substantial amount of sugar which is a major cause for obesity, diabetes, and tooth decay. Typically, a single can of a soft drink which is around 355 millilitres, contains 39 grams of sugar (Coca-Cola Company, n.d.). This is equivalent to roughly about 10 teaspoons of sugar while the World Health Organisation (WHO) recommends that adults should not consume more than 6 teaspoons of sugar daily to lead a healthy lifestyle (WHO, 2017). Currently, the beverage and carbonated industry is subjected to a 25 per cent SD for carbonated soft drinks, and 35 per cent SD for energy drinks with a 15 per cent VAT applicable for both (NBR, 2018). In Bangladesh, carbonated soft drinks and energy drinks are widely available, and hence it is necessary to decrease the consumption of such beverages in order to reduce the associated health risks.

Therefore, CPD recommends that the government should remove the supplementary duty on both soft drinks and energy drinks and replace it with a specific excise duty of BDT 0.10 per millilitre (ml) or BDT 100 per litre (l) on soft drinks and energy drinks produced in Bangladesh in the FY2024 (Table 2.11). Since sweetened beverages are a demerit good, placing a specific excise duty will reduce their consumption and provide the government with a substantial revenue. CPD also recommends that the government stops giving high degree of tariff protection to local manufacturers of Sugar Sweetened Beverages (SSB) through VAT exemption on raw materials imported (SRO148/2016). This will give respite to our shrinking fiscal space.

Furthermore, limiting sugary beverage intake will help Bangladesh minimise the risks of related diseases and health expenditures of the general population. This will also allow the economy to achieve SDG target 3.4 which aims to reduce non-communicable diseases by one-third by 2030 (UN, 2015). Additionally, we also propose that the VAT on soft drinks and energy drinks should be increased from 15 per cent in FY2023 to 20 per cent in FY2024.

Table 2.11

Proposed tax structure for soft drinks and energy drinks

Item	**Current Tax Structure for FY2023**		**Proposed Tax Structure for FY2024**	
Beverage	**SD (in per cent)**	**VAT (in per cent)**	**Specific excise duty (BDT per litre)**	**VAT (in per cent)**
Soft drinks	25	15	100	20
Energy drinks	35	15	100	20

Source: CPD's compilation based on data from the National Board of Revenue.

Tax on sanitary napkins – a gender tax harming women and girls

Menstrual hygiene is a fundamental right and need for women and girls all over the world. But this right is violated when menstrual hygiene products are subjected to all kinds of tax – Value Added Tax (VAT) and duties. The practice of safe hygiene is strongly connected to Sustainable Development Goal (SDG) 3 which aims to ensure good health and well-being for all (United Nations, 2015). Even though sanitary products are a necessity for women and girls to maintain proper hygiene, their price is beyond the reach of most women and girls from low-income groups of Bangladesh.

Locally produced sanitary napkins, towels, and similar sanitary products for women and girls in Bangladesh are subjected to high prices because of high incidence of tax including VAT, Customs Duties (CD), Supplementary Duty (SD), Regulatory Duty (RD), and Additional Tax (AT) on imports of raw materials. The imposition of local VAT on production and sometimes sales tax is also reflected in the price of these products (WaterAid, 2019). SD on imported raw materials, such as air laid paper is 20 per cent. Additionally, all raw materials used in the production of sanitary napkins were subjected to 15 per cent and 5 per cent, respectively in FY2022 (Bangladesh Customs, 2021). In the budget speech of FY2023, it initially proposed that the VAT and SD at local manufacturing stage on the production of sanitary napkin will be exempted to ensure health protection of women and girls (Kamal, 2021). However, such exemption was not implemented later.

We, therefore, propose that the total tax incidence (TTI) on imported raw materials used to produce sanitary napkins and diapers should be made zero by exempting all form of VAT, CD, SD AIT, RD and AT to ensure affordable sanitary napkins for women and girls from all levels of income. The TTI on imported sanitary napkins and diapers in FY2022 was 127.72 per cent, which we recommend

Table 2.12

Proposed tax structure on import of sanitary napkins and related raw materials

Current tax structure in in FY2023									**Proposed**
HS code	**Product description**	**CD (%)**	**SD (%)**	**VAT (%)**	**AIT (%)**	**RD (%)**	**AT (%)**	**TTI (%)**	**TTI (%)**
96190000	Sanitary towels (pads) and tampons, napkins and napkin liners for babies and similar items	25	45	15	5	3	5	127.72	31.93
48239094	Air laid paper imported by VAT registered sanitary napkin manufacturers	25	20	15	5	3	5	85.00	0.00
35052000	Glues based on starches, dextrins or other modified starches	5	0	15	5	15	5	49.00	0.00
35069110	Adhesives based on rubber or plastic (including artificial resins)	25	0	15	5	3	5	58.60	0.00
39069000	Acrylic polymers, in primary forms and other polyesters, in primary forms.	10	0	15	5	0	5	37.00	0.00
39199020	Performance tape or closure or side tape	25	0	15	5	0	5	55.00	0.00
39201020	Other plates, sheets, film, foil and ethylene imported by VAT registered personal hygiene products manufacturing industries	25	0	15	5	3	5	58.60	0.00
40021100	Latex of styrene-butadiene or carboxylate styrene-butadiene rubber	5	0	15	5	0	5	31.00	0.00
47032100	Semi-bleached or bleached coniferous chemical wood pulp, soda	0	0	15	0	0	5	20.00	0.00
48119090	Other paper, paperboard, cellulose wadding and webs of cellulose fibres	25	0	15	5	3	5	58.60	0.00
54024400	Other yarn, single, untwisted or with a twist not exceeding 50 turns per meter	5	0	15	5	0	5	31.00	0.00
56031110	Nonwovens, of man-made filaments, weighing less than or equal to 25 gram per square meter	25	0	15	5	3	5	58.60	0.00
63079000	Made up articles (including dress patterns)	25	0	15	5	3	5	58.60	0.00

Source: CPD compilation based on data from Bangladesh Customs.

to be reduced to 31.93 per cent. This is equivalent to one-fourth the existing value (Table 2.12). Given the importance of the product to women and girls it should receive tax exemption and should not be treated as other products.

Tax on medicines in view of Bangladesh's LDC graduation

In Bangladesh, the expenditure on pharmaceutical products and health services takes up large proportion of people's income every month. The out-of-pocket spending on healthcare as a share of current health expenditure increased from 61 per cent in 2000 to 72.68 per cent in 2019 (The World Bank, 2022). Moreover, the proportion of population pushed below the USD 1.90 poverty line due to out-of-pocket expenditure on healthcare increased from 2.84 per cent in 2005 to 6.98 per cent in 2016 (World Bank, 2021). Under the new VAT and Supplementary Duty Act-2012, the government-imposed 2.4 per cent VAT on pharmaceuticals including medicines at local trading stage and 15 per cent on import of pharmaceutical products and raw materials for production of medicines (GoB, 2019). Moreover, as an LDC, Bangladesh's pharmaceutical industry is currently enjoying the facilities under the Trade-Related Aspects of Intellectual Property Rights (TRIPS) pharmaceutical waiver which provides an exemption from obligations to enforce patents along with data protection for pharmaceutical products. Unless Bangladesh gets an extension on the transition period of the TRIPS waiver after its graduation from the LDC group in 2026, the waiver would be withdrawn starting from 2026. So, Bangladesh will lose the LDC-specific international support measures under this agreement.

Therefore, we propose that the VAT on medicines should be exempted starting from FY2026 to ensure that medicines continue to be affordable to all even after the loss of TRIPS waiver in 2026. Beyond 2026, the government will need to implement a plan to protect the local pharmaceutical industry and help retain its competitiveness in the global market. This will also benefit the people from low-income groups to access medicines and other pharmaceutical products at an affordable price.

2.6.2 Fiscal policy for incentivising education

The education budget as a share of total budget decreased from 14 per cent in RBFY2015–16 to 11.7 per cent in RBFY2021–22. Additionally, the education budget as a share of GDP decreased from 1.9 per cent in RBFY2020–21 to 1.8 per cent in BFY2022–23. Education budget as a share of GDP has remained stagnant during recent fiscal years. Education budget utilisation has been decreasing over the years, especially for development expenditure.

Therefore, it is necessary to not only increase the budget allocation and budget utilisation of the education sector, but also implement a number of fiscal measures to promote improved education and in turn maximise welfare for society. In the following exposition, fiscal measures for English medium schools, imported books, and female education stipend are proposed.

Removal of existing taxes on education

The right to education is a basic human right and education should be made accessible and affordable for all individuals in a country. While the government has exempted Bengali medium schools, and later private universities, from paying VAT on tuition fees, the VAT on English medium schools continue to be at 5 per cent (NBR, 2019). It is often opined that English medium education is luxury goods and that students who study in English medium schools belong to affluent families and do not stay in the country in the long run. Obtaining education, irrespective of the source, is a basic right and should not be misconstrued as luxury goods. In their early days, English medium schools might have been suited for the privileged. However, in recent years, the dynamic has changed profusely. The number of English medium schools have proliferated over the years in Bangladesh. Many middle-income families are admitting their children to English medium schools to allow them to study in the international curriculum and gain a competitive edge in the labour market. Parents, presumably, prefer English medium education in order to provide their children with benefits that would not otherwise be available to them (Mousymi & Kusakabe, 2017). English medium schools are privatised and are not recognised to have a low tuition fee. Hence the VAT on tuition fees of English medium schools puts an extended burden on the parents of middle-income families. Therefore, CPD recommends that the VAT on the tuition fees for all academic institutions, including English medium schools, should be exempted in FY2024, and the exemption should remain in place for an indefinite period.

Additionally, since English medium schools, follow the international curriculum, the books assigned as a part of their syllabus are all imported books written by international authors. At present the TTI on foreign printed books is at 73.96 per cent. The total tax incidence includes 25 per cent as CD, 10 per cent as SD, 5 per cent as AIT, 15 per cent as VAT, and 3 per cent as RD. Such high duties on foreign books intended to provide children with quality education defeats the purpose of achieving the SDG four which aspires to 'ensure inclusive and equitable quality education and promote lifelong learning and opportunities for all' (UN, 2015). As the syllabus is revised, during every academic year parents have to buy new books for their children studying in English medium schools, while bearing such a high tax incidence. This puts further strain on families' incomes, particularly those from middle-income households. Therefore, CPD recommends that all taxes and duties on foreign imported books should be exempted in FY2023 to ensure that education remains affordable for all.

Education stipend

The allocation to Stipends for Undergraduate and Postgraduate Level Students was decreased from BDT 96 crore in FY2021 to BDT 72 crore in FY2023. We propose an increase in the allocation for all education stipends to be implemented in the budget for FY2024 (Table 2.13).

Table 2.13

Proposed education stipend structure in FY2024

Name of stipend	Current stipend structure in FY2023			Proposed stipend structure in FY2024	
	Number of beneficiaries (in crore)	Total budget allocation (in crore BDT)	Allocation per beneficiary per year (in BDT)	Total budget allocation (in crore BDT)	Allocation per beneficiary per year (in BDT)
Student stipend for primary education level	1.4000	1,900	1,357	8,400	6,000
Stipends for secondary, higher secondary and madrasah education level students	0.5290	1,980	3,524	5,225	10,000
Stipends for undergraduate and postgraduate level students	0.0136	72	6,142	195	15,000
Stipends for students of technical education institutions	0.0612	343	5,935	834	15,000

(Table 2.13 contd.)

(Table 2.13 contd.)

Name of stipend	Current stipend structure in FY2023			Proposed stipend structure in FY2024	
	Number of beneficiaries (in crore)	**Total budget allocation (in crore BDT)**	**Allocation per beneficiary per year (in BDT)**	**Total budget allocation (in crore BDT)**	**Allocation per beneficiary per year (in BDT)**
Stipends for physically challenged students	0.0100	96	9,564	200	20,000
Stipend for improving the livelihood of transgender, Bede and disadvantaged community	0.0030	26	9,759	54	20,000
Total for stipend programmes	**2.0170**	**4,417**	—	**14,908**	—

Source: CPD compilation based on data from Ministry of Finance (MoF, 2022).

Our proposed stipend reform will benefit more than 2 crore students at all levels and cost the government an additional BDT 14,908 crore.

2.7 FISCAL MEASURES TO SUPPORT GREEN TRANSITION

Efforts to address global warming issues and make the transition to a green economy that benefits all stakeholders must include green fiscal measures. Reflecting externalities in pricing, coordinating government spending with environmental objectives, and increasing revenues are all ways in which such policies might help bring about the outcomes envisioned by the Paris Agreement (UN Environment Programme 2022). Investments of enormous scale are needed to meet global climate pledges. Reaching net-zero emissions in the energy sector alone would need annual investments of around USD 3.1 trillion to USD 8.2 trillion from now until 2050 (Lenaerts, Tagliapietra and Wolff 2022). The United Nations Environment Programme estimates that eliminating subsidies for fossil fuels might generate nearly USD 2.9 trillion per year by 2022, which could be invested towards achieving global climate targets (UN Environment Programme 2022).

Bangladesh can learn a lot from international programmes and projects already underway to combat climate change. The national budget should reflect the government's efforts to advance a green fiscal policy. The government has reason to prioritise green growth: by 2026, it will no longer be a least developed country (LDC), and it hopes to achieve upper middle-income status by 2031. As a result of this shift, environmental regulations will become stricter.

There is a strong trend towards increasing urbanisation in Bangladesh, even though the bulk of the population still lives in rural areas. As it continues along the road to prosperity, Bangladesh's economy is witnessing a period of profound structural upheaval. The environment may be harmed by structural change, which is good for development. The carbon footprints of individuals increase when more people move to urban areas. There may be serious negative effects on environmental quality when these greater footprints are added together. Urbanisation is associated with greater greenhouse gas emissions and higher annual average temperature change in Bangladesh (Murshed and Saadat 2018). In spite of the fact that metropolitan areas cover such only a small portion of the earth's surface, they are responsible for 75 per cent of the world's total greenhouse gas emissions (United Nations Environment Programme n.d.). It is estimated that urban areas worldwide have the potential to suffer a loss of 44 per cent of their gross domestic product (GDP), which is equal to USD 31 trillion, as a direct result of the destruction of biodiversity and the environment (World Economic Forum 2022). Air and plastic pollution are particularly severe in Bangladesh's major cities. In this analysis, we examine the issue of air and plastic pollution in Bangladesh and provide both immediate and long-term fiscal solutions to mitigate the problem.

2.7.1 Alarming state of air pollution in Dhaka and other cities

More industrialization leads to more urbanisation and increased energy use, both of which increase carbon dioxide emissions. One of the most significant environmental and climate-related challenges brought on by increased energy usage is air pollution. The PM 2.5 concentration in Bangladesh's air was 13.2 times higher than the World Health Organization's (WHO) safe air quality guideline as of 26 March 2023 (IQAir 2022).

According to its Nationally Determined Contribution (NDC), Bangladesh pledges to cut its GHG emissions by 6.73 per cent across five sectors—electricity generation, transportation, industry, waste management, and land use—by the year 2030 (Ministry of Environment, Forest and Climate Change 2021). Bangladesh also plans to lower its greenhouse gas emissions by 15.12 per cent if supported by foreign financing and technology (Ministry of Environment, Forest and Climate Change 2021). The government of Bangladesh plans to cut transportation-related emissions by 12.30 per cent on its own by 2030, and by another 10.23 per cent with international assistance. The revised NDC states that Bangladesh needs USD 14.9 billion to achieve an unconditional commitment and USD 21.6 billion to meet a conditional commitment. Bangladesh needs to enact a number of tax and regulatory measures to reduce Greenhouse Gas (GHG) emissions to meet these goals.

Bangladesh lacks a number of fiscal policies that might facilitate a green transformation. When it comes to encouraging green and sustainable production and consumption, just a handful of tax incentives and green funds are currently accessible. In 2008, a 15 per cent VAT exemption was established for all renewable energy equipment and associated raw materials under the Renewable Energy Policy 2008. At the moment, however, SRO No. 141-Act/121/138-VAT only exempts the VAT on import and manufacturing of photovoltaic cells, solar modules, solar panels, and solar batteries up to 60 Amperes. Corporate income tax exemptions for renewable energy producers have been included in the renewable energy policy for a term of 5 years, with the possibility of extension. In the Finance Act of 2014, a new surcharge was established to help safeguard the environment. However, this environment protection surcharge (EPS) has not yet been completely implemented (Finance Division 2020). Two Bangladesh Bank funds currently support the green energy transition in Bangladesh: Refinance Scheme for bank and financial institutions, and Green Transformation Fund (GTF) for Export-oriented Industries (Bangladesh Bank 2020).

2.7.2 Plastic pollution getting out of hand

Disposable plastic is growing in popularity across the globe because of its versatility and inexpensive price, despite the harm it does to the environment and human health. Every day, 646 tonnes of plastic garbage are collected in Bangladesh, with 48 per cent sent to landfills, 37 per cent recycled, 12 per cent dumped into waterways, and 3 per cent littering urban areas (The World Bank 2021). There are 1,212 dump sites in Bangladesh that contribute between 24,032 and 36,047 tonnes of plastic waste annually to the country's rivers (The World Bank, 2021). Both plastic consumption and pollution have soared with rapid urbanisation. In metropolitan regions of Bangladesh, yearly per capita plastic use is projected to reach 9.0 kg in 2020, up from 3.0 kg in 2005. Mismanaged plastic trash in Bangladesh is mostly comprised of single-use items like shopping bags, packs, and wrappers (The World Bank n.d.). Dhaka has a plastic consumption rate that is three times higher than the national average for metropolitan regions. Urban flooding is exacerbated by the usage of single-use plastics, which clog drains. There are serious dangers to human health and the environment from using plastics designed for a single use.

Per capita plastic waste generated in Bangladesh was only 0.03 kg per day in 2010, compared to the global average of 0.19 kg per day (Jambeck, et al. 2015). However, 87 per cent of the plastic waste generated in Bangladesh was inadequately managed, which led to the country becoming the 10th largest contributor of mismanaged plastic waste in the world in 2010 (Jambeck, et al. 2015). The Ganges River, which runs through Bangladesh and into the Bay of Bengal, was estimated to be the second largest river source of plastic inputs into the ocean worldwide in 2015 (Lebreton, et al. 2017).

COVID-19 has led to a spike in unsustainable manufacture of single use plastics and synthetic materials which have been employed for creating personal protection equipment (PPE) such as body suits, masks and face shields. There has been an alarming increase in the usage of disposable plates, cups, and cutlery due to concerns about the spread of disease. Between 26 March 2020 and 25 April 2020, roughly 14,165 tonnes of single use plastic waste were produced in Bangladesh, which comprised 455 million surgical masks, 1,216 million polyethene hand gloves, 189 million surgical hand gloves and 49 million bottles of hand sanitiser (Environment and Social development Organisation 2020).

Bangladeshi policymakers have developed a number of initiatives throughout the years to combat environmental threats including pollution. Bangladeshi governments have taken action in the past to address the issue of plastic consumption. The use of plastic shopping bags was outlawed in Bangladesh in 2002 by a regulatory order issued under the 1995 Environment Act. However, the restriction was mostly ineffective since it was not strictly enforced. In 2010, the government implemented the Mandatory Jute Packaging Act, which was somewhat effective in lowering the country's plastic use. In 2010, the National 3R Strategy for Waste Management was created to provide guidelines on plastic reduction, reuse, and recycling. The Eighth Five Year Plan also called on local stakeholders like the Department of Environment, the Bangladesh Plastic Goods Manufacturers and Exporters Association, plastic manufacturers, research industries, and city corporations to actively participate in the implementation of the Extended Producer Responsibility (EPR) Policy in plastic management. Bangladesh has committed to a 30 per cent reduction in plastic waste by 2030 as part of its National Action Plan (The World Bank 2021). The country has set goals of lowering virgin material consumption by 50 per cent by 2030. It also aims to recycle 50 per cent of all plastics by 2025, with the goal of reaching a recycling rate of 80 per cent by 2030 and phasing out targeted single-use plastics by at least 90 per cent by 2026 (The World Bank 2021). The National Action Plan lays out in detail the measures and methods that will be used to achieve these objectives.

2.7.3 Budget recommendations for reducing air and plastic pollution

In light of the above, the government may adopt the following budgetary measures to minimise air and plastic pollution and support the greening of the economy:

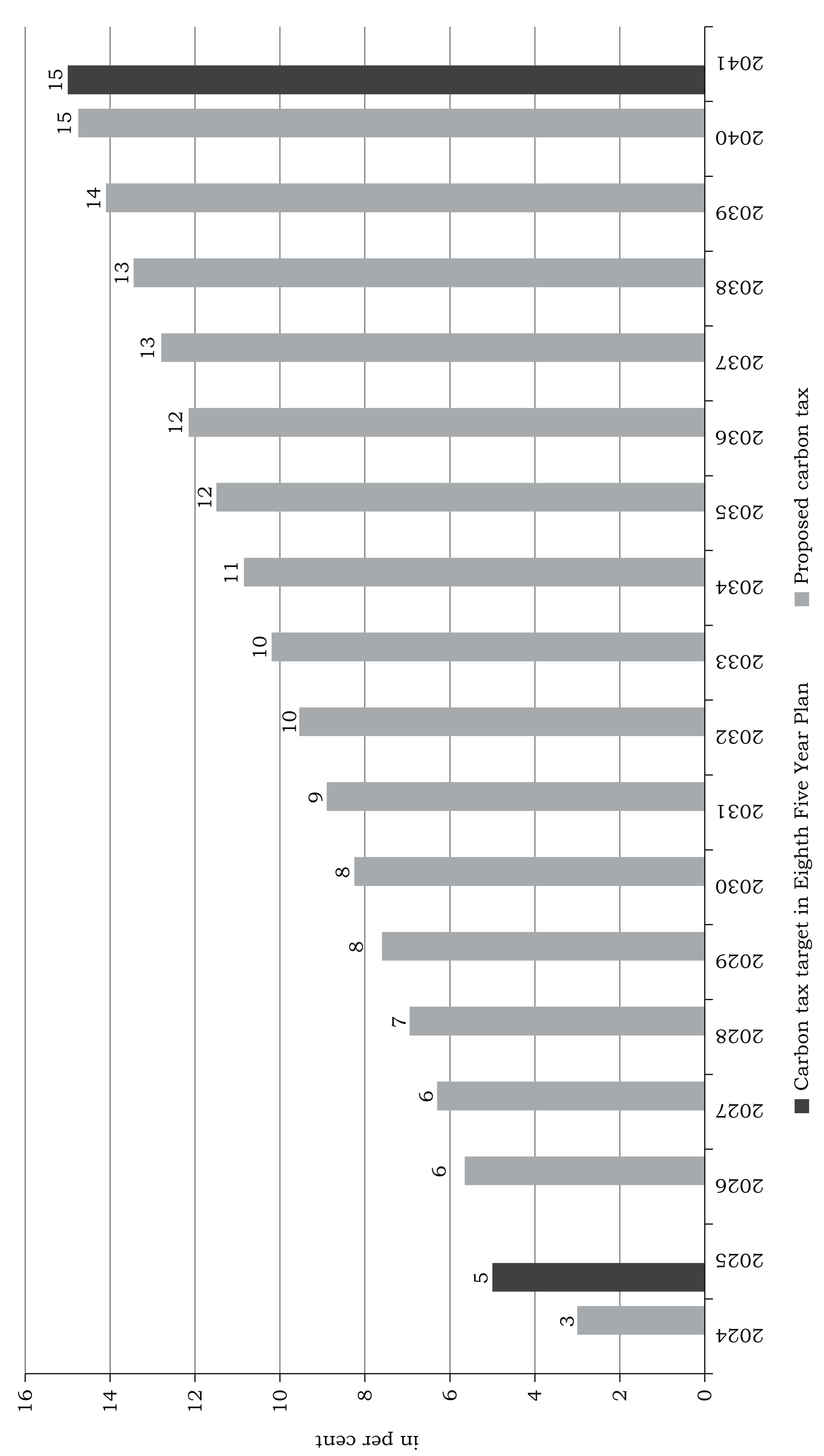
- *VAT exemption:* The government should fully implement the commitments which it made in the Renewable Energy Policy 2008. Currently, VAT exemption exists on solar panels and batteries, but there are no exemptions on solar inverters which are a crucial component of solar power plants. Moreover, the import duty on inverters (HS 85044090) was raised to 37 per cent in the

budget of FY2022. An extensive policy that considers VAT exemption on all types of equipment in a renewable power plant, especially solar power plants, should be considered from FY2024.
- *Incentive tariff:* An incentive tariff can be considered for electricity generated from renewables according to the Renewable Energy Policy 2008, which allows electricity generated from renewable sources to be priced 10 per cent higher than the highest purchase price of electricity generated from fossil fuel sources.
- *Environment surcharge:* The Finance Act of 2014 set a 1 per cent surcharge on the goods produced by industries polluting the environment. This environment protection surcharge should be implemented completely in FY2023.
- *Introduce carbon tax:* Bangladesh can implement a carbon tax equivalent to 3 per cent of the price of fossil fuels starting from FY2024 (Figure 2.19), in order to gradually meet the government's target set out in the Eighth Five Year Plan which aims to implement a 5 per cent carbon tax on the price of fossil fuels by 2025 and 15 per cent carbon tax on the price of fossil fuels by 2041 (Bangladesh Planning Commission 2020).

Such a carbon tax can bring two benefits for Bangladesh: i) a carbon tax will be a disincentive for fossil fuel-based power producers; and ii) the revenue collected from carbon tax can be utilised for the development of green energy in Bangladesh. Bangladesh has the potential to generate revenues equivalent of about 1 per cent of its GDP by charging USD 30 per tonne of carbon dioxide equivalent (World Bank 2022). The tax can be levied upstream, such as at the import level or on fossil fuel driven power producers, to make it easier to implement (World Bank 2022). Initially, the carbon tax may be levied on selected fossil fuels only. However, it would not be feasible to implement a carbon tax on liquified natural gas (LNG), as the country is already paying a lot for the import of LNG. In the long-term, the country can increase the rate of carbon tax and make it a large revenue stream to fuel green transition of the economy. A carbon tax for fossil fuel products in Bangladesh would reduce a substantial amount of carbon emissions and also yield tax revenues which could be utilised to invest in clean technologies and infrastructures that will help offset the loss of output from carbon taxes (Ahmed and Khondker 2018).

- *Phase-out fossil fuel subsidies:* The government should phase out fossil fuel subsidies starting from FY2024 in line with recommendations from the International Monetary Fund (IMF). Initially, all fossil fuels may be sold at the international market price and this price may be updated each month. Instead, the government can redirect the funds currently allocated to fossil fuel subsidies to the development of green energy.
- *Feed-in tariff:* A formal feed-in tariff policy exclusively for renewable energy needs to be implemented in FY2024 in order to promote renewable energy in Bangladesh. Currently, an informal version of the feed-in tariff policy exists in Bangladesh. However, such a mechanism does not exclusively promote renewable energy. A clear incentive package has to be present in the policy so that it reaches all types of potential renewable energy producers regardless of their generation capacity.
- In order to reduce air polluting originating from the transport sector, the government should reform the advance income tax (AIT) structure on private motor vehicles so that the AIT on fossil fuel driven motor vehicles is 5 per cent to 50 per cent higher than the AIT on hybrid and fully electric vehicles, depending on the size the vehicle's engine and electric motor (Table 2.14).

Figure 2.19
Carbon tax as a share of fossil fuel price (in per cent), target and proposed



Source: CPD illustration based on targets set out in the Eighth Five Year Plan.

Table 2.14

Proposed advance income tax structure for the owners of private motor cars in FY2024

(in BDT)

Type and engine capacity or electric motor power of motor car	AIT for hybrid and fully electric vehicles	AIT for conventional fossil fuel vehicles
A car or a jeep, not exceeding 1500cc or 75kw	**25,000**	26,250
A car or a jeep, exceeding 1500cc or 75kw but not exceeding 2000cc or 100 kw	50,000	55,000
A car or a jeep, exceeding 2000cc or 100 kw but not exceeding 2500cc or 125 kw	75,000	90,000
A car or a jeep, exceeding 2500cc or 125 kw but not exceeding 3000cc or 150 kw	125,000	162,500
A car or a jeep, exceeding 3000cc or 150 kw but not exceeding 3500cc or 175 kw	150,000	210,000
A car or a jeep, exceeding 3500cc or 175 kw	200,000	300,000
A microbus	30,000	36,000

Source: CPD compilation.

- In addition to the AIT on private motor vehicles, the government should also consider imposing an AIT on motorcycles from FY2024 (Table 2.15).

Table 2.15

Proposed advance income tax structure for the owners of motorcycles in FY2024

(in BDT)

Type and engine capacity of motorcycle	Yearly AIT
A motorcycle with engine up to 100cc	1,500
A motorcycle with engine from 101cc to 150cc	3,000
A motorcycle with engine above 150cc	5,000

Source: CPD compilation.

- With the goal of reducing plastic pollution, the government should consider bringing single-use plastic products under taxation in FY2024. Such single-use plastic products may include: cutlery such as forks, knives, spoons, and chopsticks; plates; straws; beverage stirrers; sticks to be attached to and to support balloons; food containers made of expanded polystyrene; beverage containers made of expanded polystyrene; and cups for beverages made of expanded polystyrene. Initially, the plastic tax regime should assume a moderate stance and in subsequent years the tax regime could be made more stringent, and more single-use plastic products should be brought under the ambit of taxation.
- The budget for FY2024 should allocate additional funding for the Joint Rivers Commission to establish a bilateral plastic waste reduction initiative with India. The Government of India should also contribute to this initiative with funding, as well as technical and logistical support, in order to ensure the reduction of plastic waste in the 54 transboundary rivers shared between Bangladesh and India.

2.8 CONCLUSION

The national budget for FY2024 will be placed at a time when the country is facing formidable challenges in a number of areas. The adverse impacts of the rise in global commodity prices following the conflict in Ukraine started to be felt on many socio-economic correlates of Bangladesh just at a time when the economy was recuperating from the harshest effects of COVID-19. While these factors have certainly accentuated the macroeconomic situation of the country, they should not draw the attention away from the accumulated and embedded weaknesses within the Bangladesh economy.

As far as the trends during FY2023 are concerned, the major correlates exhibit signs of serious stress within the Bangladesh economy. This has been manifested in, inter alia, negative growth in revenue mobilisation, slow implementation of ADP, increased reliance on bank borrowing for deficit financing – particularly from the central bank, skyrocketing prices of essentials, declining liquidity situation of banks, deteriorating external sector balance and foreign exchange reserve. Amid these disquieting developments, perhaps the silver lining is that the global economic situation is slowly improving, and global commodity prices are on a downward trajectory.

In the current context, policymakers' scope of manoeuvring policy measures has become rather limited given the declining fiscal space. Given the current macroeconomic situation, pressure on policymakers to provide various tax reliefs and other incentives will be intensified. At the same time, demand for budgetary allocations towards various sectors will be increased. In this scenario, targeted fiscal measures geared towards catering the needs of the fixed-income earning and low-income population should take the centre stage. Such measures should be accompanied by monetary measures focusing on stability (e.g., market-based interest rates and exchange rates). Good governance and discipline are of paramount importance for these policies to bring forth their intended results. The reform measures proposed by the IMF might prove to be beneficial in this regard.

Proper acknowledgement of the current scenario should be at the forefront while formulating the budget for the next fiscal year. While it might be disincentivising for a political government to do so in an election year, as recent experience shows, failure in this regard will result in a macro-fiscal policy stance that does not meet the needs of the time. The budget for FY2024 should take cognisance of the emerging realities adequately, assess the available policy options diligently and formulate the measures accordingly. Further instability originating on account of policy missteps may be unwarranted in an election year.

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ANNEX

Annex Table 2.1
Cash incentive for export products

Amount of proposed export cash incentives	Products
20%	Vegetables, fruits, agro processed food, active pharmaceutical ingredients, jute products; full halal meat and meat products, potato, carbon and jute particle board produced from jute; grain and vegetable seeds, agar and attar products.
15%	Light engineering products, leather goods, furniture, accumulator battery, Footwear and bags made from a mix of synthetics and fabrics, and rice.
12%	Jute final product mainly Hessian, Seking and CBC
10%	20 per cent ice-covered frozen shrimp; crust and finished leather, plastic products, paper and paper products, software, ITES and hardware, ships manufactured in factories located in Savar leather industry town and factories located outside Savar having their own ETP; pharmaceutical products; Handicrafts (from hogla, straw, sugarcane/coconut husks, leaves/shells, jute cloth for ready-made garments); Pulses, horns, horns of cows and buffaloes; Stomach Bottle-Flex; Polyester staples manufactured from PET bottle-flakes, export of photovoltaic modules, motorcycles, chemical products, razors and razor blades, ceramic products, hats, crabs and knickers, galvanised sheets; consumer electronics and electrical home and kitchen products
5%	Garments products locally procured with raw materials like yarn and fabrics
4%	Garments products
4% (additional)	Garments product (if exported to non-traditional market)
1%	For all the exported product
1% (additional)	For garments product only

Source: Authors' compilation.

Chapter 3

State of the Bangladesh Economy in FY2022–23 *(First Reading)*

3.1 INTRODUCTION

Bangladesh economy has been facing a number of longstanding structural weaknesses due to absence of appropriate policy measures which includes lack of reforms. These weaknesses have exacerbated owing to several external factors including the COVID-19 pandemic, the Russia-Ukraine war and consequent supply chain disruptions. Indeed, macroeconomic management has never seen such a difficult phase in the recent history.

The current report presents the most critical areas including high inflationary pressure, external sector, power and energy sector, banking sector, and fiscal balance. Analyses of the sectors are followed by a set of policy recommendations towards managing the ongoing economic crisis.

3.2 INFLATION

The escalation of prices of essential goods has emerged as a significant issue in Bangladesh, garnering attention from policymakers and the public alike. Indeed, the rising trend of prices for essential goods can be identified as the foremost challenge encountered by the economy of Bangladesh in recent times. Currently, Bangladesh is experiencing high inflationary pressure, which started even before the start of the Russia-Ukraine crisis. Bangladesh has lately seen dramatic fluctuations in energy prices, exacerbating this predicament. Domestic factors, such as market distortion by a few dominating businesses and weak monitoring, have also contributed to the ongoing price increase. Several necessities, produced locally or imported from a developed country, are costlier in Bangladesh than in other developing or developed nations. As prices increase, low-income households struggle to manage their regular expenses. Many households, including workers on minimum wages in almost all industries, have trouble in making ends meet. Inflationary pressure has negative consequences for all stakeholder groups. The rise in prices of basic commodities has prompted significant apprehension among the ordinary people of Bangladesh, who are affected as both consumers and producers. The continued rise of prices had a discernible impact on the real income of consumers, particularly those belonging to the low-income strata. Households with low-income levels tend to spend a substantial portion of their income on food items, and hence, experience a greater degree of inflation than households with high-income groups. Individuals with fixed and flexible incomes have experienced negative impacts because of Bangladesh's ongoing cost of living crisis. Because of the rise in the cost of the consumption basket, producers have also encountered mounting demands from their workforce for higher wages and salaries.

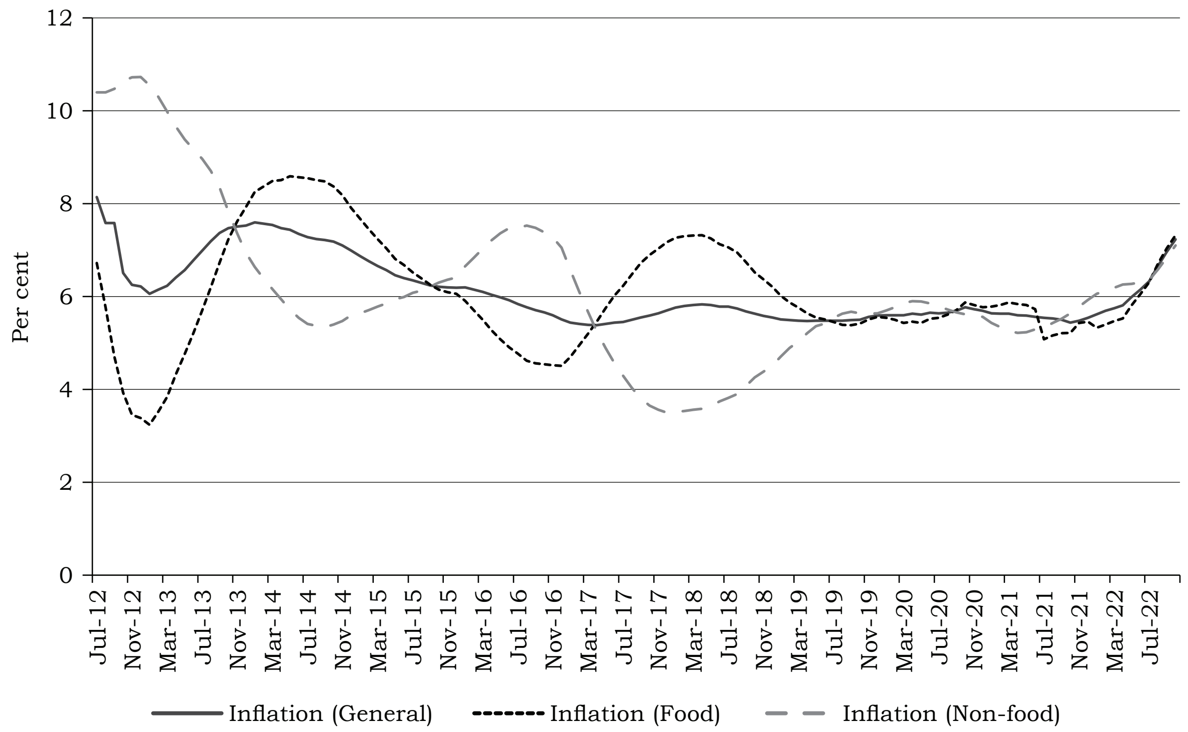
CPI inflation trends hide the rapidly rising prices

The 12-month average food and non-food inflation rates have fluctuated in a cyclical pattern over the past 10 years (Figure 3.1). Decreases in non-food inflation generally accompanied increases in food inflation, so the overall general inflation rate has remained largely stable in the short term. Recently, the overall general inflation rate has experienced a slight increase.

The 12-month average general inflation rate fluctuated from July 2012 to October 2022. In July 2012, the 12-month average general inflation rate was relatively high at 8.14 per cent. There was a noticeable decline in the 12-month average general inflation rate from 2014 to 2016, reaching a low point in mid-2016. From mid-2016 onward, there was a general upward trend in the 12-month average general inflation rate, reaching its highest point of 7.23 per cent in October 2022.

Figure 3.1

12-month average inflation rate from July 2012–September 2022



Source: CPD illustration based on data from Bangladesh Bank.

The 12-month average food inflation generally followed a similar pattern to the 12-month average general inflation but with some variations. Like the 12-month average general inflation, the 12-month average food inflation declined from 2014 to 2016, followed by an upward trend. Like the other categories, there is a general increase in the 12-month average non-food inflation over time.

The overall trend reveals the period from 2014 to 2016 was characterised by relatively low inflation across all categories. The general trend for the entire period from July 2012 to October 2022 is an increase in inflation rates, with some short-term fluctuations. High inflation rates can impact the cost of living and affect consumer purchasing power. Inflation rates have been rising in recent months, suggesting potential economic challenges.

Engel's law states that as income increases, people spend a smaller proportion of their total income on food (Norton, Alwang, & Masters, 2014). In Bangladesh, nominal household income increased by 7.86 per cent per year on average, while real household income increased by 0.16 per cent per year on average between 2010 and 2016 (BBS, 2019). Food expenditure as a share of income decreased from 53 per cent in 2010 to 46 per cent in 2016, and food expenditure as a share of total consumption expenditure fell from 55 per cent in 2010 to 48 per cent in 2016 (BBS, 2019). However, as seen in Table 3.1, the weights used for food in the calculation of Consumer Price Index (CPI) are significantly higher than the share of food expenditure in either income or consumption expenditure. The consumption basket created in 2005 to be used for calculating overall general inflation no longer reflects the current consumption pattern of consumers or the actual prices in the market in 2022.

Table 3.1

Consumption basket versus consumption pattern

Food expenditure as a share of income *(in per cent)*			
Year	**National**	**Rural**	**Urban**
2000	42	48	32
2005	45	50	36
2010	53	57	45
2016	46	52	37
Food expenditure as a share of consumption expenditure *(in per cent)*			
Year	**National**	**Rural**	**Urban**
2000	55	59	45
2005	54	59	45
2010	55	59	48
2016	48	50	43
Weight used for food in the calculation of CPI *(the base year 2005)*			
Year	**National**	**Rural**	**Urban**
2000	-	-	-
2005	56	61	47
2010	56	61	47
2016	56	61	47

Source: Based on the data from Bangladesh Bureau of Statistics.

In economics, essential commodities are typically classified as homogenous goods, wherein producers operate as price-takers and possess minimal capacity to affect the product's market price. However, Bangladesh's marketing and distribution system of essential goods has a multifaceted structure. The limited number of significant competitors in the market for essential items facilitates the perpetration of oligopolistic behaviour. In the case of numerous domestically produced goods, the availability of wholesalers is limited, while the number of retailers is significant due to the presence of multiple intermediaries. Against this contextual background, apprehensions about cartels, acts of sabotage, and hoarding were periodically expressed, although such claims are usually difficult to verify. There is a concern that there could be extensive stockpiling of crucial commodities at different tiers, resulting in interruptions in the supply chain. Additionally, there are apprehensions regarding potential entry obstacles for specific players within the value chain.

In the market for essential commodities, the concentration of market power is notably high and limited to a small number of players. The scenario could potentially lead to the occurrence of anti-competitive conduct, such as the manipulation of prices, exertion of control over the supply within the market, and the intentional creation of scarcity through the hoarding of goods to generate supernormal profits. This could be facilitated using highly organised cartels or, at the very least, some form of tacit collusion.

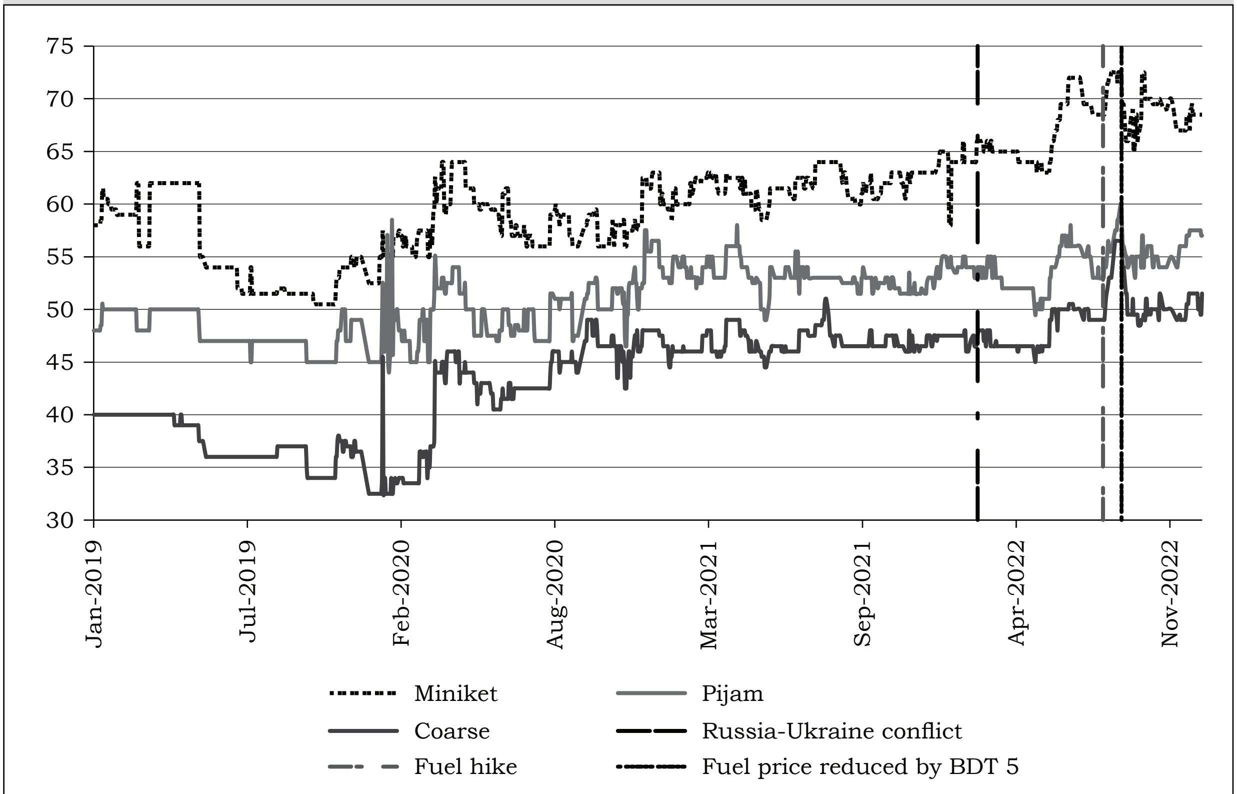
A varied distribution of market power characterises the intricate interplay and interdependence of the diverse actors within the market. For instance, about certain goods, the existence of only a handful of importers implies the possibility of oligopolistic conduct among importers of those items. An understanding of the economic mechanisms underlying the operations of market intermediaries in the value chain of essential commodities is necessary, as these intermediaries significantly impact the ultimate retail price. A comprehensive study of the process of monitoring and analysing the fluctuations in price levels of a specific group of goods throughout the entire product life cycle, spanning from manufacturers to retailers, entails identifying the underlying factors that contribute to price increases, scrutinising the conduct of the different actors within the product value chain, and formulating a range of recommendations for policy interventions aimed at mitigating the associated issues through remedial actions needs to be carried out immediately. Unfortunately, the Bangladesh Bureau of Statistics (BBS) or the Competition Commission has not conducted any such study recently, despite the unrelenting rise in the price of essentials.

To concisely present the information, we emphasise the contrast between the domestic and international prices of several food commodities: rice, soybean oil, sugar, and beef. Among these four commodities, rice and beef are primarily domestically produced, while soybean oil and sugar are predominantly imported. However, it has been observed that the cost of all four commodities in Bangladesh remains consistently elevated in comparison to the global market rates.

Analysis of the average daily prices of different varieties of rice in Dhaka over the period 1 January 2019 to 11 December 2022 shows that the average prices of Miniket, Pijam, and Coarse rice have increased noticeably over time (Figure 3 .2). For instance, the average price of Miniket rice increased by 18.10 per cent from BDT 58 per kg to BDT 68.5 per kg, the average price of Pijam rice increased by 19.79 per cent from BDT 48 per kg to BDT 57.5 per kg, and the average price of Coarse rice increased by 23.75 per cent from BDT 40 per kg to BDT 49.5 per kg, between 1 January 2019 to 11 December 2022 (Figure 3.2).

Figure 3.2

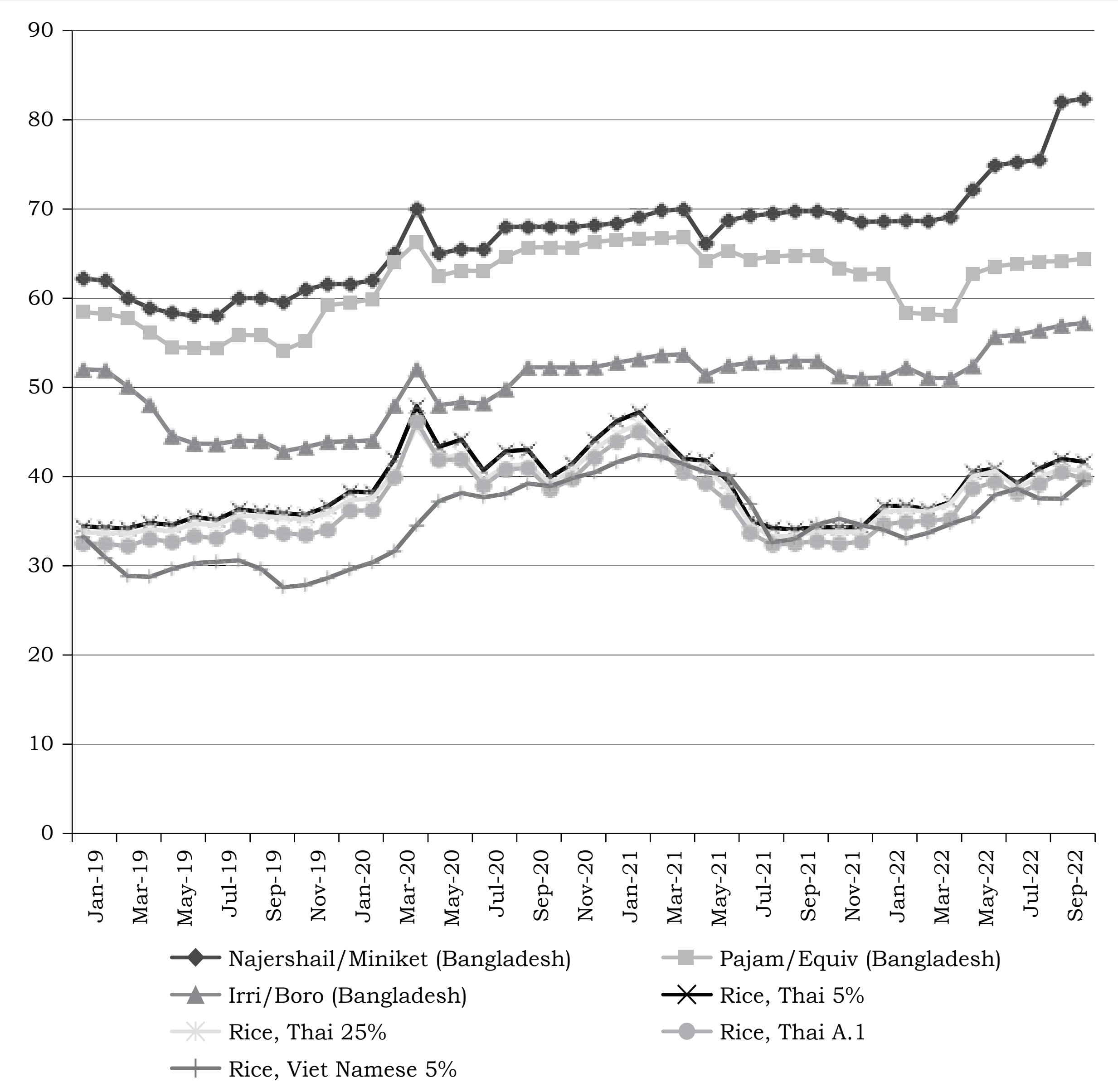
Average daily price of rice in Dhaka from 1 Jan 2019 to 11 Dec 2022 *(BDT per kg)*



Source: CPD illustration based on data from Trading Corporation of Bangladesh.

Figure 3.3

Price of rice in Bangladesh vs international markets, Jan '19–Oct '22 *(BDT per kg)*



Source: CPD illustration based on data from the Bangladesh Bureau of Statistics and World Bank.

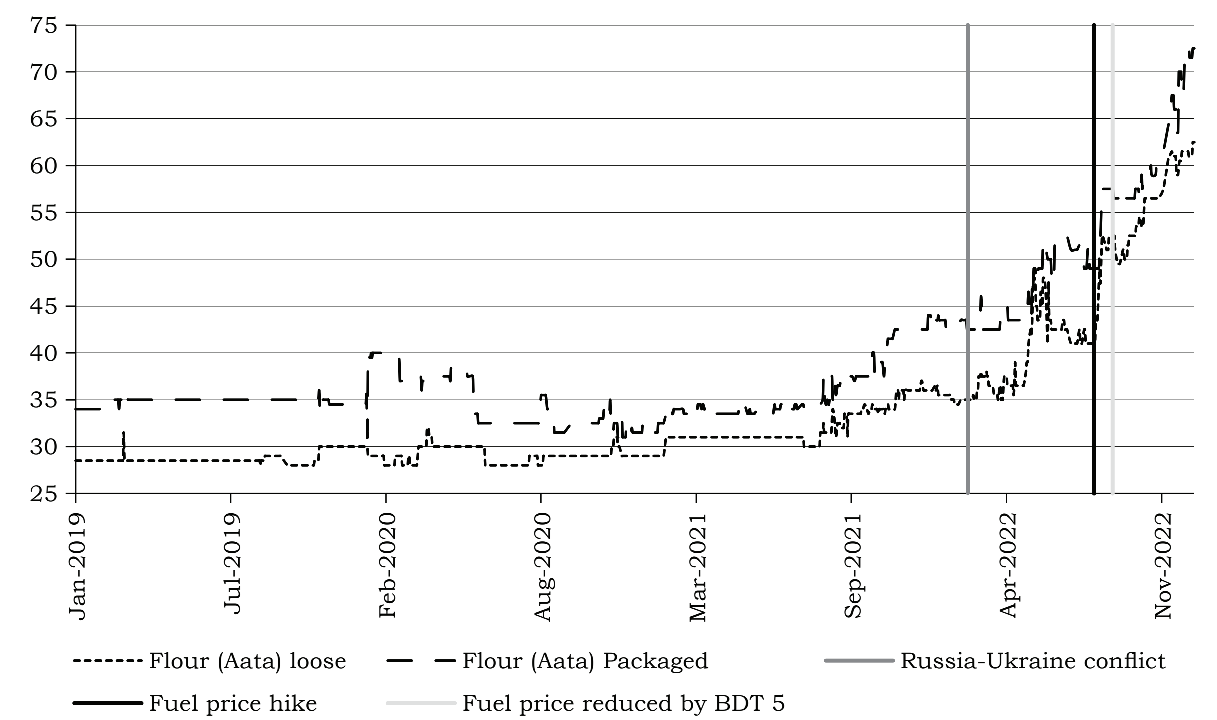
Figure 3.3 shows that the price of three common types of rice has been consistently higher than that of Thai and Vietnamese rice. Previous research has shown that in Bangladesh, in the event of a rise in the wholesale price of rice, consumers are subjected to an immediate increase in the retail price. In contrast, in the event of a decline in the wholesale price of rice, consumers do not experience a corresponding reduction in the retail price (Rahman, Bhattacharya, Shadat, & Deb, 2008).

Figure 3.4 and Figure 3.5 show that the price of unprocessed flour (Aata) and processed flour (Maida) both started increasing in Dhaka before the start of the conflict in Ukraine. This indicates that there may be other domestic causes of the increase in the price of unprocessed flour (Aata) and processed flour (Maida), which warrant a comprehensive investigation by the Bangladesh Competition Commission.

The data shows that the average price of loose unprocessed flour (Aata) increased by 115.51 per cent from BDT 29 per kg to BDT 62.5 per kg, and the average price of packaged unprocessed flour (Aata) increased by 113.24 per cent from BDT 34 per kg to BDT 72.5 per kg, from 1 January 2019 to 11 December 2022 (Figure 2.4). On the other hand, the average price of loose processed flour

Figure 3.4

Average daily price of unprocessed flour (Aata) in Dhaka from 1 Jan '19 to 11 Dec '22 *(BDT per kg)*



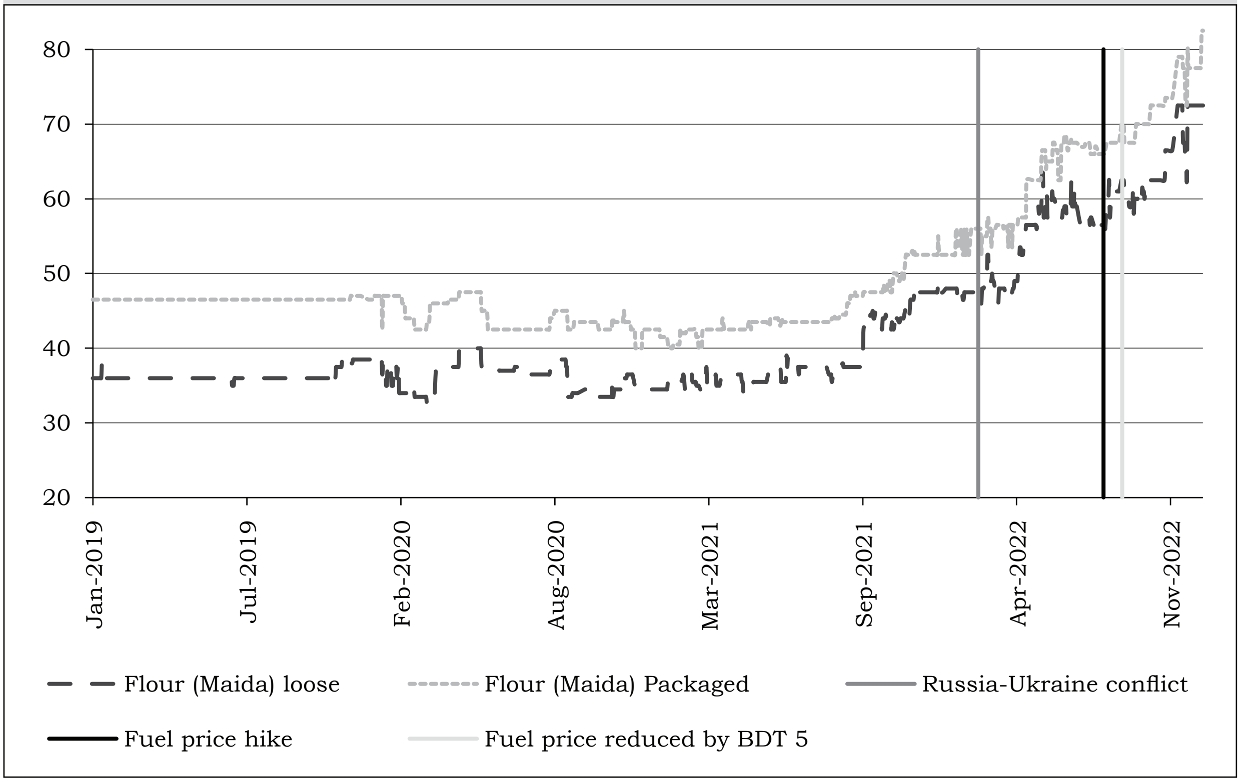
Source: CPD illustration based on data from Trading Corporation of Bangladesh.

(Maida) increased by 101.38 per cent from BDT 36 per kg to BDT 72.5 per kg, and the average price of packaged processed flour (Maida) increased by 75.53 per cent from BDT 47 per kg to BDT 82.5 per kg, from 1 January 2019 to 11 December 2022 (Figure 3.5).

Figure 3.6 shows that the price of edible oil started increasing in Dhaka before the conflict in Ukraine began. This indicates that there may be other domestic causes of the increase in the price of edible oil, which warrants a comprehensive investigation by the Bangladesh Competition

Figure 3.5

Average daily price of processed flour (maida) in Dhaka from 1 Jan '19 to 11 Dec '22 *(BDT per kg)*

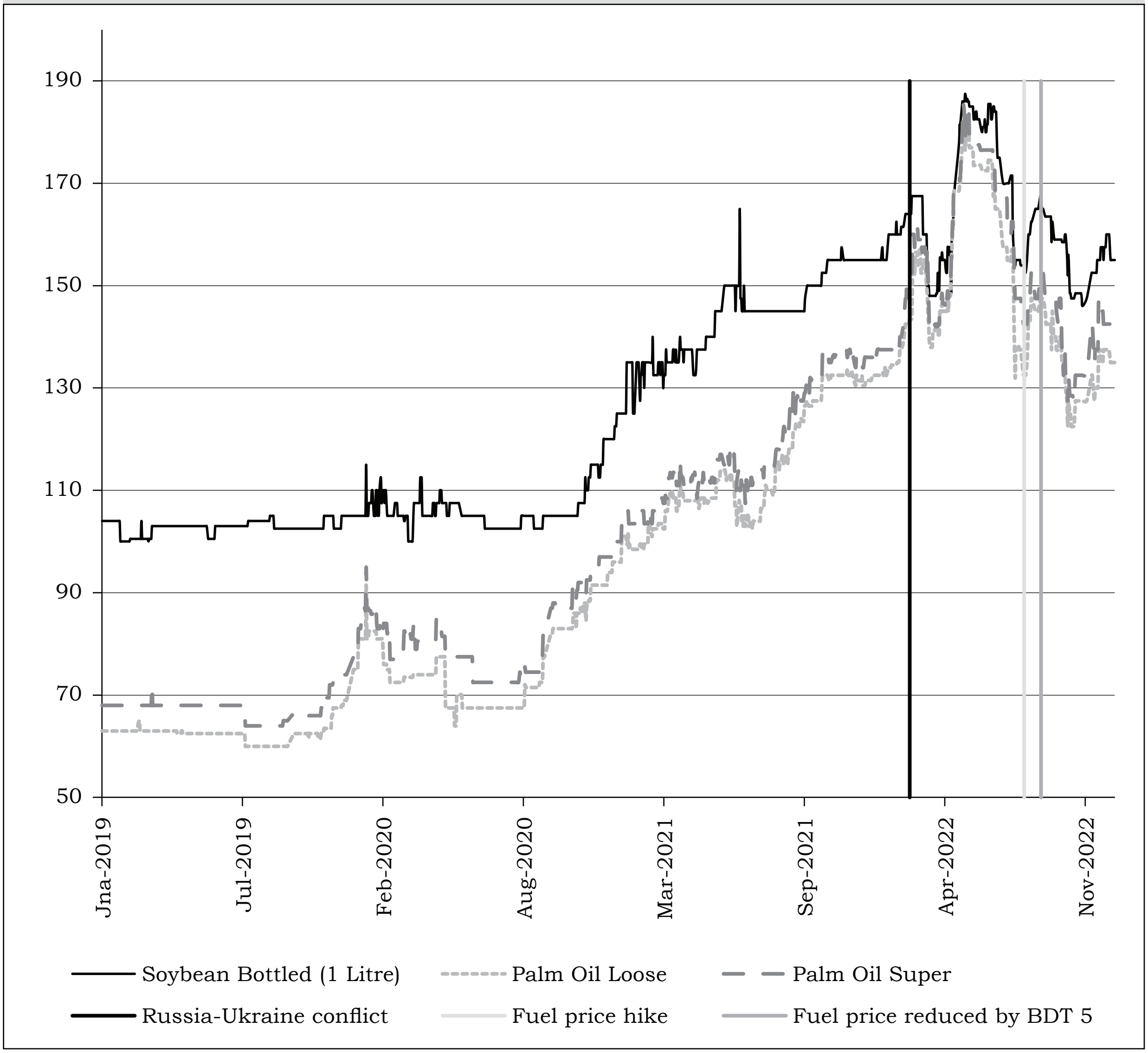


Source: CPD illustration based on data from Trading Corporation of Bangladesh.

Commission. The data shows that the average price of bottled soyabean oil increased by 49.03 per cent from BDT 104 per litre to BDT 155 per litre from 1 January 2019 to 11 December 2022 (Figure 2.6). On the other side, the average price of loose palm oil increased by 142.85 per cent from BDT 63 per litre to BDT 135 per litre, and the average price of palm oil super increased by 109.56 per cent from BDT 68 per litre to BDT 142.5 per litre, from 1 January 2019 to 11 December 2022 (Figure 3.6).

Figure 3.6

Average daily price of edible oil in Dhaka between 1 Jan 2019 to 11 Dec 2022 *(BDT per litre)*

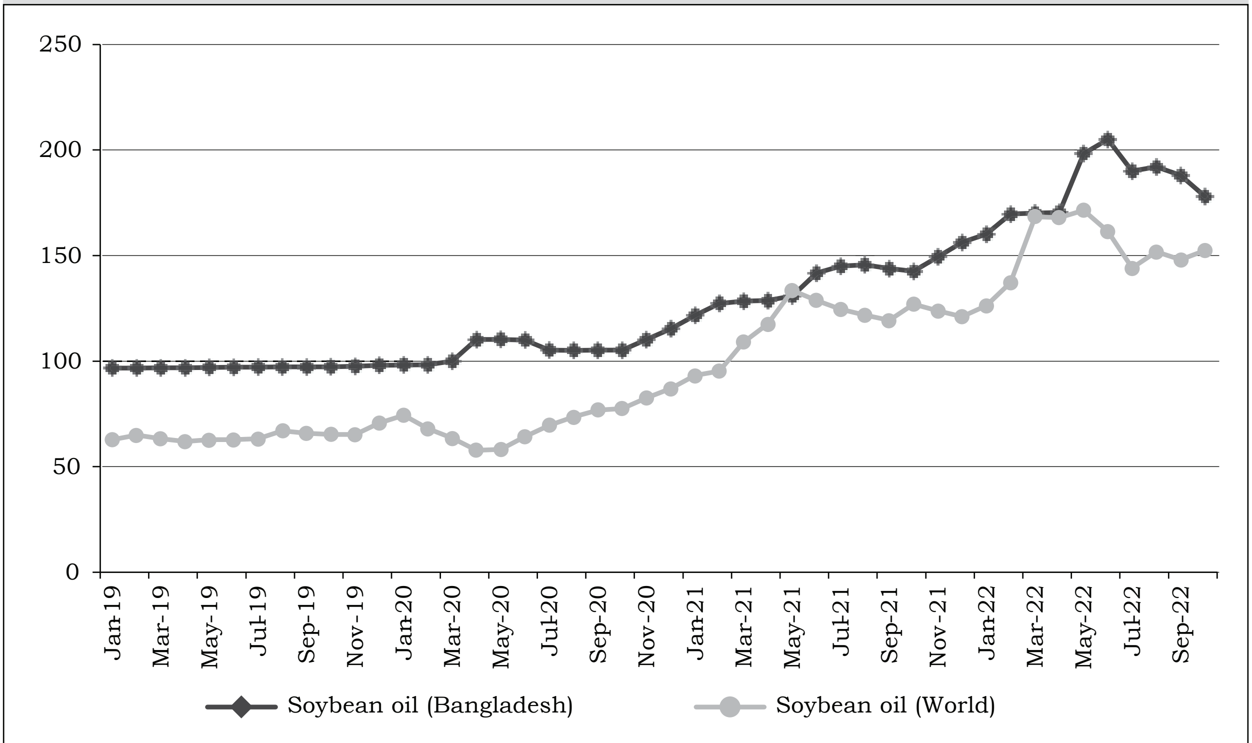


Source: CPD illustration based on data from Trading Corporation of Bangladesh.

A comparison of the price of soyabean oil in Bangladesh and the world market shows that the price of soyabean oil has been consistently higher in Bangladesh than in the world market during the period of January 2019 to October 2022 (Figure 3.7).

Figure 3.7

Price of soybean oil in Bangladesh and international markets, Jan ’19–Oct ’22 *(BDT per litre)*

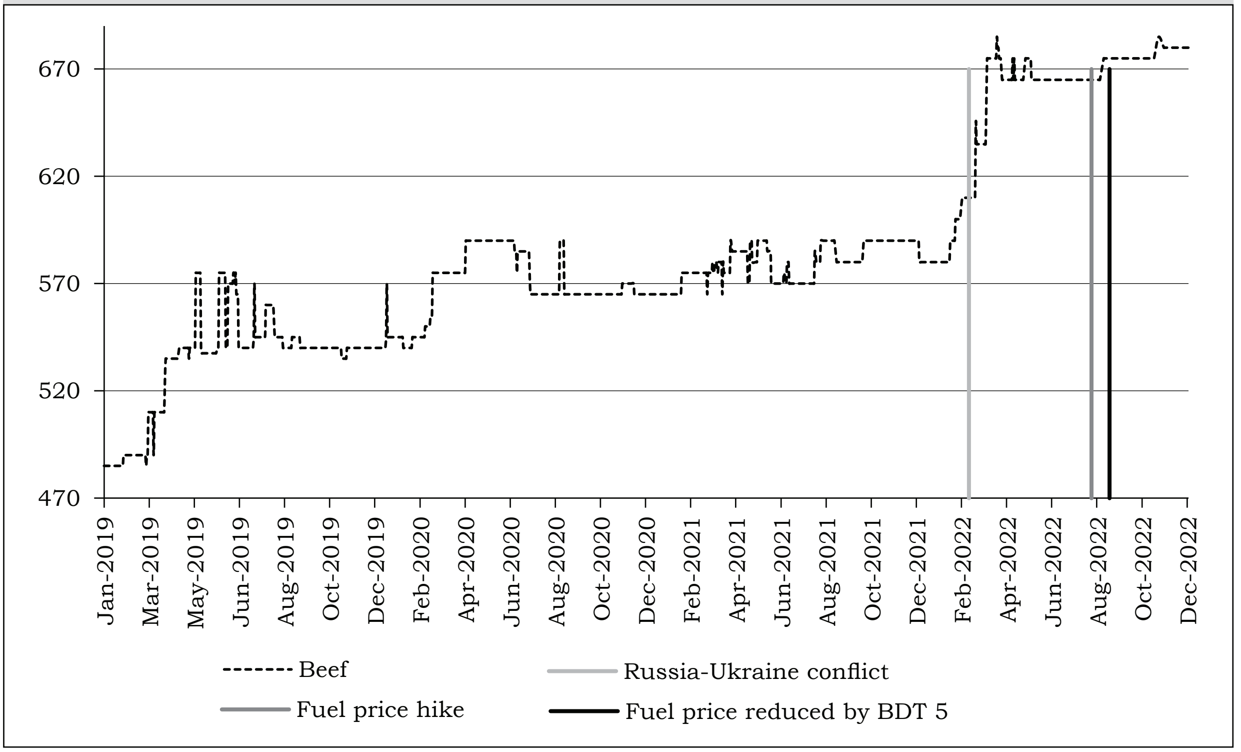


Source: CPD illustration based on data from the Bangladesh Bureau of Statistics and World Bank.

The price of beef has skyrocketed in Dhaka over the past few years, almost elevating the status of this basic food item from an essential goods to a luxury one. The data shows that the average price of beef increased by 40.21 per cent from BDT 485 per kg to BDT 680 per kg, from 1 January 2019 to 11 December 2022 (Figure 3.8).

Figure 3.8

Average daily price of beef in Dhaka between 1 Jan 2019 to 11 Dec 2022 *(BDT per kg)*

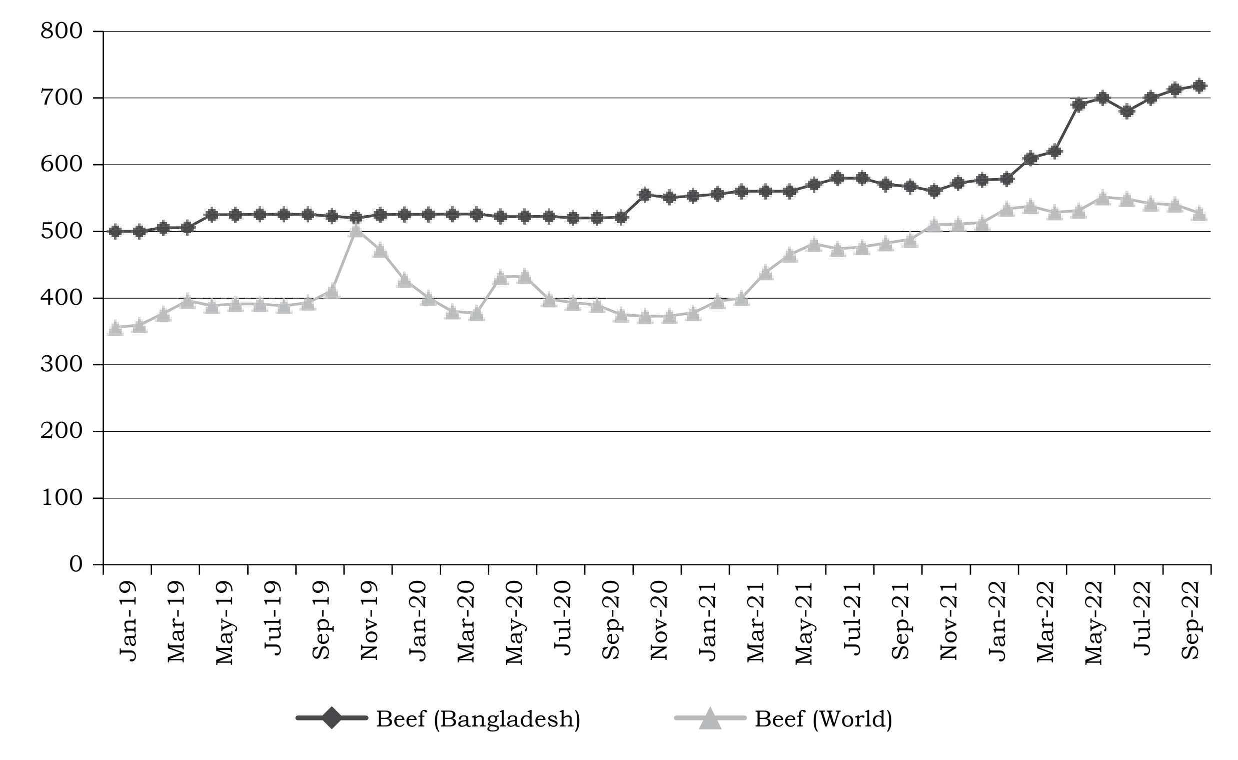


Source: CPD illustration based on data from Trading Corporation of Bangladesh.

A comparison of the price of beef in Bangladesh and the world market shows that the price of beef has been consistently higher in Bangladesh than in the world market from January 2019 to October 2022 (Figure 3.9). For instance, in October 2022, beef price was BDT 528 per kg in the world market, but it was BDT 718 per kg in Bangladesh. Moreover, the price of beef in the world market fell from June 2022 to October 2022, but the price in Bangladesh increased during the same time.

Figure 3.9

Price of beef in Bangladesh and international markets, Jan '19–Oct '22 *(BDT per kg)*



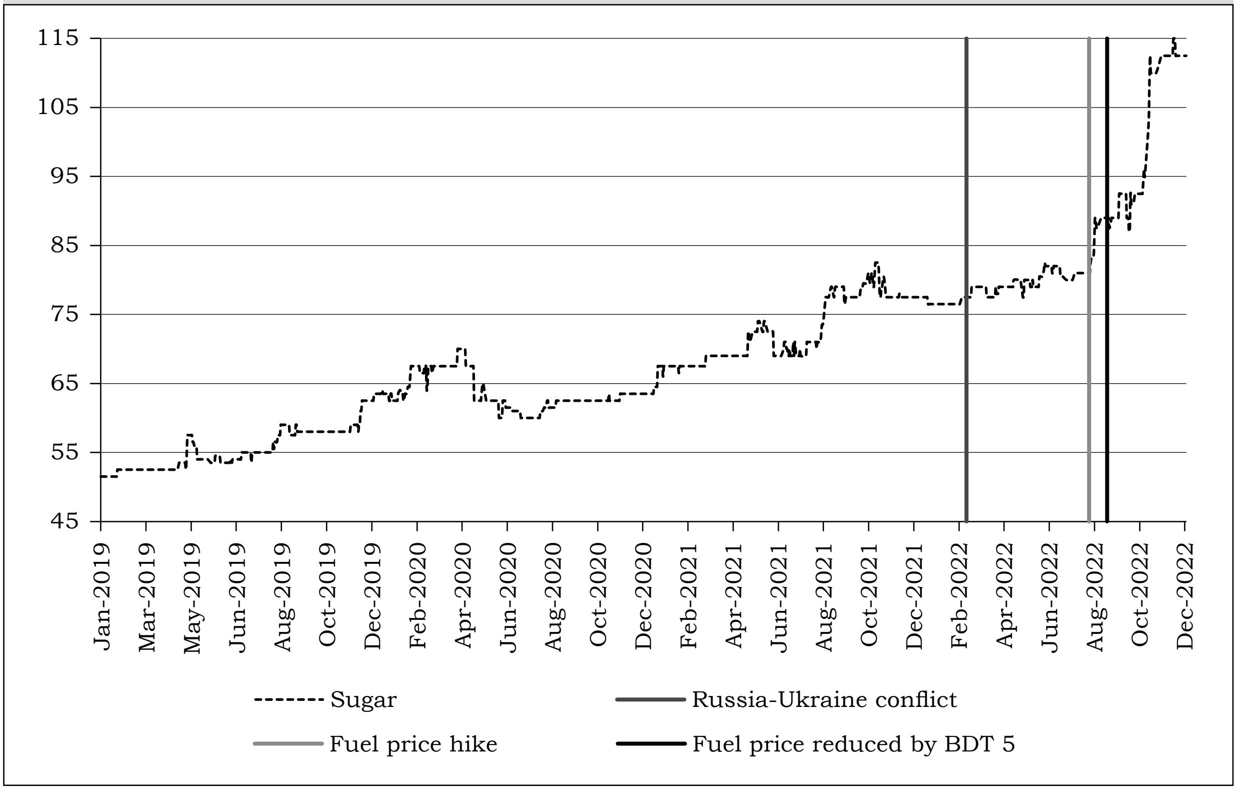
Source: CPD illustration based on data from the Bangladesh Bureau of Statistics and World Bank.

Over the past few years, the price of sugar in Dhaka has increased dramatically. The data shows that the average price of sugar increased by 116.35 per cent from BDT 52 per kg to BDT 112.5 per kg from 1 January 2019 to 11 December 2022 (Figure 3.10).

A comparison of the price of sugar in Bangladesh and the price of sugar in the European Union (EU), United States (US), and world markets shows that the price of sugar has been consistently

Figure 3.10

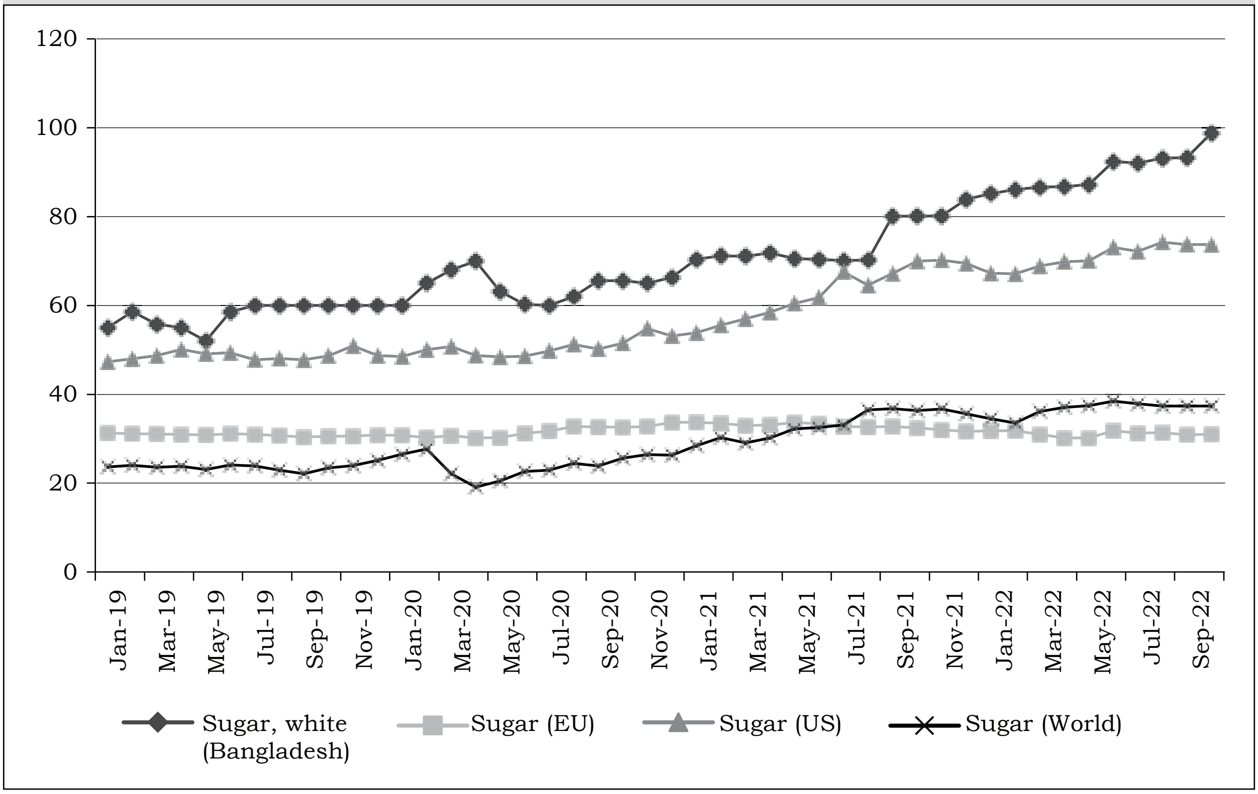
Average daily price of sugar in Dhaka from 1 Jan 2019 to 11 Dec 2022 *(BDT per kg)*



Source: CPD illustration based on data from Trading Corporation of Bangladesh.

Figure 3.11

Price of sugar in Bangladesh and international markets, Jan '19–Oct '22 *(BDT per kg)*



Source: CPD illustration based on data from the Bangladesh Bureau of Statistics and World Bank.

higher in Bangladesh than in the world market from January 2019 to October 2022 (Figure 3.11). For instance, in October 2022, the price of sugar was BDT 31 per kg in the EU market, BDT 37 per kg in the world market, and BDT 74 per kg in the US market, but BDT 98.75 per kg in Bangladesh. Moreover, while the price of sugar remained largely stable in the world market from June 2022 to October 2022, the price of sugar in Bangladesh increased during the same time.

One of the causes of the high prices of imported food items in Bangladesh has been the high incidence of tax. CPD's analysis shows that at least 29 imported essential food items currently face an increased incidence of tax (Table 3.2). High inflation has revealed the inherent weakness in the government's domestic resource mobilisation approach, mainly dependent on revenue collection from indirect taxes. The government has recently been obliged to withdraw VAT on soybean oil to prevent the price of this edible oil from increasing further. If inflation continues at the present rate, the government may be compelled to withdraw other indirect taxes on essential items as well. Thus, fiscal policy, highly dependent on indirect taxes, propagates economic inequality in society and forces the government to trade off revenue generation in the face of high inflation.

Table 3.2

High incidence of tax on some imported essential food items

DESCRIPTION	CD	SD	VAT	AIT	AT	RD	EXD	TTI
Fresh or chilled, other cuts of bovine meat with bone	25	20	0	5	0	3	0	58.6
Fresh or chilled boneless bovine meat, wrapped/canned up to 2.5 kg	25	20	15	5	5	3	0	89.3
Fresh or chilled other cuts of meat of sheep, with bone	25	20	0	5	0	3	0	58.6
Frozen cuts and offal of chicken, wrapped/canned up to 2.5 kg	25	20	15	5	5	3	0	89.3
Fish (ruhi, katla, pangash, karp & alike), excluding wrapped/ canned up to 2.5kg	25	20	0	5	0	3	0	58.6
Hilsha fish (excluding wrapped/canned up to 2.5 kg)	25	20	15	5	5	3	0	89.3
Milk & cream of greater than 1 per cent but less than or equal to 6 per cent fat, not concentrated or sweetened, wrapped/ canned up to 2.5 kg	25	0	15	5	5	3	0	58.6
Milk & cream in powder forms less than or equal to 1.5 per cent fat, concentrated or sweetened, in retail packing up to 2.5kg	25	20	15	5	5	3	0	89.3
Milk and cream in solid forms of less than or equal to 1.5 per cent fat imported by VAT registration milk and milk product	10	0	15	5	5	0	0	37.0
Milk and cream in powder, excluding powder, granules, or other solids from imported VAT-registered companies	10	0	15	5	5	0	0	37.0
Milk and cream in powder, excluding Powder, granules, or other solids from imported VAT-registered companies	10	0	15	5	5	0	0	37.0
Tomatoes, fresh	25	20	0	5	0	3	0	58.6
Onions, fresh or chilled	5	0	0	0	0	5	0	10.0
Garlic, fresh or chilled	5	0	0	2	0	0	0	7.0
Dates, fresh	0	0	0	5	5	0	0	10.0
Pepper, neither crushed nor ground	25	20	0	5	0	3	0	58.6
Cardamoms: Neither crushed nor ground, excluding wrapped/ canned up to 2.5 Kg	25	20	0	5	0	3	0	58.6
Seeds of Cumin: Neither crushed nor ground, excluding wrapped/canned up to 2.5 Kg	25	20	0	5	0	3	0	58.6
Ginger: Neither crushed nor ground, excluding wrapped/ canned up to 2.5 Kg	5	0	0	5	0	0	0	10.0

(Table 3.2 contd.)

(Table 3.2 contd.)

DESCRIPTION	**CD**	**SD**	**VAT**	**AIT**	**AT**	**RD**	**EXD**	**TTI**
Turmeric (Curcuma)	5	0	0	5	0	0	0	10.0
Other maize, excluding wrapped/canned up to 2.5 kg	0	0	0	2	0	0	0	2.0
Husked (brown) rice	15	0	0	5	5	0	0	25.8
Semi-milled or milled rice	15	0	0	5	5	0	0	25.8
Maize (corn) starch	15	0	15	5	5	20	0	67.0
Crude palm oil imported by VAT-registered edible oil refinery industries	10	0	15	0	5	0	0	32.0
Palm oil (excluding crude) & its fractions, not elsewhere specified, including refined palm oil	0	0	15	0	5	0	0	20.0
Refined palm kernel/Babassu oil & fractions, not chemically modified	25	0	15	5	5	0	0	55.0
Salt (other than pure sodium chloride) solution, salt boulder for crushing & salt in bulk	25	20	15	5	5	3	0	89.3
Sugars, pure (excluding glucose, etc.); sugar ethers, salts, etc.	10	0	15	5	5	0	0	37.0

Source: CPD compilation based on data from Operative Tariff Schedule, National Board of Revenue.

Price of Basic Food Items Beyond the Grasp of Ordinary Citizens

The price of essential food items in Bangladesh has increased exponentially over the past few years. At the same time, the wages of most workers are stagnant or growing too slowly to prevent a fall in real income. The general people of Bangladesh are going through a severe struggle and compromise due to the high food prices. To investigate whether workers earning minimum wages in Bangladesh can afford food for their families, an empirical exercise was carried out by the CPD.

Data on minimum wages of workers was collected from the Minimum Wage Board of Bangladesh. Data on prices of food items was collected from the Trading Corporation of Bangladesh (TCB), which provides the highest and lowest daily retail prices of food items in Dhaka city. The average price of food items was used and was calculated as the average of the highest and lowest prices. Data on daily food consumption was collected from the Bangladesh Urban Socioeconomic Assessment Survey.

We assume that a regular diet consists of Pijam rice, loose Aata (unprocessed flour), loose soybean oil, big Moshuri daal (lentils), local onion, local garlic, dried chillies, turmeric powder, ginger, Rui fish, beef, mutton, broiler chicken, (Marks; cheapest brand) milk powder, sugar, eggs, and salt. We also assume that a compromised diet consists of all items in the regular diet except Rui fish, beef, mutton, and broiler chicken. These diet definitions were mainly based on the dietary patterns of Bangladeshi households but were also partly driven by data availability.

We assume that each month has 30 days. We believe that each household consists of 4 individuals. We assume that there is only one earning member in each household. We assume that each individual consumes the average amount of each food item, as per the Bangladesh Urban Socioeconomic Assessment Survey.

Based on these assumptions, the average monthly cost of a basket of a ‘regular diet’ for a household of 4 persons in Dhaka city was BDT 23,676 as of 15 December 2022. Assuming that a household lives on a ‘compromised diet’ and never consumes fish, mutton, beef, or chicken, the average monthly cost of food for a household of four persons in Dhaka city was BDT 9,557 as of 15 December 2022.

Assuming a 5 per cent annual increment of the basic salary since the latest year of wage review, the minimum wage in 2022 for workers in all industries would not be sufficient to afford a ‘regular diet’ for a household of four persons (Table 3.3). Assuming a 5 per cent annual increment of the basic salary since the latest year of wage review, the minimum wage in 2022 for workers in the shrimp industry, fish and trawler industry, hotels and restaurants industry, soap and cosmetics industry, tea packaging industry, tailoring factories, cotton textile industries, bakery, biscuit and confectionery industry, automobile workshop industry, garments industry, glass and silicate industry, plastic industry, leather and footwear industry, and rice mills would not be sufficient for affording a ‘compromised diet’ for a household of 4 persons (Table 3.3). Thus, high inflation directly threatens the food security of minimum-wage workers. Hence, it is urgent to revisit and revise the minimum wages of workers in all industries immediately.

Table 3.3

Minimum wage in different industries and ability to afford average monthly cost of food

Name of Industry	Job Rank	Minimum wage in 2022, assuming a 5 per cent annual increment since the latest year of wage review	Ability to afford the average monthly cost of food for a household of four persons	
			Consuming a compromised diet without fish, beef, mutton, & chicken (BDT 9,557)	Consuming a regular diet (BDT 23,676)
Shrimp	Worker	5,616	×	×
Shrimp	Employee	6,389	×	×
Fishing & Trawler Boat Industry	Worker	6,584	×	×
Hotels & Restaurants	Worker	4,304	×	×
Hotels & Restaurants	Employee	4,304	×	×
Soap & Cosmetics	Worker	6,496	×	×
Soap & Cosmetics	Employee	6,496	×	×
Pharmaceuticals	Worker	9,293	×	×
Pharmaceuticals	Employee	9,826	✓	×
Tea Packaging	Worker	8,240	×	×
Tea Packaging	Employee	9,498	×	×
Ship Breaking	Worker	17,724	✓	×
Ship Breaking	Employee	16,695	✓	×
Tannery	Worker	14,309	✓	×
Tannery	Employee	14,309	✓	×
Tailoring Factory	Worker	5,497	×	×
Cotton Textile Industries	Worker	6,486	×	×
Cotton Textile Industries	Employee	6,486	×	×
Bakery, Biscuit & Confectionery	Worker	6,716	×	×
Bakery, Biscuit & Confectionery	Employee	7,362	×	×
Automobile Workshop	Worker	6,673	×	×
Automobile Workshop	Employee	8,612	×	×
Aluminium & Enamel	Worker	9,778	✓	×
Aluminium & Enamel	Employee	9,778	✓	×
Garments	Worker	8,884	×	×
Garments	Employee	9,312	×	×
Glass & Silicate	Worker	9,288	×	×
Glass & Silicate	Employee	9,288	×	×
Plastic	Worker	8,513	×	×
Plastic	Employee	8,513	×	×
Re-rolling Mills	Worker	11,255	✓	×
Re-rolling Mills	Employee	13,018	✓	×
Private Road Vehicles	Worker	10,766	✓	×
Private Road Vehicles	Employee	8,513	×	×

(Table 3.3 contd.)

(Table 3.3 contd.)

Name of Industry	Job Rank	Minimum wage in 2022, assuming a 5 per cent annual increment since the latest year of wage review	Ability to afford the average monthly cost of food for a household of four persons	
			Consuming a compromised diet without fish, beef, mutton, & chicken (BDT 9,557)	Consuming a regular diet (BDT 23,676)
Rice Mills	Worker	8,287	×	×
Rice Mills	Employee	8,287	×	×
Leather & Footwear Factory	Worker	7,459	×	×
Leather & Footwear Factory	Employee	8,981	×	×
Construction & Timber	Worker	16,830	✓	×

Source: Authors' calculations based on data from the Minimum Wages Board, Bangladesh Urban Socioeconomic Assessment Survey 2019, Bangladesh Household Income and Expenditure Survey 2016, Trading Corporation of Bangladesh and Numbeo.

Conclusions and Recommendations

- A new consumption basket should be formulated for calculating CPI inflation based on rigorous research as regards consumer behaviour and expenditure patterns. All targets, projections, and plans in the monetary policy and the 8th Five-Year Plan should be revised by this new consumption basket for CPI and the new base year for inflation.
- The National Board of Revenue (NBR) should consider removing the advance income tax (AIT), advance tax (AT) and regulatory duty (RD) on imported essential food items.
- The role of the Bangladesh Competition Commission needs to be strengthened, particularly in the case of the essential consumer goods market.
  o The Commission should develop a database, regularly monitor the dominant market players' operations, examine the market control and manipulation (if any), and take proper measures.
- The Bangladesh Competition Commission should adopt a strong stance against cartels and a zero-tolerance policy towards collusive practices.
- The Competition Act 2012 should be revised to address monopolies and include specific anti-trust clauses and concrete penalties for violators.
- The Minimum Wage Board should consider increasing the minimum wages in all industries so that workers earning minimum wages may at least afford basic food.
- Private sector corporations should consider a higher salary increment during increased inflationary pressure since workers must compromise their living standards.
- The sale volume of essential commodities through the open market sales (OMS) should be increased.
- Distribution of these commodities must be managed effectively and without corruption so eligible people can access these items at low prices.
- The government should provide direct cash support to people experiencing poverty, enhance social protection for low-income families, and extend stimulus to small businesses for survival during challenging times.

3.3. BANGLADESH EXTERNAL SECTOR: COPING WITH EMERGENT CHALLENGES

3.3.1 The context

Bangladesh's external sector has traditionally been a key pillar of the country's positive development narrative. This was reflected in comfortable balance of payments (BOP) position underpinned by high levels of foreign exchange reserves, exchange rate stability, robust export performance, and steady remittance growth. The rising forex reserves catered to the increasingly growing demands of a high performing economy with impressive Gross Domestic Product (GDP) growth. The robust external sector earnings helped to underwrite consumer demands and development needs of both public and private sectors, smooth debt servicing and contributed to sustaining Bangladesh's macroeconomic stability.

However, in the very recent period, several fault lines have emerged in the aforesaid narrative which have given rise to serious concerns as regards Bangladesh's macroeconomic stability. The external sector has come under considerable pressure encompassing all its critical components, manifested in depleting foreign exchange reserves and the consequent erosion of import capacity, significant weakening of the Bangladeshi Taka (BDT) against all major currencies and high rates of imported inflation.

The emergent situation was not difficult to anticipate in June 2022 when the budget for FY2023 was presented. At a time when the economy was coming out of the worst impacts of the Covid pandemic, other factors had cropped in. The Russia-Ukraine war which started in February 2022 pushed the global commodity prices through the roof and it was not difficult to anticipate that balance of trade will take a major hit because of the global price rise. In spite of this, the budget for FY2023 appears to have been formulated on the understanding that the Bangladesh economy was either isolated or immune from the global economic volatilities, and that the country would be spared the adverse consequences of the war and the developments in the global economy. The GDP growth rate for FY2023 was projected to be at 7.5 per cent, inflation was forecasted at 5.4 per cent and all key indicators were anticipated to follow historical trends. As the economy at present crosses the halfway mark of FY2023, all the projections and anticipations are proving to be wrong.

The policymakers of Bangladesh appear to have been caught off-guard by the developments in the global economy and are having to resort to fire-fighting measures to address the emergent challenges. The difficulties facing by the external sector has percolated to other areas weakening the entire edifice of Bangladesh's macroeconomic management–import restrictions had to be put in place that led to production and investment disruptions, deferred payment is resulting in supply-side shortages which could undermine the food and energy security and the dual pressure of dollar depreciation and imported inflation led to significant erosion of purchasing power of fixed income earning people, marginalised communities and even the middle income groups. To repeat, the knock-on adverse impacts and negative spillovers from the external sector has weakened macroeconomic stability which was a key mainstay of Bangladesh economy and a major driver of its formidable socio-economic achievements of the recent past years.

Whilst global factors did accentuate the country's economic woes, it is argued here that the underlying reason also originate from a number of policy failures which have accumulated over time; not everything can be explained by externally originated factors. These concerned a number of areas: exercise of autonomy and independence by the central bank, forex reserves management, exchange rate adjustment, dealing with significant capital flight from the country, lack of energetic measures to diversify both export basket and export markets, slow growth of remittances through formal channels, and overall quality of external sector and financial sector management.

Thus, whilst global factors feature prominently in giving rise to the emergent situation, the underlying factors arise also from several embedded weaknesses in macroeconomic management. Appropriate lessons should be drawn if Bangladesh is to come out of the current situation, which if not checked early on, could plunge the economy into deeper crisis.

3.3.2 Forex reserve situation

The falling forex reserves proved to be the Achilles heel of the economy of Bangladesh (Table 3.4). Recent developments have underscored the need to consider not just the gross but also the net forex reserves. The argument is that net reserves provide a better and more appropriate measure of the import capacity of a country. This was insisted upon by the International Monetary Fund (IMF) as well some time back. However, contesting this, Bangladesh Bank (BB) chose to ignore the evidence on the ground. An explanation was promised to be forthcoming which indeed never came. Now the central bank, as part of the IMF recommendation has agreed to publish the net forex figures on a regular basis. As is the case, IMF has now set quantitative targets for this (for the months of March and June 2023). The significant amount of foreign exchange that went to the Export Development Fund (worth about USD 7.5 billion at one point) as also the loan extended to Sri Lanka (USD 200.0 million) were to be excluded from the net forex reserves estimates.

Table 3.4
Factors contributing to forex reserves drawdown

B.O.P. Components	FY2023 VS FY2022, July-October (in billion USD)
Current Account Balance of which, Trade Balance	(-) 0.667 (-) 0.427
Capital Account Balance	(+) 0.007
Financial Account Balance	(-) 2.828
Overall Balance	**(-) 3.533**

Source: Based on Bangladesh Bank data.

Gross foreign reserves have now come down from USD 46.5 billion to USD 35.8 billion; in terms of months of imports from 6.2 months to 5.2 months. If the net reserves are considered, the current forex reserve would be equivalent to about four months of import payments. This happened in the face of high price of imported commodities, slow export and remittance growth and the reversals experienced by capital and financial sector balance. When reserves faced drawdown in the face of global price hikes and higher import payment for letter of credit (L/C) openings, the dearth of accessible forex reserves became increasingly evident.

3.3.3 Balance of payments

As Table 3.5 shows, the balance of payment for the first four months of FY2023 (July–October) shows the overall balance coming down by USD 3.5 billion with consequent drawdown on gross reserves.

Table 3.5
Balance of payments

B.O.P. Components	FY2023 VS FY2022, July–October (in billion USD)
Current Account Balance	(-) 0.667
of which, Trade Balance	(-) 0.427
Capital Account Balance	(+) 0.007
Financial Account Balance	(-) 2.828
Overall Balance	**(-) 3.533**
Gross Reserves	(-) 10.65
Net Reserves	(-) 10.65

Source: Bangladesh Bank and Bangladesh Bank-IMF negotiations documents.

Several short-term measures are needed to contain the risks facing the external sector. Whilst the rise in the import payments for capital machineries could be due to one-time bulk imports for mega projects, there is a need for greater surveillance of import payments to forestall over-invoicing, particularly because import duties on capital machineries are mostly zero (or very low) and consequently, the possibility of over-invoicing (and through it, capital flight) cannot be ignored. Bangladesh Bank has also unearthed incidences of under-invoicing in case of imports with a view to avoid customs duties, through payments abroad by transferring money through hundi/howla informal channels. The import categorisation made by Bangladesh Bank should be made in a more transparent manner, and the respective headings, according to HS codes, should be made public to avoid miscategorisation to avoid custom duties. It is not enough to stop payments when over- and under-invoicings are detected by Bangladesh Bank, as has been the case in recent years. Legal measures must be taken, relevant laws enforced, and violators ought to be brought to justice to transmit the right signals to the perpetrators.

3.3.4 Export earnings

Over the July-November period of FY2023, exports have registered a decent 10.9 per cent growth over the corresponding period of FY2022. However, this is informed by some underlying factors that need to be looked at more closely. Firstly, rise of raw material costs meant higher export prices. This contributed to higher growth of export earnings compared to the corresponding period of the previous year. Secondly, Bangladesh's exports are mostly driven by performance of the RMG sector while growth of most non-RMG items are in the negative terrain. Thirdly, export of RMG has mostly been driven by volume rather than value, although prices of most raw materials manifested significant rise in the global market, as was noted above.

The demand-side implications of the war and recessionary trends in major trading partner countries of Bangladesh also have contributed to muted external sector performance.

Estimations presented in Table 3.6 and Table 3.7 reveal the volume-driven nature of export earnings quite clearly.

Table 3.6

US market: Volume, price, and value changes of RMG export in percentages, 2021 vs 2022 (July–September)

HTS Code	Value	Volume	Per unit price
Knitwear (61)	18.8	-1.3	20.3
Wovenwear (62)	45.0	26.3	14.8
Overall	**34.6**	**12.3**	**19.8**

Source: Estimation based on USITC.

Table 3.7

EU market: Volume, price, and value changes of RMG export in percentages, 2021 vs 2022 (July–September)

HTS Code	Value	Volume	Per unit price
Knitwear (61)	39.11	20.38	23.52
Wovenwear (62)	39.52	21.52	22.94
Overall	**39.25**	**20.74**	**23.35**

Source: Estimation based on USITC.

The estimations clearly reveal the primarily volume-driven nature of export earnings as against primarily price-driven growth. As may be recalled, the prices of all inputs for production of apparels (cotton, yarn, and fabrics) have risen significantly during March–June 2022 period. However, brands, retailers and buyers have been able to pass on a large part of this on to producers and exporters in Bangladesh. This once again reinforces the argument for taking steps to raise the bargaining power of Bangladesh's concerned exporters and suppliers and the need to strengthen the forward linkage of export-oriented RMG industry of the country.

3.3.5 REMITTANCE FLOWS

The trends in remittance flows do not correspond to the trends in overseas employment of the recent past. The muted growth of remittance flows during the July-November period of FY2023, with a lowly 2.1 per cent (over the corresponding period of FY2022), does not match the significantly high number of migrant workers who had left for overseas jobs during the recent past period. Bangladesh Bank's supportive policies (higher exchange rate, 2.5 per cent cash incentives, relaxation in producing earnings documents, waiver of bank charges, allowing higher forex retention, etc.) also appear not to have delivered the expected results (Table 3.8).

Between January 2021 and October 2022 more than 1.56 million people have left Bangladesh for overseas job markets. There has also been no sign of unusually large number of returnee migrants. Thus, this outflow has no doubt led to an increase in the size of stock of migrant workers in concerned destination countries. A large part of these workers (about 1.3 million or more than four-fifths) went to countries in the Middle East. Surprisingly, in spite of high migrant flows, remittances came down significantly from some Middle East countries in the first five months of FY2023 compared to the corresponding period of FY2022. For example, although more than a million people have gone to Saudi Arabia over the last 18 months, remittances from the country came down by about USD 462.0 million in the first five months of FY2023 compared to the corresponding period of FY2022. On the other hand, remittance from Kuwait rose by USD

Table 3.8

Overseas employment and remittance inflow by major countries

Country	Overseas employment	Remittances inflow (in million USD)		Remittance growth (July-November)	
	January 2021–October 2022	July–November 2021	July–November 2022	Change year-on-year (in million USD)	Year-on-year growth (per cent)
Saudi Arabia	1001001.00	2065.04	1602.68	-462.36	-22.39
United Arab Emirates	118310.00	700.14	661.99	-38.15	-5.45
Kuwait	17568.00	694.78	1143.56	448.78	64.59
Oman	199890.00	419.09	269.39	-149.7	-35.72
Qatar	30913.00	568.96	615.2	46.24	8.13
Singapore	81570.00	170.34	146.03	-24.31	-14.27
UK	613.00	733.99	760.2	26.21	3.57
US	NA	1423.79	1538.32	114.53	8.04
Total	**1565082.00**	**8608.87**	**8793.12**	**184.25**	**2.14**

Source: Estimated from BMET, Bangladesh Bank.

448.7 million over the same period although the corresponding number of migrant workers was only about 17 thousand.

There is a need for a deeper investigation as regards the factors driving the fall in remittance flows from particular countries in the Middle East (e.g., Saudi Arabia, UAE) while this was not the case for other countries in the region (e.g., Kuwait). In all likelihood, the significant difference between formal and informal (hundi/howla) exchange rates may have created an added incentive for the diversion of remittance flows from formal to informal channels this indicates that in certain countries hundi/howla syndicates remain very active and they are taking advantage of the exchange rate differences.

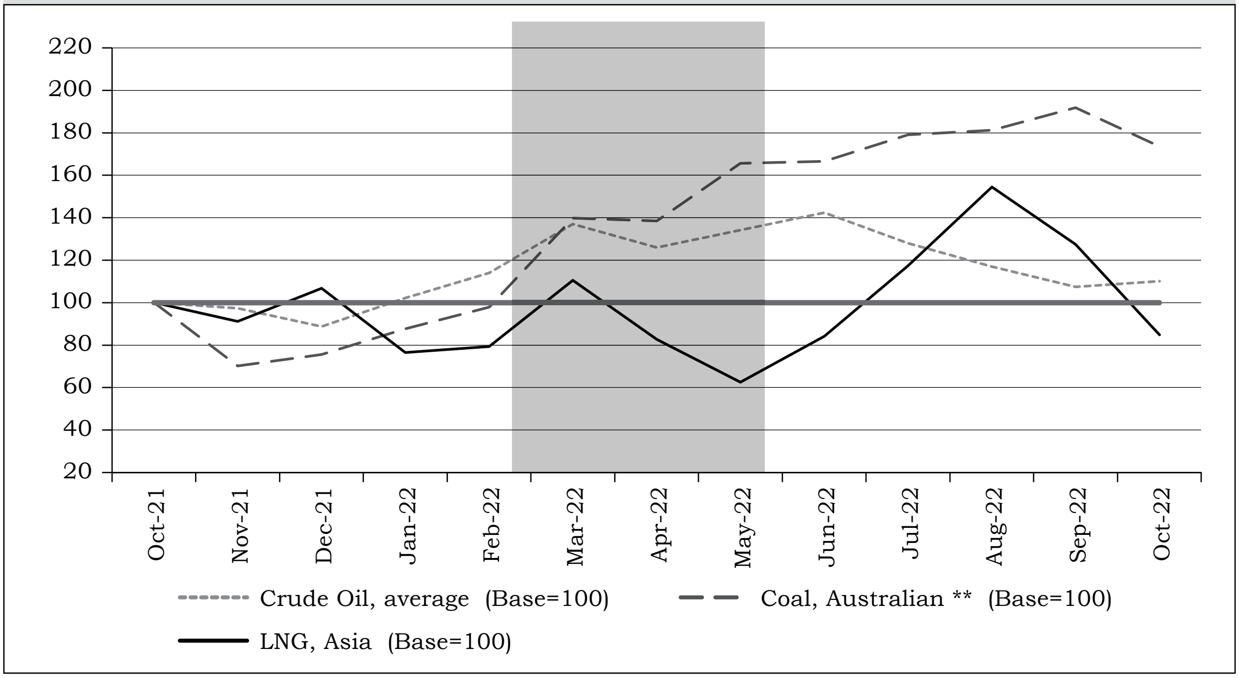
It is to be noted that the recent changes in the exchange rate for remittances (BDT 107 per USD plus the 2.5 per cent cash incentive) have significantly reduced the margin between formal exchange rate and the curb market rate in Bangladesh. To what extent the difference in the rates between the formal and informal hundi/howla market rates still persists remains an issue for speculation, although the margin must have somewhat reduced significantly in recent times.

Bangladesh Bank will need to keep the emergent scenario under constant monitoring and vigilance and both exchange rate management and enforcement of relevant laws particularly against hundi/howla syndicates will be critically important in this regard.

The policy of reining-in imports through various tools appears to be paying off though: While L/Cs settled during Q1 (July-September) of FY2023 rose by 31.6 per cent (an increase of about USD 5.39 billion), compared to the corresponding period of FY2022, L/C opening came down by 8.6 per cent (a drop of USD 1.72 billion). One can infer that L/C settlement in Q2 of FY2023 is expected to come down significantly with lower import payments and somewhat of an easing of pressure on forex reserves.

Figure 3.12

Fuel (crude oil, LNG, coal) price trends since October 2021

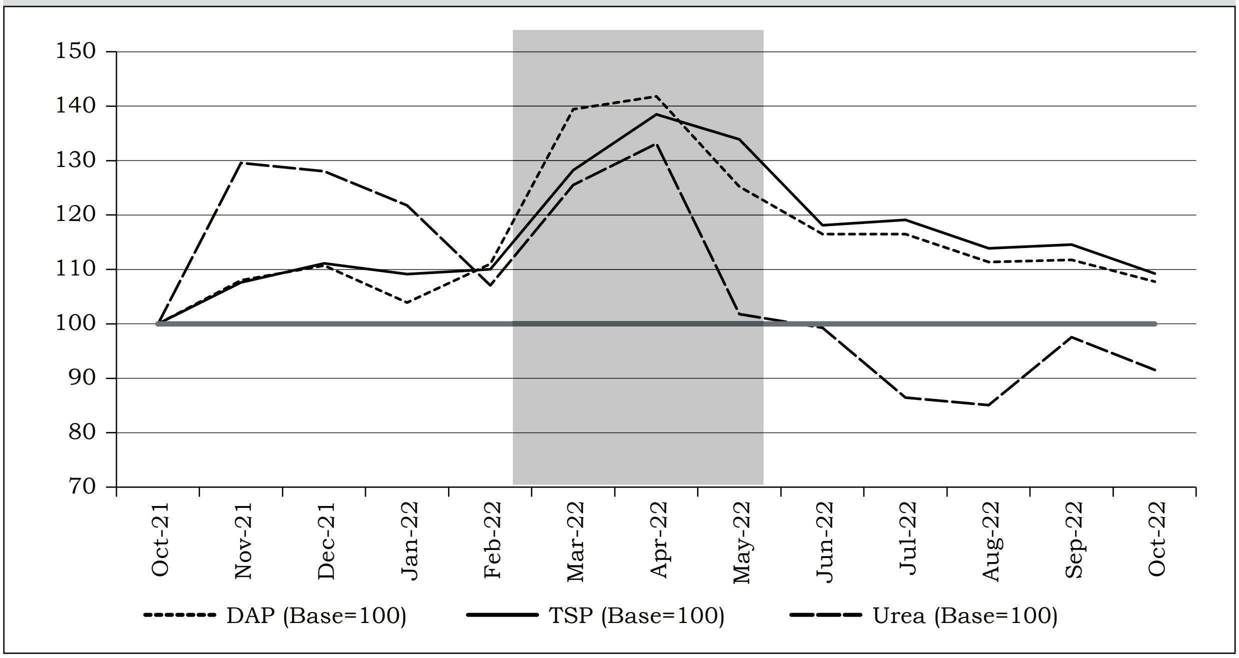


Source: World Bank Pink Sheet.

Note: Prices in October 2021 or the base price is assumed to be 100 for ease of comparison. Shaded region marks the three months after Russia invaded Ukraine in February 2022.

Figure 3.13

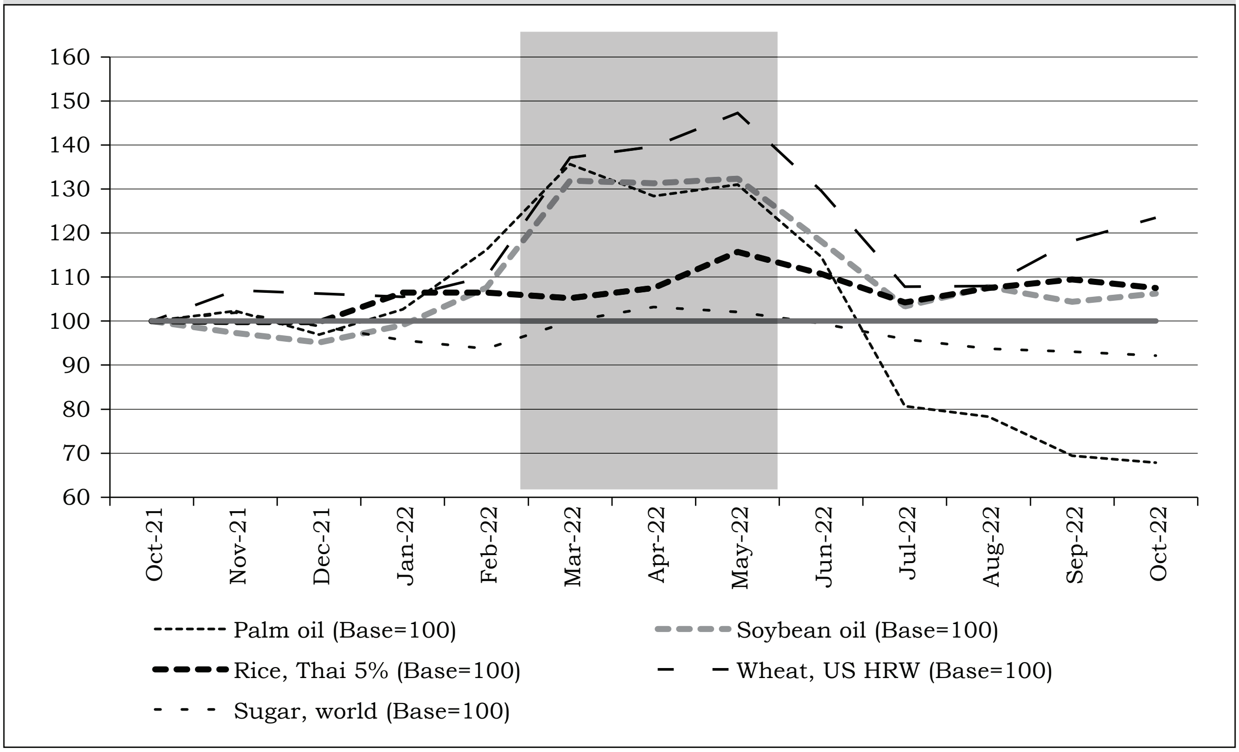
Fertiliser (DAP, TSP, urea) price trends since October 2021



Source: World Bank Pink Sheet.

Note: Prices in October 2021 or the base price is assumed to be 100 for ease of comparison. Shaded region marks the three months after Russia invaded Ukraine in February 2022.

Figure 3.14
Food grains (rice, sugar, wheat) and edible oil (soybean and palm) price trends since October 2021

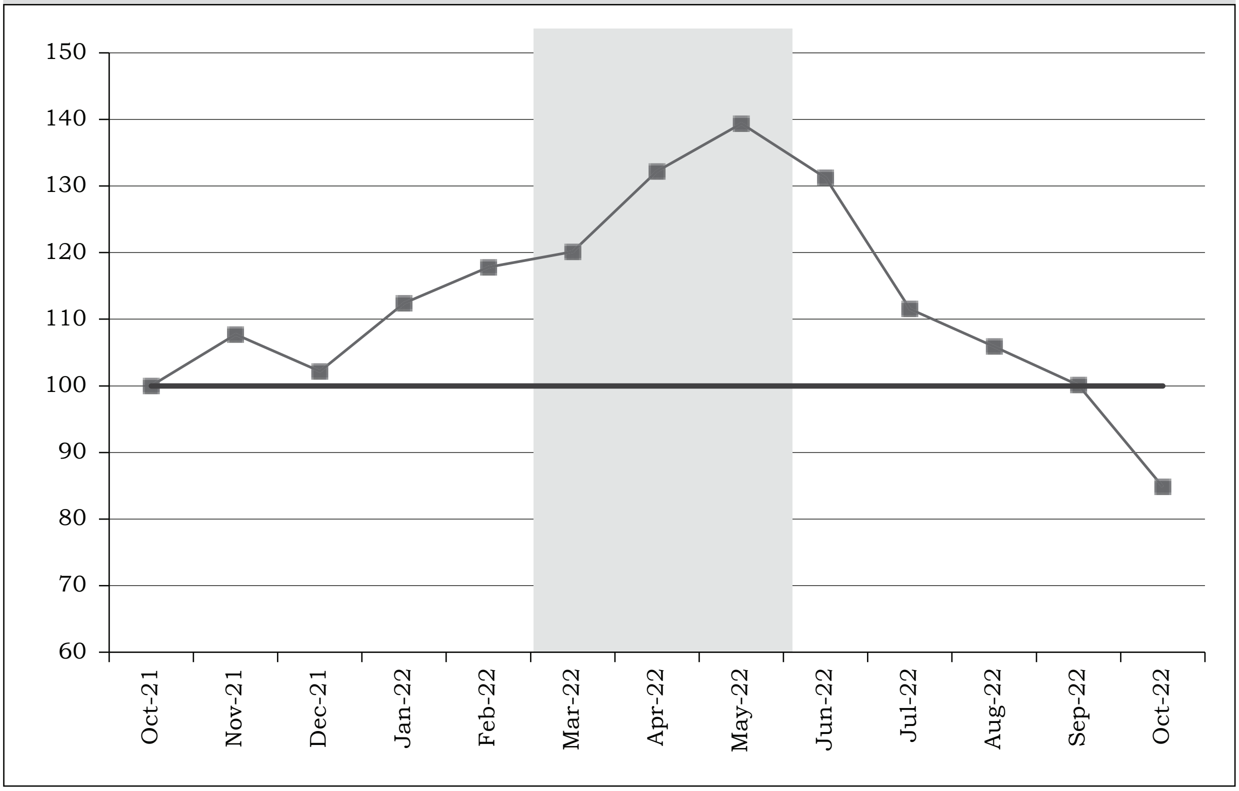


Source: World Bank Pink Sheet.

Note: Prices in October 2021 or the base price is assumed to be 100 for ease of comparison. Shaded region marks the three months after Russia invaded Ukraine in February 2022.

Figure 3.15

Cotton price trends since October 2021



Source: World Bank Pink Sheet.

Note: Prices in October 2021 or the base price is assumed to be 100 for ease of comparison. Shaded region marks the three months after Russia invaded Ukraine in February 2022.

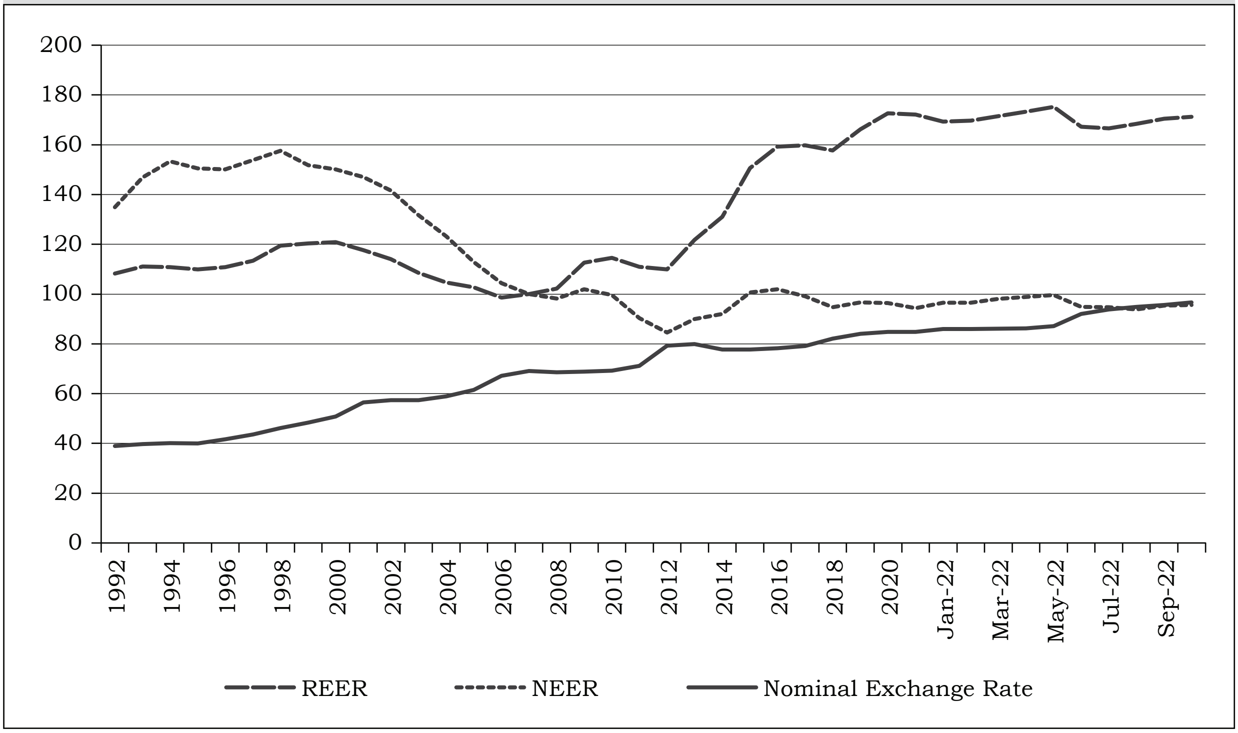
3.3.6 Global price trends

Demand-side impact on imports, induced by higher global prices and depreciation-induced price rise, are some of the reasons underlying the prevailing high inflation. The silver lining is that the global prices appear to have peaked already, and have started to come down, as can be seen from the following global price trends of some of the key commodities (Figures 3.12 – 3.15) for which Bangladesh is highly dependent on imports.

The price trends shown in Figure 3.12 – 3.14 indicate that the pressure on import payments is likely to ease in the near-term future. Together with the positive impacts of some of the restrictions put in place by the BB and the GoB, this will help arrest the rise in import payments. However, efficient market management (from import to consumers/producers/retail level and from farm gate to consumer/producer/retail level) will be important if domestic inflation rates are to be brought down in a sustainable way. In the past, failure in these areas have meant that syndications and market manipulations by unscrupulous traders have led to prices staying at high levels in spite of global commodity prices coming down. It is also to be recognised that import restrictions are likely to induce a low-level equilibrium in the economy, resulting in subdued investment with adverse labour market consequences and falling level of GDP growth.

Figure 3.16

REER vs NEER vs nominal exchange rate (Bangladesh)



Source: For REER and NEER, data from Bruegel was used. For Nominal exchange rate, data from Bangladesh Bank, Reserve Bank of India and World Development Indicators were used.

3.3.7 Exchange rate movements

As can be seen from Figure 3.16, the real effective exchange rate (REER) of BDT had appreciated significantly over the past few years, particularly between 2012 and 2021. This resulted in the undermining of export competitiveness vis-à-vis major currencies and created a disincentive for remitters. Following the depreciation of the BDT vis-à-vis major currencies, the overvaluation of the BDT as depicted by the recent past movements of REER and nominal effective exchange rate (NEER), appears to have reduced significantly.

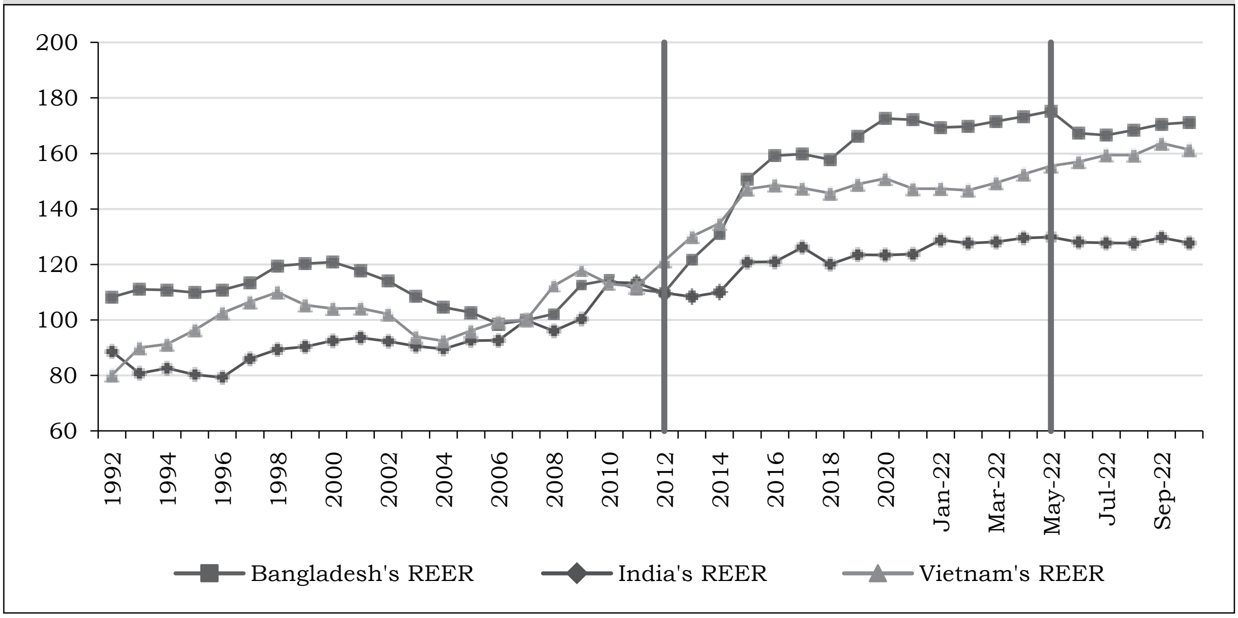
Indeed, as Figure 3.17 indicates, Bangladesh's REER was relatively the highest compared to India and Vietnam.

Thanks to recent significant depreciation of the BDT, the difference in NEER has come down with some of the competitor countries such as Vietnam and India (Figure 3.18).

The exchange rate movement indicates that the significant and rising discrepancy between the REER, NEER, and Nominal Exchange Rate (NER) of BDT appears to have significantly narrowed down in recent times (Figure 3.19). It appears that the NER is closing the gap with what would be the exchange rate had it been market-determined. It is reckoned that time has come for Bangladesh to shift from managed-float to a free-float regime. The free-float regime will necessitate dealing with the issue of imported inflation through better co-ordination of monetary and fiscal policies,

Figure 3.17

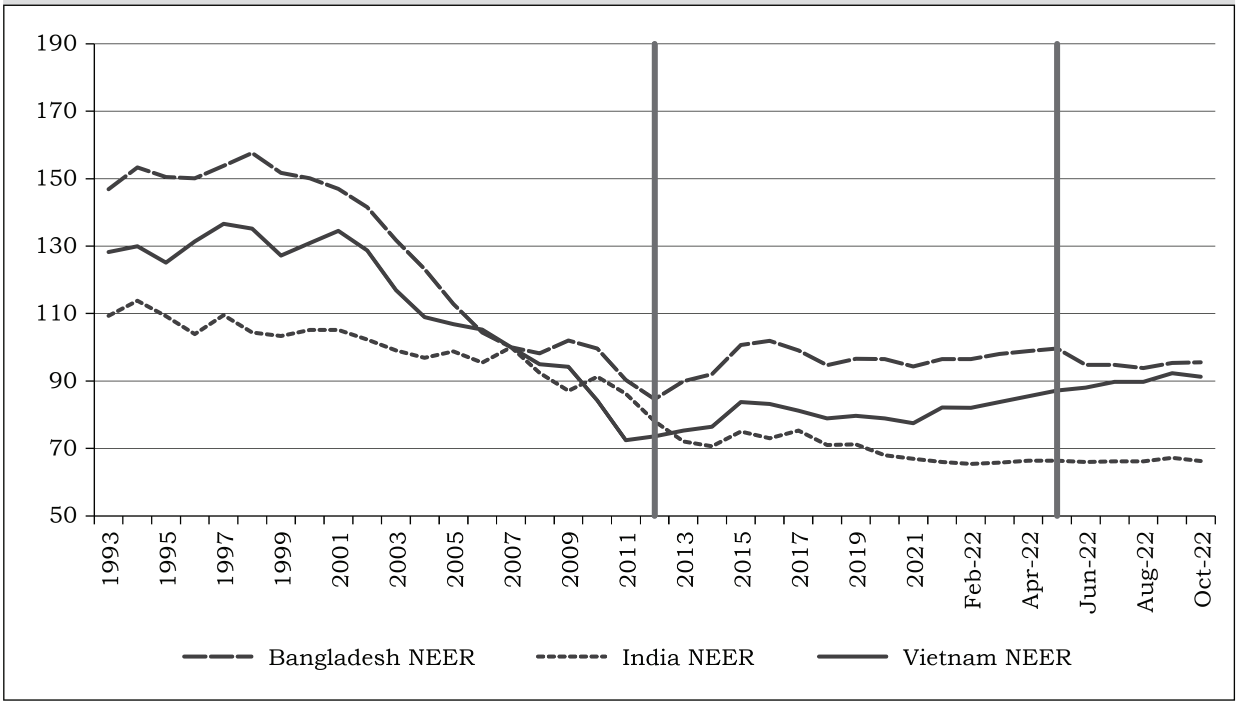
REER across Bangladesh and its competitors over the years (1992–2022)



Source: For REER and NEER, data from Bruegel was used. For Nominal exchange rate, data from Bangladesh Bank, Reserve Bank of India and World Development Indicators were used.

Figure 3.18

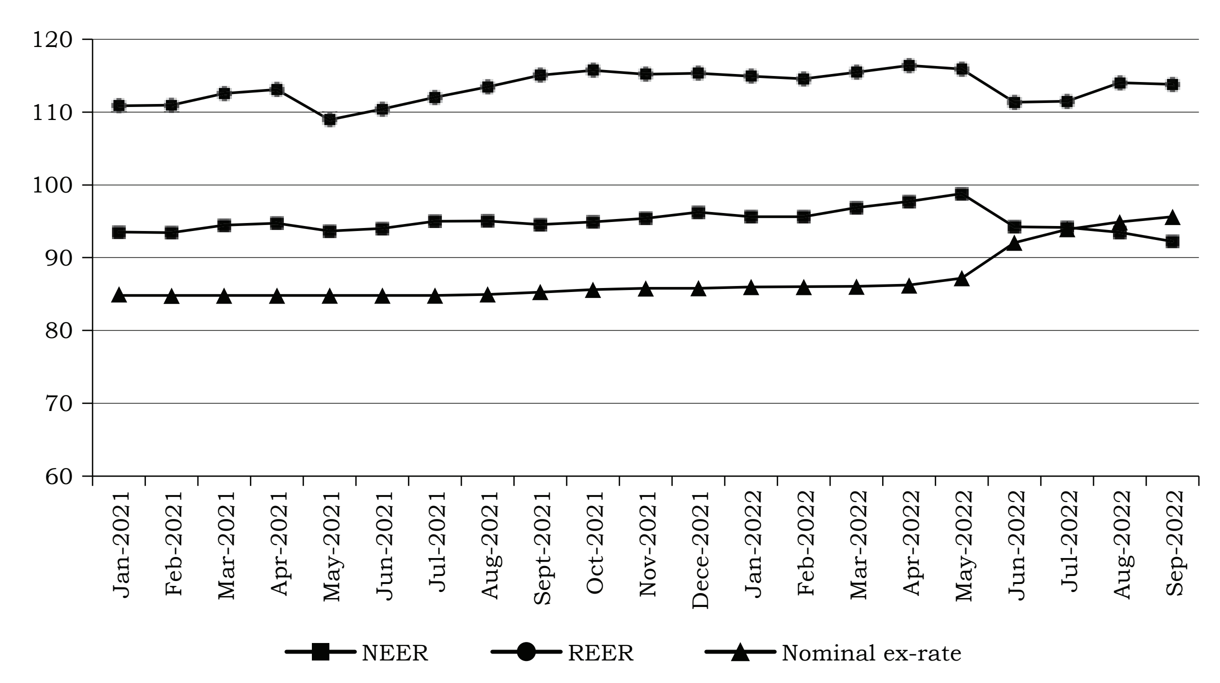
NEER for Bangladesh and its competitors over the years (1992–2022)



Source: For REER and NEER, data from Bruegel was used. For Nominal exchange rate, data from Bangladesh Bank, Reserve Bank of India and World Development Indicators were used.

Figure 3.19

Bangladesh's monthly REER vs NEER vs NER since January 2021



Source: Bangladesh Bank.

strengthening of social safety net programmes, extension of OMS programmes and, if required, targeted rationing.

3.3.8 Going forward

It needs to be understood that the Bangladesh's B.O.P support by the IMF is equivalent to less than 5.2 per cent of Bangladesh's corresponding import payment needs (of about USD 36 billion), when compared to corresponding loan tranche of about less than USD 700.0 billion every six months. True, the IMF recommendations are geared to improving fiscal-monetary management and is expected to attract other potential development partners. However, as the size of the support would indicate, it is the efficacy of macroeconomic management and the expected positive spillovers in the economy on which the economic outcomes will hinge in the coming months. The risks facing the Bangladesh economy will not go away even when the global prices come down, a trend that has already set in. Drastic import cuts, deferment of payment to creditors and the trend growth of remittance and export will likely improve the trade and current account balance. However, this will have adverse impact on economic growth. Also, as the B.O.P scenario indicates, the villain in the piece is primarily the Finance Account balance which is experiencing fast deterioration and has fallen into negative terrain in many years. Bangladesh's Finance account balance has been positive primarily thanks to robust flow of foreign funds in the form of capital account, trade credit and fund flows. In the face of depreciated Bangladeshi Taka, many trade credits are being settled early on, and in view of falling credit rating new lines of credit are also not being opened as before. Every effort should be made to accelerate deployment of foreign loans in the pipeline, particularly those that have lower import components and are more geared to domestic expenditure.

However, the key to robust external sector performance lies in the efficacy and good governance in overall macroeconomic management. Particularly in view of Bangladesh's upcoming LDC graduation with consequent significant preference erosion, and because of the middle-income transition with the consequent rise in costs of borrowings, the demand on the quality of macroeconomic and monetary management will rise manifold over the near-term future.

Bangladesh Bank's role as monetary policy regulator and capacity to exercise its independent and autonomous role has been put under close scrutiny in view of recent developments. It will need to take urgent steps to move away from its managed exchange rate policy, take energetic measures against capital flight and enforce its oversight function. Transparency in data generation and access to data produced by the Bangladesh Bank will also be a necessity.

Servicing of foreign debt, till now comfortably managed, could add new dimensions to the emerging challenges in connection with reserves management, particularly in the backdrop of maturing of some of the hard term loans of the recent past. The growing private sector foreign loan, (though not backed by sovereign guarantee but backed primarily by bank guarantee) has added a new dimension to the debt discourse. The demand for foreign currency available in the market will rise, with consequent ramifications for exchange rate movements. This needs to be factored into the country's exchange rate management strategy.

The depreciation of BDT will have important implications for debt servicing, both public and private, particularly for loans taken to underwrite projects that generate revenue in local currency (e.g., energy projects). Both debt liabilities and rate of internal, financial, and economic returns should be re-estimated in view of this, and business plans revisited, to ensure proper debt servicing.

As is known, the IMF has come up with several recommendations as regards exchange rate management, debt default and debt management, banking sector reforms, domestic resource mobilisation, overall monetary sector management, and data transparency. Many of these call for serious attention and urgent decision on the part of policymakers. Many of the IMF-supported steps have been articulated and voiced repeatedly by economists and experts for quite some time now. Reforms and concrete measures in view of these must be subject to open and transparent debates and discussions, keeping in the perspective both short-term needs of the economy and medium to long-term strategic interests of the country.

3.4 CRISIS IN THE POWER & ENERGY SECTOR: FEW PROPOSALS FROM CLEAN ENERGY PERSPECTIVE

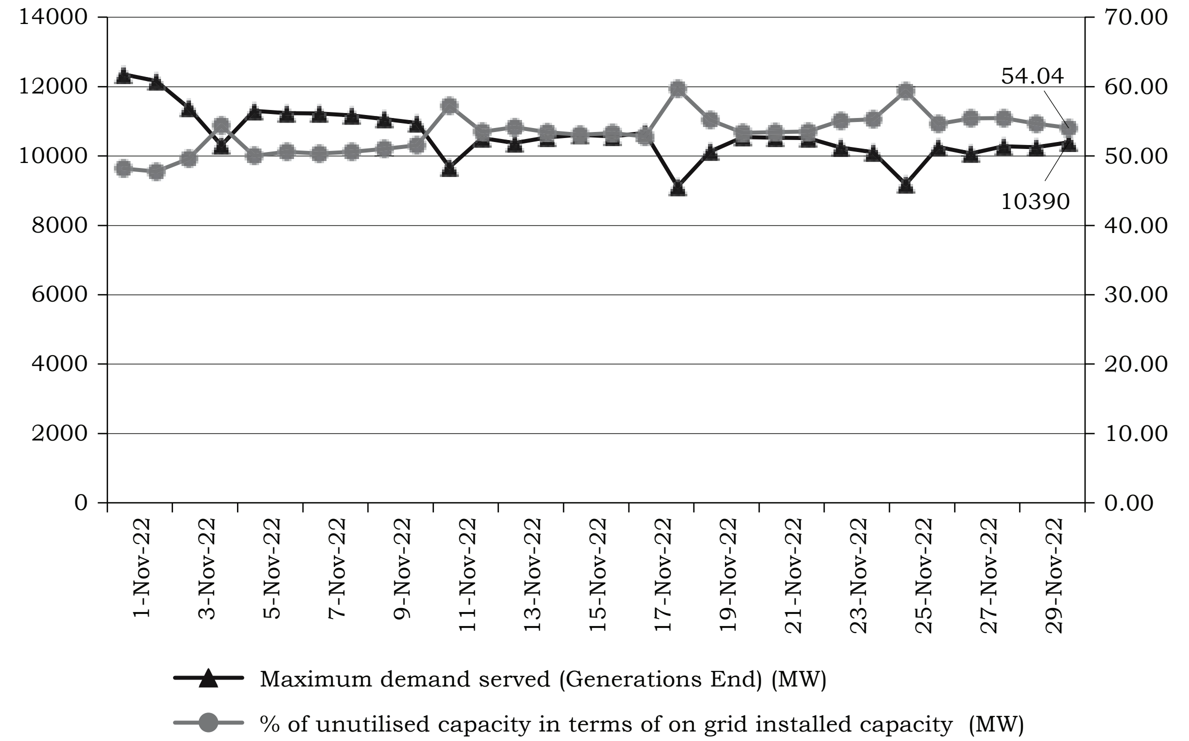
3.4.1 Current state of the power and energy sector

There has been a substantial mismatch between the demand and supply in the power and energy sector. The total power generation capacity is currently 25,826 MW of which 22,608 MW is on-grid and 3,218 MW is off-grid (as of December 2022), whereas the maximum power demand from the generation's end was 12350 MW (Figure 3.20). This huge power generation capacity has become a growing concern for the power and energy sector as the maximum demand has not increased at the same pace over the years. Excess reserve capacity in November 2022 was as high as 13,493 MW (60 per cent) against the total on- grid installed capacity of 22,608 MW.

The increasing gas demand has been partially met by the import of liquefied natural gas (LNG). The price spike in global LNG market resulted in halting Bangladesh's LNG import from the spot market since July 2022. Against the daily LNG demand of 3,500–4,000 mmcfd, about 82.6 per

Figure 3.20

Power sector demand and overcapacity scenario in November 2022



Source: Prepared by authors from Bangladesh Power Development Board (BPDB) data.

cent (2,800–2,900 mmcfd) could be supplied from long-term LNG contracts with Qatar and Oman. The government has also requested Qatar to increase the LNG supply to Bangladesh. However, Qatar declined the plea to increase its supply of LNG before 2025. As government has undertaken initiatives to explore new and old gas wells with an expected daily maximum generation of gas of 335 mcf. Bangladesh Petroleum Corporation (BPC) was struggling to make payments for refined oils as it was not getting enough dollars. However, the dollar crisis has been resolved for the nonce and BPC is being able to import the required fuel and meet the demand.

Overall, the ongoing energy crisis is not a short-term but a medium to long-term crisis for the country. The government has limited fiscal space to address these crises particularly through importing fuel. Hence, the Centre for Policy Dialogue (CPD) puts forward some medium to long-term suggestions from the perspective of development of clean energy in the country.

3.4.2 Few proposals from a clean energy perspective

Amid the prevailing medium to long-term crisis, this study has come up with a short to medium-term energy mix scenario for 2023-2025 from a clean energy perspective. The GoB has recently announced to completely phase out diesel-based power plants and gradually phase out furnace oil-based power plants. Additionally, plans have been made to install rooftop solar photovoltaics (PVs) in primary schools and convert diesel irrigation systems into solar irrigation systems. Considering all these decisions and the upcoming plans, this study has sketched up the fuel mix scenario for the next three periods.

Year 1 (January–June 2023): During the first six months, the composition of the power and energy supply will be as follows:

a) The fuel mix will remain same except for some additional 978 MW of renewable energy
b) Installation of solar rooftop PVs in the primary schools will be initiated targeting to complete in 5 years (in line with government's commitment)
c) Transformation of diesel irrigation systems to solar irrigation systems will be initiated targeting to complete in 5 years (in line with government's commitment)

Year 2 (July 2023–June 2024): During the next one year, the composition of the power and energy supply will be as follows:

a) Substantial amount of renewable energy-based power generation will be included in the fuel mix
b) 1/5th of the installation of solar rooftop PVs in the primary schools will be completed
c) 1/5th of the transformation of diesel irrigation systems to solar irrigation systems will be completed
d) All High-Speed Diesel (HSD) based power plants will be phased out (in line with government's commitment)
e) Heavy Fuel Oil (HFO) based power plants will start to phase out gradually (in line with government's commitment)

Year 3 (July 2024–June 2025): During the next one year, the composition of the power and energy supply will be as follows:

a) A major share of energy mix will be based on renewable energy
b) Another 1/5th (a total of 2/5th) of the installation of solar rooftop PVs in the primary schools will be completed
c) Additional 1/5th (a total 2/5) of the transformation of diesel irrigation systems to solar irrigation systems will be completed
d) A substantial amount of HFO based power plants will be phased out gradually (in line with government's commitment)

Table 3.9 presents the estimated demand for electricity between 2023 and 2025; and possible energy-mix. According to Bangladesh Power Development Board (BPDB) estimate, the demand for electricity will increase from 14,417MW in 2023 to 16,482 MW in 2025. If the investment for energy particularly for renewables as well as phasing out from the fossil-fuels take place as per the commitment of the government, a substantial change in the energy mix would take place even in short period of time. The share of renewables would increase from as low as 5 per cent in 2023 to as high as 26 per cent in 2025. This would cause a major reduction of share of fossil-fuel based energy in power generation particularly in HFO (from 31 per cent to 9 per cent).

Table 3.9

Power demand projection and estimated fuel mix under three different scenarios (MW)

Energy-mix	**Year 1 (June 2023)**		**Year 2 (June 2024)**		**Year 3 (June 2025)**	
	Total electricity demand (MW)	**Per cent of fuel mix**	**Total electricity demand (MW)**	**Per cent of fuel mix**	**Total electricity demand (MW)**	**Per cent of fuel mix**
Total demand	14,417.0	100.0	14,983.0	100.0	1,6482.0	100.0
Coal	2,192.0	15.2	2,804.0	18.7	2,804.0	17.0
HFO	4,500.0	31.2	3,023.0	20.2	1,413.0	9.0
Gas	5,273.0	36.6	5,740.0	38.3	5,597.0	34.0
Hydro-power	50.0	0.4	50.0	0.3	50.0	0.3
Diesel	650.0	4.5	0.0	0.0	0.0	0.0
Nuclear	0.0	0.0	600.0	4.0	1,200.0	7.3
Renewable	717.0	4.9	1,717.0	11.5	4,194.0	26.0
Imported electricity	1,050.0	7.3	1,050.0	7.0	1,050.0	6.4

Source: Authors' calculation.

3.4.3 Estimation of resources

The study observed that a substantial amount could be saved by the BPDB by phasing out fossil fuel-based power plants and thereby not providing capacity payments to the independent power producers (IPPs) particularly rental and quick rental (QRRs) power plants. However, a considerable amount of investment will be required for the development of renewable energy-based power plants. The estimates showed that even though in short-term it may appear that investment in renewable energy-based power generation is not economically viable, but in the medium-term it will be a profitable business plan which would save substantial amount of resources.

During the Year 1 (January-June 2023), the resource that could be saved from phasing out of different fossil fuel-based power plants and not paying the capacity charges to those power plants, is likely to be much lesser compared to that of investment required for implementing renewable energy-based power plants such as solar PV. As Table 3.10 postulates, during this period an estimated USD 567.1 million can be saved against an investment of USD 4,503 million in renewable energy.

During the second year (FY2024), the savings of resources by phasing out of different fossil fuel-based power plants would be higher than the investment to be required for setting up renewable energy-based power plants. As all the HSD-based power plants would be completely phased out as per the government's plan and HFO-based power plants will be started to phase out, a hefty amount of resources will be saved from not importing liquid fuel for these power plants. Moreover, phased out of these IPPs including those which are established under the QRRs will save money for not paying capacity charges. As it is shown in Table 3.11, a total amount of USD 7,324 million can be saved during this year. Against this savings, the investment required for renewable energy-based power generation would be USD 6,275 million. Overall, a significant amount (USD 1,049 million) can be saved, according to the estimates.

Table 3.10

Estimates of resources in year 1

Year 1	**Resources Saved (mln. USD)**	**Subsidy Saved (mln. USD)**	**Year 1**	**Required Investment (mln. USD)**
Diesel	613.9	0.0	Renewable Energy	2,121.9
Oil	1,540.0	0.0	Solar Based Rooftop	147.0
Power	0.0	413.1	Solar Based Irrigation	2,234.4
Sub-total in Y 1	2,153.9	413.1	Total in Y1	**4,503.3**
Total in Y1	**2,567.1**		–	–

Source: Estimation based on USITC.

Table 3.11

Estimates of resources in year 2

Year 2	**Resources Saved (mln. USD)**	**Subsidy Saved (mln. USD)**	**Year 2**	**Required Investment (mln. USD)**
Diesel	1,093.1	–	Renewable Energy	3,894.0
Oil	1,540.0	–	Solar Based Rooftop	147.0
Power	–	4,691.2	Solar Based Irrigation	2,234.4
Sub-total in Y2	2,633.1	4,691.2	Total Y2	**6,275.4**
Total in Y2	**7,324.4**		–	–

Source: Authors' calculation.

During the third year (FY2025), the subsidy to be paid for the power sector will be dropped substantially after phasing out of all the remaining HSD-based and HFO-based power plants. By the end of FY2025, no subsidy will be required for oil-based power plants. Overall, less subsidy will be required for power generation. Similar to the previous year, a total investment of USD 5,454 million would be required for investing in renewable energy-based power generation shown in Table 3.12.

Recently, the news of the demanded additional amount of subsidy has created a confusion regarding the 'actual' requirement of subsidy for this sector. A total of BDT 56,858 crore has been demanded only in the power and energy sector in addition to the already allocated BDT 23,000 crore in the national budget for FY2023.[1] The additional subsidy demanded in the power and energy sector seems to be unrealistically high. As per our estimation, only 42 per cent of the demanded additional subsidy may be required.

[1] https://www.tbsnews.net/economy/subsidy-pressure-triples-BDT16-lakh-crore-imports-remain-costly-549838#lg=1&slide=0

Table 3.12
Estimates of resources in year 3

Year 3	**Resources Saved (mln. USD)**	**Subsidy Saved (mln. USD)**	**Year 3**	**Required Investment (mln. USD)**
Diesel	1,093.1	–	Renewable Energy	3,072.8
Oil	1,540.0	–	Solar Based Rooftop	147.0
Power	–	3,651.5	Solar Based Irrigation	2,234.4
Sub-total in Y3	2,633.1	3,651.5	Total Y3	**5,454.1**
Total in Y3	**6,284.6**		–	–

Source: Estimation based on USITC.

Table 3.13
Additional resource estimates

	Additional Demanded (Crore BDT)	**Estimated Resource Required (Crore BDT)**	**Estimated Resource Saved (Crore BDT)**
Power	32,500	28,248	4,252
Oil	19,358	0	19,358
LNG	5,000	5,000	0
Total	**56,858**	**33,248**	**23,610** (42% of the additional demand)

Source: Authors' calculation.

Table 3.13 presents the additional resource demanded and estimates resources to be required for the power plants. As of November 2022, BPC has a gross profit of BDT 1,041.6 crore/USD 100.8 million. Hence the required subsidy for the BPC is likely to be zero. In FY2024, there will be a substantial reduction in subsidy for HSD as the diesel plants will be totally phased out and HFO will be partially phased out. In the following year, there would be a substantial reduction in subsidy for diesel as the diesel plants will be totally phased out and furnace oil will be fully phased out in the next year.

3.4.4 Recommendations

Amid the crisis in the power and energy sector, a clean energy-based power sector is found to be resource efficient which could generate required electricity as well as could save resources. In this regard, the following initiatives could be undertaken by the Ministry of Power Energy and Mineral Resources (MoPEMR).

a. Emphasis should be given to gas exploration in domestic gas fields: The government should emphasise gas exploration in the new and old gas fields instead of increasing import of LNG under short, medium, and long-term. The government should take initiatives to further expedite foreign investment for drilling on-shore and off-shore gas blocks.

b. Dependency on long-term LNG contracts should also be reduced: LNG-based power generation should not be encouraged further. LNG purchases from the spot market should be halted as this is a costly option in the current context. In this context, government should not consider reducing the LNG tariff as such a decision would only encourage additional LNG import which will deprive the government in getting revenues from import tariffs.

c. BPDB/SREDA/IDCOL should aggressively look for foreign financers and investors in the renewable energy sector: In order to implement the government-led initiatives on establishing rooftop solar in primary schools and solar based irrigation system, a substantial amount of investment will be required. The BPDB/SREDA/IDCOL should aggressively look for foreign financers and investors in order to implement these plans. Such tariff can generate revenues for investing in renewables.

d. The IPPs, rental and quick rentals power plants should be phased out immediately: The fossil fuel-based power plants which are in the process of retirement as per contract should not get renewal/extension further. Besides, the BPDB should come out with a workplan to gradually phase out the IPPs, rental and quick rental power plants. This would save resources in terms of not to pay capacity charges and thereby not to take loan as subsidy. Implementation of such a plan would save the forex reserve as requirement of forex will be less for importing fuels.

e. Contracts of private power plants, rental and quick rental power plants should be revisited and reviewed: The BPDB must revisit the existing IPP contracts that are yet to retire after July 2023, especially, the clauses on capacity payment and the tariff per kwh at which PDB is buying electricity from IPPs should be reviewed.

3.5 BANKING SECTOR

Banking sector displays fragility

The banking sector of Bangladesh has been suffering from various challenges for several years. High loan default and poor performance in other indicators have repeatedly revealed the banking sector's weaknesses. Due to poor governance and lack of reforms, the banking sector of Bangladesh has continually exhibited its fragility, which poses risks to the economy. Unfortunately, the government's promises for strengthening the banking sector are still unfulfilled. In the face of repeated frauds, irregularities and heists, the measures taken by the government appear to be too little or too late. This section briefly presents the performance of some key indicators in recent periods and makes a few recommendations to overcome the challenges.

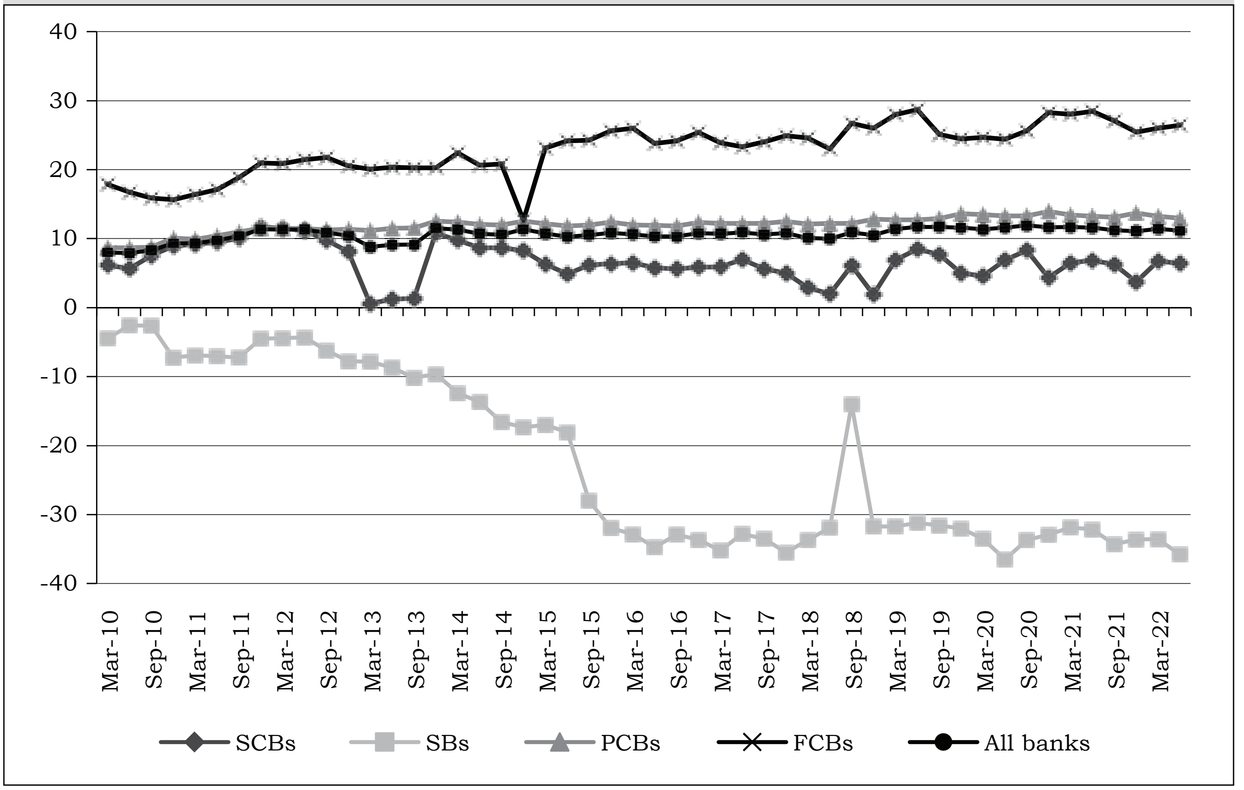
Capital inadequacy of banks

Bangladesh Bank's Guidelines on Risk-Based Capital Adequacy states banks must maintain a minimum total capital ratio of 10 per cent (or minimum total capital plus capital conservation buffer of 12.5 per cent) by 2019, in line with BASEL III. However, state-owned commercial banks (SCBs) have failed to maintain minimum capital adequacy requirements for the past 10 years (Figure 3.21). On the other part, the specialised banks[2] (SBs) have remained critically under-capitalised. Without reducing Non-performing Loans (NPLs), capital adequacy cannot be improved since higher levels of NPLs lead to increased provisioning requirements, which results in capital shortfall.

[2]Specialised banks in Bangladesh are sometimes referred to as development finance institutions (DFIs).

Figure 3.21

Capital to risk-weighted asset ratios *(in per cent)*



Source: CPD illustration based on data from Bangladesh Bank.

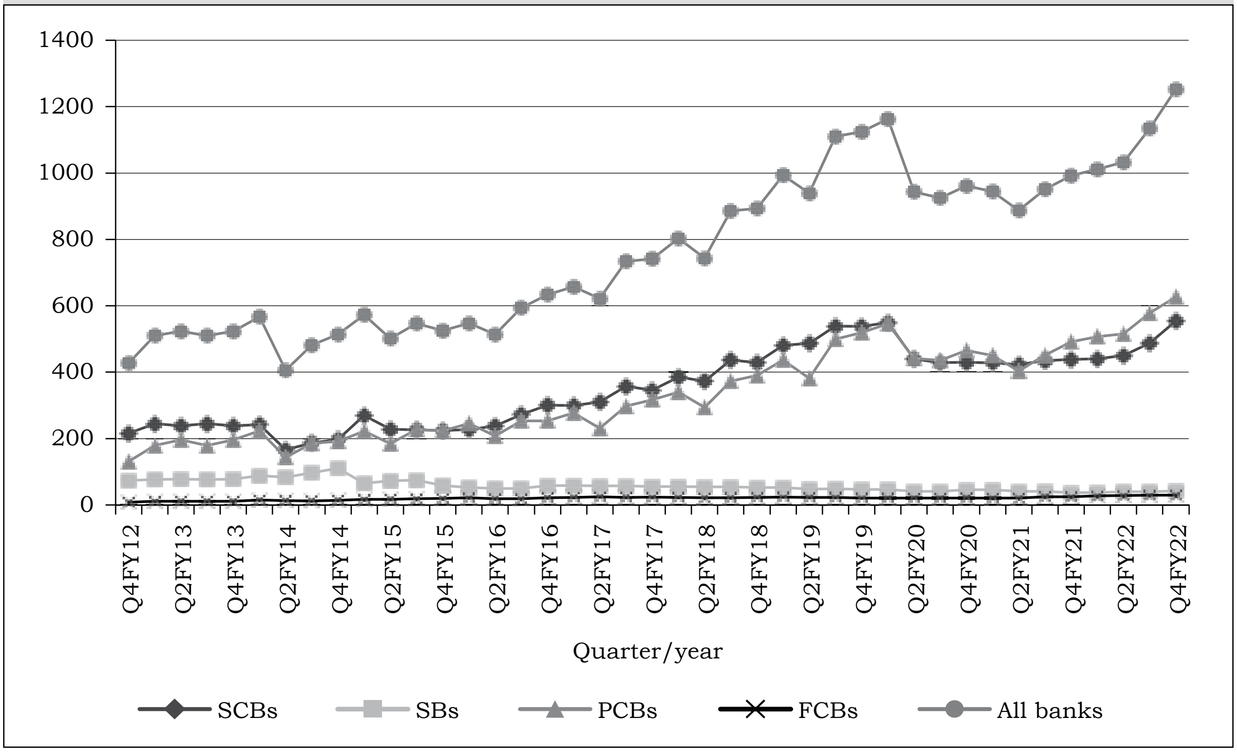
High volume of non-performing loans (NPLs)

NPLs are a direct threat to a country's financial health and development. NPLs may appear innocuous, occurring merely because borrowers cannot repay loans associated with high interest. However, studies have shown that, in general, high-interest rates are not causally related to high levels of NPLs in Bangladesh (Ahmed & Islam, 2006) (Mujeri & Younus, 2009) (Hossain, 2012). For small and medium enterprises (SMEs), high-interest rates could be a reason behind NPLs (Jahan, 2016).

The reality is that NPLs originate from uncertainty and corruption, both of which have detrimental effects on the growth of the banking sector of a country (Park, 2012) (Moshirian & Wu, 2012) (Lin, 2012) (Serwa, 2010). Research has shown that the reasons behind the high amount of NPLs in Bangladesh include political instability, corruption, poor governance, and weak rule of law (Banerjee, et al., 2017) (Alam, Haq, & Kader, 2015). Poor management of state-owned commercial banks, coupled with malpractices and corruption, has contributed to the high levels of NPL (CPD, 2018a and CPD, 2018b). Contrary to all established banking norms, state-owned commercial banks (SCBs) have been awarding loans purely on political grounds (Habib M. N., 2017). Consequently, these banks do not routinely assess the potential risks associated with the borrower. Creditworthiness is judged by political worthiness. As a result, having good political credentials is perceived to be adequate to obtain large loans. Additionally, the government's tendency to fund loss-making state-owned enterprises, through SCBs has aggravated the problem of NPLs even further. Research has shown that, on average, only 33 per cent of first-time and 30

Figure 3.22

Total classified loans *(in billion BDT)*



Source: CPD illustration based on data from Bangladesh Bank.

per cent of third-time rescheduled loans were recovered during 2011–2014 (Habib M. N., 2017). Over the same period, loans worth BDT 455.274 billion were written off by the banking sector. Evidence has also emerged that only 14 per cent of bank officials consider the borrower selection process extremely effective (Habib M. N., 2017).

The total volume of NPL has increased by more than three times in the last 10 years, from BDT 427.25 billion in Q4FY12 to BDT 1,343.96 billion in Q1FY23 (Figure 3.22). However, actual NPL will be much higher if loans in special mention accounts, loans with court injunctions, and rescheduled loans are included.

Reasons behind NPLs

Based on the review of the past literature and analysis of the developments in the banking sector, a conceptual framework explaining the reasons behind high NPLs in the banking sector was developed. Under this conceptual framework, the factors influencing NPLs were classified under four categories: i) institutional; ii) regulatory; iii) legal; and iv) data and informational (Figure 3.23).

Factors driving NPLs under the institutional category included: i) bank directors, CEOs and senior officials placed and controlled by the government (Islam, 2017) (Alo, 2018) (Khatun, 2012) (Khatun & Saadat, 2019); ii) loans sanctioned on political grounds (Parven, 2011) (Khatun, 2012) (Habib M. N., 2017); iii) rescheduling of loans despite poor record of repayment (Habib M. N., 2017) (Khatun, 2018) (CPD, 2019); iv) writing off loans to reduce tax burden and clean balance sheets (Khatun, 2018) (CPD, 2019); v) weak internal control and compliance risk management of banks

Figure 3.23

Reasons behind the high volume of non-performing loans in Bangladesh

Causes of NPL

Institutional

- Appointments of bank directors, often based on political connections
- Loans sanctioned on political grounds
- Rescheduling of loans despite poor record of repayment
- Writing off loans to reduce tax burden and clean balance sheets of banks
- Weak internal control and compliance risk management of banks
- Inability of some banks to comply with BASEL III requirements

Regulatory

- Lack of independence of the Central Bank
- Dual regulation by the Financial Institutions Division and the Central Bank
- Flexibilities given to defaulters by the Central Bank
- Bank licenses given arbitrarily to crony capitalists
- Recapitalisation of banks by the government
- Quasi-monopolistic power of few bank oligarchs

Legal

- Amendments of Banking Company Act to favour vested interests
- Weaknesses in Financial Loan Court Act
- Loopholes in Bankruptcy Act
- Delays in judicial process and long backlog of cases
- Insufficient number of judges dealing with loan cases
- Lenient legal stance against willful defaulters

Data and information-related

- Limited access to timely data
- Apprehensions regarding quality of data
- Absence of disaggregated data
- Low reflection of data use in decision-making and policy measures
- Lack of transparency about use of data in decision-making process
- False information, forged documents and fake companies used for obtaining loans

Source: CPD illustration based on review of secondary literature.

(Chowdhury, 2010) (Khatun, 2012) (Habib S. M., 2019); and vi) inability of some banks to comply with BASEL III requirements (Habib S. M., 2019) (Khatun, 2018) (CPD, 2019).

Factors driving NPLs under the regulatory category included: i) dual regulation by the Financial Institutions Division and the Central Bank (Reaz & Arun, 2006) (Khatun, 2012) (Khatun, 2018) (CPD, 2019); ii) lack of independence of Central Bank (Reaz & Arun, 2006) (Khatun, 2012) (Khatun, 2018) (CPD, 2019); iii) privileges given to defaulters by the Central Bank (CPD, 2019); iv) bank licenses given arbitrarily to crony capitalists (Nabi, 2016) (Khatun, 2018); v) recapitalisation of banks by the government (Khatun, 2018) (CPD, 2019); and vi) quasi-monopolistic power of few bank oligarchs (Haque, Jalil, & Naz, 2007) (Reaz & Arun, 2006) (Khatun, 2018) (Khatun & Saadat, 2019).

Factors driving NPLs under the legal category included: i) amendments to Banking Company Act to favour vested interests (Khatun, 2018) (CPD, 2019); ii) weaknesses in Financial Loan Court Act (Adhikary, 2006) (CPD, 2019); iii) loopholes in Bankruptcy Act (Ahmed, Zannat, & Ahmed, 2017) (CPD, 2019); iv) lenient legal stance against wilful defaulters and corrupt bank officials (Islam, 2018) (Habib S. M., 2019); v) insufficient number of judges dealing with loan cases (Khatun, 2018) (CPD, 2019); and vi) delays in judicial process and long backlog of cases (Adhikary, 2006) (Khatun, 2018).

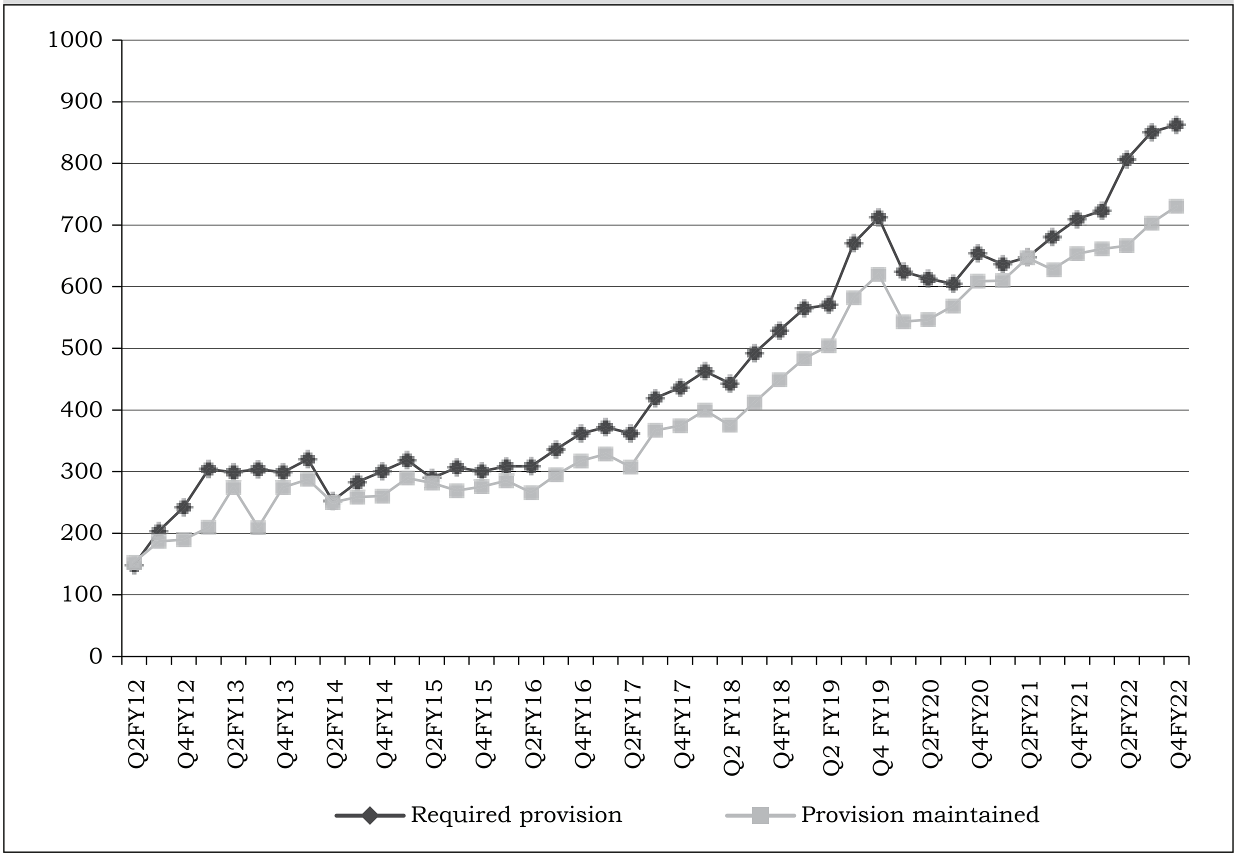
Factors driving NPLs under the data and informational category included: i) limited access to timely data (Chowdhury, 2010) (CPD, 2019); ii) apprehensions regarding the quality of data (Habib S. M., 2019) (CPD, 2019); iii) absence of disaggregated data (Chowdhury, 2010) (CPD, 2019); iv) low reflection of use of data in decision-making and policy measures; v) lack of transparency about use of data in decision-making process; and vi) false information, forged documents and fake companies used for obtaining loans (Khatun, 2012) (Habib S. M., 2019). Table 2 illustrates this conceptual framework of the nexus between governance and NPLs.

The shortfall in loan loss provisioning requirements

On a bank's balance sheet, provisions are assets put aside to cover losses expected to occur in the future. As of Q4FY22, the required loan loss provisioning was BDT 862.68 billion, whereas the actual loan loss provisioning maintained was only BDT 730.48 billion (Figure 3.24).

Figure 3.24

Loan loss provisioning, required Vs. actual *(in billion BDT)*

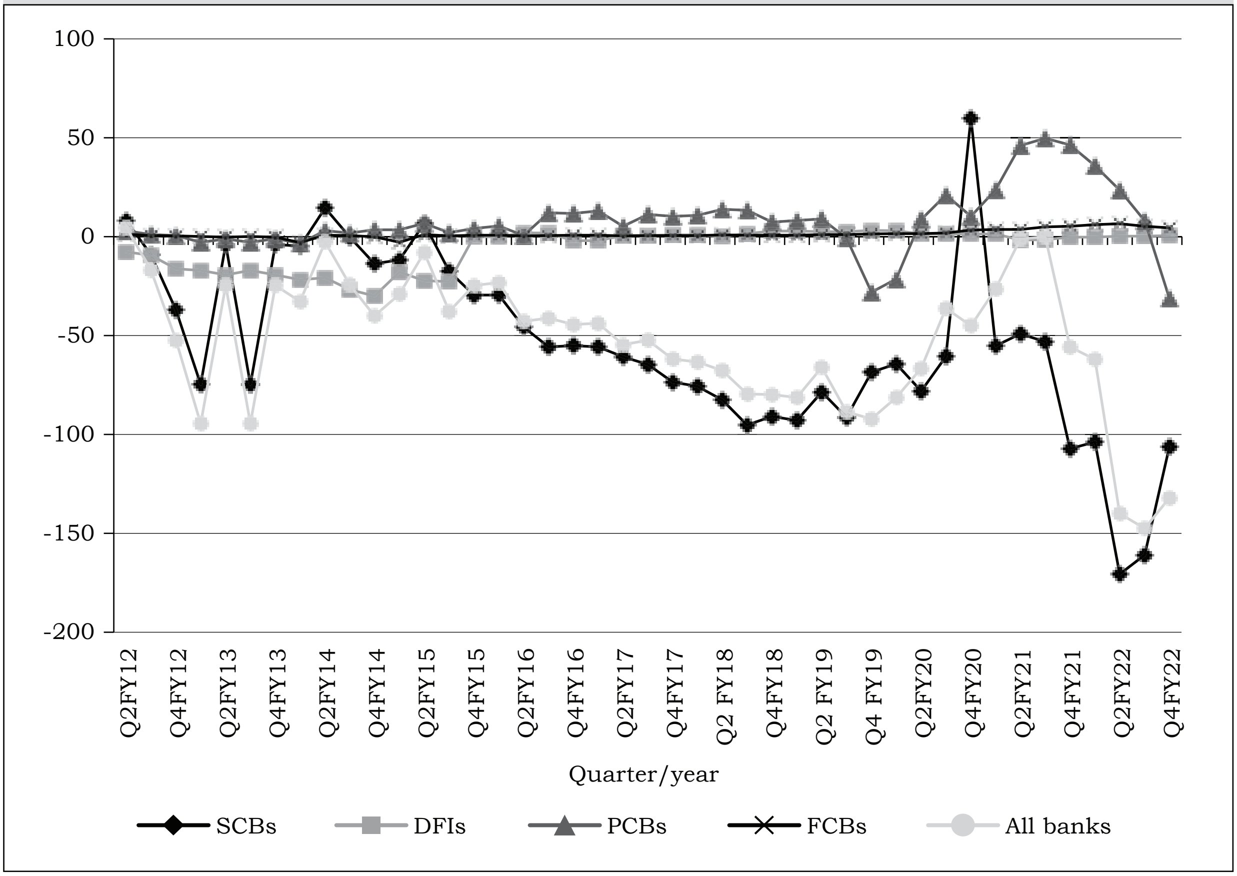


Source: CPD illustration based on data from Bangladesh Bank.

In Q4FY22, there was a BDT 132.2 billion shortfall in loan loss provisioning in the banking sector, including a BDT 106.2 billion shortfall in SCBs and a BDT 31.1 billion shortfall in PCBs (Figure 3.25).

Figure 3.25

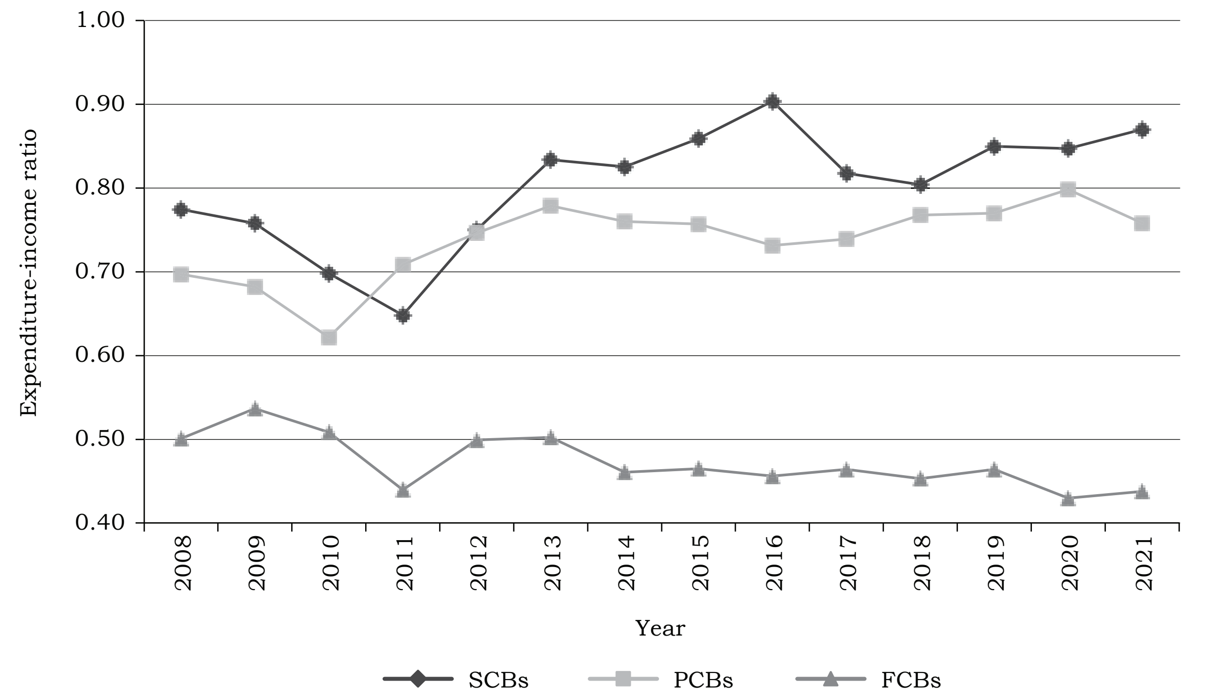
Excess or shortfall in loan loss provisioning *(in billion BDT)*



Source: CPD illustration based on data from Bangladesh Bank.

From 2008 to 2021, the average expenditure-income ratio was 0.80 in SCBs and 0.74 in PCBs. This reveals the poor management effectiveness of both SCBs and PCBs, even prior to the start of the pandemic (Figure 3.26).

Figure 3.26
Expenditure-Income ratio *(in per cent)*



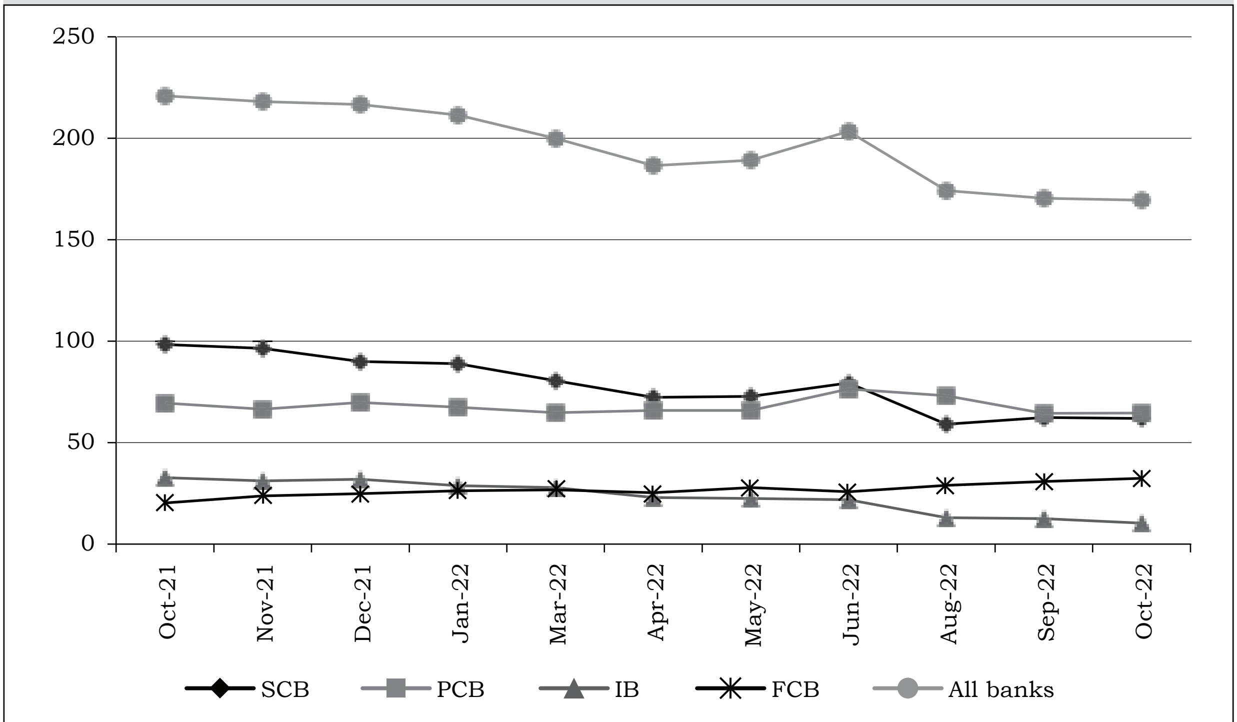
Source: CPD illustration based on data from Bangladesh Bank.

The decline in liquidity of banks

Excess liquidity in the banking sector has declined from BDT 220,866 crore in October 2021 to BDT 169,556 crore in October 2022 (Figure 3.27). Excess liquidity as a share of the total liquid assets of the banking sector declined from 49 per cent in October 2021 to 41 per cent in October 2022 (Figure 3.28).

Figure 3.27

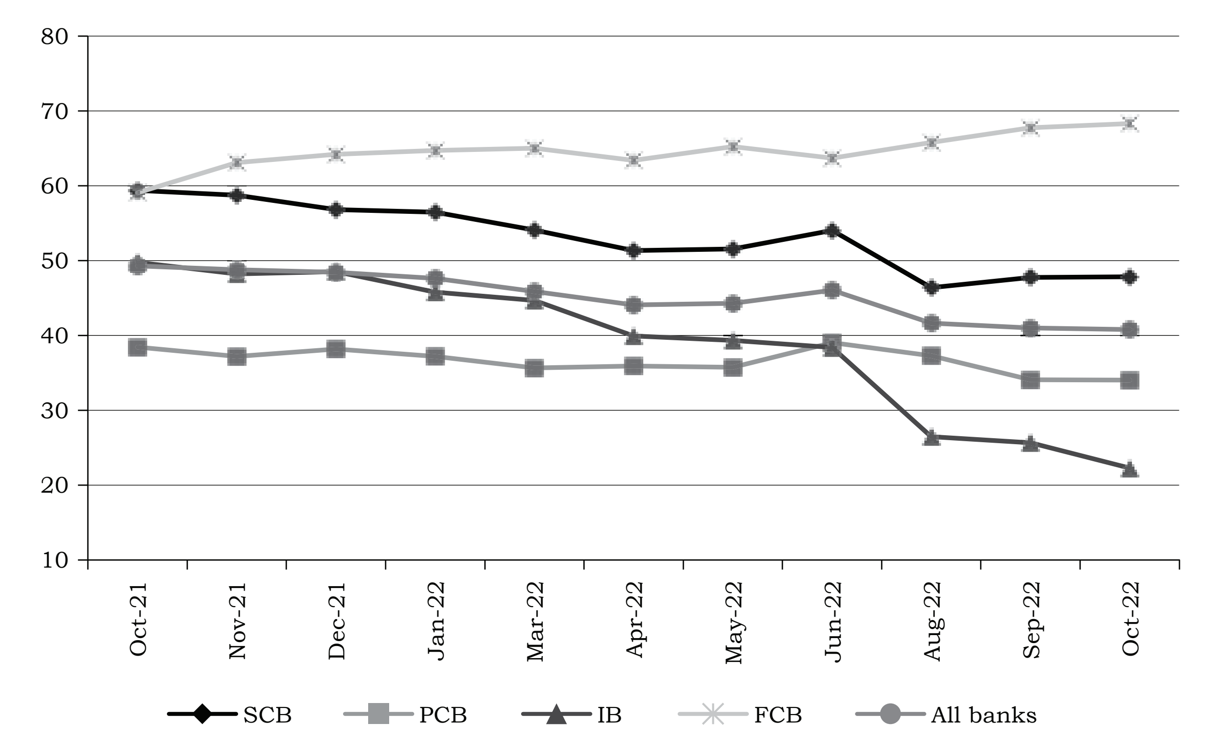
Excess liquidity *(BDT, in thousand crore)*



Source: CPD illustration based on data from Bangladesh Bank.

Figure 3.28

Excess liquidity *(as per cent of total liquid assets)*



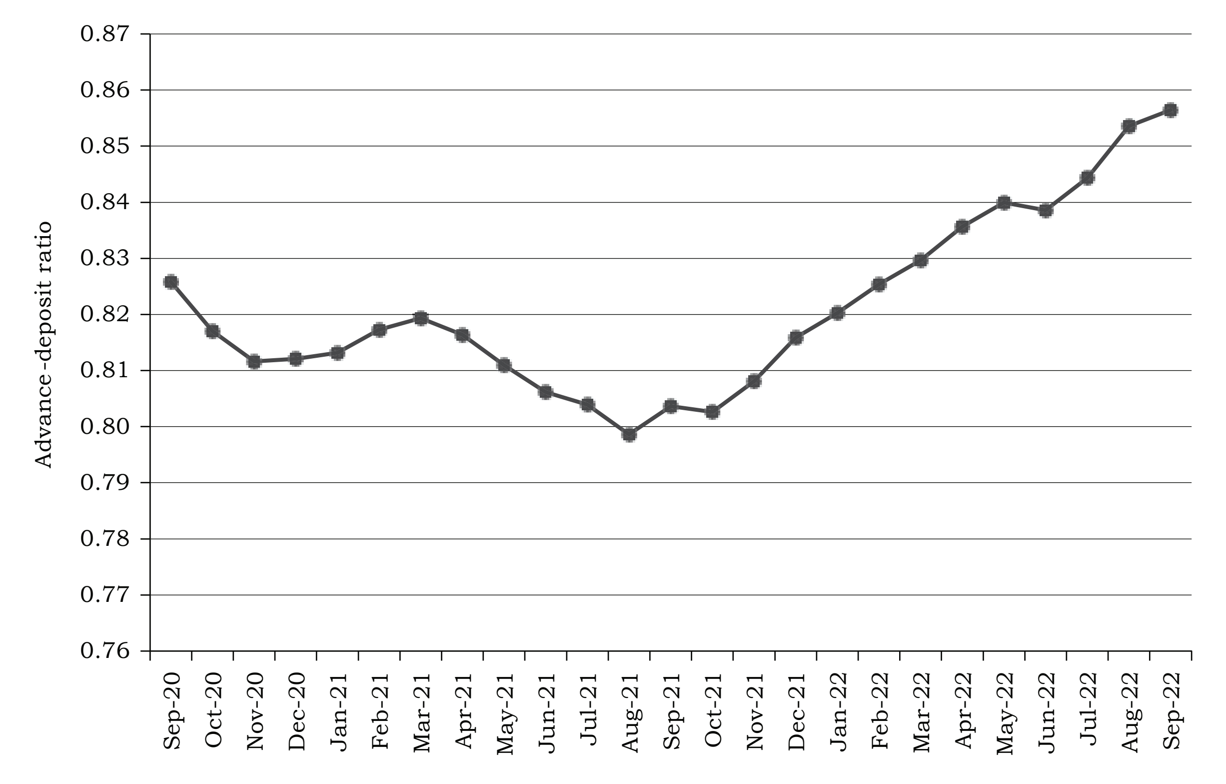
Source: CPD illustration based on data from Bangladesh Bank.

Increase in advance-deposit ratio

Banks are experiencing pressure on their liquidity positions. Since the cost of living has increased, many people are forced to use their savings to make ends meet. The advance-deposit ratio (ADR) has increased from 0.80 in September 2021 to 0.86 in September 2022 (Figure 3.29).

Figure 3.29

Advance-deposit ratio



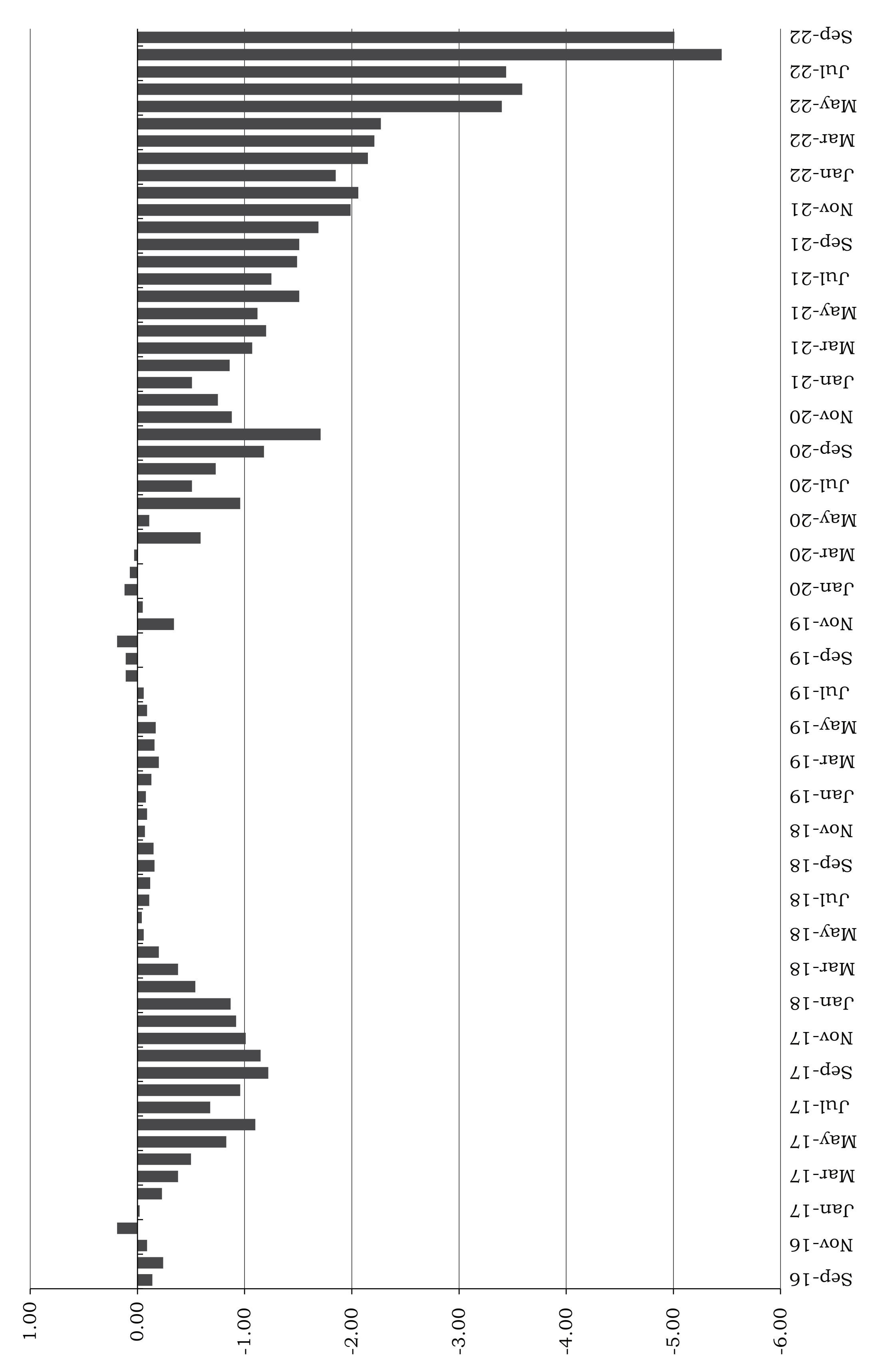
Source: CPD illustration based on data from Bangladesh Bank.

Negative real interest rate on bank deposits

The real deposit rate, calculated as the weighted average of the monthly deposit rate of all scheduled banks adjusted with the point-to-point monthly consumer price index inflation, fell from 0.03 per cent in March 2020 to -5.01 per cent in September 2022 (Figure 3.30). The negative real interest rate on bank deposits means that a depositor becomes a net loser by keeping money in the bank.

Figure 3.30
Real deposit rate in banks

(in per cent)



Source: CPD illustration based on data from Bangladesh Bank.

Recommendations

This section discussed some of the pressing issues of the banking sector based on the limited data available at the time of writing. If the banking sector is expected to play any constructive role in the economic recovery, its performance must be improved drastically. Considering the findings of this report, the following policy recommendations are put forward:

Commercial banks need to be strengthened

- Appointment of board members of banks should be depoliticised and based only on qualifications and experiences
- Loans should be sanctioned based on the Central Bank's 'Guidelines on Internal Credit Risk Rating System for Banks'
- Single borrower exposure limit for commercial banks should be strictly enforced
- Repeated rescheduling and writing-offs of NPLs should be stopped permanently
- Internal Control and Compliance Departments of commercial banks should be revitalised, and effective internal audits should be ensured
- The Central Bank should appoint firm administrators to oversee the operation of troubled banks which cannot comply with BASEL III requirements

Central Bank should be empowered to act in the best interest of the depositors

- The autonomy of the Central Bank should be upheld in line with the Bangladesh Bank Amendment Bill 2003
- Recapitalisation of poorly governed commercial banks with public money should be stopped
- An exit policy for troubled banks should be formulated by protecting depositors' money in those banks
- The need for new banks should be assessed pragmatically before issuing licenses for new banks
- Mergers and acquisitions of commercial banks should be probed for anti-competitive practices
- A single individual or group of individuals should not be allowed to obtain majority ownership of more than one commercial bank

A conducive legal and judicial environment should be created

- The Banking Companies Act should be amended to reduce both the number of family members on the board of directors and the tenure of each director
- The number of judges dealing with the Financial Loan Court Act 2003 and Bankruptcy Act 1997 should be increased to ensure speedy disposal of loan default cases and to reduce the backlog
- The Bankruptcy Act should be amended to remove mortgage-related loopholes that cause delays in settling cases
- Efforts should be made to recover NPLs through out-of-court procedures such as Alternate Dispute Resolution and the London Approach

Availability, access, and integrity of timely data should be ensured

- The report on banks and financial institutions should be published regularly and made publicly available
- All commercial banks should be obliged to make their mandatory disclosures under BASEL III in a timely fashion

- Loans should be classified by international standards, such as those outlined by the International Monetary Fund's Financial Soundness Indicators guide
- A comprehensive risk management policy should be implemented in all commercial banks to detect and deter fraud, forgery, fake companies, false identities, and other malpractices

Broadly, two types of actions are needed for the banking sector of Bangladesh: i) Comprehensive reforms of the banking sector are needed that will strengthen commercial banks, empower the central bank, create a conducive legal environment, and ensure availability of data; and ii)A goal-specific, time-bound, inclusive, transparent, unbiased and independent Citizen's Commission on Banking should be set up in order to bring transparency in the prevailing situation, identify the root causes of the manifest problems, and suggest credible measures for improving the situation sustainably.

3.6. FISCAL BALANCE

3.6.1 Current situation of public finance

According to the National Board of Revenue (NBR) data, during the July-October period of FY2023, tax collection by NBR has increased by 14.2 per cent. The corresponding figure for July-October FY2022 was 16.9 per cent. This growth was primarily driven by the indirect taxes at the import level (i.e., import duty, value added tax [VAT], and supplementary duty [SD]) amid heightened global commodity prices. However, there are concerns as regards the consistency of excise duty collection data. As can be seen from Table 3.14, a whopping 2,239.4 per cent growth has been reported for the July-October FY2023 period – a feat that is highly unlikely if past trends of excise duty collection are taken into cognisance.

Table 3.14
Growth situation of revenue mobilised by NBR

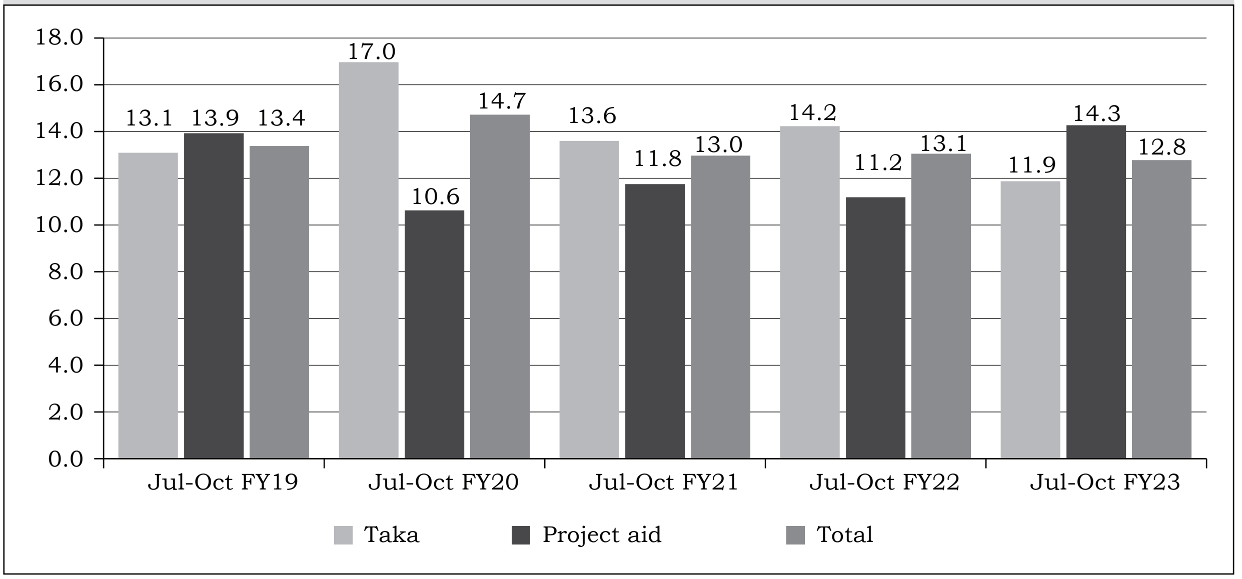
Components	Collection (in crore BDT)			Growth (in per cent)	
	Jul-Oct FY21	Jul-Oct FY22	Jul-Oct FY23	Jul-Oct FY22	Jul-Oct FY23
a. Indirect taxes at import and export level	**21,765.1**	**26,351.8**	**29,936.9**	**21.1**	**13.6**
a.1 Import duty	8,491.0	10,443.6	12,030.2	23.0	15.2
a.2 VAT at import level	10,932.3	13,131.6	14,575.5	20.1	11.0
a.3 SD at import level	2,341.9	2,776.0	3,328.5	18.5	19.9
a.4 Export duty	0.0	0.7	2.7	n/a	303.0
b. Indirect taxes at local level	**25,624.8**	**29,395.9**	**34,197.3**	**14.7**	**16.3**
b.1 Excise duty	169.6	222.1	5,194.5	30.9	2239.4
b.2 VAT at local level	17,387.3	19,880.1	19,926.8	14.3	0.2
b.3 SD at local level	7,868.5	9,061.4	8,800.9	15.2	-2.9
b.4 Turnover tax	0.3	0.3	0.1	-10.0	-55.6
b.5 Others	199.1	232.2	275.0	16.6	18.4
c. Income and travel tax	**20,740.2**	**23,874.8**	**26,783.5**	**15.1**	**12.2**
c.1 Income tax	20,687.5	23,745.0	26,339.1	14.8	10.9
c.2 Travel tax	52.7	129.7	444.5	146.1	242.6
Total NBR revenue (a+b+c)	**68,130.1**	**79,622.5**	**90,917.7**	**16.9**	**14.2**

Source: Author's calculation from NBR data.

As per data from the Implementation Monitoring and Evaluation Division (IMED) of Ministry of Planning, the implementation rate of the annual development programme (ADP) was 12.8 per cent during the July-October FY2023 period. This implementation rate was the lowest in the last five years (Figure 3.31). The critical question in this regard is whether this happened due to the government's ongoing cost-cutting measures or the inability to implement projects due to the foreign currency crisis. On a positive note, within the components of ADP, project aid utilisation (14.3 per cent) was the highest in the last five years.

Figure 3.31

ADP implementation scenario *(in per cent)*



Source: Author's calculation from IMED data.

Data from the Bangladesh Bank shows that budget deficit financing during the first four months of FY2023 was overwhelmingly reliant on bank borrowing. Bank borrowing increased substantially from BDT 9,256 crore during July-October FY2022 to BDT 20,509 crore in July-October FY2023. This was primarily due to a drastic decline in net National Savings Directorate (NSD) certificates sale. Net sale of NSD certificates was negative BDT (-) 632.6 crore during the July-October period of FY2023. Foreign borrowing also decreased by (-) 16.2 per cent during the aforementioned period despite the highest project aid utilisation in recent years. Whether it is due to higher amortisation payment or discrepancy in data remains a critical question.

Regrettably, data from the Ministry of Finance (MoF), which provides the most complete picture of national budget execution, is available only up to Jul FY2023. Such time lags hinder timely and comprehensive appraisal of the situation–both on the part of the policymakers and analysts.

3.6.2 Outlook for the remainder of FY2023

During the early months of FY2023, high prices at both local and global markets contributed to the growth in revenue earnings. Given the various import-related restrictions imposed by the government, this growth may not sustain. Nonetheless, some positive measures taken by the NBR (e.g., mandatory proof of submission of tax returns to avail 38 services, enhancement of the e-TDS system, etc.) are appreciated.

Overall public expenditure will face considerable upward pressure during the remainder of FY2023. Subsidy requirement is expected to shoot up due to higher global prices and devaluation of the Bangladeshi Taka (BDT) against major foreign currencies, particularly the US dollar (USD). Higher input prices are likely to push costs for public investment projects. In view of the current trends and outlook, prioritisation in public finance management will be critical.

ADP project prioritisation

Taking the current foreign currency crisis into cognisance, the government should prioritise the implementation of all foreign-funded ADP projects. The FY2023 ADP contains such 340 foreign-funded projects with a total allocation of BDT 130,535 crore. The government should also prioritise implementing projects that are closer to completion (i.e., projects that should be implemented 95 per cent or above by FY2023 if all allocated resource is exhausted). Excluding foreign-funded projects, the FY2023 ADP comprises 235 such projects with a total allocation of BDT 14,621 crore. Implementation of relatively new projects (except those with foreign finance) should be slowed down. Thirty-three (33) such projects with a total allocation of BDT 1,788 crore are in the FY2023 ADP. Projects that were implemented 10 per cent or below up to FY2022 should be deprioritised. The ADP for FY2023 includes 302 projects, with a total allocation of BDT 17,238 crore, meeting this criterion. 'Carryover projects' (i.e., projects scheduled to be completed by the previous fiscal year but still ongoing) with a maximum possible implementation rate of below 30 per cent up to FY2023 should be reviewed and may be discontinued. The FY2023 ADP contains 70 such projects with a total allocation of BDT 2,015 crore.

Subsidy management

Rising global prices coupled with significant depreciation of BDT resulted in serious pressure on subsidy requirements, particularly for agriculture (fertiliser and irrigation), energy (oil and LNG), power, and social protection (including food). Apparently, the budget for FY2023 failed to foresee these global and consequent domestic trends. As has been reported in the media, citing an official document, an additional allocation of approximately BDT 110,000 crore owing to subsidies for fuel oil, agriculture, power, LNG import, food, and TCB activities are sought by different agencies on top of the initial budgetary allocation of BDT 56,000 crore (Kashem & Islam, 2022). This additional requirement appears to be overestimated, considering the global prices are mostly on a downward trend. Even if the depreciation of BDT is considered, the estimates may not be justified. For example, agriculture subsidy should not be three and half times the original FY2023 allocation even if the entire financial burden is absorbed by the government. Undoubtedly, higher subsidy allocation will be required, but the estimations should be rigorous and transparent.

Fiscal balance and financing of the budget deficit

If the current revenue mobilisation trend continues, revenue shortfall (including grants) may reach as high as BDT 64,000 crore at the end of FY2023. Considering the substantial additional expenditure owing to subsidies, and past trends of budget execution, total public expenditure should be around BDT 600,000 crore, which is lower than the annual target. Under such a scenario, budget deficit would be less than the budgetary target of FY2023 by about BDT 10,000 crore. Hence, the concern will not be fiscal balance per se – rather, the structure of deficit financing will pose a significant challenge for macroeconomic management. It is likely that a significantly enhanced bank borrowing will be required–it could be as high as BDT 140,000 crore. It needs to be mentioned that the FY2023 budget earmarked a bank borrowing of BDT 106,334 crore. In view of the declining liquidity in the banking system, heightened inflation, and the central bank's rigid position on not withdrawing interest rate caps, the government may put itself in a difficult policy position.

3.6.3 PARTING THOUGHTS

In view of the current trends and likely scenarios in the foreseeable future concerning public finance management, three policy initiatives should receive heightened importance. These include (i) prioritising ADP projects, (ii) ensuring subsidy management in favour of the marginalised groups, and (iii) synchronising budget deficit financing with the current monetary policy. At the same time, three associated policy efforts are called for curbing tax evasion and illicit financial flows, revisiting tax incentives, and taking steps to review costing of public investment projects immediately.

3.7. CONCLUSION

The ongoing economic crisis would require the policymakers to make tough policy decisions. The policy decisions encompass two intertwined streams viz. macroeconomic management and economic governance.

The policy actions under macroeconomic management stream include (i) pursuing a free floating exchange rate instead of managed exchange rate, (ii) withdrawing interest rate caps on both lending and deposit and establish a install market-based mechanism for interest rate management, (iii) revisiting national budget with a view to revise the targets of domestic resource mobilisation, prioritise public expenditure and strategise deficit financing, and (iv) ensuring co-ordination between fiscal and monetary policies – e.g., accommodate monetary policy steps such as floating exchange rate with adequate fiscal policy response. For example, extending social protection programmes for low-income groups and ensuring required bank borrowing to finance budget deficit.

The policy actions under economic governance stream include (i) establishing good governance in the banking sector and initiating necessary reforms, (ii) revisiting the public procurement deals to guarantee that public interest is upheld, (iii) reviewing the costing of public investment projects to ensure good value for money, (iv) strategising energy and power sectors from economic viability and good governance point of view, and (v) strengthening market monitoring to safeguard the interests of the consumers.

It is important that the economic decisions are made in a transparent and accountable manner. To this end, quality disaggregated data should be made available and accessible to all stakeholders in a timely manner.

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