State of the Bangladesh Economy in FY2009-10

(IRBD 2009-10: Second Reading)

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The CPD-IRBD team alone remains responsible for the analyses and interpretations presented in this report.

Expert Group Meeting
on
CPD-IRBD 2010 (Second Reading)

As part of the CPD-IRBD tradition, CPD organised an Expert Group Consultation on 30 May 2010 at the CPD Dialogue Room. The working document of the Second Reading of *State of the Bangladesh Economy FY2009-10* prepared by the CPD-IRBD team was shared at this in-house meeting with a distinguished group of policymakers and professionals. The CPD team is grateful to all of those present at the consultation for sharing their views, insights and comments on the draft report. However, the IRBD 2009-10 team alone remains responsible for the contents of this report.

A list of the participants of the meeting is provided below (in alphabetical order):

Dr A K Enamul Haque	Professor, School of Business United International University
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SECTION I: INTRODUCTION

Macroeconomic management in FY2009-10 had to confront and address the twin tasks of reviving the investment which had slowed down the GDP growth performance in the recent past, and responding to the lagged impact of the global financial crisis with its demonstrated adverse consequences for Bangladesh's increasingly globalising economy. As may be recalled, CPD's analysis of the macroeconomic performance of the previous FY2008-09 identified seven areas which were perceived to pose challenge for the then newly elected government as it got ready to take charge of the economy for the first full fiscal year in the course of its current tenure. These were (a) energising investment, (b) consolidating agriculture, (c) protecting the external sector, (d) strengthening public finance, (e) combating climate change, (f) reviving development administration, and (g) continuing the reforms.

In the backdrop of this scenario, the budget for FY2009-10 had set out an agenda for economic development that was underpinned by targets of higher levels of public sector investment albeit with modest target for GDP growth, robust domestic resource mobilisation targets, higher levels of public expenditure in social sector and a target of double-digit export growth keeping an eye on global economic recovery that was marshalling some momentum. Larger fiscal deficit was to service the ambitions of expansive investment and the counter-cyclical measures put in place to stimulate domestic demand and aid the external sector.

This report takes a close look at the performance of the economy in FY2009-10 by examining the dynamics of selected key macroeconomic correlates based on available data and information, in most cases for the first three quarters and beyond. In doing so, the report presents an assessment of policies pursued in some key sectors and areas and flagging some emerging challenges as the economy enters into FY2010-11 at the end of which the government will have crossed its halfway mark in power.

Following the introductory remarks, Section II presents an analysis of the macroeconomic scenario as it evolved in FY2009-10. Section III then goes on to portray the dynamics of price movement and inflationary trends in FY2009-10 taking into cognisance their emergence as major concern in recent times. Section IV captures investment scenarios involving both public and private sectors of the country and focuses on the challenges inhibiting its growth. Section V presents an analysis of the current energy scenario and future plans of the government. Performance assessment of country's agriculture and the issue of food security are presented in Section VI. Section VII undertakes an evaluation of the implementation of the government's employment generation programmes, whilst Section VIII reviews current status of the country's achievement towards education and health related MDGs. This is followed by an analysis of the performance of the external sector in the context of the global economic crisis in section IX. Section X highlights a number of issues which are perceived to be important from the perspective of macroeconomic policymaking in FY2010-11. Finally, Section XI concludes with some of the emerging policy challenges and tensions which the government will need to take note of as it prepares to get on with the task of macroeconomic governance in FY2010-11.

SECTION II: MACROECONOMIC SITUATION

2.1 Growth Performance in FY2009-10

Real GDP growth is estimated to be lower (at 5.54 per cent for FY2009-10[1]) than the target, driven by sluggish investment, severe power crunch and lower export growth. If this actually turns out to be the case, it will be for the fourth consecutive year that growth rate has come down year-on-year. It is thus to be noted that this lower growth would be attained over a lower-than-provisionally estimated GDP for FY2008-09[2]. Whilst, from expenditure side, growth in consumption and public development expenditures contributed to the GDP growth in FY2009-10, decelerated growth rates of both agriculture and industry held the growth back from sectoral perspective. The below par performance of the economy reflects lackluster performance by the manufacturing sector which is projected to post a modest growth of 5.28 per cent in FY2009-10 against 6.68 per cent growth in FY2008-09 and was significantly lower than the performance recorded in the recent past[3]. Industry sector as a whole could manage only a 6.04 per cent growth in FY2009-10 compared to the 6.46 per cent growth attained in FY2008-09. Agriculture sector's performance is also expected to be lower than the target, recording 2.20 per cent growth. While high base-year growth was an important factor, impact of price disincentive at farmgate in FY2008-09, a drought during the *Aus* season and flash flood also contributed to the lower growth performance. The 6.59 per cent growth projected for the service sector was in line with trend growth rates of recent times (6.3 per cent in FY2008-09). Fall in global commodity prices and lower import demand resulted in only a 1.37 per cent growth for import duty in FY2009-10.

It is to be noted that these provisional estimates of GDP are calculated on the basis of economic performance during the first half of the fiscal year, for most of the indicators. Improvement in export receipts in later months of the fiscal year[4] could result in subsequent upward revision of industrial growth[5] while the growth of service sector may also pick up further since it is largely related to performance of tangible sectors such as industries. Additional public expenditure on account of hike in public sector pay under the new pay scale and deployment of resources as part of the stimulus package is also expected to contribute to higher public consumption expenditure. It is also to be noted that some of the proxy indicators (e.g. disbursement of term loan, actual import and L/C openings of capital machineries) suggest some rebound in investment towards the end of the fiscal year. Taking into consideration this late momentum, there is a likelihood of upward revision of the GDP, albeit by a small margin when final estimates are readied[6].

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[1] The GDP growth target for FY2009-10 was set at 6 per cent. This provisional estimate will be subsequently revised at a later date when data for the entire fiscal year will be available to the BBS.

[2] GDP for FY2008-09 was revised downward by 0.14 percentage point, to 5.74 per cent (from earlier estimated 5.88 per cent). This was primarily attributed to deceleration of growth in the crop sector and import duty components (by 1.0 percentage point and 5.9 percentage points respectively). The upward revision of manufacturing sector growth rate for FY2008-09 (by 0.78 percentage point) could not compensate the impact of the negative factors.

[3] Growth rate for manufacturing sector was 9.2 per cent on an average during FY2005-06 to 2007-08.

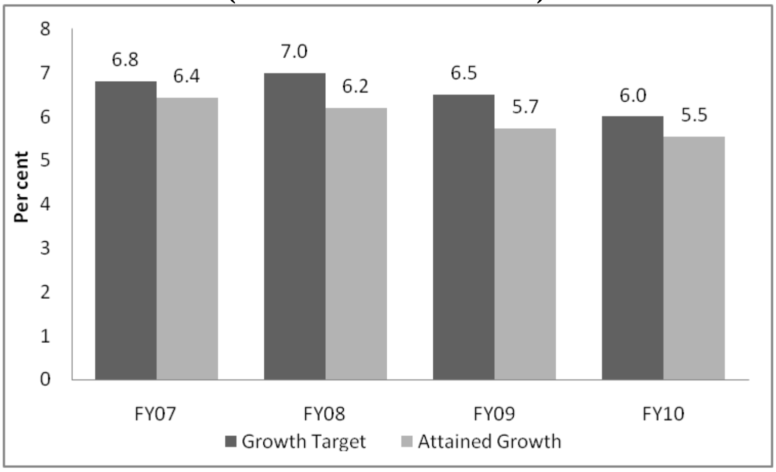
[4] Export receipts during January-April FY2009-10 registered an impressive 12.11 per cent growth when compared with the 6.08 per cent decline during the first half of the fiscal.

[5] Production of large and medium industries during the first half of the fiscal year registered 6.61 per cent growth even though "Group 32", that includes major manufacturing export industries in Bangladesh, declined by 2.85 per cent. The growth rate for small industries during the same period was 13.89 per cent.

[6] If this happens, it will be for the first time since FY2004-05 when the GDP growth rate was revised upward by 0.66 percentage point.

Over the last four years, GDP growth performance has been consistently lower than the targets set in respective budgets (Figure 1). As a result, the GDP in FY2009-10 was lower by 2.23 per cent than it would have been had the targets in last four years been achieved.

FIGURE 1: TARGETED AND ATTAINED GDP GROWTH RATES (FY2006-07 TO FY2009-10)



Source: Compiled from BBS data and various budget documents

2.2 Macroeconomic stability in FY2009-10

Overall macroeconomic stability was maintained in the backdrop of higher NBR-generated income and lower fiscal deficit on account of lower subsidy payment and underspent ADP. During the first ten months, NBR was able to collect about 77 per cent of the revenue target with a growth rate of 17.16 per cent that comfortably crossed the targeted growth of 16.13 per cent for the full fiscal year. In the event only a 12.85 per cent growth will be required over the last two months to attain the target set out for the NBR (Table 1). Although Customs Duty (CD) collection will still require a big jump to achieve the target set out for this particular sub-component, it was partially compensated by higher revenue collection efforts from Value Added Tax (VAT) and Supplementary Duty (SD) at the import stage. However, overall indirect tax collection at the import stage was off the track with only 8.79 per cent growth during the first ten months against an annual target of 11.34 per cent. Income tax collection was impressive, along the demonstrated trends of the recent past. Here the growth was 20.83 per cent although revenue earnings performance under the ambit of the *legalisation of undisclosed income* scheme (Box 1) was dismal by any account. Indirect tax collection, particularly the VAT component at local stage achieved higher growth than that was targeted (25.60 per cent and 26.72 per cent respectively)[7].

[7]Higher deployment of Electronic Cash Register (ECR) may have contributed to the impressive VAT collection. It is to be noted that NBR decided to make use of ECR compulsory in big and medium stores across the country from 1 July, 2009 and targeted to ensure installation of ECRs in 2,00,000 shops by the end of FY2009-10. World Bank (2009) reports that new VAT registration during the first 8 months of FY2009-10 reached 9,000 and helped the VAT collection at local stage.

TABLE 1: STATE OF REVENUE COLLECTION IN FY2009-10

Source	Annual Growth Target for FY10	Achieved Growth (Jul-Apr FY10)	Required Growth (May-Jun FY10)
NBR	16.13	17.16	12.85
Indirect Tax at Import Stage	11.34	8.79	21.50
Indirect Tax at Local Stage	19.29	25.60	-3.77
Income Tax	19.50	20.83	16.76
Source	**Annual Growth Target for FY10**	**Achieved Growth (Jul-Mar FY10)**	**Required Growth (Apr-Jun FY10)**
Non-NBR Tax	11.38	4.20	27.12
Non-Tax	39.43	14.00	133.85

Source: Estimated from NBR (2010) and Ministry of Finance (MoF) data

However, in contrast to the NBR, the non-NBR tax[8] and non-tax revenue[9] records portray a rather disappointing figure. The growth for non-NBR tax was targeted at 11.38 per cent; however, only a 4.20 per cent has been achieved up to March compared to the matched period of the last fiscal year. Non-tax revenue collection has fared even worse with only a 14.00 per cent growth achieved against the formidable growth target of 39.43 per cent that was set out for[10]. As a result, the current trend of NBR tax collection suggests that it will surpass the target. However, as was noted, the other two components are not likely to achieve the targets. CPD estimates indicate a shortfall of about Tk. 2,400.00 crore in total revenue mobilisation which was equivalent to 3.00 per cent of the total revenue target for FY2009-10.

BOX 1: LEGALISATION OF UNDISCLOSED MONEY: MUCH HYPE, BUT WITHOUT THE EXPECTED OUTCOME

As would be recalled, the provision for legalisation of "undisclosed income" was at the centre of attention and debate when the budget for FY2009-10 was presented in June 2009. It was the third consecutive year that such a facility was given in the budget. A flat rate of 10 per cent of the disclosed income was to be taxed with no penalty rates charged (as was the cased in FY2007-08) while economy-wide sectors were earmarked for investment under this facility. However, the provision failed to attract any notable amount of investment - only Tk. 50.15 crore legalised or invested during the first nine months of the current fiscal year, equivalent to about 0.04 per cent of private investment estimated for FY2009-10. It is interesting to note that half of the aforesaid investment went to the capital market (Tk. 19.54 crore) and housing or real estate sector (Tk. 5.60 crore). On the other hand, the revenue collection from this head was also negligible (only Tk. 5.19 crore compared to the Tk. 9,820.03 crore earnings from income tax). The provision of legalising undisclosed income does not merit continuation in the upcoming budget, both on moral ground and on the logic of economic reasoning.

The overall budget deficit during the first three quarters remained relatively low at 0.4 per cent of GDP compared to 1.0 per cent of GDP during the corresponding period of FY2008-09 and well below the target of 5.0 per cent for FY2009-10. Along with the impressive revenue collection record, lower than projected government expenditure contributed to this lower level of budget deficit. Lower global commodity prices contained spending on subsidies for agriculture and fuel[11], while expenditure for food procurement was also lower than usual. Moreover, allocations for stimulus package including cash subsidy for export, employment

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[8] Includes taxes on narcotics & liquor, vehicles, land and stamp

[9] Includes dividend & profit, post office & railway, interest/fees/tolls and other receipts

[10] Revenue collection from "Dividend and Profit" may be blamed for the dismal performance of non-tax revenue component.

[11] For example, MoF (2010) reported that during the first half of FY2009-10 no demand for subsidy was placed from the Bangladesh Petroleum Corporation (BPC).

generation scheme and funds for ADP[12] were also substantially underspent. The fund earmarked for the PPP projects (Tk. 2,500 crore) also went unutilised. Relatively low government expenditure from these heads also helped to keep the interest payments by the government to a minimum.[13]

Deficit financing in FY2009-10 was largely met through non-bank borrowing, which is of high cost but non-inflationary nature. Government borrowing was mainly done through the high interest bearing National Savings Directorate (NSD) certificates; net sale of NSD certificates was about three times higher during July-March FY2009-10 when compared with the corresponding period of the previous fiscal. On the other hand, net foreign aid during July-March FY2009-10 was 7.49 per cent higher than the matched period of FY2008-09. This allowed the government not to undertake deficit financing through bank borrowings. Given the non-inflationary nature of borrowings from non-bank and foreign aid sources, both the size of the deficit and the nature of financing helped the government to contain inflationary pressure. However, higher interest payments originating from the increasing non-bank borrowings raised concerns about higher fiscal burden in future on account of debt servicing.

Macroeconomic stability during the second half of FY2009-10 came under some strain because of the inflationary pressure driven by significant rise in food prices. On a point to point basis, during March of FY2009-10, inflation reached 8.78 per cent while food inflation kept running at double-digit level during the third quarter period (January to March: 10.56 per cent, 10.93 per cent, and 10.80 per cent progressively). However, average inflation figure was expected to stay close to the targeted level thanks mainly to lower levels in the beginning of the fiscal year[14]. Though the inflationary phenomenon in FY2009-10 was somewhat similar to the one experienced by Bangladesh during 2007 and 2008, when inflationary trends were driven by the upturn in international commodity prices, particularly in India[15], and also because of the supply side constraints[16]. In FY2009-10, the situation was further aggravated by the issue of excess liquidity overhang in the economy. Excess liquidity of the scheduled banks remained over Tk. 30,000 crore for most part of the fiscal year until recently[17]. As a result, Bangladesh Bank opted for go for demand side management. In May 2010 Bangladesh Bank revised fundamental bank rates by raising the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) by 0.5 percentage points (to 5.5 per cent and 18.5 per cent respectively[18]) applicable from May 15, 2010. The central bank expected to withdraw about Tk. 1,500 crore from the market (5.0 per cent of the prevailing excess liquidity) with these revised rates. With this action the central bank, for the first time in recent years, changed its position from the hitherto pursued accommodative monetary policy. Growth of domestic credit, however, remained at low level, posting a growth of only 13.27 per cent at the end of

[12]The allocation for ADP FY2009-10 was slashed by Tk. 2,000 crore in the revised ADP.

[13] Interest payments over first eight months declined by (-) 3.69 per cent against the annual growth target of 4.11 per cent.

[14]The inflation target for FY2009-10 was set on an annual average basis at 6.5 per cent. The annual average inflation in March FY2009-10 was 6.26 per cent.

[15]Wholesale price inflation in India during March, 2010 was 9.9 per cent. India has a large influence on Bangladesh's commodity prices as it supplies around 40 per cent of total food import (World Bank 2010).

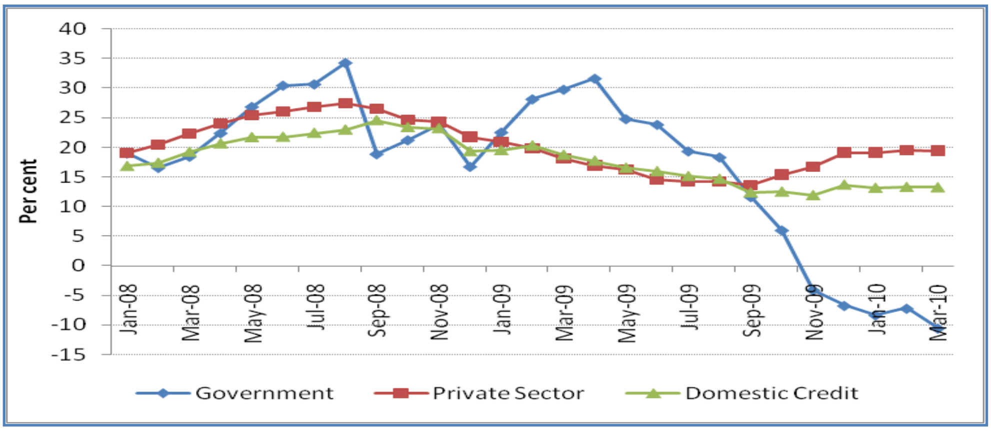
[16] International food markets suffered adverse supply shocks due to drought in India and successive cyclones in the Philippines. Rice production in Bangladesh during *Aus* season was also 9.8 per cent lower than that of the last year.

[17]This is considerably higher compared to historical trends e.g. average excess liquidity during FY2007-08 was Tk. 12,932 crore. As of March 2010, excess liquidity of the scheduled banks came down to Tk. 29,842 crore against Tk. 34,762 crore as of June, 2009.

[18]SLR for Islami banks was raised to 10.5 per cent at the same time.

March 2010, due to negative net borrowings from government[19] and contained growth of private sector credit (19.45 per cent) (Figure 2). With the improving investment scenario and the envisaged higher government expenditure, domestic credit flow will possibly rise in the near future. Given this scenario increased policy rates could discourage credit flow in the economy. The Bangladesh Bank will need to be alert to the changing scenario and act accordingly. In contrast to the credit flow, the growth of broad money supply (M2) was stronger (21.29 per cent) owing to formidable growth of net foreign asset (70.02 per cent) resulting from buoyant remittance inflow.

FIGURE 2: GROWTH OF DOMESTIC CREDIT



Source: Estimated from Bangladesh Bank, *Major Economic Indicators: Monthly Update,* various issues

FY2009-10 experienced improved balance of payments position in the backdrop of lower levels of import and the continuing robust remittance inflow. Even though growth of exports receipts remained in the negative bracket during the first nine months of FY2009-10, negative growth of import payments resulted in somewhat lower trade deficit[20]. The deceleration in net Foreign Direct Investment (FDI) flow was offset by the improved net foreign aid situation. Reduced trade deficit, along with remittance growth of 16.72 per cent, resulted in an improvement the balance of payments position. Balance in the current account was equivalent to 2.6 per cent of GDP as against 1.1 per cent of GDP in FY2008-09. Bangladesh bank also managed to maintain a stable taka-dollar exchange rate (at about Tk. 69/USD) helped by periodic and active market operation[21]. Lower imports, higher remittance and central bank operation combined their forces to help maintain a healthy foreign exchange reserve[22] that was equivalent to a comfortable five months worth of import payments.

[19] In fact the net outstanding borrowing of government from banking sources declined by 10.55 per cent as of March FY2009-10.

[20] Growth of export in FY2009-10 period entered to a positive terrain in April. The export during the first ten months registered only 0.97 per cent growth.

[21] Bangladesh Bank has been pursuing this type of open market operation over the last few years. In FY2008-09, the central bank bought USD 1.38 billion (in net terms), whereas in the previous fiscal, it bought USD 202.50 million only while selling USD 735 million. It is reported that till 11 May FY2009-10, USD 1.69 billion (net) was withdrawn from the market by the Bangladesh Bank through such interventions.

[22] Foreign Exchange reserve has remained over USD 10 billion since November, 2009.

SECTION III: PRICE AND INFLATION SCENARIO

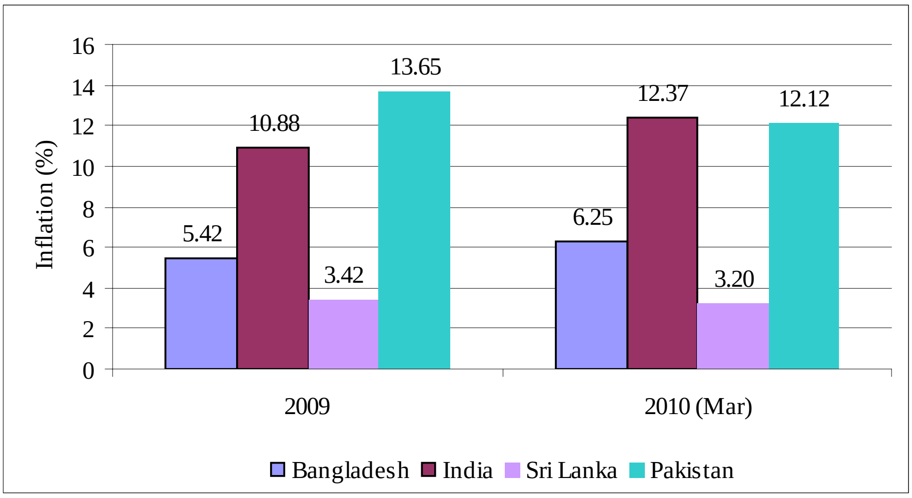
Inflationary trends in Bangladesh have tended to follow global trends, with pressure building up in recent times. Global commodity prices have experienced unprecedented volatility since 2004-05 due to loss of production of major crops in some of the important food producing countries and diversion of foodgrains for ethanol in a number of developed countries including the USA and the EU. The situation had eased during the second half of 2008 in the face of global financial crisis which contributed to a sharp decline in the aggregate demand in the developed and developing countries. Bangladesh also experienced inflationary pressure in line with the global trend. Bumper foodgrain production coupled with falling global prices led to a decline in inflation rate in Bangladesh since September 2008 when twelve month average inflation rate reached as high as 10.06 per cent, and food and non-food inflation rates were 12.63 per cent and 6.01 per cent respectively. After a short spell of respite in terms of lower inflation and prices, the country has again started to feel the pinch of high inflation which is sneaking into the day to day lives of common people. Though Bangladesh had successfully navigated itself from the headwinds of the ongoing financial crisis and remained largely unaffected by the first wave of the global economic slowdown mainly due to its limited openness to short term capital flows, and the robust performance of its export sector and remittance flows, the recent trend of creeping inflationary pressure has emerged as a new challenge for the economy during the later part of FY2009-10.

3.1 Recent trends in inflation and prices

Inflation was higher for food items and in urban areas. Though inflation rate in Bangladesh was lower when compared to that of other South Asian counties, except for Sri Lanka (Figure 3), price levels, particularly for food items, have been on the rise in the recent past. Point to point inflation rose from 2.25 per cent in June 2009 to 8.78 per cent in March 2010 (Figure 4) and was driven mainly by the rise in food inflation. However, non-food inflation decreased during this period both in rural and urban areas. Twelve month average national inflation, however, decreased from 6.66 per cent in June 2009 to 6.26 per cent in March 2010 thanks mainly to lower levels during the earlier months of FY2009-10 when global commodity prices were lower and in the domestic front the agriculture sector posted commendable performance.

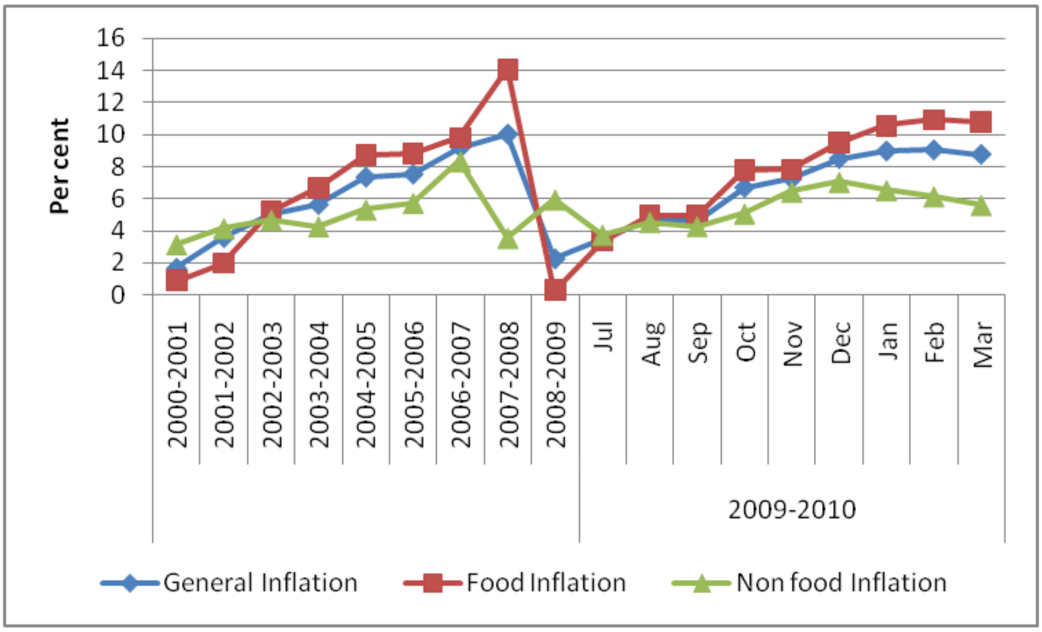
An urban-rural comparison of 12 month moving average inflation rates reveals that in March 2010 food inflation was much higher in urban areas (8.08 per cent) than in rural areas (6.11 per cent). On a point to point basis, food inflation in both rural and urban areas reached two digits in January 2010 and continues to remain high (10.35 per cent in rural areas and 11.86 per cent in urban areas in March 2010) posing a threat of eroding purchasing power of people with fixed income if current trend sustains over the medium term.

FIGURE 3: INFLATION IN SOUTH ASIAN COUNTRIES (MOVING AVERAGE)



Source: Bangladesh Bank, Reserve Bank of India, State Bank of Pakistan, Central Bank of Sri Lanka.

FIGURE 4: POINT TO POINT INFLATION RATES



Source: Bangladesh Bureau of Statistics.

3.2 Interpreting the nature of forces driving inflation

In view of price hikes the government has continued to take up a number of fiscal and monetary measures. While these measures may result in some positive changes in the short run, keeping price stability over the medium term would necessitate identification of the driving forces of inflation and interpreting their nature.

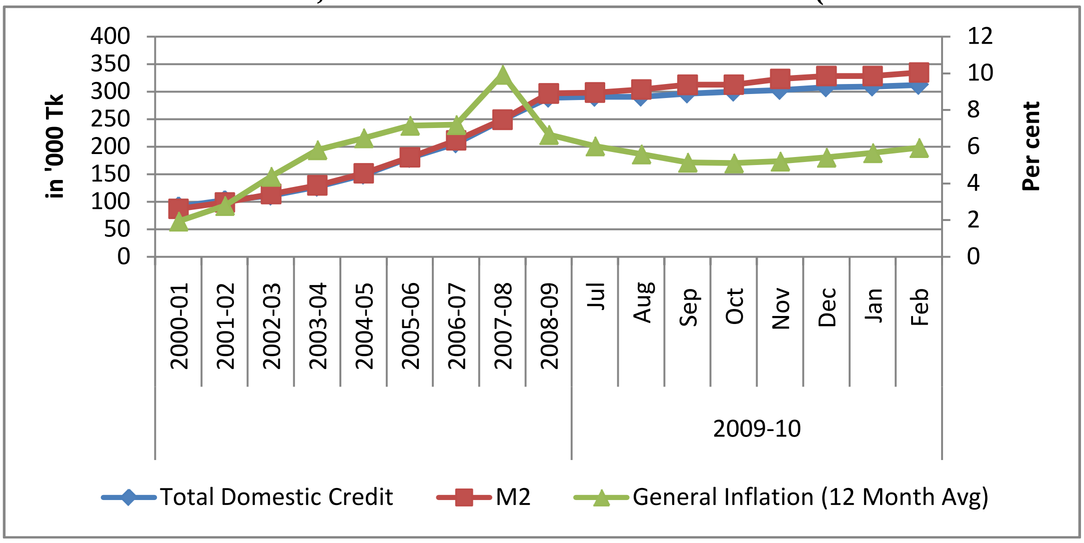
3.2.1 Monetary factors

a. Growth in money supply

Inflation and money supply have started to rise in tandem since November 2009; however, contractionary monitory policy may not be the answer. A look at the short term movement of inflation and monetary growth indicates that since November, 2009 both inflation and money supply have started to rise. At the end of March, 2010 broad money (M2) grew by 21.29 per cent as opposed to a growth rate of 19.30 per cent at the end of March, 2009 and against the target of 15.50 per cent at the end of June, 2010 set by the Bangladesh Bank. The growth of reserve money (RM) at the end of March, 2010 was 17.86 per cent, a moderate decline from the 22.93 per cent experienced in March, 2009 but much higher than the target of 7.0 per cent by June, 2010.

Despite lower demand for credit, money supply in Bangladesh has been increasing in recent times, particularly due to high foreign exchange reserves (net foreign assets). However, growth in money supply and inflation did not always follow the same direction (Figure 5). Consequently, it is difficult to correlate these two factors, particularly in the absence of any rigorous empirical work towards establishing a relationship between these two[23].

FIGURE 5: BROAD MONEY, DOMESTIC CREDIT AND INFLATION (12 MONTH AVERAGE)



Source: Bangladesh Bank.

Theoretically, inflation has been associated with interest rate and money supply. Overtime, various theoretical models have been developed to rationalise the use of interest rate policies to control inflation rates (Taylor 1993; Svensson 1999). In a bid to facilitate economic growth and control inflation, Bangladesh Bank has been using various tools such as repurchase agreement (Repo), Reverse Repo, CRR and SLR from time to time. However, striking a balance between inflation and interest rates has always been a challenge for central banks around the globe. Bangladesh Bank has been pursuing an accommodative monetary policy in line with domestic and international market developments.

As was noted in Section II, Bangladesh Bank has recently increased the rate of CRR by 0.5 percentage point in order to dampen the rise of inflation.[24] The increase in CRR is tantamount to basically a contractionary monetary policy whereby credit becomes more expensive. However, this policy stance has been criticised by some stakeholders. Growth in domestic credit is lower at 13.27 per cent as of March, 2010 as opposed to the central bank's target of

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

[24] Similar measures were taken in 2006 when the central bank resorted to the mechanism of increasing CRR by 0.5 percentage point (from 4.5 per cent) and SLR by 2 percentage points (from 16 per cent) in order to put a restrain on money supply.

15.60 per cent by June, 2010. The business community apprehends that credit to the private sector may slow down further as commercial banks' lending rate could rise following this decision. This could undermine the growth of already low domestic investment which has gained some momentum in recent months but is yet to fully recover from the pull-back effects created during the days of anti-corruption drive by the caretaker government (CTG) followed by the global financial crisis of the recent past.

However, experience of the past does not indicate that a cut in policy rates would necessarily increase the appetite for credit in the private sector. During the recent global financial crisis when the interest rate was reduced globally in order to boost investment and effective demand, Bangladesh Bank also reduced the Repo and Reverse Repo rates in March, 2009 by 0.25 basis points to 8.5 per cent and 6.5 per cent respectively from 8.75 per cent and 6.75 per cent with the objective of stimulating credit flow for productive activities. However, this initiative had only limited success. This would imply that in the Bangladesh context, interest rate is not a major motivating factor for credit demand. In contrast, factors such as effective tax measures and supporting business environment which includes improved infrastructure, adequate availability of energy and political stability are important considerations in terms of attracting investment. The increase in CRR comes at a point when larger economies around the world have started to recover from the shock of financial crisis. In view of recent improvements in their economic activities a number of these countries have increased interest rates as a safeguard against inflationary pressure in the economy. It is to be noted in this connection that recently India has also increased her interest rate with a view to containing inflation.

The tightening of monetary policy by the Bangladesh Bank is expected to put some restrain on bank loans going to unproductive sectors that contribute to building up inflationary pressure within the economy. However, such a policy ought to be seen as a short term measure. Credit expansion in the productive sectors may need to be stimulated in view of the uptake of the export and production-oriented sectors, as also indicated by increased disbursement of industrial term loan during July-March period of FY2009-10 (see Section IV for details). This is also important from the perspective of maintaining the interest rate spread (IRS) below 5 per cent, a longstanding concern in Bangladesh.

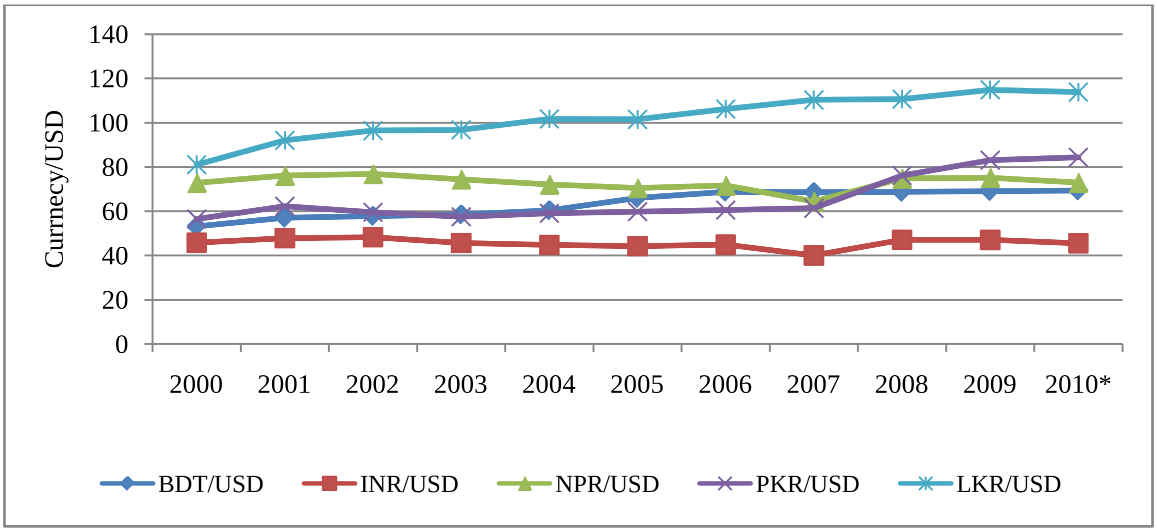
b. Exchange rate policy

Exchange rate management policy pursued by the central bank helped maintaining taka-dollar rate stable. Exchange rate is a key macroeconomic variable because of its implications for inflation, export sector performance and competitiveness, import and overall state of economic activities. Several countries have used exchange rate as a tool for inflation targeting through appreciation of their currencies (Bernanke, 2004; Bernanke *et al*, 2001; Jones and Mishkin, 2003; Mishkin and Sabastano, 2001; Corbo and Schmidt-Hebbel, 2003). Exchange rate depreciation directly affects prices of tradable goods in domestic currency units and indirectly affects the general price level if pricing decisions are influenced by the cost of imported inputs. Depreciation of Bangladeshi Taka (BDT), particularly against currencies which could have an influence on the domestic prices, such as the Indian Rupee (INR), may have contributed to higher food inflation in Bangladesh in the recent past (Osmani, 2007).

It has been Bangladesh Bank's practice to resort to sterilisation, on a regular basis, to maintain stability in the country's exchange rate market and protect the interests of exporters and remitters. It is to be noted that the corresponding exchange rate as per Real Effective

Exchange Rate (REER) has been lower compared to Nominal Effective Exchange Rate (NEER) during FY2009-10 indicating a depreciated BDT against USD. In the event this policy may have contributed to a larger foreign exchange reserves. In order to understand the linkages between inflation and exchange rate in the Bangladesh context, there is a need to examine the long-term trend which reveals that BDT has depreciated over time against the United States Dollar (USD) compared to other South Asian countries[25] (Figure 6). Though depreciation of BDT against the INR in recent months may have helped the Bangladeshi exporters, corroborated by recent rise in Bangladesh's export to India, this contributes to increase in relative prices of food items imported from India. Indeed, exchange rate management in the Bangladesh context is a challenging task in view of the multi-dimensionality of its impact on the economy and the trade-offs that it entails.

FIGURE 6: MOVEMENT OF CURRENCIES AGAINST US DOLLAR



* Up to May, 2010.
Source: www.oanda.com

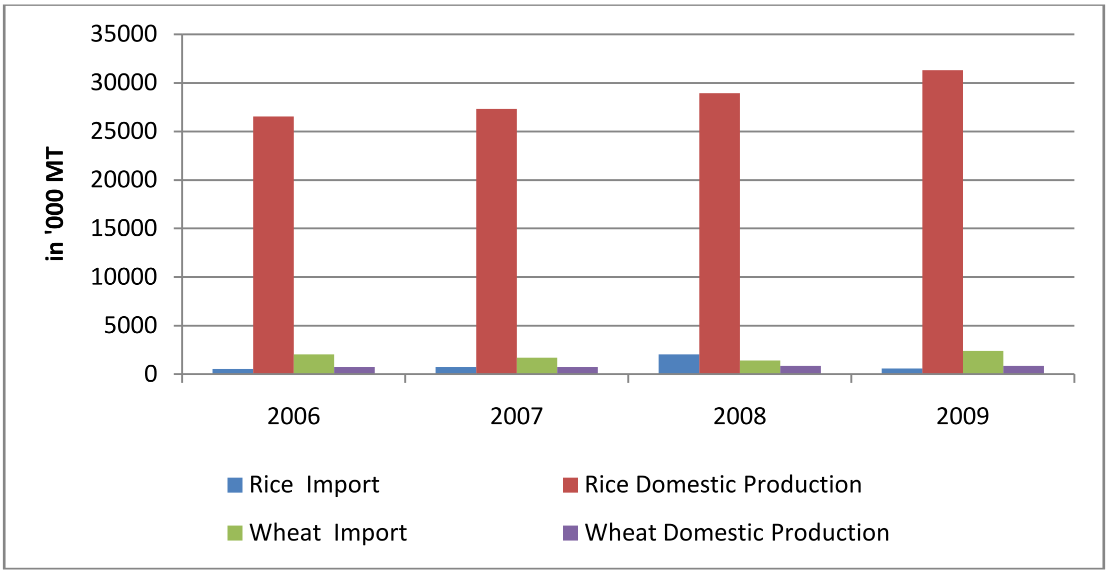
3.2.2 Output gap and international prices

Movement of prices in the domestic market has tended to follow price behavior in the global commodity market. Bangladesh is now able to largely meet its demand for rice through domestic production (Figure 7). The narrow gap between production and demand for rice is met through imports mainly from Thailand and India. During periods of lower global production of rice, Bangladesh needs to import rice at a high price which may lead to inflationary pressure with negative impact on purchasing power of people with limited income. For many other major items such as wheat, pulses, sugar, soybean oil, onion and milk, Bangladesh has to rely more on importation. Consequently, price volatility of these items in the international market affects prices in Bangladesh to a significant extent. In FY2009-10 variability in prices in the domestic market decreased for rice, flour, soybean oil, milk powder and sugar, but increased for lentil, eggs, potato, onion and egg plant. It is to be noted in this connection that between the July, 2009 and April, 2010 prices of rice, soybean oil, sugar, and crude oil have shown fluctuating but rising trend in the international market.

[25] In recent times, however, BDT remained fairly stable against USD, particularly since June, 2006 in view of the relatively high levels of foreign exchange reserves underpinned by unprecedented growth in export and remittance flows. BDT has remained strong against the USD in contrast to what has happened to USD against other major currencies. USD has appreciated in value against most currencies since June, 2008 (except for April and May, 2009).

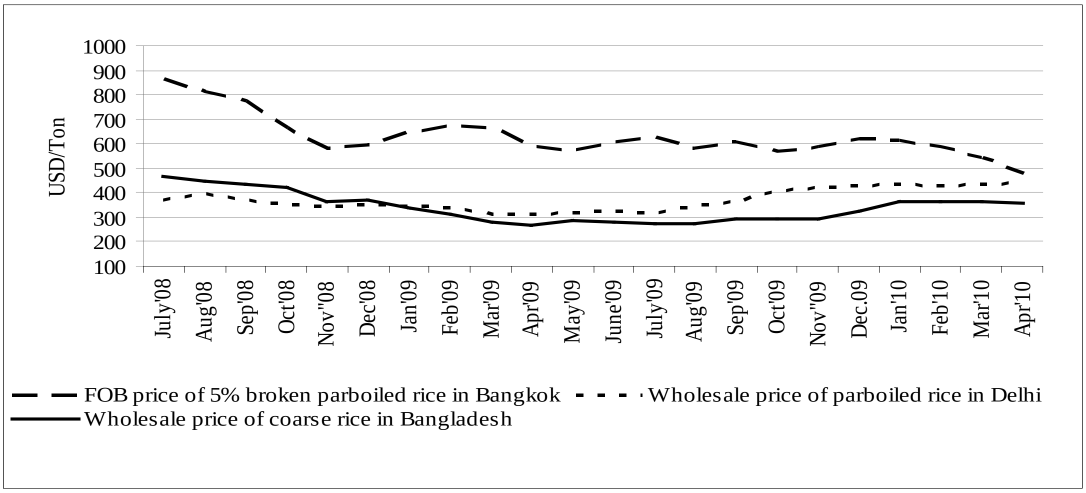
Price of rice, which accounts for the major weight in the food basket of Bangladesh, has moved upward since October, 2009 and thereafter remained stable for the last four months. Though price of rice is lower in Bangladesh compared to other rice producing countries (Figure 8), given the predictions that rice prices may rise in the international market, particularly in India (food inflation may be as high as 18 to 19 per cent), it will be a challenging task to keep the prices of rice at a lower level to avoid inflationary pressure.

FIGURE 7: DOMESTIC PRODUCTION AND IMPORT OF RICE AND WHEAT



Source: Bangladesh Economic Review 2009 and Bangladesh Bank.

FIGURE 8: DOMESTIC AND INTERNATIONAL RICE PRICE



Source: Department of Agricultural Marketing (DAM) for Bangladesh; Thailand Rice Exporters Association for Bangkok; and Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

3.3 Policy implications

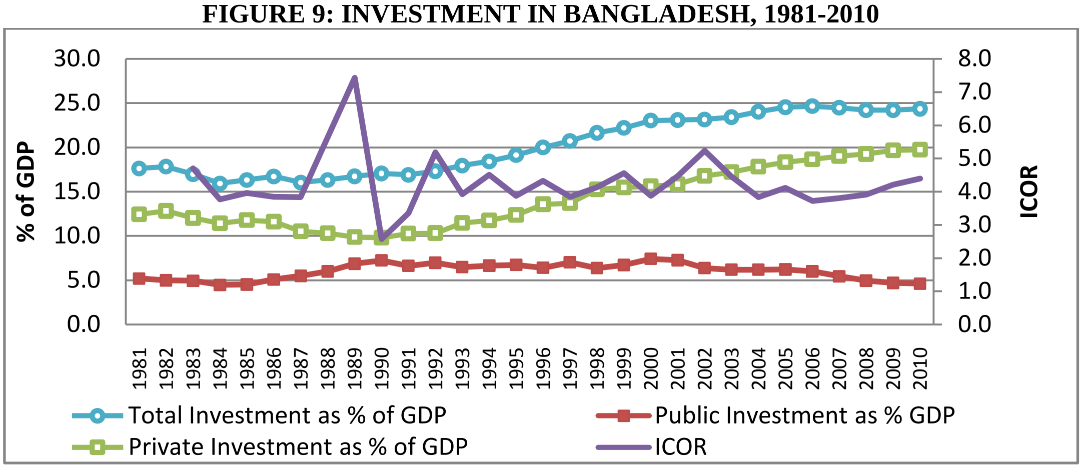
Inflation in Bangladesh is determined mostly by international prices. Though a good harvest of rice is essential for output stability and food security, general price levels tend to rise in tandem with rise in global prices since other essential commodities such as wheat, pulses, onion and sugar are mostly imported. Current inflationary pressure tends to be mostly due to supply constraints, and not arising from any significant monetary expansion. The current contractionary monetary policy is, thus, likely to have limited impact in terms of containing inflationary trends in the economy. The average inflation for the FY2009-10 is targeted at 6.5 per cent by Bangladesh Bank in its Monetary Policy Statement (MPS) for the period January-June 2010 (Bangladesh Bank, 2010). Though Bangladesh Bank has stated that the monetary policy stance of the government is to sustain broad-based economic growth and contain inflation within 'tolerable moderate levels', restraining the rising inflationary trends will be a challenging task. It will warrant prudent use of weapons from the government's armoury of monetary management in the short and medium term, keeping an eye on the fast changing domestic investment scenario and volatilities in the global market.

SECTION IV: PUBLIC AND PRIVATE INVESTMENT

4.1 Overall Investment

Bangladesh has witnessed sluggish public sector investment which had adverse implications for investment by the private sector. Declining investment efficiency also emerged as a concern. Low level of investment has been a major barrier to stimulating economic growth in Bangladesh in recent years.[26] Although nominal growth in FY2009-10 for public and private investment were 10.3 per cent and 12.7 per cent respectively, investment has stalled at around 24 per cent of GDP since FY2003-04[27] (Figure 9). More importantly, a continuing fall of public investment as a share of GDP (from 6.2 per cent in FY2004-05 to 4.6 per cent in FY2009-10) [28] is emerging as a serious concern in the context of the need to generate the desired crowd-in effect on private investment and to attain higher levels of investment efficiency (Hatano, 2010; Mitra, 2006). Investment efficiency, as measured by Incremental Capital Output Ratio (ICOR), has also seen declining trends in recent years as evinced by gradual rise of the ICOR (4.4 in FY2009-10 from 3.72 in FY2005-06). If this trend continues, without accelerating the growth of investment (to 31.5 per cent of GDP in FY2014-15) it would be difficult to attain the targeted level of GDP growth of 6.9 per cent as articulated in the Sixth Five Year Plan (SFYP).

FIGURE 9: INVESTMENT IN BANGLADESH, 1981-2010



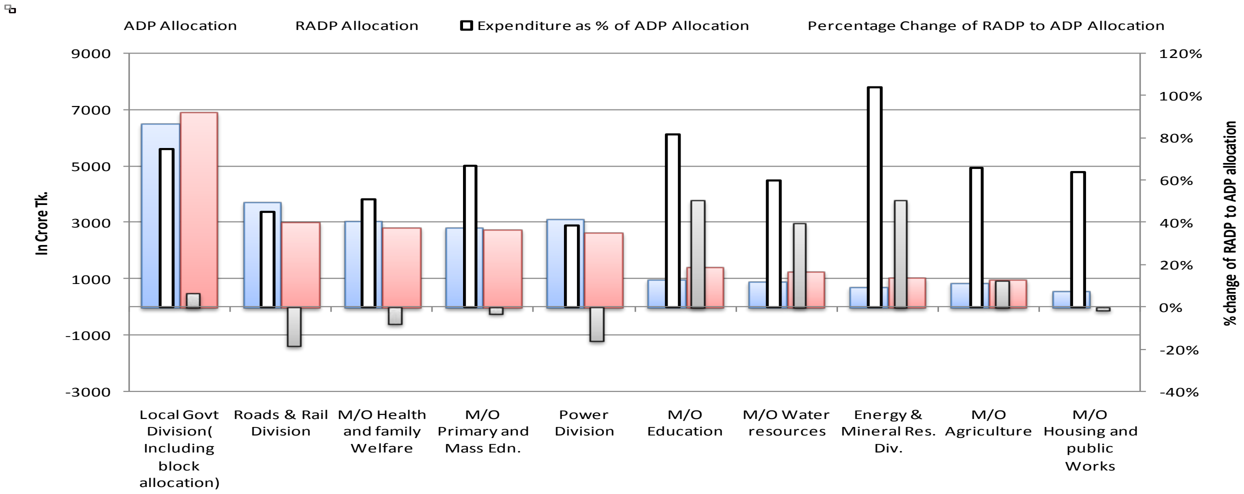
Source: Authors' calculation based on *Bangladesh Economic Review*, Different Issues

[26] CPD's analysis found significant positive Granger causality in GDP growth by investment. However, the relationship in reverse order is positive, but not significant.
[27] Total investment in FY2009-10 is expected to be about Tk. 1682 billion, at around 24.4 per cent of GDP.
[28] To contrast, in India, public investment was 9.1 per cent of GDP in 2008.

4.2 Public Investment: Annual Development Programme (ADP)

In the context of 'low level' public investment scenario, the weak ADP performance has undermined the catalytic role that public sector is expected to play in terms of stimulating domestic private sector investment. In Bangladesh public investment (Tk. 31,875.2 crore during FY2009-10) is largely driven by government's Annual Development Programme (ADP) (89.4 per cent of public investment in FY2009-10). While the ADP for FY2009-10 was set at Tk. 30,500 crore, the RADP for FY2009-10 was slashed by an amount of Tk. 2,000 crore and was set at Tk. 28,500 crore. However, allocation for top ten ministries (according to implementation performance during the first part of the fiscal year) saw an upward revision by an amount of Tk. 671 crore in the RADP (Tk. 23,837.8 crore) (Figure 10). Thus, a number of ministries such as Water Resources (39.5 per cent growth in allocation in RADP), Education (50.4 per cent), Energy and Mineral Resources (50.7 per cent) and LGD (6.2 per cent) saw increased availability of resources in the RADP. Mainly project-funded activities were revised downward (-12 per cent). Earlier, development partners had raised concern with regard to some modifications in the Public Procurement Act (PPA) 2006 and Public Procurement Rules (PPR) 2008 which the government had made with a view to speeding up the ADP implementation (e.g., exclusion of experience requirement for projects not exceeding Tk. 50 lakh, etc.).

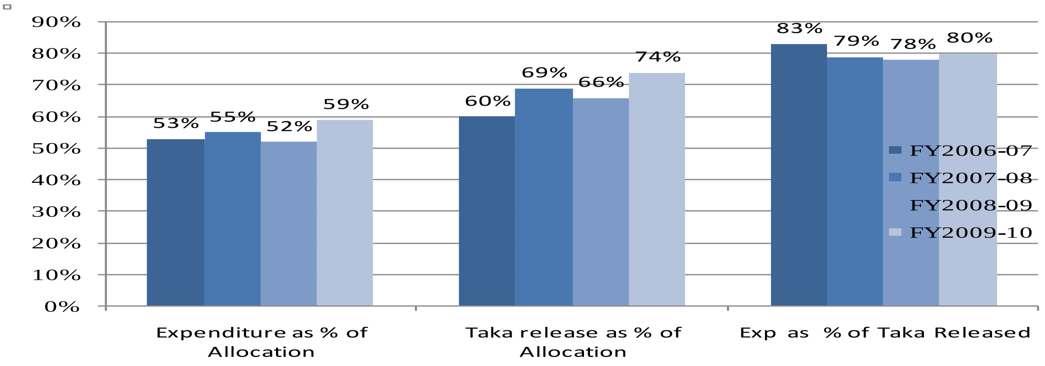
FIGURE 10: ALLOCATION AND EXPENDITURE OF TOP 10 MINISTRIES: ADP AND RADP



Source: Implementation Monitoring and Evaluation Division (IMED), Ministry of Finance, GoB

Whilst expenditure in nominal terms has posted impressive growth, underspending of ADP continued to remain a recurring phenomenon. It is of interest to note, however, that expenditure of ADP in FY2009-10 has seen significant improvement in monetary terms - during July-April period total expenditure was Tk. 16,701 crore, which was 41 per cent higher than that of the corresponding period. While release of fund was earlier considered as a major hindrance to timely implementation of the ADP, a high release of funds (74 per cent of total taka allocation in the RADP) seen in recent years with expenditure of 80 per cent of the released fund tells about opportunities for further acceleration of spending by the ministries (Figure 11). Of concern is the performance record of the 20 ministries under the Medium Term Budgetary Framework (MTBF) which was below the average expenditure level (56 per cent of total allocation of RADP during July-April, FY2009-10 period). There is thus a need to strengthen the capacity of the MTBF ministries in such areas as designing the budget, planning the activities, sequencing the disbursement and implementing the planned activities.

FIGURE 11: PERFORMANCE OF RADP DURING JULY-APRIL (FY2006-2007 TO FY2009-10)



Source: Implementation Monitoring and Evaluation Division (IMED), Ministry of Finance

If the monthly expenditure rates during the last couple of months of the fiscal year is considered (i.e. 18.25 per cent per month based on the average for the last three years), the actual expenditure in FY2009-10 is likely to exceed 90 per cent of the RADP. This would imply a total expenditure of RADP to the tune of Tk. 25,650 crore, which in monetary terms will be about 30.4 per cent higher compared to the previous year. The expected RADP expenditure in FY2009-10, along with the 'non-ADP' component expenditure (if it remains at the same level as the last year when it was Tk. 8,822 crore) would necessitate an upward revision of total public investment in FY2009-10.

The ADP for FY2010-11 is targeted to be Tk. 38,500 crore. New ADP is envisaged to give priority to infrastructure, agriculture and rural development. The seven priority sectors under the new ADP are: Transport (Tk. 5,510.6 crore; 14.3 per cent of ADP), Education & Religious Affairs (Tk. 5,184.2 crore; 13.5 per cent), Power (Tk. 4,994.7 crore; 12.9 per cent), Rural Development & Institutions (Tk. 4,440.3 crore; 11.5 per cent), Health, Nutrition, Population & Family Welfare (Tk. 3,920.3 crore; 10.2 per cent), Physical Planning, Water Supply & Housing (Tk. 3,530.7 crore; 9.2 per cent) and Agriculture (Tk. 2,495.1 crore; 6.5 per cent). The size of ADP for FY2010-11 was about 35 per cent higher compared to the RADP of FY2009-10. Considering the projected realised expenditure in FY2009-10 (90 per cent of RADP), the ADP for FY2010-11 will be 50.1 per cent higher. Given the demands of the economy this is not 'big' (and way below the 6.2 per cent GDP threshold of some years back); however, implementation will be a challenge.

4.3 Investment under Public-Private Partnership (PPP)

The much hyped PPP component of the FY2009-10 budget has remained unutilised inspite of some progress being made in terms of putting in place the regulatory framework. With an investment target of Tk. 70 billion, government had allocated an amount of Tk. 25 billion earmarked separately under the PPP budget. Rather, Tk. 5 billion was slashed from the PPP budget in the revised ADP for FY2009-10. It is anticipated that Tk. 30 billion will be allocated in the upcoming budget for FY2010-11 under the PPP head; the public-private investment leverage ratio is estimated to be close to 1:2.7. Also, 23 projects under PPP relating to power, infrastructure and healthcare sectors have been included in the FY2010-11 ADP project list though no fund has been allocated for these projects.

At present, there is no 'sanctioned' PPP Policy Guideline (P4G) in place. The government is now finalising the P4G following the submission of the report by the committee set up to review the earlier draft prepared by the Board of Investment (BoI).[29] The envisaged P4G is likely to incorporate some provisions of the *Private Sector Infrastructure Guidelines* (PSIG 2004) relating to transparency modalities with regard to profit-sharing, allocation of risks, responsibilities, mode of operation in terms of structure of ownership (BOO, BOT, BOOT).[30]

Government will need to design an appropriate PPP strategy which should have clear guidelines for financial participation of the government, incentives and risk sharing arrangement with private investors, and institutional framework for implementing the PPP. The PPP strategy should also have clear cut guidelines for appraisal of the PPP and the procedure that will be followed for approval of the identified projects. The procedure for both appraisal and approval of different projects according to scale and size (three slabs have been identified for this purpose) should also be spelt out clearly and separately.

To harmonise the dichotomy of public and private interests, appropriate legislation should be enacted in order to provide both the parties necessary legal coverage. The government could contemplate on developing a legal framework to put the PPP agenda in effect where lessons can be drawn from other countries such as Mauritius which has both (a) PPP Act laying out the principles guiding public private relations; and, (b) a comprehensive document dictating PPP programmes of action. The PSIG 2004 institutional framework and organizational structure for developing projects (which includes 7 stages starting from identification to project construction) are, however, cumbersome. To accelerate the process of project implementation, the new P4G needs to engineer a comprehensive framework in order to ensure competent administration, regular monitoring and sound accountability. Furthermore, the envisaged P4G should provide transparent time-lines according to project categories. A separate PPP office, vested with adequate power and endowed with human resources, will need to be set up to generate the required momentum.

4.4 Private Investment

Private investment remained subdued because of weak public sector response with regard to investment in power and infrastructure. Private investment has maintained a double-digit growth in nominal terms over last two decades (e.g. on an average 13.1 per cent in FY2001-05 and 14.3 per cent in FY2005-2006). Private investment's share in GDP is about 19 per cent, accounting for about 80 per cent of total investment in the country. Low levels of private investment (Tk. 13,6284.6 crore or 19.7 per cent of GDP in FY2009-10) was mainly due to absence of conducive investment environment rather than availability of funds (considering the prevailing high level of excess liquidity with the scheduled banks), although investors have complained about high interest rates and high spread between lending and deposit rates.[31]

[29] The ongoing projects being implemented through PPP by the Infrastructure Development Company Limited (IDCOL) and Investment Promotion and Financing Facility (IPFF) with technical and consultancy support from the Infrastructure Investment Facilitation Centre (IIFC), follow the PSIG 2004 guidelines.

[30] A number of countries have ensured transparency through constructing websites (e.g. www.pppindia.com) containing all the necessary and up-to-date information concerning PPP projects, according to sectoral and state programmes. A similar initiative could be considered by the Government of Bangladesh (GoB) to generate awareness among all stakeholders in order to bring transparency to PPP rules and regulations.

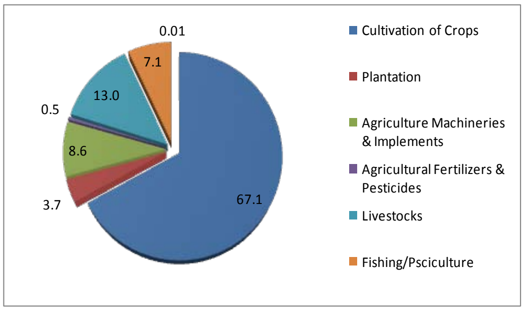
[31] Country's gross national savings as percentage of GDP has been higher than gross domestic investment since 2001-02. Higher national savings (compared to domestic savings) is largely explained by the buoyant inflow of remittance.

Composition of private investment in the form of outstanding credit balance appears to have remained unchanged over the past several years.[32] As of December, 2009 shares of outstanding credit balance for various sectors were as follows: 35.5 per cent in manufacturing activities, 6.15 per cent in agriculture, 1.94 per cent in services, 6.85 per cent in construction and 36.8 per cent in trading (including export and import financing).

4.4.1 Investment in Agriculture Sector: Disbursement of Agricultural Credit

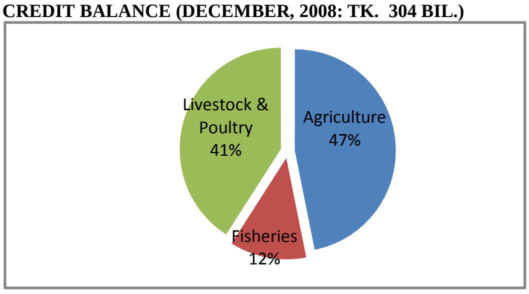
In view of development of diversified agriculture, particularly in non-rice and non-crop sectors, large scale private investment is needed along with public investment, if required on PPP basis. Investment in agriculture, in terms of share of outstanding credit balance, in December, 2009, was only about 6.2 per cent (Tk. 14,369.1 crore). This small share of institutional credit does not reflect the substantial investment in agriculture since a large part of investment in the sector originates from other sources.[33] In terms of outstanding loans, major share of investment in agriculture sector was mainly for crop cultivation (67 per cent of outstanding loans to agricultural activities as of December, 2009) (Figure 12a).[34] Credit disbursed by microfinance institutions (MFIs) was another source of capital for investment in agriculture sector. As of December, 2008 their disbursement of agricultural credit was Tk. 1,42,725.7 million, which was 31.6 per cent higher compared to that of commercial banks (Figure 12b). In view of its high income elasticity, and the expected rise in demand, investment in non-crop agricultural activities needs to be increased further through channeling of more financial resources of commercial banks and MFIs into the related areas. However, till now commercial banks have not been forthcoming in this regard – they have disbursed only a small amount of credit to non-crop and non-rice agriculture.[35] Main sectors were livestock rearing (13 per cent of total outstanding), purchasing agricultural machineries (8.6 per cent) and fishing (7.1 per cent). MFIs, on other hand, have disbursed a substantial amount of credit (Tk. 1,62,019 million as of December, 2008) for non-crop agriculture particularly for fisheries, livestock and poultry related activities. Envisaged government policy initiatives as regards crop diversification in northern region, and strengthening of rice cultivation in southern and coastal regions will require restructuring of the distribution of agricultural credit in line with the expected policy changes.

FIGURE 12A: COMMERCIAL BANKS: DISTRIBUTION OF OUTSTANDING AGRICULTURAL CREDIT BALANCE (DECEMBER, 2009: TK. 132 BIL.)



Source: Bangladesh Bank

FIGURE 12B: MFIS: DISTRIBUTION OF OUTSTANDING CREDIT BALANCE (DECEMBER, 2008: TK. 304 BIL.)



Source: Bangladesh Microfinance Statistics

[32] It is to be noted that outstanding credit balance may indicate a higher share because of higher amount of non-performing loan.
[33] According to the *Agricultural sample survey 2005*, only one-third of farmers received credit from formal financial institutions (BBS, 2006).
[34] Total outstanding advances to agriculture at the end of December, 2009 was Tk. 14,369.1 crore, which was 6.5 per cent higher compared to December, 2008.
[35] Outstanding credit balance as of December, 2009 was Tk. 40,553.8 million.

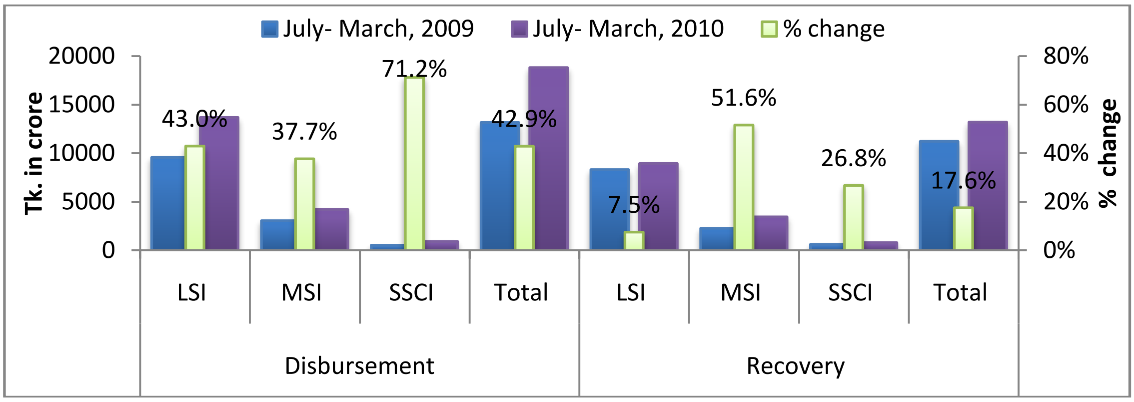
Disbursement of agricultural credit during July-April FY2009-10 was Tk. 8,949.3 crore, in line with the pace set out in the previous year, with growth rates being 15.8 per cent and 14.8 per cent respectively. In order to expedite agricultural credit, a number of policy changes or operational measures have been initiated in the current fiscal year such as new directives of the central bank as regards disbursement of agricultural credit being mandatory for all commercial banks, organising of country-wide road-show to raise awareness about disbursement of agricultural credit etc.[36] However, growth of agricultural credit recovery during July-April FY2009-10 was lower than that of the last year (23.4 per cent vis-à-vis 34.1 per cent). Although share of overdue loans during this period has somewhat declined, it continued to remain at higher levels (29.1 per cent of total outstanding as of March, 2010).

4.4.2 Investment in the Manufacturing Sector: Disbursement of Credit

Manufacturing sector experienced a declining trend in production in the current year (coming down from 10.8 per cent in FY2005-06 to 5.28 per cent in FY2009-10). Production in the manufacturing sector was affected mainly due to lack of adequate supply of electricity and gas.[37] Other contributing factors were volatility in the market for raw materials particularly of cotton yarn and raw jute, depreciation of Euro, and low demand of some of the export items. However, several export-oriented industries have posted higher growth including leather and leather products, jute goods, and ceramic products among others.

It is of interest to note that disbursement of industrial term loan recorded significant improvement thanks to increased demand for credit by major industries. During July-March, FY2009-10 disbursement of term loan was Tk. 18,827.5 crore registering a growth 42.9 per cent compared to that in the previous year (Tk. 13,174.2 crore; growth (-) 9.6 per cent) (Figure 13).[38] Quarterly disbursement and recovery of credit for all categories of industries, has improved in later part of the year. Special drive undertaken by the government towards better recovery has helped in this regard (Box 2).

FIGURE 13: DISBURSEMENT AND RECOVERY OF INDUSTRIAL CREDIT TO LARGE, MEDIUM AND SMALL SCALE INDUSTRIES



Source: Bangladesh Bank

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[36] Bangladesh Bank in its five-year strategic plan for 2010-2014 has reemphasised, among others, enhancement of disbursement of agricultural credit.
[37] Industrial use of electricity has increased only by 0.1 per cent during July-March, FY2009-10 compared to the corresponding period of the previous year.
[38] Disbursement of industrial term loan to large and medium enterprises (LMEs) and small scale enterprises (SSEs) during July-December, FY2009-10 was higher at 41.7 per cent and 71.2 per cent respectively compared to the corresponding period of the previous year.

Outstanding credit balances for a number of 'domestic market-oriented industries' were significantly high. This is observed in case of industries such as soaps and detergents (88.7 per cent), electrical equipment (106.2 per cent), rice and flour mills (93.1 per cent), and paper and paper products (171.8 per cent). Same holds true for some export-oriented industries e.g. jute mills (77 per cent), ceramic products (61.2 per cent), and leather and leather products (645.8 per cent). Most of these industries experienced better export performance in FY2009-10 relative to others. It is to be noted here that import of capital machineries has started to pick up gradually (6.03 per cent in July-March FY2009-10 vis-à-vis -13.8 per cent in July-March FY2008-09). However, a number of industries have registered negative growth in terms of outstanding credit balance. These were prawn/shrimps processing, fruit juice processing, rubber products, cement and asbestos, salt manufacturing, plastic products and weaving industries. Lower growth of recovery of industrial credit to large scale enterprises during July-March FY2009-10 (7.5 per cent vis-à-vis 51.6 per cent for medium scale industries and 26.8 per cent for small scale industries) may have increased outstanding balances (not necessarily overdue loan) in the coming year.[39]

BOX 2: FINANCING THE SMES: RESULT FROM CPD FIELD SURVEY

Financing of SMEs received some impetus this year thanks to a number of initiatives of the government in support of domestic market-oriented industries particularly in view of the global economic recession. Bangladesh Bank had undertaken a number of activities this year including establishment of a separate department called 'SME and Special Programme Department'[40] and preparation of a SME financing guideline called 'SME Credit Policies and Programme' focusing on an 'area based approach' for disbursement of credit by commercial banks[41] setting targets at Tk. 24,000 crore for disbursement of credit in 2010[42]; and Bangladesh Bank had also organised a road show from *Teknaf* to *Tetulia* called 'SME Financing, Raising Awareness about Agricultural Credit, Anti-Money Laundering and Encouragement to Transfer Remittance through Banking Channel'.

CPD carried out an area-based rapid assessment to examine the impact and implications of recent initiatives of the Bangladesh Bank with regard to financing SMEs. The assessment has been carried out in *Narayangonj* both at bank level (one branch of a state-owned commercial bank (SCB) and one of a private commercial bank (PCB) and at borrowers' level (with 24 borrowers). The survey reveals that branches of both SCB and PCB have in general put emphasis on financing the SMEs. However, there was serious weakness in terms of following the provisions of the Central Bank Guidelines. Major observations emanating from the survey are: (a) higher rate of interest charged by PCBs; (b) absence of upper ceiling on the interest rate (as high as 17 per cent); (c) ambiguity in terms of defining SMEs particularly in case of the SCBs; (d) inadequate number of SME centres set up by SCBs; (e) restrictive guidelines designed by the banks for selecting prospective borrowers (e.g. minimum two years of experience, health insurance, fire insurance, trade license). It was also noted that compliance with provisions entailed an extra burden equivalent to 1 to 2.5 per cent of credit disbursed to the SMEs.

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

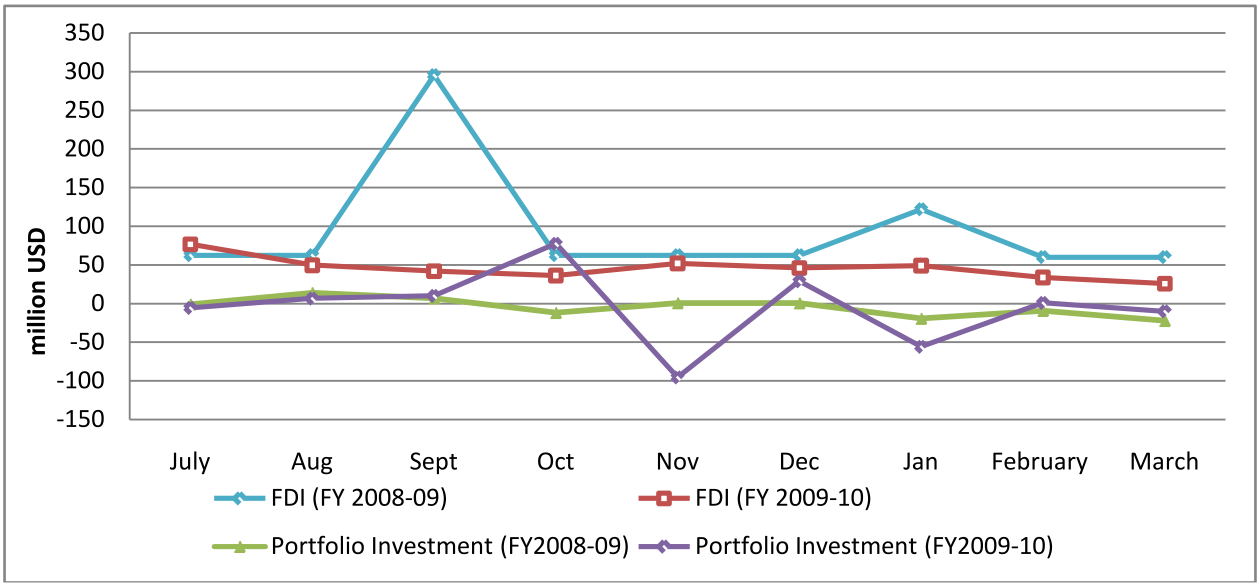
[39] It is to be noted that overdue loan in general and in different categories of industries has decelerated as of December, 2009 compared to that as of December, 2008.
[40] Earlier it was under the 'Department of Agricultural Credit and Special Programmes'.
[41] Other major aspects of the guideline are: clearly specified definition of SMEs, reservation of fund for small enterprises, putting priorities in case of funding to industries and services, financing women-led enterprise at 10 per cent rate of interest, identification of potential sectors for financing in major upazillas of 64 districts and providing specific monitoring guideline of financing SMEs by Bangladesh Bank.
[42] At least 40 per cent of the total disbursement of credit for SMEs is targeted to small enterprises.

4.4.3 *Foreign Investment: FDI and Portfolio Investment*

Aggregate FDI inflow was dismally low; however, higher FDI flow to EPZs has reinforced the need to address power and infrastructure issues on an urgent basis. FDI inflow (gross) in July-March FY2009-10 (USD 447 million) has declined by 50.9 per cent compared to the corresponding period of the previous year (Figure 14).[43] Because of various constraints, including shortages of electricity and gas, FDI in the domestic tariff area (DTA) has declined by 61.7 per cent during this period (Box 3). On the other hand, FDI flow to export processing zones (EPZs) was able to demonstrate high growth, (24.9 per cent in July-March, FY2009-10) most likely because of assured power and utility facilities and better infrastructure.[44] FDI in the power sector has also fallen significantly in recent years, as shown in Figure 15. The 'road shows' organised in New York and Singapore to attract FDI in the energy sector is yet to generate results in terms of concrete investment proposals.

Portfolio investment flow was negative during July-March FY2009-10 ((-) USD 42 million), continuing the trend of FY2008-09 in the backdrop of the global financial crisis. In contrast to the high growth of registration of local companies (3,293 units; with a growth of 63 per cent during July-April, FY2009-10) registration of FDI, similar to the FDI flow, has experienced negative growth (797 units and (-) 62.0 per cent growth).[45] It would not be unjustified to remark that FDI was unlikely to pick up unless domestic investment scenario changes for the better.

FIGURE 14: MONTHLY FLOW OF FDI IN 2008-2010



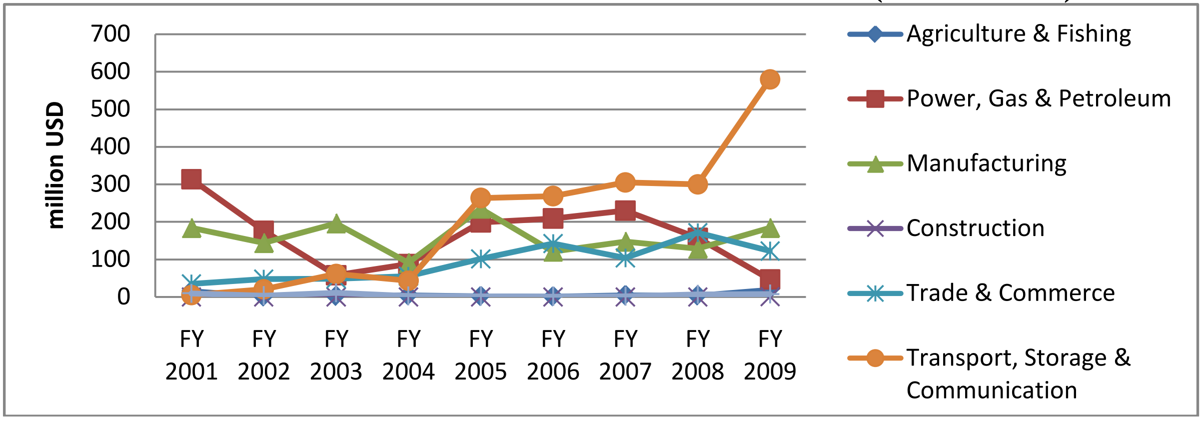
Source: Estimated from Economic Trends, April 2010; Bangladesh Bank

[43] The share of FDI to GDP in FY2008-09 was 1.1 per cent and appears to be declined in this fiscal.

[44] Major EPZs such as Dhaka and Chittagong received about 30 to 40 percent more FDI compared to that of the corresponding period of the previous year. On the other hand, two joint venture initiatives undertaken for establishment of dry-cell batteries and leather shoe factories, have contributed to the higher level of investment in Comilla and Uttara EPZs (USD19.03 million; growth 126.5 per cent).

[45] FDI registration was made for traditional as well as non-traditional industries such as textiles, RMG, garments accessories, footwear, bicycle and metal and electrical goods.

FIGURE 15: SECTOR-WISE FDI INFLOW IN BANGLADESH (MILLION USD)



Source: Compiled from Statistics Department data, Bangladesh Bank

BOX 3: FDI DATA: NEED FOR RECONCILIATION

Data on flow of FDI to the country is reported and published by Bangladesh Bank and BEPZA. It is to be noted that FDI data published by Bangladesh Bank is often confusing (Table 2). FDI data published in the *Major Economic Indica*tors under balance of payment did not match the data mentioned in the *Monthly Economic Trends*. This happens because of non- reporting of FDI flow to EPZs in the *Major Economic Indicators*. On the other hand, FDI flow published in *Foreign Direct Investment in Bangladesh: Survey Report* has serious discrepancy with that published in Bangladesh Bank's annual publication *Annual Balance of Payments*. Bangladesh Bank may like to review all the relevant documents which reported FDI flow, and ensure consistency in definition and estimates.

TABLE 2: DIFFERENCES IN FDI RELATED DATA REPORTED IN DIFFERENT DOCUMENTS OF BANGLADESH BANK

Amount (million USD)	FDI Survey (A)		Balance of Payment (BOP) (B)		Difference between (A) and (B) = (C)		Major Economic Indicators (D)	Monthly Economic Trends (E)	Difference between (E) and (D) = (F)
	FY 2007-08	FY 2008-09	FY 2007-08	FY 2008-09	FY 2007-08	FY 2008-09	FY 2009-10 (July-January)	FY 2009-10 (July-January)	
Total	768.69	960.59	650.19	1034.07	118.5	-73.42	228	352.78	124.78
Equity Capital	545.69	535.42	380.52	713.55	165.17	-178.13			
Reinvestment earnings	197.71	336.61	231.88	277.15	-34.17	59.46			
Intra company loans	25.29	88.56	37.8	43.37	-12.51	45.19			

Source: Authors' calculation based on Different Publications of Bangladesh Bank

It is pertinent to note here that a substantial amount of foreign exchange is going out of the country on account of FDI in the form of payment of royalties, profit and dividend and earnings of oil, gas and power companies (Table 3). Transfer of income by power generation companies is likely to rise further in the coming years. Net FDI received by Bangladesh during July-December, 2009 was indeed negative (USD 79 million). Since a number of multinational companies (MNCs) (particularly the telecom companies) transfer profit in the form of intracompany loan to their subsidiaries, net FDI is likely to be a large negative number. As a matter of fact, repatriation of profit in full amount is allowed as per the FDI Act. It is to be expected that with cumulative FDI rising, outflow is also expected to rise. What is important here is to encourage companies to invest their retained surplus. Outward transfer in the form of 'transfer pricing' should be strongly monitored. Global studies indicate significant transfer of resources from developing countries through 'transfer pricing'.

TABLE 3: FDI INFLOW & OUTWARD TRANSFER OF FDI (MILLION USD)

Components	FY 2006-07	FY 2007-08	FY 2008-09	FY2009-10 (July-December)
FDI Inflow				
A. Total inflow	792.74	768.69	960.59	303.48
Equity	464.5	545.69	535.42	
Reinvested Earnings	281	197.71	336.61	
Intra company loans	47.24	25.29	88.56	
Outward Transfer				
B. Total Outward Transfer	575.83	653.05	879.93	382.96
Royalties & License Fees	6.47	7.89	22.66	5.66
Profit & Dividends	165.41	173.33	207.39	104.7
Earnings of Oil, Gas and Power companies	403.95	471.83	649.88	272.6
C. FDI Inflow after deducting outward transfers (A-B)	216.91	115.64	80.66	-79.48

Source: Compiled from Statistics Department data, Bangladesh Bank

Healthy reserves of over USD 10 billion has allowed Bangladesh Bank to sanction foreign currency loans for investment purposes. Private investors are now allowed to take loan in foreign currency for implementing offshore investment projects, though on a limited scale. The central bank is also thinking of developing a 'sovereign wealth fund' with an initial capital of USD 500 million to provide credit to local investors for investing abroad.[46]However, Bangladesh Bank should apply due diligence in terms of selection of projects and disbursement of credit from this fund.

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

4.4.4 Investment in the Capital Market

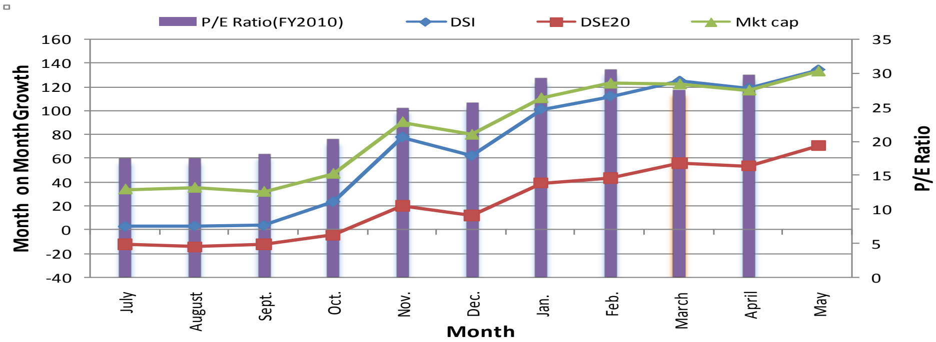
In the backdrop of slow growth of industrial production over the last few years, particularly during the first half of FY2009-10, significant growth of capital market attracted attention of industrial analysts. Between May, 2009 and May, 2010, DSI index registered a growth of 134.4 per cent (index value was 5,030.05 at the end of May, 2010), DSE20 index gained 70.5 per cent (index value was 3,432.23 the end of May, 2010); market capitalisation rose by 133.6 per cent (amounting to USD 36.88 billion at the end of May, 2010 which was equivalent to about 40 per cent of the GDP) (Figure 16). These developments in the market are particularly attributed to a number of issues: *firstly*, highest number of initial public offerings (IPOs) were floated during the ongoing fiscal year (21 new IPOs) which included a large MNC the GrameenPhone (GP), which contributed to the depth of the capital market.[47] *Secondly,* the bullish market attracted a huge number of small investors (in April, 2010 total number of BO account holders reached about 2.5 million).

[46] Bangladesh Bank in its strategic vision for 2010-2014 has emphasized on setting up such a fund in order to optimise returns from investment of resources with due attention to liquidity and risk concerns.

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

Number of new BO accounts that were opened in the DSE between April, 2009 and April, 2010 was 0.32 million (corresponding figures for the same period of previous two years were: 0.34 and 0.31 million, respectively). Most of these investors were small investors with limited knowledge about the market.[48] Some analysts have argued that the market is becoming overheated and investment in the market is becoming increasingly risky (Box 4). The sharp rise of price earnings (P/E) ratio (P/E ratio for DSE was 29.9, whereas for some companies it was as high as 75 and above) has reinforced this argument.[49]

FIGURE 16: TREND OF MAJOR INDICATORS OF CAPITAL MARKET (DSE)



Source: DSE website (Assessed on 20 May, 2010)

Capital market is experiencing significant volatility in recent times in the backdrop of impressive buoyancy. Following the methodology of Rahman and Hossain (2008), volatility was calculated to see the stability of the market both in short and long terms. The 'volatility index' for DSI during July, 2009 to May, 2010 was 1.7, which has gradually increased in recent time (For BSE this index ranges in between 1 to 1.3) (Table 5). This is also true for DGEN, market capitalisation, total trade and total volume; these indicators were found to be less stable and experiencing volatility in recent times. The volatile nature of the market can be explained by various economic and non-economic factors such as global recession in 2009, offloading of GP shares in the market, inconsistency in SEC's decisions with regard to margin loan facility, face value harmonisation, and apprehensions about capital gain tax (Figure 17).[50] According to Table 6, relatively higher growth of market capitalisation over time compared to that of issued capital confirms market volatility owing to accelerated growth on the demand side. Demand for new shares in the capital market needs to be addressed through off-loading of shares of (SOEs) (26 SOEs are in the list for off-loading), issuance of the proposed infrastructure bonds and raising of equity from the capital market for large scale power sector projects to be developed under various PPPs.

[48] According to anecdotal information, small investors control around 30-40 per cent of daily trade, institutional investors account for around 30 per cent and long-term investors are responsible for the rest 30 per cent of daily trade at DSE.
[49] The P/E ratio in case of Bombay Stock Exchange (BSE) is found to be stable and hovers around 19-21 between January, 2009 and April, 2010.
[50] However, this extreme high value of volatility can be also attributed to the faulty calculation system of indices followed by the DSE.

BOX 4: MARKET EFFICIENCY OF DHAKA STOCK EXCHANGE (DSE)

In an efficient market stock prices usually reflect all the relevant information of real economy such as production, inflation, money supply as well as other insider information (e.g. expansionary or contractionary production decisions of companies) in its price behaviour (Beechey, Gruen and Vickery, 2000). To find out the efficiency in the capital market of Bangladesh market, a time series analysis has been carried out using various secondary data such as monthly data of QIP for general manufacturing, flow of remittances, CPI, broad money supply (M2), and commercial deposit rates (less than for 3 months) for the period of July, 2005 to December, 2009, as independent variables. One period lag of DGEN was considered as the dependent variable due to anticipatory behaviour of the investors in the capital market. Due to unavailability of information on other real economic variables, most importantly, for QIP and other insider information data for the latest months could not, however, be used. From the estimated model, none of the variables were found to have strong relationship with lagged value of DGEN, except M2, which is an indication of inefficiency in the short run (Table 4). Extension of the analysis further, to examine, the long term relationship, also leads to similar conclusions, which was in line with some of the earlier findings in this regard (Ahmed and Imam, 2007).

TABLE 4: MARKET EFFICIENCY OF DSE

	OLS		Auto-correlation adjusted	
Indicator	Coefficient	P-value	Coefficient	P-value
Dependent Variable	One month lag of DGEN		One month lag of DGEN	
Constant	-5.48	(0.01)	-5.98	(0.08)
Ln (QIP Gen. Manuf.)	-.89	(0.02)	-.24	(0.18)
Ln (Remittance)	.21	(0.30)	.01	(0.88)
Ln (CPI)	.20	(0.00)	.13	(0.61)
Ln (M2)	1.36	(0.00)	1.24	(0.00)
Ln commercial deposit rate (less than 3 months)	-.75	(0.03)	-.27	(0.40)
Number of observation	65 (Jul. 2005 to Dec. 2010)		65 (Jul. 2005 to Dec .2010)	
R-squared	0.76		0.93	
Durbin-Watson d-statistic(6, 65)	0.34		1.74 (transformed)	

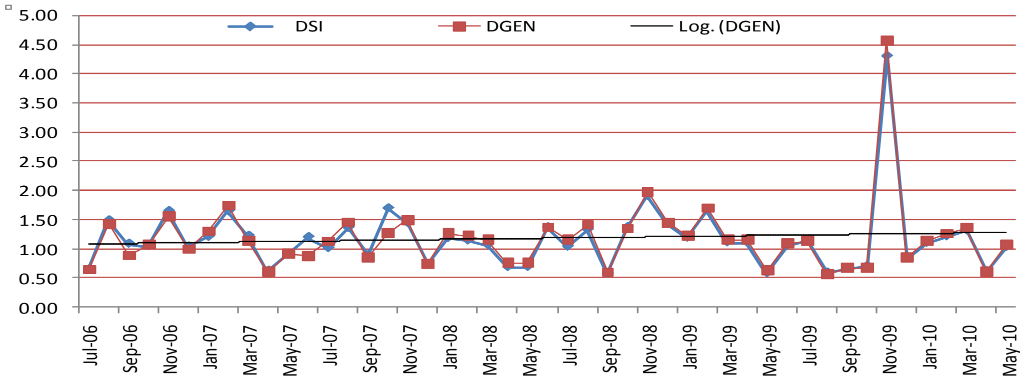
Source: Authors' estimation

TABLE 5: INTER TEMPORAL VOLATILITY OF MAJOR DSE INDICATORS

Indicator	**July, 2005 to May, 2010**	**July, 2006 to May, 2010**	**July2007 to May2010**	**July2008 to May 2010**	**July 2009 to May 2010**
Total Trade	15.12	16.05	14.80	14.83	13.08
Total Volume	23.10	23.86	22.15	19.21	16.09
Value in Taka	20.95	22.15	18.61	12.38	15.03
Market Cap	1.02	1.20	1.19	1.23	1.38
DSI	1.14	1.35	1.38	1.48	1.62
DGEN	1.16	1.37	1.43	1.54	1.70

Source: Authors' calculation based on data collected from the DSE

FIGURE 17: PATTERN OF VOLATILITY OF MAJOR DSE INDICES



Source: Authors' calculation based on data collected from the DSE

TABLE 6: GROWTH OF MARKET CAPITALIZATION (DEMAND SIDE) AND ISSUED CAPITAL (SUPPLY SIDE)

Period (1)	Growth of Issued Capital (2)	Growth of Market Capitalization (3)	Demand-sully Gap (Difference between 3 and 2) (4)
June, 2007	93.48	119.88	26.40
June, 2008	74.35	97.63	23.28
June, 2009	59.89	35.09	-24.79
April, 2010	24.45	78.01	53.55

Source: Authors' calculation based on the *Monthly Review* of the DSE, various issues

The Securities and Exchange Commission (SEC) was not always successful in keeping the volatility in the capital market under check. SEC has tried to correct market fundamentals from time to time by applying various instruments including changing of the margin loan ratio and discouraging trade of overvalued shares (through 'over the counter' or 'spot market' trading). In this context, there is a need to strengthen SEC's surveillance and monitoring role. SEC may consider some operational restructuring in line with what is the case with India's SEBI (Securities and Exchange Board of India). SEBI is directed by a Chairman, usually well-reputed public/private sector personnel which is mainly run by thirteen different committees (each comprises of 3-19 members) to foresee different activities of all stock markets operating in India. SEC should also strengthen its independent research and monitoring capacity. There should be an effort to explain to investors the reasons for particular decisions by the SEC. Major regulatory decisions should be made on the basis of a broad-based consultation with the concerned stakeholders. There is a need for the SEC to more carefully scrutinise and examine the quality of audited reports submitted by the listed companies. Brokerage houses should be set up in major points throughout the country. Expansion of capital market educational programme up to local levels may be considered by the SEC to raise awareness about stock market. Setting up a separate judiciary mechanism for settlement of disputes in the capital market could help bring more transparency in SEC's operation.

4.4.5 Factors Influencing Investment during 2009-10: Entrepreneur's Perception Survey

Entrepreneurs felt that the most important discouraging factor for businesses in 2009 was inadequate infrastructure. CPD carried out a perception survey on business environment in the country during February, 2009 to January, 2010. A total of 88 entrepreneurs participated in the survey. Entrepreneurs' perception as regards inadequate infrastructural facility is well matched with the crisis of electricity and gas supply in the industrial sector, as lack of adequate supply caused underutilisation of production capacity, extra cost for using diesel to operate captive power plants and damage sophisticated industrial machineries due to frequent power outages etc. Entrepreneurs opined that inefficient government bureaucracy is becoming a major concern for business operation in the country as it came out to be the second most important problematic factor (14.6). Corruption was considered as the third-most important negative factor by the entrepreneurs.

Respondents thought that inflation would become a major challenge in 2010. As high as 77 per cent respondents expressed this opinion. Majority of respondents (over 80 per cent) did not feel that supply of electricity and gas will significantly improve in 2010; more than 75 per cent respondents thought that there was high level of insider-trading in the capital market. However, a number of positives were also mentioned by the entrepreneurs: such as relatively less difficulty in obtaining collateral free credit (61 per cent), and easy to raise money from the capital market (61 per cent).

Overall, entrepreneurs were optimistic about economic growth in 2010 (January-December, 2010 period) - 57 per cent of the entrepreneurs believed in high prospect for growth in 2010. The comparable figure for 2009 was at a much lower level (21 per cent).

SECTION V: ENERGY: PERFORMANCE AND PLAN

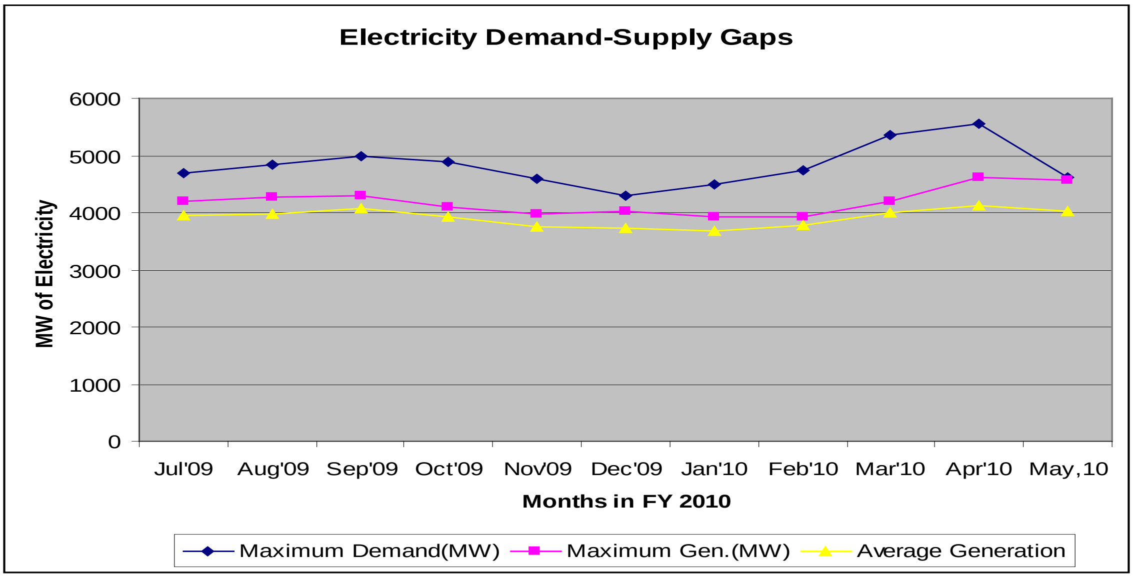
Addressing the power situation emerged as the most challenging issue for Bangladesh in the FY2009-10. Shortage of power supply has caused serious damage to the economy and its growth prospects in terms of reduced industrial production, lower exports, less investment, besides making citizen's life miserable. The government gave topmost priority to the task of improving the ongoing situation in the power sector and took a number of immediate and medium term initiatives. Stimulating investment and production and the targets of higher GDP growth will critically depend on the government's ability to deliver the expected results.

5.1 Power Sector

State of the Electricity Generation

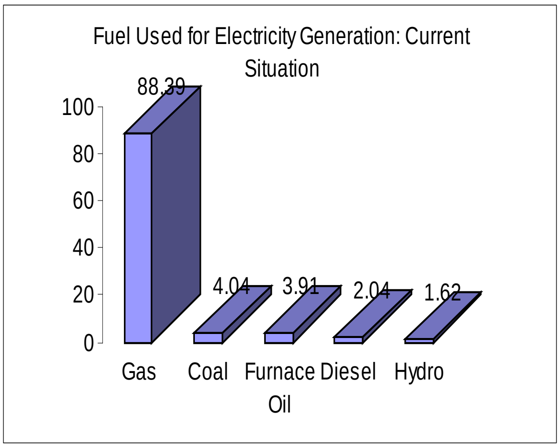
Despite the new initiatives taken to enhance country's electricity generation capacity Bangladesh will need to go a long way to meet her rising demand for power (Figure 18). There was significant demand-supply gap throughout FY2009-10, as is seen from Figure 18. The current electricity crisis was fuelled mainly by increased gas demand for both electricity generation and non-electricity sectors of the economy with slow increase in gas supply besides frequent disruption in many of the ageing plants and transmission lines. One of the key contributing factors leading to the current electricity shortage was the dwindling gas supply in a situation of exclusive dependence on gas for electricity generation, which is about 88 per cent (Figure 19a). The main reason behind the current gas crisis can be traced to the increasing demand for gas in various other sectors of the economy (demand increased by 16.8 per cent), in addition to that for power generation (increased by 13.5 per cent) (Figure-19b). Lack of investment in gas extraction and new exploration contributed to the looming shortage. No tangible effort was taken to explore the significant coal resources of the country either. Many ageing electricity units of the existing plants and grids got frequently disrupted due to technical faults and lack of timely repair. All these have culminated in a situation where costly policy choices have to be made to address the power crisis at hand.

FIGURE 18: GAPS BETWEEN MAXIMUM DEMAND, MAXIMUM GENERATION AND AVERAGE GENERATION OF ELECTRICITY IN THE FY2009-10



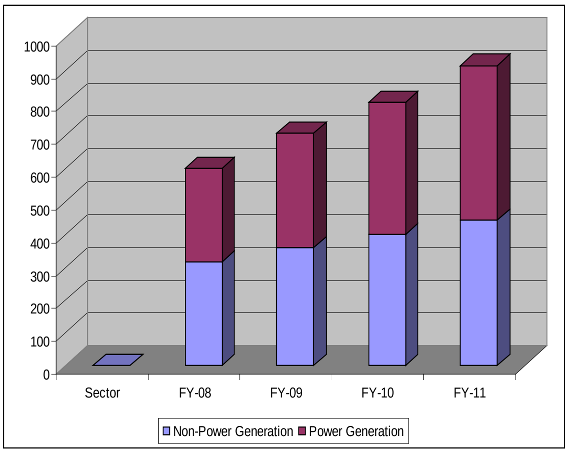
Source: BPDB, 2010

FIGURE 19A: CURRENT FUEL USE FOR ELECTRICITY GENERATION



Source: BPDB, 2010

FIGURE 19B: PROJECTED GAS DEMANDS

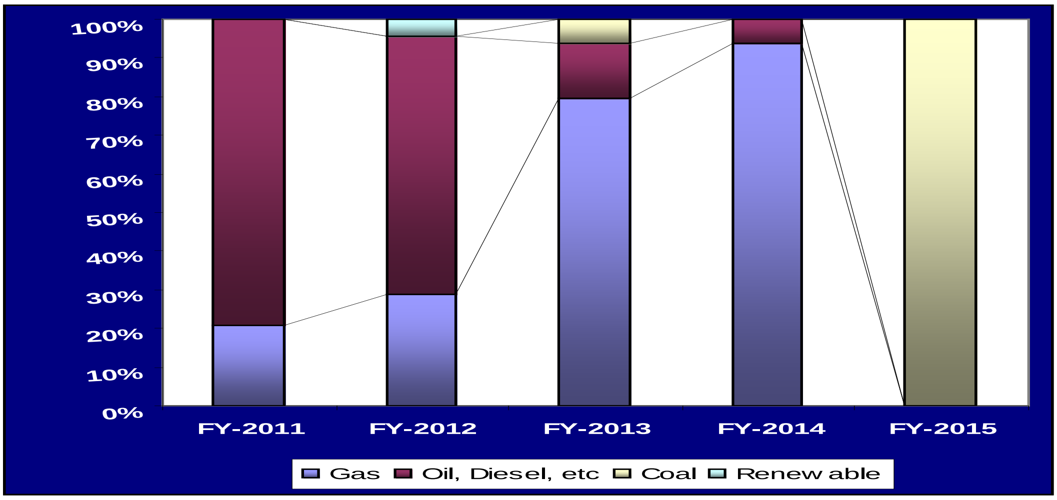


Source: Petrobangla, 2010

Recent Initiatives Taken by the Government for the Development of Electricity Sector

Power crisis in the recent months compelled the government to undertake some immediate and medium-term plans to generate additional electricity, initially from oil and diesel-fired 'quick rental' and 'peaking' plants (FY2010-11 and FY2011-12) and then go for gas-based power generation in the FY2012-13 and FY2013-14 with improvement in gas supply and finally rely more on coal-fired plants in FY2014-15. The government has recently come up with a plan for the development of the electricity sector over the short to medium term. This includes establishing 'quick rental' and 'peaking' plants, both by state and by private actors for ensuring immediate improvement in the electricity supply situation. Under this plan additional 9,426 MW of electricity was expected to be produced by 2015.[51] Total cost for implementing the plan is estimated to be about USD 12 billion. In the context of shortage of gas the government had to opt for HSD (High Speed Diesel) or HFO (Heavy Fuel Oil)-fired seven ‘quick rental’ plants, with generation of a total capacity of 790 MW in 2010. Gradually, with the increase in gas supply, gas is planned to be used as fuel for electricity generation for the majority of the new plants by 2014 (Figure 20). But in 2015 two coal-fired mega-plants, each having generation capacity of 1,300 MW, under the PPP/ IPP are expected to be started with mostly imported coal.

FIGURE 20: SHARE OF FUEL ACCORDING TO THE GOB'S PLAN FOR ELECTRICITY GENERATION FOR 2011 TO 2015 PERIOD



Source: BPDB (2010)

The Memorandum of Understanding (MoU) signed between India and Bangladesh in January, 2010 for importing 250 MW of electricity from India is a new initiative that will make power a tradable item for the first time in Bangladesh context. To facilitate import of 250 MW of electricity from India the country needs to install a 45 km transmission line from the border to her national grid. The estimated installation cost is expected to be about Tk. 1,100 crore which needs to be incorporated in the upcoming budget. Also there is yet another plan on the table to have joint collaboration between BPDB and National Thermal Power Corporation (NTPC) of India to install a 1,320 MW thermal power plant in *Khulna*. Initiatives are also being taken to develop a 2,000 MW capacity nuclear power plant at *Rooppur* in *Pabna* with support from the Russian government. Implementation of all these plans will require substantial funding, careful sequencing of activities and building of the requested infrastructure. Many of the related activities will need to be initiated in FY2010-11 with appropriate resource allocations in the budget.

Implementation of the recent plan unveiled for additional power generation is expected to increase power subsidy taking into consideration various scenarios with respect to power tariff. Realisation of government’s power plan will entail allocation of significant resources to accommodate the additional fiscal burden even if the government plans to increase the existing tariff rate over the next five years. CPD has carried out an exercise to estimate the extent of tariff burden which the government will need to bear for implementing the plan, under three possible scenarios. First, if the tariff rate remains at the present level of Tk. 3.66 per kWh of electricity over the next five years, the subsidy is expected to be in the range of

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

Tk. 3,775 crore to over Tk. 5,000 crore for various years in this period (Table 7). On the other hand, if the tariff rate is to rise by 5.75 per cent annually (considering the tariff hike over the last three years average) the annual subsidy requirement will be in the tune of Tk. 3,200 crore to Tk. 4,500 crore per year over the next five years. The figure is estimated to be between Tk. 2,500 crore to Tk. 3,400 crore per year considering an annual growth rate of 12 per cent for the period of FY2010-11 to FY2014-15.

TABLE 7: FISCAL BURDEN FROM THE RECENTLY UNVEILED POWER GENERATION PLAN BY THE GOB

Fiscal Year	Fiscal Burden (in crore)[a]	Fiscal Burden (in crore)[b]	Fiscal Burden (in crore)[c]
FY2010-11	3775	3570	2505
FY2011-12	5070	4525	3370
FY2012-13	5070	4220	3370
FY2013-14	4605	3550	3065
FY2014-15	4605	3250	3065
Total (FY2010-11 to FY2014-15)	23125	19115	15375

Source: Author's calculation

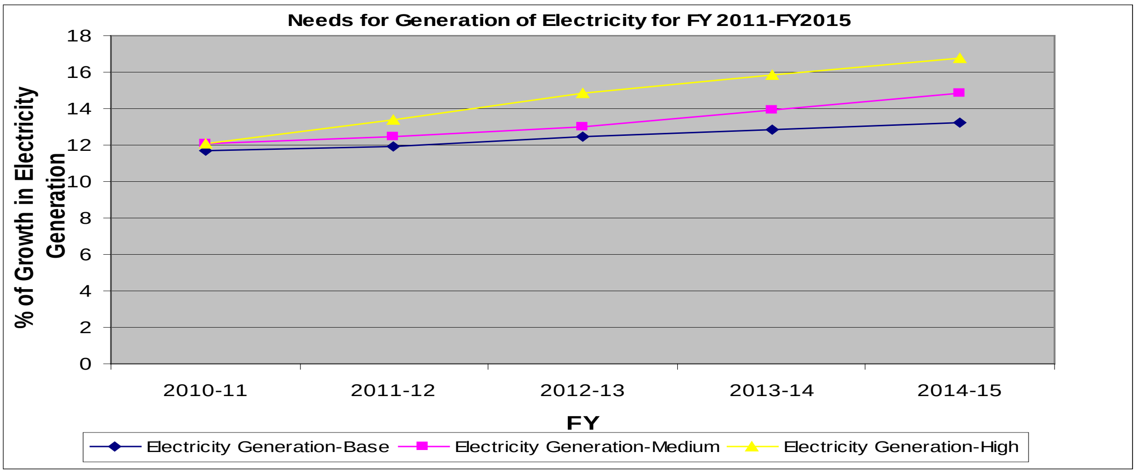
Note: Production in the proposed *Meghnaghat* is considered to be 400 MW and the probable starting time for 20 MW capacity (3 yearly) rental plant in *Baghura* is taken as July 2010

a. considering tariff to be at the present level (3.66 per cent annually) over the next five years
b. considering tariff to rise by 5.75 per cent (average of the past three years) annually over the next five years
c. considering tariff to be increased by 12 per cent annually over the next five years

Average electricity generation needs to be increased annually at the rate of 12.5 per cent to 14.5 per cent to commensurate with the GDP growth targets over the Sixth Five Year Plan period (FY2010-11 to FY2014-15). Keeping in mind the GDP targets for SFYP period of the country (FY2010-11 to FY2014-15), an exercise was carried out at the CPD to estimate the required growth in electricity generation for the country during the SFYP period. Estimates indicate that the average annual growth of electricity generation should be in the range of 12.5 per cent to 14.5 per cent to meet the GDP growth targets for the period of FY2010-11 to FY2014-15 (Figure 21). In view of the GoB's recently unveiled power plan, annual average growth of electricity generation is expected to be about 26.6 per cent for the entire sixth five year plan period. However, it would need to be kept in mind that it is the net generation capacity, not the installed capacity which actually matters. Also frequent disruption in power supply due to disfunctioning of old plants or grids and maintenance work are commonly experienced problems which could infact make the actual availability lower than what is projected. Another serious problem of power sector development in Bangladesh is undue delay in completion of new plants. Moreover, system loss (T&D) needs to be reduced further.[52] This would mean that there is a renewed need for technical upgradation and raising the efficiency level of the existing power plants, grids and transmission lines, along with setting up new plants towards additional power generation capacity.

[52] One appreciable development in the power sector in the recent past has been the significant decrease in loss of electricity due to system loss. The range currently stands between 21-23 per cent of next generation.

FIGURE 21: GROWTH IN ELECTRICITY GENERATION REQUIRED FOR THE SFYP PERIOD (FY2010-11 TO FY2014-15) FOR ATTAINING GDP GROWTH TARGETS



Source: Estimated using Assaduzzaman and Billah, 2008 and BIDS, 2010

The most challenging part of the power plan placed by the GoB will be managing the required fuels. Purchasing electricity from 'quick rental' and 'peaking' plants will be costlier and will increase government's fiscal burden. On the other hand, production of electricity by using less costly natural gas could have adverse impact on availability of gas for other sectors of the economy (fertiliser factories, dyeing industries, transportation, etc). Thus there was a need for a cleverly crafted energy management and conservation policy for the country, taking the long term perspective.

Minimizing System Loss (T&D Loss)

System loss in power generation, transmission and distribution has substantially been reduced over the last two decades (from 40 percent in the early 1990s to less than 25 per cent in May 2010) and there is yet enough scope to reduce it further by five percentage point in the next few years. Developing countries tend to have high system loss in power generation, transmission and distribution. Bangladesh has been no exception, although there is enough scope to cut down its higher system loss. The positive sign is that it is gradually coming down in the recent years from about 40 per cent in the 1990s to below 25 per cent in FY2009-10.[53] If the current demand-supply gap for electricity, to the tune of about 1,768.1 MW[54] is considered, only due to system loss (T&D) the daily electricity loss is estimated to be in the range of 871-952 MW (May, 2010). The significance of this figure is that it is about 49-54 per cent of the current supply shortage in Bangladesh. This could have saved about Tk. 6,375 crore to Tk. 8,538 crore annually at the rate of Tk. 7.66 if there was no such loss at all. Whilst system loss is a common phenomenon in all electricity systems and cannot be totally reduced yet by improving certain areas in the system this can be significantly reduced. Introduction of smart grid, strengthening the enforcement mechanism, converting all old meters into digital meters, obstacle-free electric lines, among others, could reduce the loss from the current 21.6-23.6 per cent to 16.6-18.6 per cent which could have saved about 202 MW of electricity daily (more than 10 per cent of the shortage), equivalent to Tk. 1,355 crore per annum. The upcoming budgetary allocation for this sector should given due

[53] In the month of May, 2010 the overall system loss is remained in the range 21.6 to 23.6 per cent of the total net generation, where the distribution, transmission and 'station use' losses are about 14.6, 4-5 and 3-4 per cent, respectively.

[54] The current Demand is about 5,800 MW, whereas the net average production for the month of May (as of 24th May, 2010) is estimated to be 4,031.89 MW.

attention to this important issue so that improvements can be undertaken keeping in view a set target of reduction.

5.2 Gas & Coal Sector

State of the Reservation

Amount of known gas reserves in the existing fields are limited and inadequate to satisfy our demand in the coming years while the coal reserves are found to be quite substantial. Till date total 23 gas fields have been discovered in Bangladesh which has all together 29.2 trillion cubic feet (tcf) of gas reservation but only 15.4 tcf is found to be recoverable. Out of this, 8.4 tcf gas has already been produced by June 2009, leaving only 7.0 tcf of recoverable gas in the country. Also another 5.5 tcf gas reserve is expected to be found in the country (BER, 2009). All proven large reservation fields such as *Titas, Habiganj* and *Bibiyana* have been in operation for quite an extensive period of time and do not have enough reservation for a secure future. Until any large proven and recoverable discovery is made, Bangladesh will need to plan her gas use strategy keeping in mind the remaining 7.0 tcf of proven reservation. On the other hand, a total of 2,700 million tonnes of coal have been discovered so far in the various coal-mines in some of the North and North-western districts of the country. This is equivalent to about 37 tcf gas for energy generation, a huge reservation indeed. However, except *Barapukuria* underground coal mining, this resource has continued remain untapped.

Extraction & Exploration

Increased extraction of gas resources has depleted gas reserves at a rapid pace, underscoring the need for urgent initiatives for gas exploration in on-shore and off-shore zones. Gas extraction in Bangladesh is managed by BAPEX and International Oil companies (IOCs). Gas production has increased at a rate of 6.7 to 8.8 per cent per year in the recent past (FY2005-06 to FY2009-10). In the FY2009-10 (July-March), production of gas posted 7.4 per cent growth with a total production of about 14904.9 mmcm, indicating an increased use of the existing reserves. At present, Bangladesh continues to face a daily shortage of more than 250 mmcfd. There is need for immediate gas exploration in the remaining blocks, and especially in the off-shore zones. Coal mining at the *Barapukuria* site started with the help of Chinese Government from September 2005. Till December 2008 about 1.8 million metric tonnes of coal has been extracted from the *Barapukuria* site, which has mainly been used for *Barapukuria* thermal power plant of 250MW. Coal for power generation, in the medium to long run, has no viable alternative in the context of Bangladesh. Indications are that the coal policy is being prepared keeping in mind the requirements of exploring the country's coal-based power generation opportunities.[55] Careful consideration will need to be given to mitigate environmental consequences, rehabilitation and recruitment of the local people, undertaking required safety measures for the workers and the possibility of open-pit mining.

5.3 Proposals for Power Sector Development

a. Careful consideration of gradual increase in power tariff over the next 5 years (FY2010-11 to FY2014-15)
b. Finalisation of the coal policy with a balanced view that takes cognisance of investors' interests, interests of local people, environmental concerns and required safety measures for the workers.

[55] The idea of establishing *Khani Bangla* has been floated in this regard.

c. Accelerate gas exploration in the off-shore zones and the remaining blocks of the country. Solving the disputed issues with the neighbouring countries (India and Myanmar) also demand proper attention.
d. If the option of open-pit coal extraction is considered, adequate provisions should be there towards rehabilitation of the affected people and sharing of potential benefits by the local people.
e. Power generation through alternative and non-traditional sources such as solar or wind power should be encouraged through fiscal-monetary incentives. The government can also allow power generation from these sources to add to the national grid which will reduce cost by doing away the need for storage.

SECTION VI: AGRICULTURE AND FOOD SECURITY

In FY2009-10, five major features were observed in the agriculture sector and food security situation in the country. These were: (i) Attainment of self-sufficiency in rice production and highest ever level of production of foodgrains; (ii) Improvement in delivery mechanism for public support and input delivery to the farmers; (iii) Increase in per capita availability of foodgrains; (iv) Vulnerability of *Haor* areas due to early flash flood; and (v) Dampening of enthusiasm of potato growers due to low price.

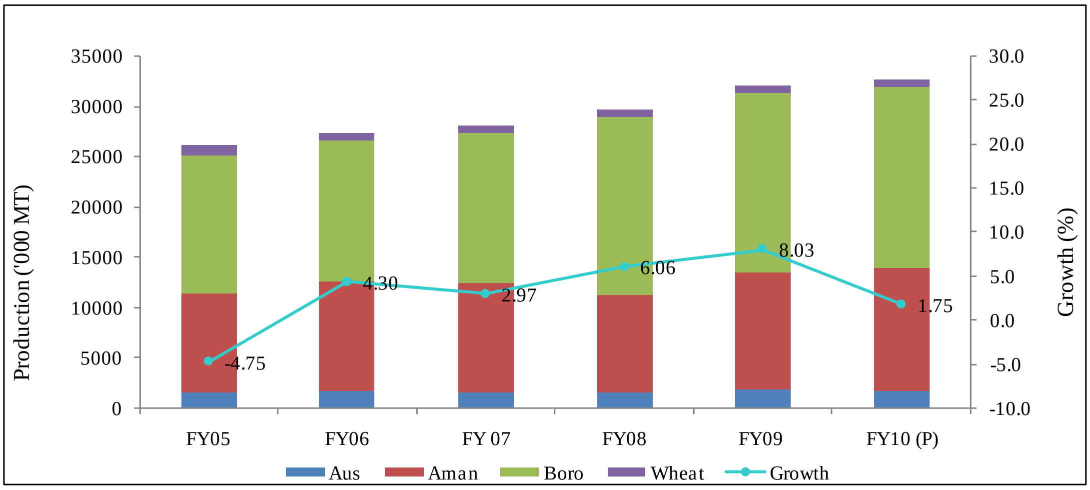
Self-Sufficiency in Rice Production

Bangladesh achieved highest level of foodgrains production and self-sufficiency in rice production in FY2009-10. BBS has recently released estimates of *Aus* and *Aman* rice production in FY2009-10. Production of *Aus* rice in FY2009-10 was 1.71 million metric tons (mt) which is 9.82 per cent lower than actual production in FY2008-09 and 31.36 per cent lower than target.[56] On the other hand, production of *Aman* rice in FY2009-10 was 12.21 million mt which is 5.11 per cent higher than actual production in FY2008-09, though 4.21 per cent lower than targeted production. Farmers have already harvested the wheat crop, whilst harvest of *Boro* rice is currently ongoing. BBS and the Department of Agriculture Extension (DAE) are yet to release any estimate about production of wheat and *Boro* rice in the country. Production of *Boro* rice in FY2009-10 has experienced some negative shocks and positive developments. Negative shocks included damage of seedlings by fog and cold at the beginning of the season, damage of paddy fields to the tune of 51 thousand hectares (ha) in *Haor* areas due to early flash flood, and diversion of rice area to tobacco area in some northern and western districts. On the other hand, positive developments included balanced use of fertiliser in response to reduction in administered price of non-urea fertilisers, good sunlight and weather condition[57], and use of relatively young rice seedlings and less number of seedlings as advocated by agronomists[58]. It is also known that sales of hybrid rice seed were less in the current year and, as a result area under hybrid rice has declined in the current *Boro* season. [59]Area under some competing crops such as maize and tobacco has also increased. An attempt has been made to estimate the likely production of *Boro* and wheat in

[56] According to BBS (2009), total production of foodgrains in FY2008-09 was 32.16 million mt comprising 31.31 million mt of rice (Aus: 1.89 million mt, Aman: 11.61 million mt, Boro: 17.81 million mt) and 0.85 million mt of wheat. In FY2008-09, compared to FY2007-08, production of foodgrains was 8.03 per cent higher while rice production was 8.25 per cent higher.
[57] This was likely to enhance photosynthesis by plants of *Boro* rice resulting in higher productivity.
[58] The so-called system of rice intensification (SRI) which leads to better crop growth and yield.
[59] It may be noted that hybrid rice provides about 20 per cent higher yield than High Yield Varieties (HYVs).

FY2009-10. Considering all the aforesaid factors, total production of *Boro* rice was likely to be about 18.00 million mt or about be 1.1 per cent higher than FY2008-09 but 3.7 per cent lower than the revised target. Area under wheat has declined in the current year to about 370 thousand ha from about 425 thousand in FY2008-09. With an approximate average yield of 2.2 mt/ha, wheat production in the current year is likely to be about 814 thousand mt (i.e. 4.12 per cent lower than that of FY2008-09 and 20 per cent lower than target). Thus, total rice production in FY2009-10 may be 31.9 million mt whilst total foodgrain production would possibly be about 32.73 million mt (Figure 22). In other words, total rice production in FY2009-10 may be 1.9 per cent higher than last year but 6.3 per cent lower than the revised target, while total production of foodgrains in FY2009-10 is likely to be 1.8 per cent higher than that of last fiscal year but 6.7 per cent lower than revised target. Annual compound growth rate in production in the 2000s (FY2001-02 to FY2008-09) was 3.15 per cent for rice and 2.56 per cent for total foodgrains and negative (-11.34 per cent) for wheat. With this level of production (31.9 million mt), Bangladesh is likely to achieve highest level of production in its history. There is a clear indication that Bangladesh is likely to achieve self-sufficiency in rice production in FY2009-10.

FIGURE 22: ESTIMATED PRODUCTION OF FOODGRAINS IN FY2010-11



Source: BBS (2008 and 2009) for production data for FY2005 to FY2009; BBS (2010) for production of Aus and Aman rice, CPD for estimates of Boro rice and wheat.

Attainment of self-sufficiency in rice production may be cross checked with rice import situation. In the event of self-sufficiency, it is likely that there will be no commercial import of rice in the near future. An analysis of the rice import situation in the current fiscal year revealed that during July-May of FY2009-10, commercial import of rice was only 62 thousand mt against 573 thousand mt during the comparable months of FY2008-09.[60] During this period Bangladesh received less than four thousand mt of rice as food aid. Such a low level of rice import may be explained by good domestic production situation and lower level of rice price prevailing in the country compared to international market (*See Section 3.2*, for price comparison). Thus, Bangladesh has relied on its own rice production in FY2009-10 to satisfy its demand.

[60] It is pertinent to mention here that Bangladesh's commercial import of rice in FY2007-08 was 1,967 thousand mt.

Delivery Mechanism for Public Support and Input Delivery

Introduction of a number of important and complementary measures resulted in notable improvement in delivery mechanism for public support and input delivery to the farmers. A number of important and complementary measures have been introduced and implemented by the government in the current fiscal year for effective delivery of subsidy and fertiliser to the farmers. These include introduction of agriculture inputs assistance cards for farmers, direct disbursement of diesel subsidy to the farmer's bank account, free electricity for irrigation to face early drought in the monsoon season, new mechanism for fertiliser delivery, and collateral free credit for tenant farmers. The government has also continued 20 per cent subsidy for electricity used by irrigation pumps and increased amount of agricultural credit provided to the farmers.

The Ministry of Agriculture (MoA) has introduced 'Agriculture Inputs Assistance Cards' (Krishi Upakaran Sahayata Card) for the farmers. The government has set a target to distribute these cards among 18.20 million farmers residing throughout the country. Until mid-May 2010, about 8.73 million farmers have received this card. It is being used to pay both in kind and cash support directly to the small and medium-sized farmers. This card contains detailed personal information about the farmers along with their requirement of inputs such as seeds, fertiliser, pesticides, agricultural credit and provision for irrigation subsidy. It will keep record of the amount of subsidy given to the farmers in each season. The government has provided a unique identity number to each of the card holders. A national farmer database will be established using these cards. It has also been decided that input subsidy will be delivered only to the card holders through banks. This initiative will be helpful in enhancing efficiency and transparency in the distribution mechanism and needs to be appreciated.

As a complementary measure to the Agriculture Inputs Assistance Card, Bangladesh Bank has directed the state-owned commercial and specialised banks to allow farmers to open accounts with an initial deposit of Tk. 10 to get input subsidies without any hassle. The opening of the account does not require the condition for keeping minimal amount of money as security or any identifier. As of 29 April 2010, more than 8,456 thousand farmers have opened bank accounts in their respective names.[61] Considering the total number of people who will need to be covered, this is a huge task which will take time and considerable expansion of logistics to complete.

Increased subsidy for diesel-based irrigation in Boro rice cultivation and continued 20 per cent subsidy on electricity used in irrigation are commendable. The government has allocated Tk. 7.50 billion as diesel subsidy for irrigation in the budget for FY2009-10. Accordingly diesel subsidy for irrigation is to be provided to 9.10 million *Boro* rice cultivating marginal, small and medium farmers.[62] Until third week of May, 2010, about Tk. 7.22 billion has been disbursed to the deserving farmers through their respective bank accounts. Farmers received 20 per cent subsidy for electricity used by irrigation pumps.

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[61] Of which 2,002 thousand in Sonali Bank Ltd; 1,294 thousand in Janata Bank Ltd; 1,213 thousand in Agrani Bank Ltd; 430 thousand in Rupali Bank Ltd; 2,231 thousand in Bangladesh Krishi Bank; 1,286 thousand in Rajshahi Krishi Unnayan Bank; and 18 farmers in Basic Bank.

[62] Amongst the farmers, 8.30 million Boro rice growing small (owning 0.50 to 2.49 acres of land) and marginal (having 0.05 to 0.49 acres of land) farmers using diesel for irrigation will get Tk. 800 per head. On the other hand, 0.80 million Boro rice cultivating medium farmers (having 2.50 to 7.49 acres of land) who have irrigated through diesel-operated machines will get Tk. 1,000 per head.

MoA introduced subsidy for agricultural machinery purchase to raise productivity and encourage the use of modern equipment. A new project titled "Enhancement of Crop Production through Farm Mechanisation" with an allocation of Tk. 1.49 billion was introduced in FY2009-10. Under the scheme, farmers of 237 upazilas in 25 districts will receive 25 per cent subsidy on the cost of buying agricultural machineries (tractors, power tillers, thrashers for rice and wheat, and transplanters) to boost crop production and reduce post-harvest losses. However, government has recently reduced allocation for this project and revised it to the tune of Tk. 150 million for FY2009-10. Another project to install deep tube wells (2nd phase) with an estimated cost of Tk. 2.48 billion was approved with a view to irrigate 37,500 ha of land which will help to produce an additional 187 thousand mt of crops.

Implemented new fertiliser delivery system to ensure availability and promoted balanced use of fertilisers through further reduction in price of non-urea fertilisers. MoA has implemented a new policy for appointing fertiliser dealers and rearranged the fertiliser distribution system to ensure proper and timely delivery of fertiliser. As per the new policy, one dealer has been appointed in each union and each municipality area. In addition, five to nine retailers have been appointed for each union who purchase fertilisers from the dealers and then sell to the farmers. Farmers can purchase fertiliser both from dealers and retailers. Following the consecutive decline in international prices of non-urea fertilisers, the government has re-fixed the prices of Triple Super Phosphate (TSP), Muriate of Potash (MoP) and Diammonium Phosphate (DAP) in November 2009.[63] There was no complaint about fertiliser availability in FY2009-10. As is known, international prices of all types of fertilisers except for MoP had increased significantly between April 2009 and April 2010.[64] The rising tendency in Urea, TSP, and DAP prices may increase burden for the government since it is now heavily subsidising these commodities. In view of the rise in fertiliser price in the international market, the government has increased allocation for fertiliser subsidy to Tk. 3,387 crore in the revised budget for FY2009-10.

Average level of implementation of irrigation and drainage projects during the first 10 months (July-April) was half of the allocation in the revised budget in FY2009-10. Tk. 14.63 billion was allocated for development of irrigation and drainage projects in FY2009-10. Allocation for irrigation has been reduced to Tk. 13.12 billion in the RADP. During July-April FY2009-10, about 50 per cent of the total RADP allocation for these projects were spent. Implementation rate of individual projects ranged between 21.70 to 99.69 per cent of the RADP, whilst three projects were yet to get off the ground.

Implementation status of seed production and distribution projects in FY2009-10 was mixed. To increase availability of quality seed for agricultural production, Tk. 2.80 billion was allocated in the national budget for FY2009-10. Special new projects have been approved under the ADP for FY2009-10. A review of the implementation status of various seed related projects under the RADP for FY2009-10 revealed that during the first 10 months of FY2009-10, implementation rate was between 31.0 to 95.42 per cent, ranging from the frustrating to the encouraging.

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

[64] In April 2010, international prices of a mt of Urea, TSP and DAP were USD 253, USD 373 and USD 446 respectively, while MoP was sold at USD 314. Between April 2009 and April 2010, price of Urea, TSP and DAP increased by 3 per cent, 34 per cent, and 39 per cent, respectively while price of MoP decreased by 58 per cent.

Increased distribution of agricultural credit and introduction of collateral-free credit for share croppers benefited farmers in FY2009-10. Amount of agricultural credit disbursed to the farmers increased significantly in the current fiscal year. During July-April of FY2009-10, total amount of agricultural credit disbursed by commercial and specialised banks was Tk. 89,493 million which was 15.79 per cent higher than that of the comparable months of the previous fiscal year (*See Section 4.4* for details). Tk. 5 billion has been made available to the sharecroppers in 150 upazillas as collateral-free loans at 10 per cent interest rate through a special refinancing scheme with the BRAC.

Per Capita Availability of Foodgrains

Commercial import of rice was negligible in FY2009-10 but substantial increase in wheat import increased total import of foodgrains. Bangladesh has traditionally been a net food importing country. External sources of foodgrains comprise of food aid and commercial import.[65] In recent years, commercial import of rice and wheat has been mainly carried out by the private sector. In FY2009-10 (July-May), commercial import of rice was only 62 thousand mt against 573 thousand mt during the comparable months of FY2008-09. During this period, total import of foodgrains and wheat was 3,158 thousand mt and 3,093 thousand mt which was respectively 7.45 per cent and 32.23 per cent higher than that of comparable months in FY2008-09 (Table 8). Increased demand for wheat and wheat products in the country along with low level of domestic production explains the underlying reason for increased import of wheat. It may be recalled here that current wheat production (about 814 thousand mt) was only about 45 per cent of the historically highest production of wheat in FY1999-00 (1,840 thousand mt). Production of wheat has declined in the country due to change in climate, lack of comparative advantage and opportunities for producing alternative crops (maize) with higher return.

TABLE 8: IMPORT OF FOODGRAINS IN FY2009-10

(in '000 mt)

Category of imports	FY2008-09 (July-May)			FY2009-10 (July- May)		
	Rice	Wheat	Total Foodgrains	Rice	Wheat	Total Foodgrains
Food Aid	27	71	98	3.6	56	60
Public Commercial Import	386	296	682	25	392	417
Private Import	187	1972	2159	36.6	2645	2681
Total	600	2339	2939	65	3093	3158

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

Total distribution under Public Foodgrain Distribution System (PFDS) decreased due to lower level of distribution under non-priced channel even though distribution under priced channel increased substantially. In FY2009-10, as is the practice, the government distributed rice and wheat under PFDS through priced and non-priced (targeted) channels.[66] During July- April of FY2009-10, amount of foodgrains distributed under various PFDS channels was about 1,407 thousand mt against 1,566 thousand mt distributed during the

[65] Food aid comes through public import but commercial import is made by both the public and private sectors.

[66] Distribution under priced channel included sale of rice and wheat through Essential Priority (EP), Other Priority (OP), Large Employee Industries (LEI), Flour Mill (FM), Open Market Sale (OMS) and Fair Price Card (FPC). Non-priced (targeted) channels include targeted safety net programmes such as Food for Works (FFW), Test Relief (TR), Gratuitous Relief (GR), Vulnerable Group Development (VGD), Vulnerable Group Feeding (VGF) and other relief channels.

comparable period of the previous year (Table 9). In other words, during the first 10 months of the current fiscal year total distribution under PFDS was 10 per cent lower than that of last year. Distribution through non-priced channel (887 thousand mt) was 24 per cent lower than that over comparable period of last year. On the other hand, distribution under priced channel during July- April of FY2009-10 was 520 thousand mt which was 30 per cent higher than comparable period of the previous fiscal year. With a view to ensuring food security of low-income industrial workers, the government has sold about 21 thousand mt of rice (until April 2010) @Tk. 16 per kg to the garments workers and industrial workers of *Narayanganj, Gazipur, Narsingdi* and *Khalispur* area of *Khulna.*

TABLE 9: CHANNEL WISE DISTRIBUTION OF FOODGRAIN IN FY2009-10

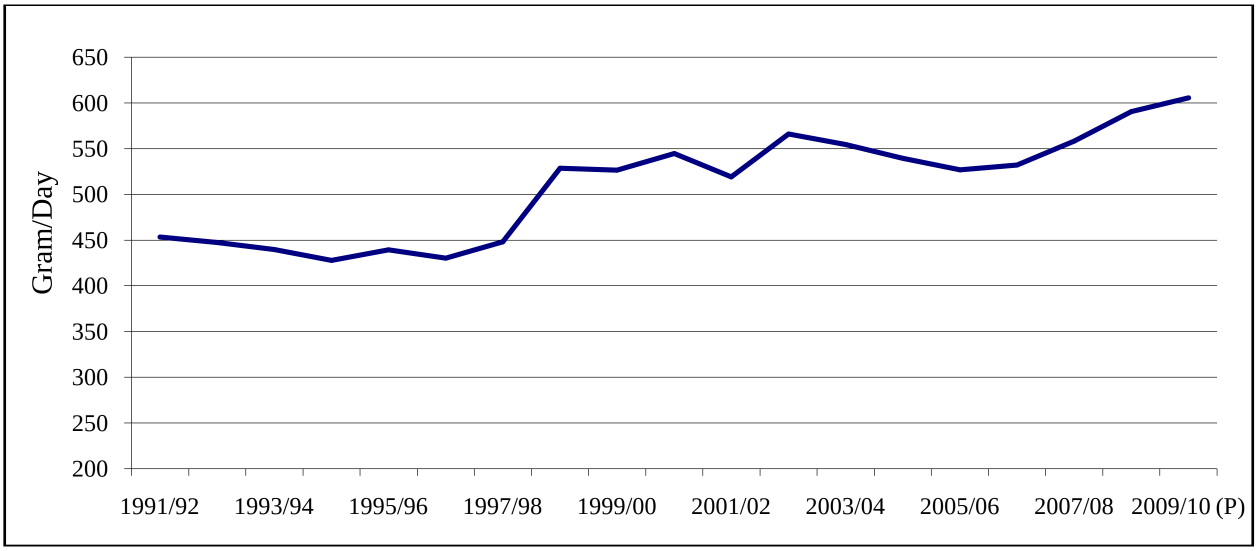
('000 mt)

Channel	**FY2007-08**	**FY2008-09**	**FY2008-09 (July-April)**	**FY2009-10 (July-April)**
Priced				
Essential Priorities (EP)	210	219	178	204
Other Priorities (OP)	21	22	18	17
Large Employers (LE)	12	10	8	13
Open Market Sale (OMS)	268	194	194	286
Sub Total	*510*	*445*	*399*	*520*
Non-Priced				
Food for Work (FFW)	154	395	268	243
Test Relief (TR)	76	368	141	112
Vulnerable Group Development (VGD)	268	279	228	225
Vulnerable Group Feeding (VGF)	188	507	437	241
Gratuity Relief (GR)	38	43	9	28
VGF (Relief)	232	31	31	-
Others	95	92	54	39
Sub Total	*1050*	*1714*	*1167*	*887*
Total	**1560**	**2159**	**1566**	**1407**

Source: Food Policy Monitoring Unit (FPMU), Bangladesh.

Increase in domestic production of rice along with increase in import of wheat has increased per capita availability of foodgrains in FY2009-10 (Figure 23). Per capita availability of foodgrains was 453 gram (gm) per day in FY1991-92 which declined to about 430 gm per day in the mid 1990s, and thereafter gradually increased to 544 gm per day in FY2000-01. After that it declined to 519 gm per day in FY2001-02 and showed some fluctuation for several years. Since FY2005-06, per capita availability of foodgrains has been gradually on the rise. According to CPD estimates, per capita availability of foodgrains has increased to 590 gm per day in FY2008-09, and further increased to 605 gm per day in FY2009-10. Given the achievement in terms of per capita availability of foodgrains, it appears that time has come to make renewed efforts toward ensuring a nutritionally balanced diet for citizens through fixing cereal production target at the current level and increased production of other crops. To this end, increase in rice yield will allow the country to release some area under rice for production of other crops.

FIGURE 23: PER CAPITA AVAILABILITY OF FOOD GRAINS



Source: For 1991-92 to 2007-08, World Food Programme; For 2008-09 and 2009-10, authors' estimate based on data collected from Food Policy Monitoring Unit (FPMU), Bangladesh.

Vulnerability of *Haor* Areas Due to Early Flash Flood

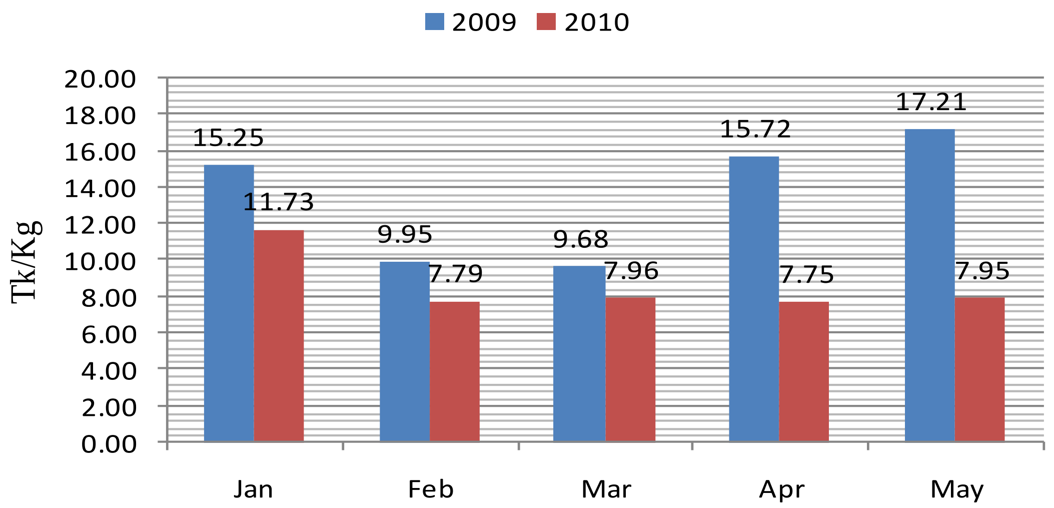
Pre-monsoon heavy rainfall and flash flood damaged Boro rice in Haor areas and led to increased vulnerability of people in the affected areas. In early April of 2010, *Boro* rice in *Haor* areas especially in *Sunamganj*, *Kishoreganj* and *Netrokona* districts was damaged due to pre-monsoon heavy rainfall and flash flood from upstream hilly lands of neighbouring country. Due to the rise of river water level, flood protection embankments collapsed and thousands of ha of *Boro* rice got submerged. According to an estimate by Bangladesh Space Research and Remote Sensing Organization (SPARRSO), about 51 thousand ha of *Boro* rice area has been damaged by the flash flood. *Haor* areas generally tend to be single-cropped. Therefore, total damage of rice crops by the flash flood will have seriously negative impact on the food security situation in those areas. With a view to helping the affected people, the government has taken a number of initiatives which include postponing credit repayment for a year and providing seeds and fertiliser at subsidised price in the next *Boro* season. Apart from these initiatives, the government should take some medium-term initiatives to minimise production risks in the *Haor* areas. To this end, there is a need to develop varieties which could be harvested by mid-April. Development of cold-tolerant, early maturing varieties will be needed for this purpose. Bangladesh may take help from South Korea for this purpose which already has advanced research capacity for development of cold-tolerant rice varieties. Proper maintenance of the embankments will also help to reduce the risk of flood damage. Most importantly, allocations under targeted safety net programmes and employment generation programmes in these areas should be increased in the upcoming budget of FY2010-11.

Low Price Dampened Enthusiasm of Potato Growers

Bangladesh recorded highest level of potato production in its history, but low price created a disincentive for potato growers. The reported total production of potato in FY2009-10 was 8.0 million mt which would be 52.0 per cent higher than that of FY2008-09 and 20.3 per cent higher than that of FY2007-08. It may be noted here that annual compound growth rate in potato production in the 2000s (FY2001-02 to FY2008-09) was 9.7 per cent. Increase in potato production in FY2009-10 was due to increase in both acreage and yield. In FY2009-10, potato area was 440 thousand ha (11 per cent higher than that of FY2008-09 and 9.5 per cent higher than that of FY2007-08) while potato yield was 18.18 mt/ha (36 per cent higher than that of in FY2008-09 and 9.9 per cent higher than that of in FY2007-08). High price of potato (about Tk. 30 per kg) prior to the planting time (September-October 2009) induced farmers to increase area for potato cultivation. Favourable weather and availability of adequate non-urea fertilisers at subsidised price have contributed towards balanced fertiliser use and, helped achieve higher level of potato yield.

Inspite of the bumper harvest, potato farmers were rather disappointed than delighted. Farm level price of potato during the harvesting period was much lower in FY2009-10 than the previous year. Average farm level price of potato in January, 2010 was Tk. 11.73 per kg but it declined to Tk. 7.79 per kg in February, rose to Tk. 7.96 per kg in March, fell to Tk. 7.75 per kg in April and then rose somewhat to Tk. 7.95 per kg in May, 2010 (Figure 24). To contrast, average farm level price of potato for the same period was consistently higher last year.[67] It may also be noted here that average cost of production of per kg potato in FY2009-10 was between Tk. 10 to Tk. 12.

FIGURE 24: COMPARISON OF FARM LEVEL PRICE OF POTATO IN BANGLADESH: 2009 AND 2010



Source: Department of Agricultural Marketing (DAM).

Besides the lower price, inadequate storage capacity aggravated the problem. Bangladesh has 350 cold storages which have about 2.40 million mt of storage capacity. Around 4.00 million mt of potato is usually stored at home to be subsequently sold in the first half of the year. Thus, there was lack of storage facility for about 1.60 million mt of potato. In FY2009-10, storage problem had emerged as a severe problem. Taking advantage of the emergent situation, cold storage operators increased their tariff from Tk. 220 to Tk. 260 per sack (80 kg).

Formulation of an appropriate policy can reduce the existing price risk in potato farming. There is a cyclical pattern relating to acreage of cultivation and production of potato in

[67] In January, February, March, April, and May, 2009 was Tk. 15.25, Tk. 9.95, Tk. 9.68, Tk. 15.72, and Tk. 17.21 per kg respectively.

Bangladesh. Bumper harvest is normally followed by lower production due to low price, poor storage capacity and inadequate marketing facilities. In this backdrop, the government can (i) encourage investors to establish new cold storages in major potato growing areas[68] by providing credit at lower cost, offering tax holiday, and reducing import duty on machineries used in cold storages; (ii) ensure adequate electricity supply in cold storages; and (iii) provide priority to farmers in terms of storing their potato in cold storages. Government could also think of setting up cold storages on PPP basis.

To stimulate export, the government has raised cash incentive for potato exporters from existing level of 10 per cent to 20 per cent, with effect from April, 2010 which had a positive impact on potato exports. Potato export in April 2010 (4,182 mt) was 18 per cent higher than in March 2010. Bangladesh exported about 9,000 mt of potato, mainly to Malaysia and Singapore, during February-April of 2010. Cash incentive for export of potato should be continued in the next year. Provision of cash incentive could be linked to traceability condition, meaning that in all exported potato sacks putting the identity number of farmer, producing the potato, should be made mandatory. This will help Bangladesh to export potato to super-markets in the developed countries which will help to fetch higher price. If it can be successfully implemented then Bangladesh in the long run will be able to translate the existing adversity into a real opportunity for the country. Export of potato to Malaysia, Sri Lanka, Singapore, Thailand and Middle East has good potential.

SECTION VII: EMPLOYMENT GENERATION PROGRAMMES OF THE GOVERNMENT

In Bangladesh, a large number of social safety-net programme (SSNP) are in operation[69]. Each year the government spends significant amount of resources to service these programmes[70]. Often the system has been criticised for lacking coordination and a coherent strategy. The idea of comprehensive, household based welfare programme has also been mooted by some in this context with a view to raising the efficacy of these programmes. The government initiated two new programmes namely (a) *Employment Generation for the Hardcore Poor* (EGHP); and, (b) *National Services Pogramme* (NSP) in FY2009-10 with a view to creating jobs for two important groups of citizens: the very poor who tend to have low capacity for labour market participation during lean periods, and the educated youth for which group the unemployment rate is significantly high. The first one was indeed a continuation of the earlier *100-Day Employment Generation Programme* while the second one was a new one.

The following two sub-sections undertake an assessment of these two important programmes with a view to identifying their core strengths and weaknesses.

7.1 Employment Generation for the Hardcore Poor (EGHP)

The government had allocated Tk. 778 crore to implement the EGHP in the course of FY2009-10. It is being implemented during the two lean periods in selected poverty-prone

[68] It is to be noted that ten major potato growing districts (*Bogra, Chandpur, Comilla, Dinajpur, Joypurhat, Munshiganj, Nilphamari, Naogaon, Rajshahi* and *Rangpur)* produce more than 70 per cent of total potato production in the country.
[69] Currently there are sixty seven such programmes in existence.
[70] 15.22 per cent of total budget was allocated for safety-net programmes in FY2009-10.

areas. During the first phase (Sept.-Nov., 2009), the programme encompassed 16 districts. However, only 3.96 per cent of the 10.40 million[71] people living below the lower poverty line in those districts was covered under the programme. The second phase of the EGHP (Mar.-Apr., 2010), however, has been wider in terms of both coverage (all 64 districts with 4.69 per cent of population under the lower poverty line being brought under the programme) and allocation (with a higher wage rate of Tk. 120 per day compared to Tk. 100). In terms of budget expenditure, about 86.7 per cent and 90.9 per cent[72] of the allocated funds were respectively utilised during the two phases. It is encouraging to note that project completion rate, which was about 62 per cent in the first phase, reached 82 per cent during EGHP-II.

TABLE 10: COMPARATIVE PICTURE OF TWO PHASES OF THE EGHP

Line Items	**Phase I**	**Phase II**	**% change**
Districts	16	64	300.00
Wage (Tk.)	100	120	20.00
Beneficiary coverage (mln)	0.44	1.25	184.09
Initiated projects	7014	20122	186.88
Average number of projects per district	438.38	314.41	-28.28
Mandays per project	2269.32	2239.87	-1.30
Completion rate (% of initiated projects)	62.08	82.10	20.02*
Total allocation (mln Tk.)	1775.41	6000	237.95
Allocation per district (mln Tk.)	110.96	93.75	-15.51
Allocation per initiated project (mln Tk.)	0.25	0.30	17.80
Total expenditure (mln Tk.)	1538.72	5455.30	254.53
Expenditure as % of total allocation	86.67	90.92	4.25*

Source: Calculation based on data from MoFDM, GoB
Note: Allocation and expenditure for Phase II as of 13 May 2010
* Percentage Points

Though the progress registered during the second phase of the programme has registered some positive achievement, analysis of official data and investigation at the field level exposed a number of disquieting features with regard to various activities at the allocation, beneficiary selection and project implementation stages.

Coverage, Allocation and Project Selection: While the exclusion of *Jamalpur* from Phase I of the EGHP was a surprise, it was no less notable that the number of beneficiary cards in *Nilphamari* and *Kurigram* in the second phase was lower when compared to the previous phase, despite both the districts being high-poverty prone areas. This raises significant concern with regard to the targeting mechanism of the overall programme. It is also to be noted that beneficiary coverage in 7 out of 16 districts covered under Phase I has been reduced in Phase II. In view of this, the importance of using the *Household Income & Expenditure Survey* (HIES) Poverty Map for target identification for these types of programmes cannot be overemphasised.

Some experts have recommended to concentrate on specific poverty-prone regions rather than attempting to cover the entire country. In industry-intensive regions (e.g., Chittagong), minimum daily wage for labourers are higher than the Tk. 120 stipulated under the EGHP which makes it difficult to find appropriate candidates, and often leads to higher degree of leakages. Greater coverage in *monga* and river bank erosion prone areas (*Nilphamari, Kurigram* or *Jamalpur*, etc.) would perhaps be a better option in this regard. This calls for

[71] BBS (2009)
[72] Allocation and expenditure for Phase II as of 13 May 2010.

designing of a *Region Specific Master Plan* (RSMP) to cater to the needs of the deserving beneficiaries.

Although allocation per district in Phase II has decreased by around 16 per cent, this can be explained by the fact that less poverty prone districts are supposed to have lower coverage. Project completion rate till the beginning of May, 2010 was almost 20 percentage point higher than the total completion rate in Phase I. While this development is encouraging, one will need to be cautious as to whether this reflects the current policy emphasis on selecting more small scale projects, or this owed to more efficient performance at the implementation level. It has been found that man-days per project in Phase II decreased by 1.3 per cent when compared to that of Phase I. Though an insignificant departure, this could be an indication that more smaller projects were initiated during the current phase. However, findings from a survey by the CPD show that some relatively larger sized projects were also initiated in Phase II with two or more small projects linked together in some instances.

Beneficiary Selection and Monitoring: The EGHP guideline advised inclusion of NGOs in the beneficiary selection process; however, this provision was largely ignored at the operational level. Besides, the new lists prepared by the Upazilla Committees were reported to be subject to nepotism in a number of cases. In view of these, it is recommended that beneficiary selection should be conducted in consultation with local NGOs. This is particularly important since most of these NGOs have their own database of the poor community of the area along with resource maps, coverage of other SSNPs and other household level data. Taking inputs from local NGO databases could be beneficial in terms of identifying most appropriate candidates for inclusion under the programme. Government may also partner with local NGOs for monitoring the implementation process since these entities are more conversant with the reality on the ground and tend to have greater acceptability among the local community.

In order to ensure successful implementation of the EGHP, it could be integrated with other programmes as in the case of Argentina which has linked employment-generation programmes to mandatory enrolment in schools and immunisation for children. Similarly, a database could be developed containing the coverage of SSNPs which would be helpful in the beneficiary selection procedures. Most importantly, the EGHP should have a quota involving women and indigenous communities into the programme. It was also suggested by many that inclusion of more women workers in the programme could create an opportunity for the male members of the respective families to migrate to urban or semi-urban areas which could eventually lead to better combined earnings by the family as a whole. This could also complement the government’s efforts towards attaining some of the key targets of the *Millennium Development Goals* (MDGs).

Administrative Costs: There has also been significant concern with regard to allocation of resources for administrative cost related to monitoring of the programme during the previous *100-Day Employment Generation Programme*. However, the EGHP made a departure in this context and funds were allocated to carry out administrative duties. Nevertheless, discussions with relevant stakeholders revealed that the allocation was not adequate in many districts. In view of this, funds for administrative costs should be allocated on a case-by-case basis considering the grass root level reality rather than these being equal across the board. This argument can be strengthened by the fact that expenditure by a tag officer in *Kurigram* differs significantly from that required by an officer in the *Haor* areas due to a number of factors including location of the project, distance from the centre, and mode of transport.

Project Period: It is of importance in this particular situation to complete project and beneficiary selection, along with fund disbursement, prior to the commencement of the lean periods. This would leave adequate time in hand to deal with administrative procedures at the local level and reduce the likelihood of late start of the programme. Besides, lean periods in the annual cycle (as is set in the programme) are not uniform for all eco-regions. There is significant seasonal diversity among *monga*, flood and river-bank-erosion prone areas. The aforesaid RSMP can be a useful tool towards addressing this concern.

Other Recommendations: On the whole, in order to induce a demand-driven (bottom-up) process, in terms of both selection of beneficiaries and projects, this programme could be enacted into a law (similar to India's *National Rural Employment Guarantee Act* or NREGA). To reduce the scope for nepotism, corruption and leakages, and to enhance transparency and accountability, Bangladesh may follow the NREGA practice of providing beneficiaries with bank accounts. This will also reduce the scope for manipulation with regard to distribution of cards, and the cheque books could keep leakage and corruption in check. Reforms have to be initiated where the central bank should become an active partner. The government may also consider creating a dedicated website highlighting regularly updated information with regard to the implementation status of the project. Such an initiative could be considered in line with the government's pledge to create a *Digital Bangladesh*. This could also play a pivotal role in meaningful implementation of the *Right To Information* (RTI) Act. Mention may be made here of India's NREGA website which is rich with relevant information and has proved to be very useful in terms of facilitating the monitoring process of the programme.

The upcoming National Budget for FY2010-11 will need to allocate adequate funds to fulfill the mandate and objectives of the EGHP, particularly keeping in view the envisaged coverage and diversity and location specific requirements.

7.2 National Services Programme (NSP)

The second programme, the NSP scheme was initiated in the FY2009-10 budget with an aim to provide employment opportunities to the educated unemployed in selected areas. Tk. 20 crore allocation was made to this end. Initially, the beneficiaries for the progamme were to include 6,700 youths from *Kurigram* and *Borguna* with higher secondary or higher qualification. Subsequently, the eligibility criteria were relaxed and now the target group will also include those having educational qualification equivalent to secondary school certificate (SSC). This has increased the number of applicants for the programme. Latest data (as of March, 2010) shows that with the new criteria in place, 31,620 applicants have been selected for training from about 37 thousand applications in *Kurigram*. Of this, a total of 9,950 youths are receiving training in the first phase of the programme; they are to be subsequently place with government jobs for two years.[73] This leaves more than 27 thousand candidates, from *Kurigram* alone, to be trained in a phase-by-phase manner. Moreover, the programme is planned to be expanded to *Gopalganj* and *Barguna*. In this backdrop, there is a need to allocate adequate funds to keep the programme running in the upcoming budget, taking into cognisance the higher demand for resources.

Trainers and other implementing officers reported to have found it difficult to cope with the programme requirements as the responsibilities have to be carried out in addition to their

[73] So far, about Tk. 9 crore has been allocated for the 3 month's training in FY2009-10.

regular official duties. Creation of a separate division/wing for the NSP with dedicated manpower could help overcome these bottlenecks. Furthermore, government may also consider hiring qualified trainers/consultants to reduce the burden this entails for the government officials involved. Besides, it was also suggested by many that a part of the trainees' salary may be deposited in their respective bank accounts so that after completion of the provisioned two years they may have some capital in hand to start a venture or become self-employed.

Field level information suggests that some of the provisions in the related Guideline are not clear and needs to be revisited. Besides, the government's commitment with regard to job creation for the trained youths raises question as to whether there is a match between demand and training, or whether adequate vacancies can be subsequently created to recruit these trained youths. More than that, how high or low is the possibility/consequences of a *mainstreaming/absorption movement* once the two-year job contract had expired? With the programme still in its pilot phase, there could not be a better time to address these crucial concerns upfront and take flanking measure.

Policymakers will need to take the abovesaid issues into cognisance, and the upcoming National Budget for FY2010-11 will need to reflect the attendant strategy by taking a long-term perspective.

SECTION VIII: TOWARDS ATTAINING MDGs IN EDUCATION AND HEALTH SECTORS

It has been estimated that an amount of Tk. 7,00,000 crore will be required over the next six years (2010-2015) in order for Bangladesh to attain the seven MDGs by 2015. About a quarter of this will need to be allocated towards the health and education sectors alone (GoB, 2009) to attain the related targets. The latest *Global Monitoring Report*, published by the World Bank (WB) and the International Monetary Fund (IMF), has come up with the theme of 'development emergency', and called for urgent global actions to avoid the erosion of hard-won gains against poverty, hunger, illiteracy and diseases. Such concerns, coupled with various fiscal and administrative limitations, transmit a desperate need to not only maintain but also significantly augment public spending in priority areas of health and education. It is also to be noted that the target year for the MDGs, 2015, coincide with the Sixth Five Year Plan (SFYP) period of Bangladesh, of which FY2010-11 will be the first year. Hence, it is crucial that Bangladesh is up-to-speed in this final round of the journey.

8.1 Education Sector

Education and poverty are positively correlated: more education increases the scope of the poor to participate in the mainstream economy activities, thereby allowing them to upgrade their living standards. MDG-2 stipulates achieving universal primary education by 2015.[74] Available official statistics show that the rate of net enrollment at the primary level in Bangladesh currently stands at around 91 per cent (as of 2008)[75] while only about 80 per cent of the primary school children are able to reach Grade Five. Taking 1990 as the base year,

[74] The target is to ensure that by 2015, all children (girls and boys) will be able to complete a full course of primary schooling.

75 However, independent studies somewhat contradict this position and claim that the rate is not over 80 per cent (particularly due to high rate of school dropout).

progress with regard to enrollment was found to be 30 percentage points while that for the latter indicator was about 39 percentage points. Besides, about 2.4 million children within the 6 – 10 year age group are not enrolled in primary schools (GoB, 2009). With the global financial crisis clearly reversing the progress made to date, apprehensions are mounting with regard to mobilisation of the required funds for attainment of MDGs in countries such as Bangladesh.

It is encouraging to note that various initiatives taken by successive governments in Bangladesh towards addressing the overwhelming need to ensure education for all has positioned the country on a positive track, with regard to a number of key indicators. However, maintaining the pace and achieving the target post formidable challenges. As in previous years, education sector received highest priority in FY2009-10 and received about 12 per cent of the total allocation in the ADP.[76] With regard to utilisation, Ministry of Education (MoE) exhausted about 82 per cent of the allocation till April, 2010 while the corresponding share for the Ministry of Primary and Mass Education (MoPME) reached 67 per cent during the same period.[77] This underscores the need for urgent completion of the projects under the MoPME. This necessity is further corroborated by the finding that while a sum of Tk. 1,00,000 crore will need to be spent in the education sector during 2010-2015 for the country to achieve MDG-2, the lion's share (79 per cent) will need to be allocated towards the primary sector to ensure that children remain in schools (*ibid*).

While there are several quality enhancement and stipend programmes in place, the *Primary Education Development Program* (PEDP), currently running in its second phase, is considered to be the most comprehensive endeavour in this context. The PEDP II aims at creating opportunities for all to have access to primary education along with removal of gender discrimination at the primary level institutions. During the first ten months of FY2009-10, expenditure under the programme is recorded to be about 70.4 per cent of the total allocation. Whilst above average, full utilisation of the allocated funds was essential to attain the MDG-2. The *Reaching Out of School Children* (ROSC) project is yet another useful programme towards attaining MDG-2. Although only about 45 per cent of the released fund (Tk. 92.89 crore) for FY2009-10 has been utilised till March, 2010, this share is expected to be doubled by the end of May, 2010 when the second installment is channeled to the respective implementing organisations at the local level. In addition, the government, with support from donor agencies, is also implementing a number of school feeding programmes. Of these, the *EC Assisted School Feeding Programme,* with a project life till 2013, aims at covering 2 lakh students in 617 government primary schools across 10 upazillas. Although currently at an early stage, the project, along with the ongoing ones, is likely to be critical towards improving retention rate at the primary schools especially in the poverty prone areas. The possibility of large scale school-feeding programmes to enhance nutritional intake of students needs to be seriously considered in view of its critical importance for both in terms of enhancing education intake capacity of students and their retention in classes. In view of this, the upcoming national budget will need to focus extensively on the timely and quality implementation of the aforesaid programmes. While

76 About 3 per cent (Tk. 948 crore) allocated to Ministry of Education and 9 per cent (Tk. 2,828 crore) to Ministry of Primary and Mass Education

[77] However, these utilisation rates changed significantly (54 per cent for MoE and 69 per cent for MoPME) when compared to Revised ADP (RADP) allocation for FY2009-10. This is explained by the fact that RADP allocation for MoE was raised substantially (from Tk. 948 crore to Tk. 1,425.46 crore) while the same for MoPME was scaled down (from Tk. 2,828 crore to Tk. 2,742.84 crore).

bringing more children under the umbrella of literacy is the key objective under MDG-2, the necessity to ensure quality education shall not, in any way, be undermined.

Notwithstanding the progress made in terms of interventions on the supply-side, other supportive steps will be required. Salaries of primary school teachers will need to be increased, perhaps by more than 20 per cent, in order to motivate them to provide quality teaching and ensure their regular attendance. Motivated teachers play an important role in retaining students in the class room (*ibid*). As would be recalled, the recently prepared list for the *Monthly Pay Order* (MPO) scheme has come under criticism from various quarters. Good governance in education must be ensured if the MDG-2 targets are to be achieved and the MPO listing could become a litmus test for this.

It is encouraging to observe that in India the *Right To Education* (RTE) Act, with the provision of providing free and compulsory schooling to children in the 6-14 year age cohort, has come into force in April, 2010. By taking this measure, India has joined some 20 other countries including China and Switzerland which have laws guaranteeing free and compulsory education for eight years of elementary education. At some point in time Bangladesh may also think of joining this group of countries.

8.2 Health Sector

There is no denying the revealed experience that access to basic health care is of paramount importance for any country to build a sustainable base for economic development. As for Bangladesh, health sector has always received significant importance in terms of budgetary allocation. However, the fact remains that currently only 40 per cent of the total population has access to basic health care and roughly 51 per cent has access to essential medicines.[78] Therefore, one can hardly underestimate the need for quality enhancement in healthcare services with a view to attaining the three health related MDGs[79] by 2015. While some mentionable progress has been made in Goal 4 and 6, attainment of Goal 5, *Improving Maternal Health*, has become doubtful. As Table 11 underscores, there is an urgent need for policy intervention to build up a core of skilled professionals in the maternal healthcare sector which could help Bangladesh attain the related target.

TABLE 11: PROGRESS IN SELECTED MDG INDICATORS

MDG Indicators	Base year (FY91)	Current Status	Target for 2015
Under-five mortality rate	146	62 (2009)	50
Infant mortality rate	92	45 (2009)	31
Proportion of 1-year old children immunised against measles	54	87 (2008)	100
Maternal mortality rate per 100,000 live births	574	348 (2008)	143
Proportion of births attended by trained health personnel	5	24.4 (2009)	50

Source: Compiled from GoB (2009) and BBS

According to GoB (2009), about Tk. 78,000 crore will need to be allocated towards the health care sector if Bangladesh is to achieve the targets of MDGs 4, 5 and 6 with the greater share (52 per cent) to be allocated towards enhancing human resources through increasing salaries and providing in-service training.

[78] http://www.apc.org/en/blog/digital-bangladesh-prime-ministers-dream-vs-unders

[79] The three health related goals are (i) *Goal 4*: Reduce child mortality, (ii) *Goal 5*: Improve maternal health, and (iii) *Goal 6*: Combat HIV/AIDS, malaria and other diseases.

As is known, the initial allocation for the Ministry of Health and Family Welfare (MoHFW) in the budget for FY2009-10 was Tk. 3,063.8 crore which was then revised downwards in the RADP to Tk. 2,814.4 crore. It is a matter of concern that total utilisation at the end of April, 2010 stood at merely 51 per cent of the original ADP allocation and 56 per cent of the RADP. With the target of exhausting the remaining 46 per cent within the next couple of months, the government now certainly has an almost impossible mission to accomplish.

Though the ongoing *Health Nutrition and Population Sector Program* (HNPSP)[80] stands out as the major initiative towards attaining health related MDGs, only about 45 per cent of the total RADP allocation for FY2009-10 could be utilised till March, 2010. Table 12 depicts a mixed picture with regard to performance of selected key components of the HNPSP which calls for urgent intervention by the government to be at par with the aims and objectives of the MDGs.

TABLE 12: PROGRESS IN SELECTED COMPONENTS OF THE HNPSP (JULY-MARCH, FY2009-10)

Selected Components of HNPSP	**RADP (*crore Tk.*)**	**Release (*as % of RADP*)**	**Expenditure (*as % of RADP*)**
Essential Services Delivery	46.1	73	67
Improved Hospital Services Management	16.2	66	30
Pre-Service Education	4.8	47	43
In-Service training	2.4	67	90
Micro Nutrient Supplementation	2.1	86	15
Maternal, Child and Reproductive Health Services Delivery	22.4	41	40
National Nutrition Programme	19.1	37	35
Physical Facilities Development	67.5	79	48

Source: MoHFW, GoB

The ongoing *Maternal Health Care Voucher Scheme* should be continued and expanded to cover at least 60 upazillas from the existing 45 upazillas. Special attention needs to be given to *monga* prone, *char* and *Haor* areas. Besides, ensuring quality services by, and management of, the *Community Clinics* (CCs) is a key issue since these centres can play a strategic role in ensuring access to basic healthcare facilities by the poor and marginalised sections of the population.

8.3 The Way Forward

Budget for FY2009-10 did not clearly articulate whether allocations for education and health sectors were designed in line with the MDG requirements. The budget for FY2010-11 should be designed in such a manner that allocations are in sync with resource requirements for the MDG targets.[81] Bangladesh will also need to raise voice to pull additional international assistance to meet the MDGs.

[80] Under the HNPSP, a total of 55 operational plans (OP)/projects are currently being implemented.

[81] Bangladesh is now in the process of preparing the country document in view of the MDG summit in September 2010. It is thus essential that there is coherence between the budget FYT2010-11 and the strategies articulated in the MDG country report.

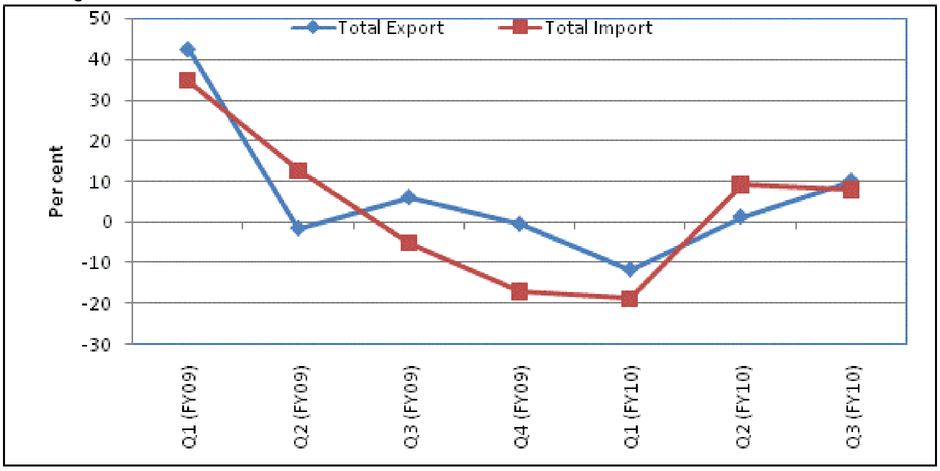
SECTION IX: EXTERNAL SECTOR: NEED TO REPOSITION IN VIEW OF RECOVERY

With the lagged impact of the global economic crisis having negative consequences for Bangladesh's export sector performance, external sector experienced some pressure in FY2009-10. Both export and import have picked up towards the end of the fiscal year, and it is important that Bangladesh is able to take advantage of the recovery through higher exports, and higher level of imports is able to stimulate domestic investment.

9.1 Export Sector Performance

Following the negative growth in export during the first and second quarter exports started to rebound from the third quarter and registered robust performance in March and April of FY2009-10. Whilst Bangladesh economy was spared from the immediate adverse impacts of the global financial crisis, to a large extent, performance of the external sector in FY2009-10, particularly in the first half, witnessed the negative consequences originating from the lagged impact of the crisis (Figure 25). Exports started to rebound from the third quarter, with March and April performance being particularly robust. As is known by now, the pace of global recovery has been more robust than was anticipated earlier.[82] Bangladesh's export sector appears to be gaining from the growth in demand in major developing countries which are her important markets. The orders being placed now by major buyers do indicate that the recent robust growth will be sustained in the next months. There are signs that rising global-demand induced imports have started to generate positive impact on Bangladesh's export-oriented sectors.

FIGURE 25: QUARTERLY EXPORT AND IMPORT GROWTH IN FY2008-09 AND FY2009-10



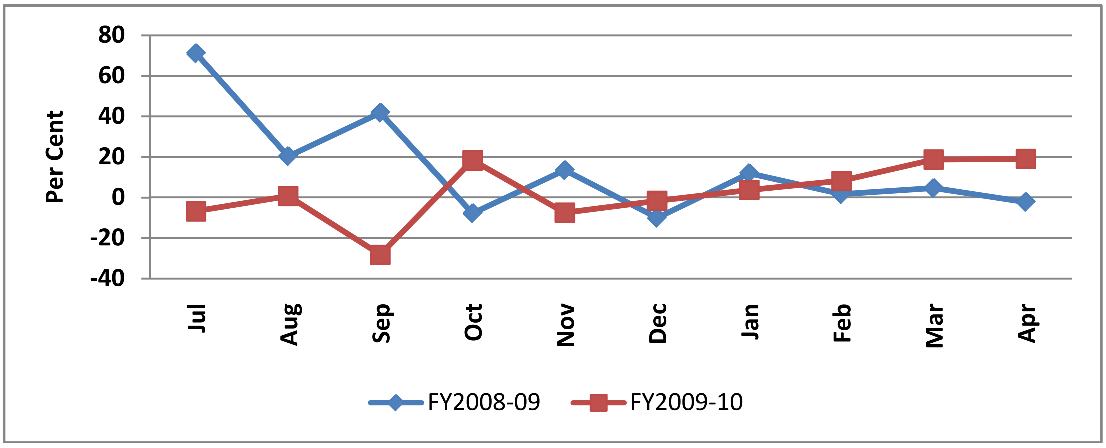
Source: Estimated from EPB and Bangladesh Bank data

Export earnings during July-April FY2009-10 stood at USD 12.9 billion posting a mere 1.0 per cent growth over comparable months of the previous fiscal year. During the first two quarters of FY2009-10, export figures displayed considerable volatility (Figure 26), although it needs to be appreciated that the growth figures were set against high benchmarks of the previous year. However, 10.1 per cent growth was registered during the third quarter of FY2009-10 as against the 6.1 per cent growth posted in the matched period of FY2008-09.

[82] Estimates of global GDP growth were revised upward to 4.0 percent for 2010 and 4.2 percent for 2011 (IMF, 2010).

Notably, total export in April, 2010 was 19.03 per cent higher (USD 1.40 billion) than that of April, 2009.

FIGURE 26: MONTH-TO MONTH EXPORT GROWTH DURING FY2008-09 AND FY2009-10



Source: Estimated from EPB data

RMG exports, inspite of the recent rebound, is yet to enter positive terrain in growth terms and declined by 1.7 per cent in view of reduced demand for apparels in the developed countries; in contrast, the non-RMG exports registered 11.9 per cent growth during July-April of FY2009-10. Non-apparel exportable items that experienced decline in growth were tea (50 per cent), frozen food (13.7per cent), and chemicals (32 per cent). Products experiencing positive growth during this period included raw jute (45 per cent), jute goods (69.8 per cent), leather (15.6 per cent), and engineering products (40 per cent). Indeed, growth rates of these items gained thanks to the low base of the previous year.

TABLE 13: QUARTERLY GROWTH OF MAJOR EXPORT ITEMS DURING FY2008-09 AND FY2009-10

	FY2008-09				**FY2009-10**			
Quarter	**Q1**	**Q2**	**Q3**	**Total (Jul-Apr)**	**Q1**	**Q2**	**Q3**	**Total (Jul-Apr)**
RMG	44.6	5.4	12.7	18.1	-9.7	-4.7	4.5	-1.7
Woven	*36.7*	*6.3*	*9.9*	*15.5*	*-9.7*	*-5.7*	*9.6*	*0.0*
Knit	*52.0*	*4.6*	*15.8*	*20.6*	*-9.7*	*-3.8*	*-0.5*	*-3.3*
Non-RMG	35.7	-22.2	-16.4	-4.0	-18.3	25.1	35.2	11.9
Total Export	**42.4**	**-1.6**	**6.0**	**12.7**	**-11.7**	**1.3**	**10.1**	**0.97**

Source: Estimated from EPB data

To take advantage of the opportunities of the ongoing global recovery, domestic policies pertaining to export-oriented sectors need to be revisited and Bangladesh must reposition herself in view of the increasing pressure from her stimulus-augmented competitors such as China, India and Vietnam (Box 5). Appropriate strategies are also needed to be put in place to stimulate the thrust sectors, particularly leather-footwear, ship-building and pharmaceuticals which appear to have promising prospects.

BOX 5: CHINA AS BANGLADESH'S COMPETITOR IN THE US MARKET

Policy changes and stimulus packages in support of export-oriented sectors, in view of the global financial crisis, have left their footprints in terms of changes in relative competitive strength in markets for apparels (Rahman *et al* 2010). This is demonstrated by Bangladesh's relative performance vis-à-vis China in the US market. US Import of top 14 Bangladeshi apparel products (HS6 digit level) declined by (-) 8.0 per cent during July-March FY2009-10, whereas China maintained a robust growth of 22.0 per cent for those same items. A disaggregate level examination suggests that China is reverting back to export of lower-end products where Bangladesh has traditionally been strong in US market. In view of the crisis, China had earlier withdrawn the duties on lower-end apparels that it had imposed to discourage exporters of those products and induced them to go for higher value-added products. The USD 760.0 billion stimulus package also included various incentives for exporters of lower end items which enhanced their competitive strength and allowed them to offer lower prices and undermine prospects of Bangladesh's exporters of low-end products. Bangladesh will need to monitor the change in structural composition of apparels export from China closely and should take proactive measures to retain her market share in the USA for these items. Bangladesh will also need to pursue most vigorously the New Partnership for Trade Development Act, 2009 (NPTDA 2009) which has been floated in the US Congress. If passed, this would allow Bangladesh and other Asia-Pacific LDCs to have AGOA-parity and duty-free access for all items including apparels. Although Bangladesh has some concern with respect to certain aspects of the Bill, overall Bangladesh stands to gain significantly if and when this Bill is passed.

Some emerging concerns: The sudden and unusual hike in yarn prices in the early months of FY2009-10 also led to undermining of export competitiveness of RMG items in the first few months of 2010. Rise in global cotton prices, in view of low production was a cause; but yarn prices rose disproportionately because of market manipulation. Given the emergent situation import restrictions on yarn were to be removed, particularly via *Benapole* land-port, which the government has recently allowed. The yarn-price crisis once again reinforces the need for forward-looking strategies for the development of this key sector of the economy.

The delayed implementation of the incentives proposed as part of the stimulus package undermined export competitiveness and export performance during a vulnerable period. Steps are only now being taken to implement the various fiscal and financial schemes in support of the export sector as part of the second stimulus package. There is a need to expedite this process (Box 6).

BOX 6: FISCAL STIMULUS PROGRAMMES: NEED TO ACCELERATE IMPLEMENTATION

In all, Bangladesh had put in place two stimulus packages in support of the export oriented sectors in view of the global financial crisis: the first one in April, 2009 and the second one in November, 2009.

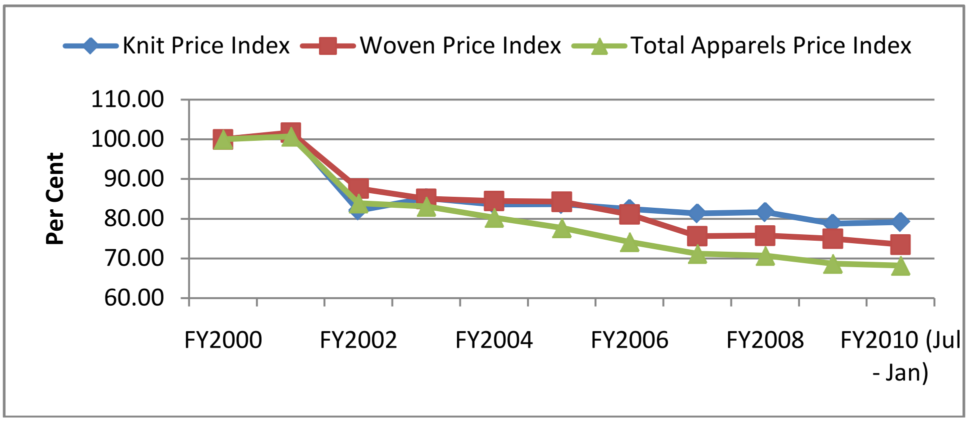
First Package (April, 2009): A stimulus package of Tk. 34.2 billion was allocated to support export, agriculture, power and SSNP sectors. An additional Tk. 4.5 billion in cash subsidies was allocated for export industries most affected by the crisis. In the budget for FY2009-10 this package was further replenished by Tk. 50 billion to support and service the incentives and policies set forth in the preceding package of which Tk. 18 billion was allocated as cash incentive for export-oriented sectors (ADB, 2010). During July-March FY2009-10, around Tk. 12.1 billion was disbursed as cash incentives (67.3 per cent of the allocation) for export-oriented domestic textile, leather products, frozen shrimp and fish, agricultural products jute industries, etc.

Second Package (November, 2009): As per recommendation of the Working Group of the GFC Task Force, a number of incentives were proposed for the RMG sector: (i) Waiver of renewal fee for captive generators (used in apparels), (ii) Cash incentives (5 per cent) for exporters to new markets, and (iii) 'Special incentives' for SMEs (apparels) exporting up to USD 3.5 million annually. The package also includes some benefits for the shipbuilding and crust leather sectors, a 5 per cent cash incentive have been proposed to promote export performance of these sectors. The second stimulus package for export-oriented sectors is yet to be implemented in full. Some initiatives have only been taken very recently to implement the proposals put forward in the stimulus package.

9.2 Terms of Trade

Terms of Trade (ToT) deteriorated with rising global commodity prices and falling prices of Bangladesh's leading export items. A decomposition of Bangladesh's export growth during July-April FY2009-10 (1.0 per cent) reveals that the growth was mainly volume-driven (2.5 per cent) with average price decreasing by about (-) 1.5 per cent (Figure 27). During July-January FY2009-10, export of woven-RMG decreased by (-) 6.7 per cent in terms of volume and by (-) 0.3 per cent in terms of price. For knit RMG, export volume decreased by (-) 7.2 per cent while unit price increased marginally by 0.4 per cent. With global commodity prices rising and prices of Bangladesh's leading export falling, the Terms of Trade (ToT) experienced further deterioration in the recent past.[83] Table 14 reinforces the fact of the falling ToT of Bangladesh. As is seen from the table, ToT for leading export items of Bangladesh with respect to some key importables have tended to fall significantly in post-crisis period when compared with the pre-crisis period.

FIGURE 27: TRENDS IN APPARELS PRICE INDEX



Source: estimated from EPB data

TABLE 14: FALLING PURCHASING POWER OF EXPORTS

Items	Dozens of RMG				Rise (in times) b/a	Rise (in times) c/a	Rise (in times) d/a	Tonnes of Jute Goods				Rise (in times) f/e	Rise (in times) g/e	Rise (in times) h/e
	2006 (Avg) (a)	2008 (Avg) (b)	2009 (c)	2010 (Jul jan) (d)				2006 (Avg) (e)	2008 (Avg) (f)	2009 (Mar) (g)	2010 (Jul jan) (h)			
1 barrel of Oil (Fuel)	2.29	3.62	1.77	2.93	1.6	0.8	1.28	0.11	0.17	0.11	0.13	1.5	0.9	1.19
1 ton of rice	10.76	24.42	16.44	20.53	2.3	1.5	1.91	0.53	1.14	0.98	0.93	2.2	1.8	1.77
1 ton of wheat	6.92	11.86	6.43	7.05	1.7	0.9	1.02	0.34	0.55	0.38	0.32	1.6	1.1	0.94
1 Metric Ton Soyabean Oil	20.75	45.75	24.13	33.90	2.2	1.2	1.63	1.02	2.14	1.44	1.54	2.1	1.4	1.51

Source: Estimated from FAO, WB, EPB and Others: Various publications

The Minimum Wage Issue: It is to be kept in mind that the ongoing work of the Minimum wage Board for RMG workers will result in rise in the wages, and the cost of apparels production. Although to what extent this rise will be is yet to be known, there is no denying the fact that minimum wage for RMG workers needs to be significantly raised, keeping in

[83] The contribution of unit value (relative to volume) will need to be closely examined to assess whether some positive signals can be discernible from global market behaviour of recent times.

view inflation, GDP growth and other relevant correlates. It is also equally true that a renewed effort towards productivity enhancement in the RMG sector will be required to take advantage of the global recovery by remaining competitive.

9.3 Trends in Import and L/C

Import declined during the first ten months (July-April) of FY2009-10, however, in the recent months imports have bounced back and L/C openings for imports have been posting impressive growth performance. Import payments have followed a declining trend since the second quarter of FY2008-09 due to the fall in import of rice and other items and also because of the fall in commodity prices in the international market. During the July-March FY2009-10, total merchandise imports was to tune of USD 17.20 billion, which was 1.4 per cent less than that of the corresponding period of the last year. However, imports have picked up in recent months, particularly during December-March of FY2009-10 when import increased by 14.1 per cent. This rise in imports is likely to continue in the coming months in view of higher industrial lending, the positive growth prospects of RMG sector and also the rising trend in global commodity prices including fuel and fertiliser.

Declining trend in import of RMG raw materials such as raw cotton (-3.38 per cent), yarn (-17.03 per cent), and textile & articles thereof (-10.88 per cent) during the first three quarters reflected the depressed RMG export scenario in FY2009-10. Fall in import of capital machineries for textile (-7.85 per cent) and export oriented garment industries (-6.48 per cent) also coincided with this trend.

However, import of all capital machineries posted a 6.0 per cent growth during July-March, FY2009-10. A disaggregated analysis shows that capital machineries for which import growth was high included those of leather and tanning industries (56.1 per cent), plastic industries (159.5 per cent), printing industries (40.7 per cent), packing industries (67.2 per cent). Import of heavy machineries including those used for power generation also registered positive growth (3.1 per cent).

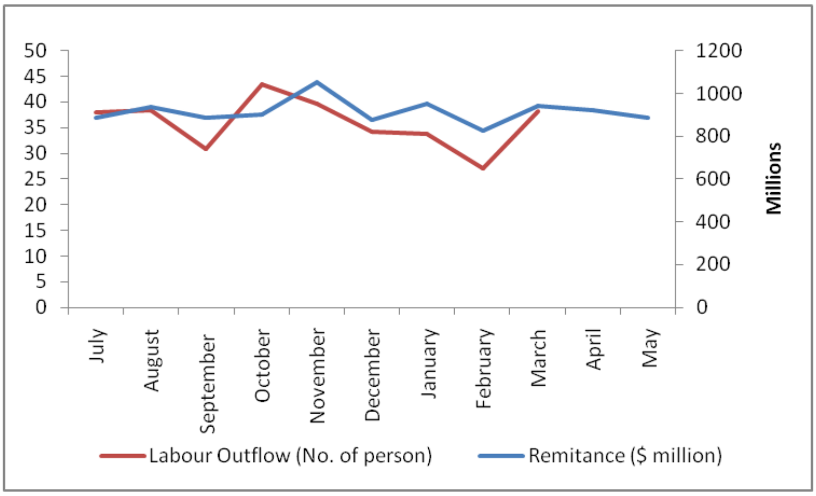
L/C opening figures corroborate the hypothesis of investment gradually picking up towards the end of FY2009-10. Total L/C opening increased by about 22.9 per cent in the first three quarters of FY2009-10. L/C opening for industrial raw materials and capital machineries has also entered into positive terrain, posting a rise of 9.5 per cent and 51.6 per cent, respectively over the corresponding period. However, settlement of import L/C (total) during July-March FY2009-10 decreased by 0.3 per cent (USD 16.5 billion against USD 16.6 billion during July-March FY2008-09). Mismatch between historical figures for L/C opening and settlement remain a perplexing paradox. Rising L/C openings does augur good for the economy. What likely impact this will have on forex reserves will hinge on continuity of the recent trends in export performance and the remittance flows.

9.4 Remittances and Overseas Employment

Overall remittance flow during the first 11 months was robust; however growth has slowed down over the last three months (February to April) of FY2009-10. During the first eleven months of FY2009-10, remittance earnings rose to USD 10.1 billion (14.9 per cent growth, despite the high benchmark of 22.5 per cent in FY2008-09) (Figure 28). This must be seen as exceptional in the backdrop of the bleak outlook with regard to remittance flows worldwide. However, recent slowdown in remittance flow should transmit disquieting signals (7.75 per cent growth in last three months) and will need to be carefully observed. Outflow of migrant workers, however, decreased by 45 per cent in the first nine months of FY2009-10. The monthly average figure of migrants was 39,606 in 2009, way down from 72,921 a year ago, visibly getting back to the pre-2007 trends. Recently, Kingdom of Saudi Arabia (KSA) and Malaysia have planned to recruit 1.4 million workers which could perhaps enhance job opportunities for Bangladeshi migrant workers if some of the initiatives to take advantage of this is followed up through further actions**.**

A number of initiatives are being taken in support of the migrant workers which need to be welcomed. The government has approved the *Expatriate Welfare Bank Bill 2010*. The bank is to be set up to provide financial assistance to overseas jobseekers. A number of actions will be needed to address the concerns in this sector. These relate to (a) migration from hard-core areas; (b) skill upgradation of migrant workers; (c) lowering the cost of migration, (d) further lower cost of remitting money from host countries; (e) encouraging investment by returnee migrants; and (f) mobilisation of funds from migrant workers and diaspora to service domestic resource needs. Bangladesh will need to develop a comprehensive strategy to take advantage of global market opportunities in export of migrant workers. Designing of appropriate domestic action plans and active participation in WTO negotiations in GATS Mode-4 will be required.

FIGURE 28: REMITTANCES AND OVERSEAS EMPLOYMENT



Source: Bangladesh Bank and Bureau of Manpower, Employment and Training (BMET)

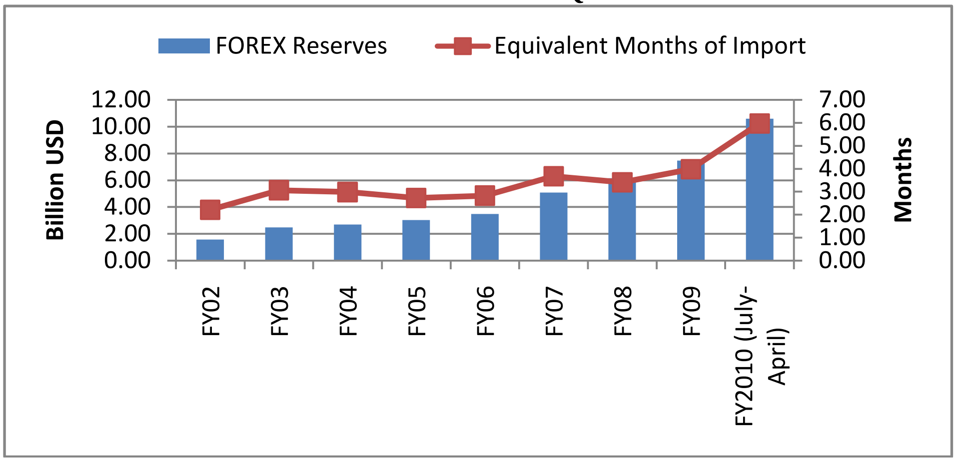
9.5 Balance of Payment

Balance of Payment situation was comfortable, thanks to rapid fall in import payments in spite of lacklusive performance of export sector; this could change as imports are likely to pick up in near term. Trade deficit narrowed down to USD 3.9 billion during July–March in FY2009-10 from USD 4.1 billion of the corresponding period of the earlier year thanks to faster decrease in import payments compared to rate of fall in export earnings. With the lower deficit in trade, and surplus in current transfers in the backdrop of robust growth of remittances (17.36 per cent), the current account surplus rose significantly to USD 2.6 billion during the first nine month of FY2009-10, from USD 1.02 billion in the same period of the previous year. Once imports pick up, and with recent slowdown in remittances, a drawdown in the current account surplus is not unlikely in near future.

9.6 Impressive Forex Reserve

The growing foreign exchange reserves will call for prudent management both in terms of maintaining a competitive exchange rate and also portfolio management of the reserves. After crossing the USD 10.0 billion mark in November, 2009, the country's foreign exchange reserves has continued to rise. Gross foreign exchange reserves of Bangladesh Bank reached USD 10.06 billion (worth about 5 months of import goods and services) at the end of April, 2010, up from USD 7.5 billion a year earlier (Figure 29).

FIGURE 29: FOREIGN RESERVE TRENDS AND EQUIVALENT MONTHS OF IMPORT



Source: Bangladesh Bank

Bangladesh's foreign reserves are mainly in US dollars (about half), with a significant part being in Euro (about one-seventh) and the rest in other currencies. Prudent management of the growing reserves has become important in view of the rising fluctuations in the value of the currencies in Bangladesh's currency basket. This issue has become more important in view of the falling value of the Euro over the last few months.[84] It is to be noted that in recent times a number of countries including China, India, Mexico, the Philippines, Venezuela, and Equador have been purchasing gold to keep as reserves. Cleverly crafted forex reserve management will be required so that Bangladesh does not take a hit because of the growing volatility in the foreign exchange market.

SECTION X: CHALLENGES OF MACROECONOMIC MANAGEMENT IN FY2010-11

Macroeconomic management in FY2010-11 will need to address two core objectives – fast-tracking the pace of economic growth, and keeping the emerging inflationary trends in the economy contained[85]. Attaining the targeted growth rate will require active policy responses on both domestic and external fronts addressing lagged impact of global financial crisis and promoting investment backed by the required infrastructure support. Containing the inflationary pressure will call for a comprehensive action plan beyond the mere use of macroeconomic tools. Whilst macroeconomic stability will be a key determinant of growth in

[84] Value of Euro against USD has fallen roughly by 12.8 per cent against the US dollar (between 1 January to 26 May, 2010).
[85] This phenomenon of high growth with low inflation is often coined as *Goldilocks Economy*. The targets for economic growth and annual average inflation for FY2010-11 is likely to be set at 6.5 per cent and 6.7 per cent respectively.

FY2010-11, in attaining the goal policymakers will need to address a number of apparently conflicting interests that will call for greater coherence in the policy framework.

Macroeconomic policy-making in a developing country context often tends to be led by fiscal policy, and it comes as no surprise that the government is expected to announce a large expenditure target of about Tk. 1,32,000 crore (16.00 per cent or Tk. 18,181 crore higher than the proposed budget for FY2009-10) in the forthcoming budget for FY2010-11 (Table 15). In one sense, this higher expenditure is justified in view of the tasks at hand, involving both revenue expenditure and developmental needs. *Firstly*, a larger ADP (Tk. 38,500 crore) will be needed to meet the growing investment demand, along with the carried-over projects. *Secondly*, the urgent task of reinvigorating the PPP programme to attract additional private sector investment will call for the much needed allocation (about Tk. 3,000 crore). *Thirdly*, to facilitate revitalising export performance, the fiscal stimulus will need to continue and at the same time the undisbursed committed resource allocation announced in earlier packages (e.g. cash subsidies[86], waiver of renewal fee for captive generators, etc.) will also need to be met. *Fourthly*, additional subsidy for the newly negotiated rental power plants will require additional subsidy of between Tk. 2,900 crore and Tk. 3,200 crore. *Fifthly*, fiscal support will need to be continued to curb the inflationary pressure in terms of providing support to agriculture in the form of subsidised fertiliser and fuel. In this connection, there will be a need to replenish the buffer stock of food grains through domestic and international procurements. Government's plans to expand the coverage of social protection and safety net schemes in support of the marginalised will involve additional resource commitments in FY2010-11. *Sixthly*, the creeping inflationary trend in international market particularly for foodgrains, fuel and fertiliser will demand additional expenditure from the government exchequer in the form of subsidies. And finally, higher deficit originating from these additional expenditures would mean higher borrowing and consequently higher interest payments (expected to be Tk. 2,000 crore next year).

TABLE 15: FISCAL STRUCTURE OF BUDGETS FOR FY2009-10 and FY2010-11

(crore Tk.)

Items	FY2009-10[B]	FY2010-11[P]
GDP at current price	**6,90,571**	**7,77,378**
Revenue Earnings	79,461	93,000
as % of GDP	**11.5**	**11.9**
Non-ADP Expenditure	83,319	93,500
as % of GDP	**12.1**	**12.1**
ADP	30,500	38,500
as % of GDP	**4.4**	**4.9**
Total Budget	1,13,819	1,32,000
as % of GDP	**16.5**	**16.9**
Deficit	34,358	39,000
as % of GDP	**5.0**	**5.0**

Source: Calculated from MoF (2009) and various media reports
Note: B stands for budget and P stands for projected figures
Projected GDP for FY2009-10 has been calculated considering inflation rate target of 6.5 per cent plus 6.7 per cent projected real GDP growth.

[86] It is expected that a cash support announced for RMG export to non-traditional markets would require about Tk. 350 crore for FY2009-10 which will be carried forward in FY2010-11. Besides, as is known, the package also includes support to SME-RMGs, ship-building and some other sectors.

There is no doubt that higher revenue mobilisation is the most desired way to meet such high expenditures. It is perceived that a 17 per cent higher (than the target for FY2009-10[87]) target will be set for total revenue collection. This will no doubt require much higher tax effort than has been in the past, and much of this will hinge on the performance of the NBR. Tax collection at import stage is expected to pick up with the rise in global commodity prices. The government will also need to step up its efforts to reduce any system loss in this area (usually attributed to under-invoicing). Whilst more rationalisation of the existing tariff structure may be required to stimulate investment, the trade-offs, both short and medium term, will need to be carefully weighed, particularly the possible impact on revenue collection. Evasion of customs duty could be significantly reduced if data on revenue collection could be shared with the NBR monitoring cell on a regular basis through online network between the customs points and the NBR. Automation of the customs points should receive priority in the coming fiscal year. Income tax collection has emerged as one of the star performers in mobilising government revenue in recent years. Given that a large number of Tax Identification Number (TIN) holders do not pay taxes, enhanced effort to mobilise tax from them is likely to generate rich dividends.[88] NBR's plans to simplify the existing tax laws and tax submission system should also ease the hassles faced by the taxpayers. A programme under NBR may be undertaken to popularise online submission of tax returns with the online tax form having an in-built tax calculator to facilitate self-assessment. It is also learnt that the government was planning to explore new avenues to generate additional income tax. Introduction of tax on capital gains, particularly for the capital market, can be one potential source, but with a number of overreaching implications (Box 7). Revenue collection from VAT at the local stage will depend on the economic performance as well as on continuing enhanced efforts (particularly successful enforcement of mandatory use of ECR and increasing number of registered VAT payers). To enhance tax collection effort strengthening, the NBR manpower should also receive required attention[89]. It is important to note here that the tax buoyancy for Bangladesh is estimated to be 1.16, which means a per cent change in GDP influences a 1.16 per cent change is tax revenue collection[90]. Thus, in a business as usual scenario, growth of tax revenue may be limited to 14.58 per cent for FY2010-11; implying that a considerable amount of incremental growth in tax collection must be contributed by administrative tax collection effort. The experience of current fiscal year also indicates that earnings from non-tax revenue will also require special attention for the overall revenue outcome.

[87] Considering an estimated shortfall of about Tk. 2,400 crore, the growth target may actually turn out to be about 20.7 per cent.

[88] Only 7.5 lakh people submitted their income tax returns in 2009, although more than 23 lakh people have TIN. One caveat, though, is that the actual number of tax-payers is higher because of the significant number of people who are covered under tax deduction at source, many of whom do not submit tax returns. NBR was able to include only about 1.5 lakh taxpayers during July-March FY2009-10 against the target of 4.25 lakh in FY2009-10.

[89] Due to legal disputes, NBR has not been able to properly expand its manpower capacity since the mid-1980s. It is estimated that there are currently eight thousand vacancies available in different levels in NBR.

[90] Following Haughton (1998), tax buoyancy for Bangladesh is estimated by an ordinary least squares (OLS) regression taking (ln of) tax revenue as dependent variable and (ln of) GDP as independent variable considering the period of FY1991-92 to FY2008-09. Subsequently Prais-Winsten AR(1) regression was carried out as a refinery process for autocorrelation issue. Rho factor stabilizes at 4th iteration. This is close to the estimated tax buoyancy for Bangladesh by Begum (2007) at 1.24 considering a time period FY1990-91 to FY2004-05.

BOX 7: TO IMPOSE OR NOT TO IMPOSE -CAPITAL GAINS TAX (CGT)

Recently, there has been much talk about imposing a tax on capital gains, particularly in the context of the country's capital market. Two important reasons could be cited in favour of such a proposal. This would lead to additional resource mobilisation, and secondly, a CGT if carefully crafted could play a positive role in curbing market volatility, particularly in the context of a bullish market situation. The Securities and Exchange Commission (SEC) has recently suggested that if this be imposed, the tax rate should be at a low level of about 3 per cent and that the tax should be imposed only on banks and other financial institutions, not individuals. The idea of introducing a CGT on property has also been mooted. The Dhaka Stock Exchange (DSE) has endorsed the idea of imposing CGT on institutional investors and argued for imposing a surcharge of Tk. 100 for every Beneficiary Owner (BO) account in aid of revenue mobilisation. In the event that a CGT is imposed, a number of issues will need to be taken into consideration. One of the major issues will be whether to deduct the tax at source or charged on an annualised return basis. Bangladesh experience reflects that tax deduction at source or using a framework, similar to Advance Income Tax (AIT), is a better way to go. If tax is deducted at source, then the question would be how to factor-in the issue of considering capital losses (if any). It needs to be taken into cognisance that this will impose additional responsibilities on the brokerage houses. Capital losses may be adjusted against capital gains, while unabsorbed losses could be carried forward for a specific period. Then again, if CGT is deducted on an annualised basis, the expected revenue outcome may be undermined. Procedural mechanisms for implementation of the CGT could be put in place according to the length of period, by differentiating short and long term investment in the bourse. Considering that the capital market in Bangladesh is still at an infant stage, it may be advisable to impose CGT only on capital gains made in the short term. It is to be noted here in this connection that India has a CGT in place on transactions made within one year time span. The issue of not discouraging the increasingly large number of small investors also needs careful consideration. One potential solution could be introduction of CGT in a progressive manner or through fixation of a threshold/slab, protecting the interest of small investors. Above all, policy makers must take into cognisance the technical requirements (i.e. software to calculate the tax at the time of transaction), human resource capacity of implementing authorities and also going for a decision in this respect. Even if no such decision is taken in FY2010-11, signals may be transmitted through the upcoming budget about its possibility, should the government decides to go for it, but defer it. This will prepare the market, and reduce any short term volatility that could arise from this possibility.

Even if the challenging revenue mobilisation target is achieved, about Tk. 39,000 crore will be required to finance the expected budget deficit in FY2010-11. This estimated budget deficit figure for FY2010-11 indicates that it may well remain within the FY2009-10 target of 5 per cent of the GDP. In the present context of the Bangladesh economy, the major concern is the mode of financing rather than the size of the deficit. An important aspect of the deficit financing will be the ability of the government to draw on foreign sources, particularly the grant component along with budgetary support[91]. It is envisaged that about one-third of the total deficit will be financed from the net foreign aid. This will, however, largely depend on project-aided fund utilisation capacity of the line ministries[92]. It is also pertinent to mention here that currently about USD 9.0 billion foreign aid remains in the pipeline. In the context of the macroeconomic outlook for FY2010-11, it will be important to ensure that domestic borrowing does not crowd-out private investment demand and that the deficit financing is made in a non-inflationary manner. In this context the government will be better off to use non-bank borrowing window of domestic financing even though it may mean borrowing at higher interest rates and could create future fiscal burden[93]. At 21.66 per cent of the revenue expenditure this burden has been on the rise; however, the critical factor here will be government's ability to appropriately use the borrowings so that these generate higher returns.

[91] Economic Relations Division (ERD) projected that it may be possible to finance 10 per cent of the total deficit through grant and budgetary support.

[92] 80 per cent of the total foreign aid projected for FY2010-11 will be under project aid head.

[93] Average interest rate of non-bank borrowing of government is 11.75 per cent which is 4 percentage points higher compared to that of bank borrowing (7.75 per cent) (MoF 2010).

The government is currently considering the idea of reducing the interest rate for NSD certificates by 0.5 percentage point and also to lower the maximum investment limit to Tk. 30 lakh from the existing Tk. 50 lakh in the backdrop of the prevailing significant gap between NSD interest rates and the interest rates offered by the commercial banks, and the higher interest burden in servicing the NSD loans. However, it may be argued that even after the notable growth in net sales of NSD certificates, the domestic interest payments by the government during the first eight months increased by only about 2.0 per cent over the corresponding period of the preceding year. Moreover, it should also to be noted that about half of the NSD sale owes to *3-Month Interest Bearing Savings Certificate* which is generally preferred by small savers and pensioners. This often acts as a social welfare provision for the aforesaid groups of the population. At the same time, in view of the continuing high interest rate spread (5.28 per cent in March FY2009-10), commercial banks should be encouraged to enhance efficiency of their operation and reduce the spread not by reducing the deposit rate but by bringing down the lending rate. In view of the above, it is advisable to defer this year, a review of interest rates on NSD certificates.

The outlook for FY2010-11 suggests that there will be an increase in credit demand from both the private and the public sectors. If the government can ensure a conducive investment climate and is able to appropriately address the power issue, in these times of continuing global economic recovery, it is likely that the private sector will require more credit for investment. Import demand and consequently its financing needs are also expected to increase through both price effect (rise in commodity price) and volume effect (higher demand for imported goods such as capital machineries for new investment, intermediate products such as inputs for export-oriented and domestic industries, and petroleum and fuel in view of the planned increase in power generation).

Higher investment demand along with the increased import demand are expected to pull private sector credit demand. As was noted, the government will also be required to borrow more from the banking sources to implement the forthcoming budget. All these will require a vigilant monetary policy attuned to the dynamics of the real sector. In the present context, it appears to be prudent that the monetary policy should use domestic credit as the anchor variable in view of the government's and private sector's credit requirement, which has not been the usual practice in Bangladesh[94]. In order to rein in agflation, disbursement of agricultural credit will also have to be increased significantly. If credit demand continues to rise with better economic performance, the level of excess liquidity is also likely to reduce. Monetary policy in FY2010-11 should closely follow these developments and act in support of the fiscal policy[95]. From inflation targeting perspective, one needs to take into cognisance that in Bangladesh inflation has been mainly of agflationary nature, and tends to be largely influenced by external forces. One should also recall that the prevailing high growth of money supply is attributed to sharp rise in net foreign assets and not owing to very high growth of domestic credit. It is observed that growth of remittance inflow has slowed down in recent months; import payments are expected to rise, and consequently, the growth of net

[94] Monetary aggregate targeting will need to be the intermediate objective to accelerate growth without dampening the inflationary pressure in the present context. Using "Instability Index", Bhattachrya and Khan (2010) found that in Bangladesh the aggregate money supply is often used as "anchor" variable and the shares are distributed accordingly. While, standard theory suggests that it would be more efficient to target the components to achieve objectives and let the aggregate adjust automatically (Ramey and Ramey, 1995).

[95] A number of experts have endorsed the expansionary fiscal stance and accommodative monetary policy to boost up of globally-linked economies (Krugman, 2009; Shiller and Akerlof, 2009)

foreign assets is expected to fall. Thus, it will be appropriate supply-side management which is likely to prove to be the better option to curb agflation.

Performance of the country's external sector will largely depend on the dynamics of the global market and nature of the economic recovery. As was noted, import is set to pick up in the coming months. With remittance growth falling, the balance of payments situation could come under some pressure. In such a context prudent exchange rate management will be required to balance the interests of export and import-oriented sectors, and producers and consumers.

Overall, in view of the challenges that are expected to be faced by the Bangladesh economy in FY2010-11, it will be prudent to anchor the policymaking in fiscal management whilst monetary policy should play a supportive and accommodative stance. Performance of the economy in FY2010-11 will hinge on the efficacy of macroeconomic management, and at the same time, success of macroeconomic management will, to a large extent, be dependent on performance of the economy. From both these perspective, the upcoming budget for FY2010-11 will be an important milestone.

SECTION XI: CONCLUDING REMARKS: MAJOR CHALLENGES

Review of key macroeconomic performance indicators of FY2009-10 undertaken in the preceding sections alludes to a number of positive developments: prudent fiscal management underwritten by enhanced tax mobilisation effort and higher development expenditure (in nominal terms), improved balance of payments situation, stability of exchange rate, growing foreign exchange reserves and successful input delivery for farmers. On the other hand, there were some nagging concerns: lower than target GDP growth rate, power shortage that continued to undermine growth prospects and investment, implementation delays (both ADP and fiscal stimulus for export-oriented sectors), pressure on domestic labour market in view of lower migration figures, and mounting inflationary pressure. The overall macroeconomic stability, in FY2009-10 could not be translated into accelerated economic growth because of the investment and infrastructural bottlenecks. In this backdrop, economic management in FY2010-11 will hinge on the government's ability to deal with a number of issues highlighted in the following discussion.

In FY2010-11, a major challenge will be the ability of the government to raise its delivery capacity, particularly in such areas as power generation, infrastructure development, and attracting investments in public-private partnerships. Inordinate delay in finalising various policies which lead to delayed implementation are proving to be increasingly costly, both in monetary terms, and also in terms of its adverse impact on private sector investment. Once policies have been finalised, there should a concerted effort towards their timely execution. This will require coherent, coordinated and well-sequenced action plans on the part of various Ministries and Agencies. There will need to be a renewed effort to fully implement the envisaged large public expenditure earmarked to attain the projected 6.5 per cent growth in FY2010-11. In the event, this will call for smart fiscal management through higher levels of domestic resource mobilisation and management of the fiscal deficit in a non-inflationary manner. It will be important to maintain macroeconomic stability as the government strives to attain the higher growth target it has set for FY2010-11. The policy choice here will need to be a well-crafted supply-side management through higher production and productivity, along with keeping the focus on public distribution mechanism. There will be a need to carefully balance the often conflicting interests of producers and consumers, by maintaining food security and providing adequate incentive to farmers and producers. In a similar vein, through prudent exchange rate management, competitiveness of the export-oriented sectors will need to be ensured without undermining consumer's welfare security.

There will be a need to take appropriate preparation before going for implementing particular policies that could have short and long term implications. For example, whilst capital gains tax could be a potential source for revenue generation, investors, market and regulatory authorities will all need to be appropriately tuned towards possible changes that this will entail, if and when such policies are implemented.

In the recent past, the government has been involved with a number of bilateral economic cooperation initiatives, including those with India and China. A set of follow-up actions (building of infrastructure, trade facilitation, etc.) including the required resource allocation, will now need to be put in place to materialise the envisaged opportunities. FY2010-11, being the first year of the *Sixth Five Year Plan* (SFYP), and also of the ten-year perspective plan, will need to be in sync with the medium term planning framework and targets. This will call for both coordination and coherence between short and medium term policy making.

There will be a heightened need to improve the quality of economic governance to address the aforesaid challenges and the attendant tasks. In order to create a conducive environment for this, a renewed effort will need to be undertaken to raise the efficacy of public institutions and quality of development administration. Regulatory reform initiatives must be continued and further expanded, and commitments made by the government towards citizens' empowerment will have to be met through a transparent and accountable system of governance that ensures participation and voice of elected representatives, at all levels, and relevant stakeholders groups.

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