

State of the Bangladesh Economy in FY2008

Paper 65

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The Centre for Policy Dialogue (CPD), established in 1993, is a civil society initiative to promote an ongoing dialogue between the principal partners in the decision-making and implementing process. The dialogues are designed to address important policy issues and to seek constructive solutions to these problems. The Centre has already organised a series of such dialogues at local, regional and national levels. The CPD has also organised a number of South Asian bilateral and regional dialogues as well as some international dialogues. These dialogues have brought together ministers, opposition frontbenchers, MPs, business leaders, NGOs, donors, professionals and other functional group in civil society within a non-confrontational environment to promote focused discussions. The CPD seeks to create a national policy consciousness where members of civil society will be made aware of critical policy issues affecting their lives and will come together in support of particular policy agendas which they feel are conducive to the well being of the country.

In support of the dialogue process the Centre is engaged in research programmes which are both serviced by and are intended to serve as inputs for particular dialogues organised by the Centre throughout the year. Some of the major research programmes of the CPD include **The Independent Review of Bangladesh's Development (IRBD), Trade Related Research and Policy Development (TRRPD), Governance and Policy Reforms, Regional Cooperation and Integration, Investment Promotion and Enterprise Development, Agriculture and Rural Development, Environment and Natural Resources Management, and Social Sectors.** The CPD also conducts periodic public perception surveys on policy issues and issues of developmental concerns. With a view to promote vision and policy awareness amongst the young people of the country, CPD is implementing a **Youth Leadership Programme.**

Dissemination of information and knowledge on critical developmental issues continues to remain an important component of CPD's activities. Pursuant to this CPD maintains an active publication programme, both in Bangla and in English. As part of its dissemination programme, CPD has been bringing out **CPD Occasional Paper Series** on a regular basis. Dialogue background papers, investigative reports and results of perception surveys which relate to issues of high public interest are published under this series. The Occasional Paper Series also include draft research papers and reports, which may be subsequently published by the CPD.

The present paper titled *State of the Bangladesh Economy in FY2008* has been prepared under the CPD programme on *Independent Review of Bangladesh's Development (IRBD)*. This programme aims at strengthening institutional capacity in Bangladesh in the area of trade policy analysis, negotiations and implementation. The programme, *inter alia*, seeks to project the civil society's perspectives on the emerging issues emanating from the process of globalisation and liberalisation. The outputs of the programme have been made available to all stakeholder groups including the government and policymakers, entrepreneurs and business leaders, and trade and development partners.

The paper has been prepared by the CPD IRBD Team 2008.

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List of Acronyms

| | |
|--------|--|
| ACU | Asian Clearing Union |
| ADB | Asian Development Bank |
| ADP | Annual Development Programme |
| BB | Bangladesh Bank |
| BBBF | Bangladesh Better Business Forum |
| BBS | Bangladesh Bureau of Statistics |
| BJMC | Bangladesh Jute Mills Corporation |
| CPA | Chittagong Port Authority |
| CPD | Centre for Policy Dialogue |
| CTG | Caretaker Government |
| DAE | Department of Agricultural Extension |
| DAE | Department of Agriculture |
| DFIs | Development Finance Institutions |
| DSE | Dhaka Stock Exchange |
| FAO | Food and Agriculture Organization |
| FBs | Foreign Banks |
| GDP | Gross Domestic Product |
| GR | Gratuitous Relief |
| IPO | Initial Public Offering |
| MDG | Millennium Development Goals |
| MKWh | Million Kilo-watt hour |
| mt | Million Metric Tons |
| MoP | Murate of Potash |
| MRP | Maximum Retail Price |
| MW | Mega Watt |
| NBDC | Non-Bank Depository Corporation |
| NBR | National Board of Revenue |
| NCT | New Mooring Container Terminal |
| NRB | Non-resident Bangladeshi |
| NSD | National Savings Directorate |
| OMS | Open Market Sale |
| PCBs | Private Commercial Banks |
| PFDS | Public Food Distribution System |
| QIP | Quantum Index of Production |
| RRC | Regulatory Reforms Commission |
| SCB | State Owned Commercial Bank |
| SEC | Securities and Exchange Commission |
| SPARSO | Space Research and Remote Sensing Organization |
| TEU | Twenty-Foot Equivalent Unit |
| TSP | Tripple Super Phosphate |
| VAT | Value Added Tax |
| VGD | Vulnerable Group Development |
| VGf | Vulnerable Group Feeding |
| VOIP | Voice Over Internet Protocol |
| VRS | Voluntary Retirement Scheme |

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1. INTRODUCTION

Over the first six months of the current fiscal year, almost all the major targets set for FY2007-08 by the current Caretaker Government (CTG) came under serious test. Two successive floods, cyclone Sidr, global market situation, domestic inflation and the consequent impact on investment and business scenarios have raised serious concerns as to whether the macroeconomic targets set for FY2008 could be achieved. Whilst forex reserves, remittance flow, revenue collection by the National Board of Revenue (NBR) and stock market performance give some hope, there are alarming developments in the area of prices, export and investment undermining the prospects of achieving the Gross Domestic Product (GDP) target for FY2008.

In view of the above, the present report focuses on three major areas: (a) analysis of the performance of major macroeconomic correlates during the first six months of the current fiscal year (depending on data availability); (b) outlook for the prospects of achieving the targets set for FY2008; and (c) some of the major challenges facing the CTG as it moves toward the dead line set for holding the national elections by the end of 2008.

2. STATE OF THE BANGLADESH ECONOMY IN FY2008

2.1 PUBLIC FINANCE

2.1.1 Revenue Earnings

Data for the initial months of FY2008 indicates encouraging achievements in terms of revenue mobilisation, thanks to positive outcomes of the recent NBR drive to enhance coverage of tax payers and bring undisclosed earnings into the ambit of tax net. NBR figures available for July-November period shows a 22.4 per cent growth in income tax generation. This contrasts quite sharply with growth figures for the matching period of FY2007 which was only 9.7 per cent. Considering that the annual target for growth of NBR revenue earnings is 21.2 per cent over the actual figures of FY2007, NBR appears to be well on track. Collection of income tax registered significant growth of 44.0 per cent, which is unprecedented in recent times. Income tax contributed 34.0 per cent of total additional revenue collection of the NBR during the period under consideration. It should be mentioned here that introduction of the universal self-assessment system has played a positive role in this context. Collection of VAT also sustained impressive growth with an increase of 16.8 per cent. Revenue earnings from import duties recovered to some extent with 10.7 per cent growth during July-November of FY2008, from a marginal growth of 3.8 per cent achieved in FY2007. However, meeting an ambitious growth target of 23.4 per cent over the actual receipts in FY2007 will demand acceleration in import duty collection over the next seven months. Collection of all import related duties (import

duties, import VAT and import portion of the supplementary tax) registered significant growth of 18.8 per cent, most likely because of higher import price and improved administrative scrutiny, rather than the larger volume of imports. During this period, NBR achieved 36.1 per cent of the annual target, compared to its 31.5 per cent achievement during the corresponding period of FY2007.

Data for non-NBR revenue collection is available only for the first two months of FY2008. During this period, non-NBR revenue collection grew significantly by 35.7 per cent, with impressive performances by both non-NBR tax component (19.9 per cent growth) and non-tax component (37.9 per cent growth).

In view of the significantly high expenditure target envisaged in the budget for FY2008, mobilising additional revenue during FY08 will be a key challenge facing the CTG. Though achievements over the first five months are commendable, sustaining the current growth momentum over the rest of the fiscal year will not be an easy task. The CTG will need to improve tax administration with a view to raising the efficiency of domestic resource mobilisation and taking advantage of the ongoing anti-corruption drive.

2.1.2 Revenue Expenditure

FY2008 budget has targeted significant increase in revenue expenditure, by 15.6 per cent, over the actual expenditure of FY2007. However with data for July-August period of FY2008 showing much higher growth of revenue expenditure (30.7 per cent), apprehension is that the revenue expenditure will overshoot the target, particularly on account of debt servicing. Against the target of 14.7 per cent growth in interest payments, till now the growth recorded has been as high as 38.5 per cent. Latest available figure shows that revenue expenditure during FY2008 July-August period, stood at Tk 5,294.4 crore, i.e. 10.8 per cent of the total annual target, which was Tk 4,050.4 crore or 9.5 per cent of the original target during the matching period of FY2007.

Consecutive floods and the cyclone will in all likelihood lead to increased government expenditure in the upcoming months. Revenue expenditure budget for FY2008 has kept Tk 2,182.2 crore as block allocation, of which only Tk 5.2 crore has been spent during July-August period. This block allocation could be used to finance the rehabilitation programmes associated with floods and cyclone Sidr.

2.1.3 Annual Development Programme (ADP)

Latest data available for the July-October of FY2008 shows an ADP expenditure of TK 3,042 crore, which was 11 per cent of total ADP target for the fiscal year. Such expenditures are in line with the declining trend observed in recent years. To a large extent this year's low figures are quite understandable; being accounted for by restrained

expenditure by the CTG. Expenditure during the corresponding period of the last fiscal year amounted to 14.5 per cent of the total annual allocation. Even the 14 ministries that are responsible to develop their own budgets could not register high performance in this regard. During these first four months in FY2008, 25 per cent of the local currency component was released, which was lower than the matching figure of the previous year (29 per cent), perhaps attributable to a pre-election rushed disbursement of the then outgoing government.

The expected increase in expenditure for targeted programmes, in view of the consecutive floods and the cyclone, will call for a restructuring of the ADP allocation for the current year and funds will have to be diverted towards rehabilitation efforts. While scaling down, more focused expenditure should be targeted with particular emphasis on Agriculture, Rural Development, Infrastructure Development, Education, Health and Power. The CTG needs to take a closer look at the ADP projects with a view to cancelling or suspending those without approval, alongside projects with no or insignificant fund release.

ADP of FY2008 has allocated Tk 898 crore against unapproved projects and Tk 1,414 crore as special block allocation, with the total amount being Tk 2,312 crore. Within the allocation against unapproved projects, Tk 646 crore has been kept to be financed from domestic resources and the rest as project aid. The domestic portion of this fund, along with unutilised block allocation, should be important options for the government to finance rehabilitation programmes for the floods and the cyclone.

2.1.4 Budget Deficit

Large deficit target was a prominent feature of the budget for FY2008 with the deficit being set as high as 5.6 per cent of the GDP, against 3.7 per cent of FY2007. Even if BPC liability is excluded, the deficit target stands at 4.2 per cent of the GDP. Total deficit, excluding BPC liabilities, is set to grow substantially by 28.5 per cent during the current fiscal year. At the end of October 2007, total deficit stood at Tk 9,850.01 crore, which is 55.5 per cent higher than the corresponding figure of FY2007. In financing this deficit, domestic sources contributed 83.3 per cent to the total deficit. Government borrowing from domestic sources increased significantly, by 33.3 per cent during the July-October period. In the early months of FY2008, the government has drawn mostly from the banking sources. Respective shares of bank borrowing and non-bank borrowing, in the total domestic financing, stood at 88.9 per cent and 11.1 per cent respectively. On the other hand, commendable success was achieved in mobilising foreign resources. Net foreign financing amounted to Tk 1,642.74 crore during this period against Tk 163.51 crore during the same period of FY2007, indicating a more than nine fold increase in the inflow of foreign assistance.

While the large growth in budget deficit during the recent months can be attributed principally to the flood rehabilitation programme, financing requirements are likely to grow further in the coming months, owing to rehabilitation programme associated with the cyclone. Together with domestic shocks, increased import payments attributed to higher international price of oil and food items, will require the CTG to pursue the objective of fiscal prudence by increasing revenue, as well as curbing expenditure on account of less important heads. Since opportunity to curb the revenue expenditure is rather low, the CTG needs to cutback the ADP, freeze funds for approved but unimportant projects, freeze funds for approved but undisbursed projects, divert resources from block allocations and give priority to foreign aided projects. Sustaining the enhanced foreign financing will also hinge on the country's capacity for aid absorption.

2.2 MONETARY SECTOR

2.2.1 Money Supply, Reserve Money and Liquidity

Money supply (in terms of M3) posted a growth of 13.23 per cent at the end of October 2007, while reserve money registered a marginal rise of 5.68 per cent. However, excess liquidity of the scheduled banks stood almost steady at Tk.14274.55 crore as of end October 2007, against Tk.14279.42 crore as of June 2007.

2.2.2 Domestic Credit

FY2008 observed a rather depressed growth of domestic credit at a rate of 12.92 per cent, at the end of October 2007 on a point-to-point basis, over the corresponding figure of FY2007.

2.2.2.1 Government Sector Borrowing

At the end of October FY2008, total outstanding domestic credit to the public sector increased by 6.85 per cent, underwritten by a sharp decline in credit to other public sectors. Credit to other public sectors reduced by 22.17 per cent during the period under review. Government borrowing, accounting for 87.85 per cent of the total public sector credit, posted a moderate rise of 12.66 per cent. Government borrowing from National Savings Directorate (NSD) certificates during this period registered a low growth of 8.32 per cent growth, while government borrowing from banking sector posted a rise of 17.41 per cent. Government borrowing is expected to surpass the targeted figure as a consequence of the need for high government expenditure for post-Sidr rehabilitation.

2.2.2.2 Private Sector Borrowing

At the end of October 2007, total outstanding domestic credit to the private sector posted a moderate 16.84 per cent growth on a point-to-point basis. Within the total credit to the

private sector, 92.31 per cent came from the banking sector, while the rest came from the non-bank depository corporations (NBDCs).

With the central bank's monetary policy for the rest of the fiscal to be released shortly, it is expected that boosting private investment and supporting government plan to recover the loss from the natural calamities (floods and particularly cyclone Sidr) will be given high priority.

2.2.3 Industrial Loan

Data on industrial term loan for the first quarter of FY2007 recorded a significant 42.70 per cent growth in total disbursement. With a robust 57.76 per cent increase, domestic private commercial banks (PCBs) remain the single largest contributor in terms of loan disbursement, with a 69.03 per cent share in total disbursement. Overall recovery of the term loan also posted a significant growth of 50.79 per cent during the reported period. On the other hand, disbursement of working capital increased by 12.54 per cent during this period. PCBs (domestic) recorded the highest contribution, a 10.69 per cent growth during the period under consideration. On the contrary, NCBs posted a significant decline of working capital disbursement, recording (-) 77.49 per cent reduction.

However, the nominal figures should be deflated with the inflation indices to arrive at the real dynamics of change over the period under consideration.

2.2.4 Loan Default Scenario

Total classified loan during July-September registered a 12.41 per cent growth over the corresponding period of FY2007. Contradicting the historical trends, foreign banks (FBs) had the largest share in the total classified loan, with a two-fold hike compared to the corresponding period of the previous fiscal. The state owned commercial banks (SCBs), PCBs and development finance institutions (DFIs) saw a worsening default loan situation, by 11.32, 20.0 and 3.61 per cent respectively, over the corresponding period of FY2007.

2.2.5 Agricultural Credit

During July-November period, total disbursement stood at Tk 1,869.3 crore, which was 6.6 per cent higher than the disbursement during the comparable period of FY2007. Conversely, recovery remained 16.5 per cent lower than the corresponding figure of the previous fiscal year understandably, as a result of consecutive floods and the damage caused by the Sidr. Thus in net terms, credit flow to the agriculture sector registered a positive rise (Tk. 392.6 crore), recovering from a negative trend during the previous fiscal. The maximum rise took place in areas of crop and agricultural equipment.

However, in a situation where one would reckon that credit needs would be substantial, the growth rate in agricultural credit disbursement is not very encouraging. The

government needs to focus on mobilising more funds for agricultural credit and see to it that these reach the farmers in order to help them regain and revive their livelihoods, in view of the crop damages caused by floods and cyclone Sidr. This will be particularly pertinent for the upcoming boro season and will be critical from the perspective of food security for the country in 2008. This is also important from the perspective of reining in the ongoing food inflation in the country.

2.2.6 Consumer Price Inflation and Price Hike

Taming the ongoing rise in consumer prices, particularly food prices, is the foremost challenge facing the CTG in FY2008. Inflation rates continued to move upward during the first four months of FY2008. At the end of October, general, food and non-food inflation rates on a point-to-point basis were 10.06 per cent, 11.73 per cent and 7.42 per cent respectively. On the basis of moving average, consumer price inflation increased from 6.98 per cent in October 2006 to 8.25 per cent in October 2007. It appears that the overall inflationary trend was fuelled by the food inflation, which registered substantial rise - from 7.69 per cent in October 2006 to 9.29 per cent in October 2007. Low levels of production in the domestic market, rising prices in the international market and supply disruption were the major instigating forces behind this situation. In the global market, the conflict between food and fuel is becoming increasingly fierce. FAO projections of food availability, although somewhat higher in 2008 than in 2007, is not very reassuring as the levels still fall short of the 2006 figures. The experience of the first four months suggests that the targeted inflation figure of 6.5 per cent will not be maintained, unless prices come down sharply in the next few months. This is not a likely prospect.

It may be noted in this context that our Asian neighbours are also experiencing rise in terms of their living costs. Registering macroeconomic stability remained the primary challenge for policymakers in all the countries of this region. Both India and China registered rise in inflation, posting 5.51 per cent and 4.40 per cent rise respectively during November 2007. Pakistan notably recorded a higher rate of inflation at 7.6 per cent under an unstable political situation. All of these countries however managed to keep their inflation moderate, compared to Bangladesh. However, these are also countries with higher economic growth rates providing them a higher capacity to absorb higher prices. Sri Lanka, on the other hand, remained an outlier in the region with inflation rate at 15.4 per cent in November 2007; however, it needs to be noted that Sri Lanka is going through a domestic turmoil.

It is pertinent to recall here that in December 2007, the CTG initiated the long awaited *Consumer Rights Protection Ordinance 2007* providing full-fledged legal cover for consumers' interests. Once the Act is passed, consumers will be able to seek legal protection against charging of irrational price of essentials by sellers, raising of price by

creating artificial crisis, hoarding, obstructing goods transportation, taking money by cheating in the name of providing services and adulteration of medicine and other goods. The Ordinance will also ensure other standard consumer rights including displaying maximum retail price (MRP), expiry date etc. Earlier the CPD had strongly recommended mandatory display of MRP along with the manufacturing and expiry dates on the packet/container for the producer/importer/processor. As the CPD's Price Study suggested, a massive campaign needs to be conducted among the retailers and consumers not to sell and buy products above the specified MRP and to have MRP labels in place on sold items. The success of the reform will depend on its full and faithful implementation, which will require priority attention of the CTG.

2.2.7 Interest Rate

The real commercial lending rate stood at 2.51 per cent as of October 2007, lower than the 3.5 per cent at the end of FY2007. Deposit rate (3 to 6 months) however, could not protect its real value and remained negative in real terms. Real deposit rate failed to show any corrections, declining further from (-) 2.16 per cent in June 2007 to (-) 2.88 per cent in October 2007. In view of high inflation rate, it is unlikely to retain real value of the deposit in near future. This situation is a disincentive for the depositors and it is likely to have negative implications in the medium term. The recent rush of equity money to the stock market is a manifestation of this decline. The gap between lending and deposit rates has remained unchanged, despite initiatives taken by the Bangladesh Bank to reduce it.

2.2.8 Exchange Rate Situation

In November 2007, taka appreciated by 1.85 per cent compared to the corresponding period of last year. However, rapid depreciation of the Taka against Euro and Indian Rupee has continued, by 11.95 per cent and 12.18 per cent respectively, during the reported period. The ongoing debate on using exchange rate as a monetary tool, to reduce inflationary pressure by making import price cheaper (through appreciation of taka), has to be scrutinised by the central bank. In order to increase supply, the central bank has gone for selling the US dollar in the foreign exchange market. However, any serious misalignment among the exchange rate in the Bangladesh market compared to those in the international markets could not be found. Because of rapid currency appreciation against the US dollar of other currencies, namely Euro, India Rupee and Thai Bath, the move had limited implication. Euro, Rupee and Bath have appreciated by 12.28 per cent, 12.06 per cent and 7.25 per cent respectively, against the US dollar in November 2007 compared to November 2006. Bangladesh currently holds foreign exchange reserve which is sufficient for about three to three and half months' import payments. It is expected that import payments would register high growth during the rest of the year, fuelled by high food and oil prices in the global market, while export is yet to recover

from the earlier shock. Thus, a policy of high volume release of foreign exchange to control inflation may not be a viable policy. Rather, stabilising the exchange rate at the current level may be the best policy option for the central bank.

2.3 REAL SECTOR

2.3.1 Agriculture

2.3.1.1 Production of Foodgrains

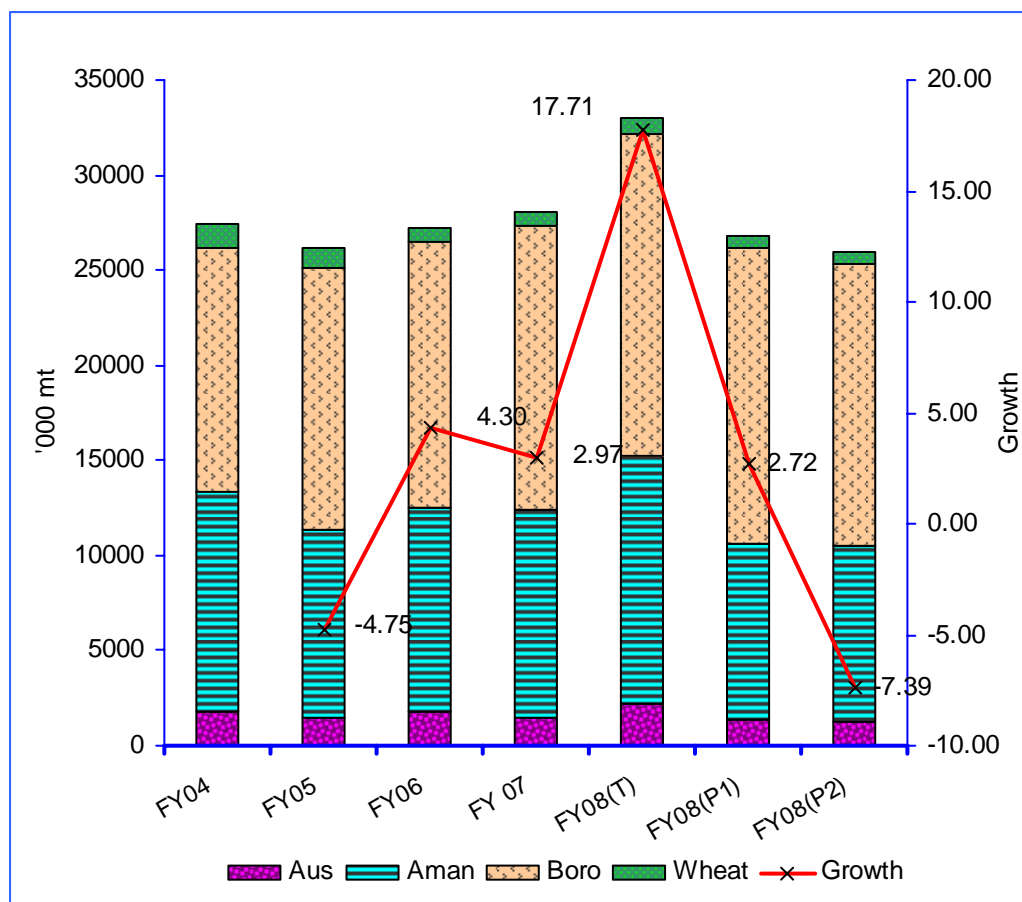
According to the final estimates of the Bangladesh Bureau of Statistics (BBS), total foodgrains (rice and wheat) production in FY07 was 28.07 million metric tonnes (mmt) (Aus: 1.51 mmt, Aman: 10.86 mmt, Boro: 14.97 mmt and wheat: 0.74 mmt) which was 2.97 per cent higher than the previous year (FY06). However, it was 14.6 per cent less than the targeted foodgrain production (32.87 mmt in FY07). Total production of foodgrains in FY07 increased due to increase in rice production, wheat production has been on a gradual decline since 1999.

According to the Department of Agricultural Extension (DAE), the operational target for foodgrains production in FY08 has been set at 33.05 million mt (Aus 2.22 mmt, Aman 13.05 mmt, Boro 16.95 mmt and wheat 0.84 mmt) which is 15.04 per cent higher than actual production in FY07. BBS and DAE have not yet provided any estimate on production of Aus and Aman in FY08. It is pertinent to recall that both Aus and Aman rice were affected by two consecutive floods in 2007 and cyclone Sidr has also destroyed the standing Aman crops in the Sidr-hit areas. According to the estimates of the CPD and BRAC, about two million metric tons of rice was lost by floods and cyclone Sidr. Farmers are currently planting the Boro paddy. BBS and DAE are yet to come up with any estimates/ projections about Aman and Boro production. Concerned agencies (BBS, DAE and SPARSO) should jointly come up with an estimate of Aus and Aman production and a projection about likely production of Boro rice. This is urgently needed for an effective procurement programme and strategy for import of rice.

In the absence of any released estimate/ projection of total foodgrain production in FY08, the CPD has made an attempt to project the likely production level of foodgrain production in FY08. According to the CPD estimates (Figure 1), Aus production is likely to be in the range of 1.30 mmt to 1.40 mmt; Aman production is likely to be in the range of 9.00 mmt to 9.25 mmt; Boro production is likely to be in the range of 14.8 mmt to 15.5 mmt and wheat production is expected to be around 0.70 mmt. Thus, foodgrain production in FY08 is likely to be in the range of 26.00 mmt and 26.80 million metric tons. In other words, foodgrains production might be 1.2 to 2.0 million metric tons (4.4 per cent to 7.4 per cent) lower than the actual production of FY07. It is pertinent to

mention here that the CPD considered the following factors in estimation and projection of production in Aus, Aman and Boro rice: damage due to flood and Sidr, fertiliser situation, effect of increase in diesel price in April 2007, availability of electricity for irrigation and most importantly, implementation of agricultural rehabilitation programme.

Figure 1: Foodgrain Production Projection for FY08



In addition to floods and Sidr, farmers in some areas faced fertiliser shortage during the Aman season. Farmers of Manikganj and some of the other districts had made public protests in view of non-availability of fertiliser. Though subsequent efforts of the CTG to ease the problem are also visible, ensuring availability of fertiliser for production of Boro rice and other Rabi crops would be a challenge which will need to be met with due care and urgency.

Smooth supply of diesel and electricity for irrigation would also be a major requirement in boro season. It may be recalled here that electricity for irrigation was a major problem in FY07. Electricity used for irrigation was 39.66 MKWh in FY07 (July-Feb), compared to 78.80 MKWh in FY04 (July-Feb). That is, only 50 per cent of the electricity that was used two years earlier was available for irrigation in the last year (FY07). We cannot afford such a situation to emerge this year. The CTG has decided to provide subsidy for

diesel used in irrigation, amounting to Tk 750 crore. It is planned that the government will distribute the subsidy for diesel @Tk 700 per acre through Sub-assistant Agriculture Officers (previously called as Block Supervisors) and members of local government (Union Parishad members and Chairman). Subsidy for diesel will be distributed during January-May 2008. Timely availability of diesel, its distribution and avoiding leakages will be the major tasks that await the CTG. This will need to be carried out with due efficiency.

2.3.1.2 Food Aid and Commercial Import

Imports of foodgrains to Bangladesh are sustained from two sources: food aid and commercial imports. The latter comes through both government and private channels. During July-December of FY08, total rice import (rice aid and commercial imports) was 844 thousand mt out of which 17 thousand mt was food aid, 101 thousand mt as commercial import by public sector and 726 thousand mt was imported by the private sector import (Table 1). It may be noted that private sector import during the comparable months of FY07 was 143 thousand mt. On the other hand, wheat import by private sector during July-December of FY08 was 891 thousand mt against 997 thousand mt in comparable months of FY07. Total import of foodgrains and rice during July-December of FY08 was respectively, 53.6 and 402.5 per cent higher than that of comparable months in FY07. Even though import of foodgrain in FY08 was substantially higher than that of last year (FY07), it failed to meet the gap in view of the requirement and the production loss caused by flood and Sidr, leading to price volatility in the market.

On 5 January 2008, the government decided to import one million metric tons of rice. Materialising such a large amount of import would require special import procedures, including reduction of procurement time. A Special Committee may be set up so that they will be able to import rice within a short time span.

Table 1: Food Import in FY08

(in '000 metric tons)

| Category of Imports | FY07 (July-December) | | | FY08 (July-December) | | |
|--------------------------|----------------------|-------|------------------|----------------------|-------|------------------|
| | Rice | Wheat | Total Foodgrains | Rice | Wheat | Total Foodgrains |
| Food Aid | 25 | 31 | 56 | 17 | 102 | 119 |
| Public Commercial Import | 0 | 0 | 0 | 101 | 0 | 101 |
| Private Import | 143 | 997 | 1140 | 726 | 891 | 1617 |
| Total | 168 | 1028 | 1196 | 844 | 992 | 1837 |

2.3.1.3 Rice Price

In the beginning of FY08 (i.e. July 2007) the wholesale price of coarse rice in Bangladesh was Tk 18,700 per mt which reached to Tk 24,290 per mt in December 2007 and further increased to Tk 29,000 per mt in early January 2008 (Figure 2). However, price of rice in the world market was much higher than that of the domestic market (Figure 3). A comparison of wholesale prices of coarse rice in Dhaka with import parity price of rice in Delhi and Bangkok reveals that during the first two months of FY08 (July'07-Aug'07), price of rice was lower in Dhaka than import parity price of rice in Delhi and Bangkok. After two consecutive floods, when it was clear that there is substantial production loss and price was increasing in the domestic market, private sector imported a large quantity of rice. Import would have been much more if there was no restriction in export of rice and other foodgrains by different countries (see Box 1 for details).

Figure 2: Average Wholesale price of Coarse Rice in Bangladesh

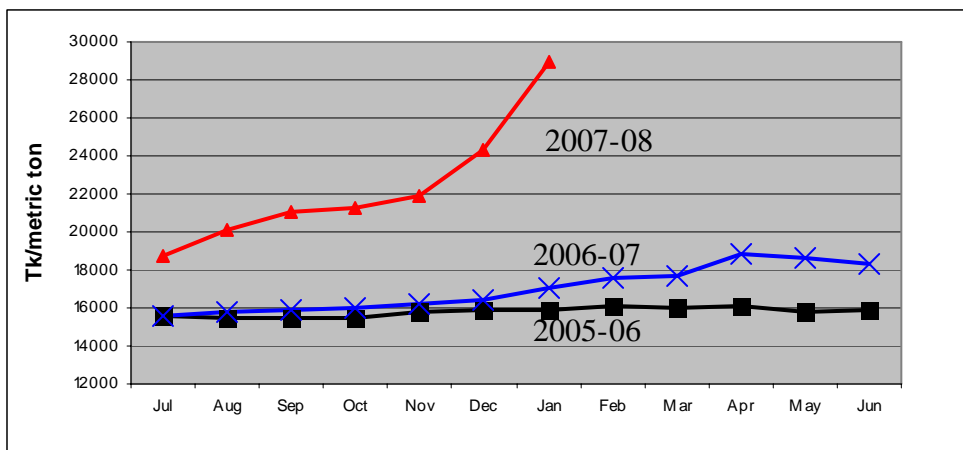
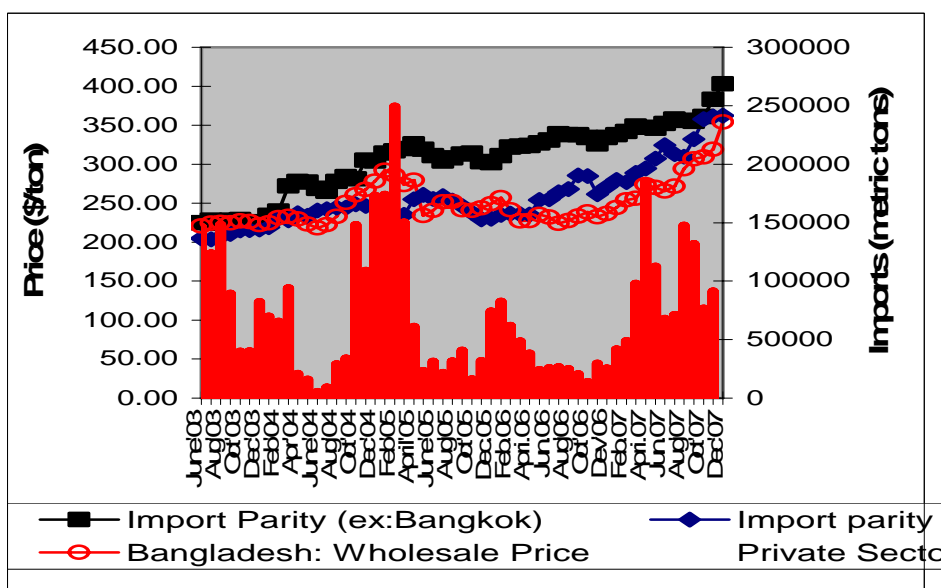


Figure 3: Rice Prices and Quantity of Private Rice Imports in Bangladesh, 2003-2007



Box 1: Export Restrictions Imposed by Different Rice Exporting Countries

- July 6, 2007: Thailand and Vietnam, the world's top two rice exporting nations, began three days talks focusing on mutual co-operation in the rice trade with the hope of ending a price war between the two countries.
- July 6, 2007: China lifted its four year old ban on Japanese Rice Import
- July 26, 2007: Chinese government has introduced an export tax on major grain products
- August 2007: In the last two and a half years, Pakistan has been imposing an export ban on wheat to protect its domestic suppliers.
- September 3, 2007: Indonesian government increased import duty on rice from Rp 450 per kg to Rp 550 per kg (from US\$ 0.05 to US\$0.06 per Kg)
- September 4, 2007: Vietnam decided to cease signing rice export contracts until next year
- October 9, 2007: India's Cabinet Committee on Economic Affairs decided to ban exports of non-basmati rice
- October 25, 2007: India's Cabinet Committee on Economic Affairs decided to exempt non-basmati rice varieties from export ban, but set a minimum export price (MEP) of US\$425 per tonne for export in the global market.
- December 02, 2007: India lifted rice export ban for cyclone-hit Bangladesh. However, it was communicated later on that Bangladesh will have to import rice from India through government agencies.
- Dec. 17, 2007: China's Ministry of Finance cancelled the value-added tax rebates on exports of products, made from wheat, corn, rice, soybeans and flour, effective from Dec. 20.
- December 27, 2007: Indian government decided to raise the export price of rice from US\$ 425 to US\$ 500 per MT.
- January 3, 2008: Vietnam extended its suspension of duty on rice imported by Cambodia until 2009, and increased the tax-free limit by one-third to 200,000 tonnes next year. Vietnam has allowed Cambodian rice to be imported without tax since 2006.
- January 04, 2008: About 5,000 rice mills in the northern districts of Bangladesh remained either idle or closed, while scores face closure due to poor supply and unusual spike in paddy prices.

2.3.1.4 Livestock Production

Livestock farmers were severely affected by flood and cyclone Sidr in 2007. According to the Department of Livestock Services, Sidr led to the death of 108 thousand livestock

(cattle, buffalo, sheep and goats) and 2.57 million poultry birds; Sidr also destroyed more than six thousand livestock and poultry farms. Estimated loss of livestock sector, affected by Sidr, is about Tk 132.26 crore. Government will need to undertake large scale rehabilitation programme in view of this scale of devastation. To offset the losses caused by flood and Sidr, government and NGOs may undertake a rehabilitation programme which would include distribution of calves, free distribution of feed and fodder seeds, vaccination and treatment of livestock and credit with low interest rate. Poultry productions in some areas are facing bird flu (avian influenza). It is pertinent to mention here that Bangladesh had experienced Bird flu in FY07, which were contained by concerned agencies of the government through prompt actions such as active disease surveillance, culling of birds in affected farms, limiting human movement in affected farms and disinfecting the affected farms. Prompt and effective action by the government was crucial to containing the situation but the threat is not yet over. Potential threat of economic loss is very high, could be to the tune of Tk 5000 million even if 10 per cent of the total poultry farms and birds are affected (i.e. a real pandemic occurs). Therefore, effective implementation of two projects on prevention of bird flu and development of poultry sector, with an approved budget of Tk 400 million declared in the National Budget FY2007-08, is urgently required to reduce possibility of any epidemics.

At present, about 1.5 lakh small and medium poultry farms and a large number of poultry feed producing millers are operating in the country. They are providing employment opportunity to about 5 million people. Considering potential negative impacts on income, employment and health government has to strengthen its actions in view of the bird flu.

2.3.1.5 Fisheries Production

Fisheries sub-sector was also adversely affected by flood and Sidr. Coastal fisheries particularly the shrimp farms were severely affected. Sidr hit the coastal belt at a time when it was off-season for *bagda*. However, loss to the fish farmers who invested in ponds with prawn (*galda*) and various types of fresh water fish was substantial. Fish farmers made fairly substantial investment, often financed through micro-credit. The extent of loss from fish production was particularly noticeable in the Bagerhat area. It is to be noted that fish farming is no longer a business of the riches only. To sustain the growth in fisheries sub-sector, a massive rehabilitation programme would be required. Small farmers would require both technical (reclamation of damaged fish pond, fish fry) and financial support in the form of loan.

2.3.2 Industry

Industrial sector was not able to overcome the decline in growth rates during the first half of FY2008, which had continued from the second half of FY2007. A persistent decline of growth in industrial production (QIP of manufacturing output) over the last three quarters is visible: 8.1 per cent in January-March 2007 compared to that of the previous year, 6.1 per cent in April-June 2007 and even negative (-1.0 per cent) in July-September 2007 (Table 2). The estimation of QIP of manufacturing output has been done by the BBS using new weights (new base year 2000/01, old base year was 1989/90). This initiative of the BBS should be welcomed. It is pertinent to recall that the CPD had earlier suggested such a revision in view of the changing industrial structure (*State of Bangladesh Economy 2004-05 and Outlook for 2005-06*). Overall growth of manufacturing output in last three quarters using old weights showed a similar trend (though not negative in the first quarter of FY2008). Such poor performance, especially in the first quarter of FY2008 is because of negative growth in production of jute, cotton, RMG and leather. Though it is difficult to extrapolate production situation of manufacturing sector in the second quarter of FY2008, because of unavailability of data, it can be discerned from relatively high level of export of RMG in October 2007 that production of RMG had increased during this period. In the first quarter, production of all other manufacturing items registered positive level of growth, though in most categories a persistent fall was evident from the earlier quarters.

Table 2: Growth of Quantum Index of Manufacturing output (By major Industry Groups)

| sub-sectors | Old weight (base:1989-90) | New weight (base 2000-01) | FY07 | | | | FY08 |
|-------------------------------|------------------------------|------------------------------|------|------|------|------|-----------------|
| | | | Q1 | Q2 | Q3 | Q4 | Q1 ^e |
| Food beverage & tobacco | 22.1 | 9.7 | 4.7 | 3.1 | 8.3 | 6.5 | 2.6 |
| Jute, cotton, RMG & leather | 38.2 | 68.1 | 4.1 | 17.4 | 8.4 | 6.1 | -2.8 |
| Wood products incl. furniture | 0.2 | 0.1 | -3.8 | -1.4 | 6.4 | 10.8 | 12.7 |
| Paper & paper products | 4.7 | 1.1 | -7.9 | 3.2 | 17.3 | 16.7 | 17.9 |
| Chemical petroleum & rubber | 24 | 15.6 | -0.5 | 5.8 | 5.6 | 5.3 | 5.4 |
| Non-metalic products | 2.8 | 3.7 | -0.7 | 5 | 5.7 | 5.3 | 3.4 |
| Basic metal products | 2.1 | 0.7 | -2.7 | 14 | 11.9 | 9.9 | 9.6 |
| Fabricated metal products | 5.9 | 1 | -3.4 | 9.6 | 10.6 | 8.3 | 9.9 |
| Growth rate (new weight) | 100 | 100 | 3.2 | 13.4 | 8.1 | 6.1 | -1 |
| Growth rate (old weight) | | | 2.1 | 10.5 | 8.3 | 6.7 | 1.6 |

Source: Bangladesh Bureau of Statistics

Note: e: estimated

Disbursement of term loans during July-September, 2007 was higher compared to that in the previous year, which is a positive sign. A total of Tk.3784.7 crore was disbursed and Tk.2625.2 crore was recovered in the first quarter of FY2008. These were 42 per cent and

50 per cent higher respectively, compared to the previous year. Data on bank advances in different industrial activities such as project financing, working capital financing, construction, transport, communication and trade indicate positive changes during the first quarter of FY2008 (Table 3). However, increasing amount of overdue loan in the first quarter (16.7 per cent of total outstanding as against 14.2 per cent in the comparable period of the previous year) is perhaps a reflection of the state of business environment.

Table 3: Growth of Bank Advances (Private Sectors) by Economic Purpose (in bill. Tk.)

| Sectors | FY 07 | | | | FY08 |
|---------------------------------------|-------|------|------|-------|-----------------|
| | Q1 | Q2 | Q3 | Q4 | Q1 ^e |
| Industry (other than working capital) | 26.3 | 32.2 | 25.7 | 23.4 | 20.2 |
| Working capital financing | 10.6 | 13.2 | 9.0 | 11.9 | 10.9 |
| Construction | 16.8 | 16.6 | 14.4 | 21.8 | 17.5 |
| Transport and communication | 40.1 | 31.9 | 25.3 | 52.8 | 51.6 |
| Storage | 19.4 | 20.0 | 2.6 | -27.2 | -27.9 |
| Trade | 8.1 | 16.0 | 8.5 | 13.9 | 13.3 |

Source: Statistical Department, Bangladesh Bank

During first quarter of 2008, import of capital goods and others have increased by 14 per cent compared to same period of the previous year (Table 4). However, import of capital machineries in the following months declined as total amount of import LCs related with opening, settlement and outstanding LCs decreased. Import of industrial raw materials and machinery for miscellaneous industries (in terms of opening, settlement and outstanding import LCs) had registered positive growth during July-October, 2007. Growth in import of capital machineries in cases of opening, settlement and outstanding LCs during July-October, 2007 were: -7.2 per cent, -8.3 per cent, and -5.8 per cent respectively (Table5). This could perhaps indicate that business has picked up in terms of current production but entrepreneurs were reluctant to make new investment.

Table 4: Import of Different Commodities in Q1 (July-September) of FY 2007 and FY 2008 (mil. US\$)

| Items | Q1, FY07 | Q1, FY08 | per cent change |
|-------------------------------|----------|----------|-----------------|
| Food Grains | 78 | 265 | 239.7 |
| Other Food Items | 312 | 473 | 51.6 |
| Consumer & Intermediate goods | 1899 | 2048 | 7.8 |
| Capital Goods & Others | 1434 | 1631 | 13.7 |
| Import by EPZ | 247 | 271 | 9.7 |
| Grand Total | 3970 | 4688 | 18.1 |

Source: Statistical Department, Bangladesh Bank

Table 5: Sectorwise Comparative Statement of Opening, Settlement and Outstanding Import LCs

| Sectors/Commodities | per cent Change during July-October,2007 over July-October,2006 | | |
|-----------------------------|---|-------------------|--|
| | Fresh LCs opening | Settlement of LCs | Outstanding LCs at the end of the period |
| Consumer goods | 99.4 | 101.5 | 67.8 |
| Intermediate goods | 19.8 | 30.6 | 26.8 |
| Industrial raw materials | 29.0 | 18.6 | 23.3 |
| Capital machinery | -7.2 | -8.3 | -5.8 |
| Machinery for misc.industry | 17.5 | 13.8 | 7.1 |
| Petroleum & petro. Products | -33.0 | -16.7 | 34.3 |
| Others | 40.5 | 20.1 | 14.7 |
| Total | 23.9 | 18.2 | 20.2 |

One of the major features of the first half of FY 2008 is the government's decisions with regard to the jute sector of the country. Important decisions that were taken by the government included: three years reform plan at four levels (administrative, industry, financing and market management); shut down 4 state owned mills out of the existing 22; winding up of 84 jute procurement centres, out of 142; retrenchment of 14,000 workers under voluntary retirement scheme (VRS) from the running mills by December 2007; a total of Tk.1367 crore will be given to the workers as golden handshake benefit, gratuity, provident fund etc.; proposal sent to the finance ministry for Tk. 200 crore to procure raw jute by July 2007; issuance of bonds and guarantees for banks in order for those to provide working capital amounting Tk.138 crore for the BJMC mills; and, sale of 120 acre land of BJMC to generate fund. Major stakeholders, including workers and NGOs, have expressed their concerns as regards to closure of the public sector jute mills and retrenchment of labour. It is to be noted here that the government is yet to clear the due of the workers of the closed jute mills. This came at a time of rising global demand for jute and jute goods, alongside a resurgence of interest in these two items. Against this backdrop, the CPD has initiated a study on *Jute Sector of Bangladesh: Constraints, Opportunities and Policy Options* with the objective of examining the economics of jute cultivation, efficiency of manufacturing jute goods and competitiveness in the international market, with a view to come up with policy suggestions for a sustainable growth of this promising sector.

Box 2: CPD Initiated Study on ‘Jute Sector of Bangladesh: Constraints, Opportunities and Policy Options’

The CPD has recently initiated a study on *Jute Sector of Bangladesh: Constraints, Opportunities and Policy Options*. The major objectives this study is to examine the economics of jute cultivation, efficiency of manufacturing jute goods and competitiveness of raw jute and jute goods in the international market, with a view to come up with policy suggestions for sustainable growth of this sector. In order to appreciate major issues and concerns related with the sector as well as to share planning of the study, the CPD organized a brainstorming session in July 2007 and held a dialogue at the Ministry of Textiles and Jute in October 2007, with participation of major stakeholders.

The whole study has three components. These are: (i) economics of jute cultivation (jute agriculture), (ii) performance of jute manufacturing industry (jute industry) and (iii) export competitiveness of jute and jute production (export and policy issues). The CPD has undertaken an extensive survey to elicit the required information and data. To this end, an indepth survey of 360 jute farmers, 109 market intermediaries in 12 districts, 50 jute mills and a significant number of jute mill workers was carried out during November-December, 2007. The study is scheduled to be completed by the end of February, 2008.

In general, industrial sector was unable to show dynamism over the last three quarters, particularly in the first quarter of FY2008. This may be related to the following factors - Firstly, international buyers placed lower orders to Bangladeshi apparels manufacturers due to political unrest in the first half of FY2007 (July-December, 2006) coupled with labour unrest in the second half of FY2007 (January-June, 2007). Secondly, anti-corruption measures taken by the current CTG that involved leading entrepreneurs and corporate groups on account of corruption charges, hoarding of essential consumer goods, land grabbing for real estate business, illegal VOIP business, bank transaction beyond the legal limits, non-reporting of wealth in wealth statements, tax default etc., would be helpful in establishing good governance in the medium-to-long term, but these had an adverse effect on investment and production in the immediate period. Thirdly, a consistent high inflation in the domestic market led to an increase in production cost, which discouraged attempts for expansion of businesses, especially in the labour-intensive enterprises. Fourthly, uncertainties about implementation of the election road map also had adverse impact on business confidence. It is hoped that the *Better Business Forum* and the *Regulatory Reforms Commission* will be able to address the attendant

concerns of businessmen and help restore business confidence of both domestic and foreign investors.

Improvement in operational efficiency of Chittagong port during the last few months has been a positive achievement for the CTG. For example, the average turnaround time or stay time declined to a record level low at 2.94 days in December, 2007 compared to 13 days in December 2006. The handling of containers by the Chittagong port also registered notable rise during the period. After completion of the New Mooring Container Terminal (NCT), which was scheduled to be completed by December 2007, CPA (Chittagong port authority) will be able to handle 5 lakhs TEUs of containers annually, resulting in further reduction of prevailing turn around time. CTG has to accelerate the completion process of the NCT.

2.3.3 Foreign Investment

During July-October of FY2008, total foreign investment posted a rise of 11.1 per cent. Total amount of foreign investment stood at US\$311 million, of which US\$263 million came as net foreign direct investment while the rest US\$48 million came as portfolio investment. Reflecting the depressed domestic investment, foreign direct investment indicates a fall of (-) 4.0 per cent compared to the corresponding period of the previous fiscal. Portfolio investment on the other hand saw a substantial hike from US\$6 million during July-October period of FY2007 to US\$48 million during the same period in FY2008. This development corroborates the buoyancy in the capital market observed in recent times.

Negative growth of FDI figures transmits a pessimistic impression. On top of this, a sharp decline in investment registration indicates that foreign investors have been losing interest to consider Bangladesh as a possible destination. In order to recover from such situation and establish confidence of foreign investors, the government should come up with decisions regarding the pending major investment proposals, and also look into the constraints both in terms of infrastructure and regulatory mechanisms that inhibit FDI. The proposed coal policy, if approved without delay, could create conducive environment for development of this potentially important source of energy and could contribute significantly to energy security. Keeping in mind the long term energy security of the country, government should immediately place work orders for establishing large scale power generation plants, since a number of proposals are under active consideration of the government. Though the CTG's measures against politically biased tendering have been well appreciated, it has not succeeded in accelerating the process. The energy issue must be given top priority.

The Board of Investment's activities will need to be geared up, as an organisation mandated to promote and facilitate investment. In this regard, strengthening of the 'one stop' service of BOI is quite critical. The decision taken by Regulatory Reforms Commission (RRC) as regards online registration of new investments with the BOI is a welcome initiative. However, this will require substantial strengthening of e-based management at the BOI. Initiatives such as the recently held 'Non-resident Bangladeshi (NRB) Conference 2007' should be taken advantage of to involve Bangladeshi expatriates in various investment activities in the country. Government's recent initiatives to formulate competition policy, consumer's right protection Act etc. will hopefully contribute to improving business environment in the country.

2.3.4 Capital Market

Momentum created in the stock markets of Bangladesh during the second half of FY2007 continued in FY2008. The Dhaka Stock Exchange (DSE) observed an increase in all of its share price indices during the first half of FY2008. The DSE all price index recorded an increase of 749.22 points (41.1 per cent) during July-December period. DGEN and DSE20 rose by 826.75 points (37.7 per cent) and 588.31 points (31 per cent) respectively in the period under consideration. Three new IPOs came to the market while five IPOs came in the first half of the previous fiscal year. Market capitalisation rose to 742.2 billion Tk. on 30 December 2007 (compared to 315.4 billion on the corresponding day of the last year) taking the market capitalisation to GDP ratio to 15.9 per cent. While this indicates robust performance by the two bourses, this ratio is still far behind that of India (about 130 per cent) and Pakistan (about 75 per cent). Country's stock market will hopefully gain momentum in this year, when the Grameen Phone off-loads its share in the stock market. This would substantially increase the level of market capitalisation of the country's stock exchanges. Success of the Grameen Phone in terms of operating in the stock market (though with a very small share of their total assets), would encourage other large scale companies, especially foreign owned companies, to off-load their shares in the stock market. Government fiscal initiatives for listed companies are likely to play a positive role in this regard.

Providing stability to the capital market and taking actions against any possible manipulations are the major tasks of the SEC. Over the last several months it has been observed that often the SEC intervened to stabilise the market. But in most cases it was unable to control market irregularities, though it successfully identified the loopholes. It is highly important to ensure effective monitoring of DSE and CSE to create confidence for large scale investors like the Grameen Phone and others, and simultaneously to generate the interest to invest in the stock market. More state owned companies should be encouraged to offload their shares in the stock market. In this context it may be recalled

here that the CPD has repeatedly suggested in its previous IRBDs to take measures that will induce floatation of shares by big companies, which in turn would create more investment opportunities for small scale investors.

2.4 EXTERNAL SECTOR

2.4.1 Export

Political unrest during the end of 2006 raised concerns regarding sustainability of the quite commendable export performance of the country in recent years. Labour unrest towards the end of May 2007 added to the worry, particularly with respect to the RMG sector. The cumulative impact of these developments had adverse implications for placement of orders in the export-oriented apparels sector. In July-August, 2007, owing mostly to the fall of both woven (-16.6 per cent) and knit (-12.0 per cent) exports, RMG export posted a (-) 12.1 per cent growth. However, gradual improvements are discernible in recent months of September and October, when exports picked up and registered positive growth rate. During July-October of FY2008 export earnings stood at US\$ 4127.3 mln, registering a (-) 2.63 per cent growth (Table 6). The negative export growth of woven garments came down to a single digit percentage (-9.34 per cent), while knit RMG almost managed to match the earnings during the corresponding period of FY2007 (with marginal - 0.56 per cent decline).

Export growth target for FY2008 has been set at 19.1 per cent, with 15.9 per cent and 20.0 per cent respective growth targets for woven and knit exports. The fall in exports during July-October period leaves an enormous task at hand. The woven and knit sectors will need to increase their exports by 28.9 per cent and 31.2 per cent respectively during the rest of the fiscal year, over the corresponding periods of the previous year. Overall, exports will need to register 30.2 per cent growth over the next eight months of FY2008. This will not be an easy task, with the sanctions on China being phased out as of 01 January 2008.

Table 6: Growth Requirements for the Rest of the Fiscal Year

| | Target growth FY08 (per cent) | Growth Jul-Oct FY08 (per cent) | Required growth for the rest of FY08 (per cent) |
|----------------|-----------------------------------|------------------------------------|---|
| All products | 19.1 | -2.63 | 30.2 |
| RMG | 18.0 | -4.92 | 30.0 |
| Woven garments | 15.9 | -9.34 | 28.9 |
| Knitwear | 20.0 | -0.56 | 31.2 |
| Non-RMG | 22.5 | 5.03 | 30.8 |

Source: CPD-IRBD database

2.4.2 Import

Total imports during the July-October period of FY2008 posted a growth rate of 20.0 per cent. A large part of this is accounted for by the rise in international market prices, and less to rise in volume. Significant growth was registered by food grain imports, both in terms of import payments and import volume. In monetary terms, high growths were observed for the import of *rice* (596.8 per cent), *wheat* (88.4 per cent) and *fertiliser* (106.7 per cent). In case of rice, 483.6 per cent growth was due to increase in import volume, whereas the rest increase is attributable to higher price in international markets and increased transport cost. *Crude petroleum* and *POL* posted negative growths of (-) 18.6 per cent and (-) 4.8 per cent respectively, inspite of the considerable rise in prices in recent times. This appears to be somewhat enigmatic! Import of capital machinery registered a slower growth of 8.0 per cent during this period, indicating to the prevailing investment situation. On the other hand, although overall settlement and opening of LCs registered 17.9 per cent and 23.7 per cent respective growths, settlement and opening of LCs for capital machinery, petroleum and petroleum products both recorded a decline (-8.33 per cent and -7.16 per cent for capital machinery and -16.74 per cent and -32.97 per cent for petroleum & petroleum products), a worrying sign indicating that the current depression in investment situation may be carried over to the next upcoming months.

2.4.3 Terms of Trade

One of the major emerging challenges in FY2008 will be to identify appropriate strategies in view of the declining terms of trade for Bangladesh. If the export price levels of FY2000 are taken to be 100, average export prices had come down to about 86 by FY2007. It is worrying to see that whilst prices in general has tended to rise quite sharply in recent years, particularly in recent months, not only did prices of apparels rise in the global market, however, for most of the items of export interest to Bangladesh, these have indeed fallen. The falling terms of trade means that Bangladesh is required to export more of her goods in exchange for the same amount of import. If the existing trend sustains, the pressure on balance of trade will deepen in the coming years. A renewed effort towards movement to upmarket segment of the global apparels market, intra-RMG diversification, product and market diversification, more export to regional countries and taking advantage of the various supply-side capacities will need to be put high on the agenda. CPD has recently completed an in-depth study on Bangladesh's Apparel Sector in Post-MFA period where a set of policy recommendation was put forward. Please see Box 3.

Box 3: CPD RMG Study- Major Policy Recommendations

The CPD has recently completed a study on *Bangladesh's Apparel Sector in Post MFA Period: A Benchmarking Study on the Ongoing Restructuring Process* with the objective of identifying major features of restructuring, that are currently taking place in the apparel sector and to put forward a set of policy recommendations to address future challenges. As part of the study, an indepth survey of 190 RMG units and 470 workers was carried out with a view to eliciting the required information and data. The findings of the study were discussed at a national dialogue held on 8 October, 2007.

Major policy recommendations that were put forward included areas such as scaling up of RMG units, advanced product and process modification, manufacturing of high-end apparels, acquisition of new technology and technology upgradation, strengthening of R&D activities in RMG enterprises, promotion of clusters for providing locational advantage to RMG units, support for enhancement of labour and capital productivity, better labour management in view of changing labour composition in RMG units, ensuring implementation of the new wage structure, improving workers' livelihood, developing 'Compliance' Brand for the RMG sector, support for relocation, support for improvement of existing laws and regulations in the RMG sector, opportunities for raising capital in the stock market, support for reduced lead time, overhauling of port and infrastructure to reduce lead time, developing the backward linkage textile sector, uninterrupted access to power supply for RMG units and pursuance of the various market access initiatives.

2.4.4 Foreign Aid

Flow of foreign aid during July-October period of FY2008 increased significantly compared to the inflow in the same period of FY2007. Total aid inflow stood at US\$ 389.7 mln, more than twice the amount received during July-October of FY2007 (125.1 per cent growth). With payment (principle) remaining at the same level (0.8 per cent growth), net foreign aid inflow registered a whopping growth of 903.6 per cent! During these first four months of FY2008, US\$ 36.0 mln came as food aid against no inflow during the corresponding period of FY2007.

According to the budgetary targets, about US\$1.5 billion of foreign assistance will be necessary to underwrite the programmed fiscal deficit. While the progress so far in mobilising foreign assistance has been good, this still leaves US\$ 1.1 bln to be mobilised during the remaining 8 months. The emerging financing requirements necessitate the

government to look for new channels of foreign aid inflow, particularly in the form of budgetary support, perhaps with support under DSC IV from the World Bank.

2.4.5 Remittances

The performance of remittance flow is quite promising with the first few months of FY2008 sustaining the growth momentum observed during FY2007. During July-November period of FY2008, total migrant workers' remittance stood at US\$ 2,806.4 million, registering a growth of 21.7 per cent. November recorded the highest inflow, for the first time crossing six hundred million USD mark in a single month (US\$ 618.6 mln). The government should take steps to encourage higher remittance flow through migration of more semi-skilled and skilled labour, compared to low skilled labour.

2.4.6 Foreign Exchange Reserves

The latest available figures for FY2008 show that foreign exchange reserves stood at US\$ 5095.31 million at the end of November 2007, registering a growth of 44.2 per cent over the corresponding month of FY2007. The current level of reserves is also marginally higher than the year-end reserves of FY2007 (US\$ 5077.24 mln), even after the Asian Clearing Union (ACU) payment of US\$ 462.3 mln made in mid-November 2007, thanks to higher remittance earnings.

However, a number of issues need to be kept in mind. The second phase of ACU payment is pending to be made in January 2008. Higher import requirements for the coming months will also have its impact on the reserve situation. At the same time, even with the higher current reserves, the amount is only equivalent to three months of import, considering the import payment for the month of October FY2008. Consequently, though comfortable, the foreign exchange reserves situation will need to be carefully monitored.

2.4.7 Balance of Payment (BoP)

Balance of Payments situation during July-October of FY2008 has been under pressure mainly on account of the deteriorated situation, with respect to balance of trade compared to the matching period of FY2007. This has largely been because of the negative export growth and the high import growth. Trade deficit stood much higher at US\$ 1739 million during the first four months (US\$ 677 million during Jul-Oct, FY07). Current account balance, despite much higher current transfers in the form of remittance flow, resulted in a deficit of US\$ 229 million. On the financial account side, BoP experienced a net inflow of US\$ 456 million during the first four months against an outflow of US\$ 88 million during the same period of FY2007. Surplus in the overall balance was to the tune of US\$ 220 million at the end of the first four months of FY2008, compared to the matching period of FY2007 (US\$ 82 million).

While the high flow of workers' remittances is expected to continue in the coming months, anticipated higher import payments combined with falling exports might create further pressure on the BoP position in the near future.

3. MAJOR CHALLENGES FOR THE NEXT SIX MONTHS OF FY2008

In the post-budget dialogue organised by the CPD, a number of immediate tasks were pointed out that the CTG would need to address in the FY2008. Although subsequent developments in the first six months have pushed forward other issues (floods, Sidr etc.), those tasks continue to remain important in terms of achieving the target, set in the budget FY2008. These tasks are as follows:

Revenue Generation

- Maintain the current momentum of revenue mobilisation
- Emphasis on assessee-friendly institutional issues
- Introduction of universal self-assessment as early as possible
- Simplification of VAT registration

Foreign Aid Flow

- Form a Task Force for accelerated disbursement of held-up project aid
- Negotiate new budgetary support for development finance
- Given the comfortable BOP situation, a new loan agreement with IMF is not advisable in the current context

Government Bank Borrowing

- Avoid volatility in bank borrowing to avoid pressure on private borrowing

Annual Development Programme

- Energetic kick-off from the very first quarter
- To develop a strategic approach focusing on e.g. power sector
- Quality must be ensured while including new projects
- Strengthen linkage with local government for project implementation
- Enhanced public-private and government-NGO partnership
- To gear up foreign aided projects
- Focus on power sector

Strengthened Monitoring of Implementation and Greater Transparency

- Periodic review of implementation status
- Mid-course speedy correction if and when deviations are detected
- Public-private partnership to monitor progress in key areas

Need for Quality and Real Time Economic Data and Improved Access

- Computerisation of tax mobilisation activities
- Generation of regular and periodic updates on key budget related indicators
- Putting in place a system whereby budget related data and information is easily accessible to stakeholders.

The CTG faces a number of challenges which need to be addressed in the next six months of FY2008. Whilst these are many, we highlight a few of those here which are reckoned to be of critical importance as the CTG enters the New Year 2008, the second year of its governance.

3.1 Attaining the Projected Growth

As is known, a growth target of 7.0 per cent has been set for the FY2007-08. However, preliminary estimates (ADB, BB) have indicated lower projections of GDP growth. Earlier the CPD had mentioned that all three major components of GDP, *viz.* Agriculture, Industry and Service, will have to enhance their contribution significantly to attain this target. The loss of crop production due to consecutive floods and the cyclone Sidr will certainly call for scaling down the growth expectations in the agriculture sector. Loss of livestock, poultry and fisheries will also be a factor to reckon with. Manufacturing sector is passing through a challenging period. Slowing down of investment has been a much discussed issue in recent times, although term loan disbursement has continued to maintain last year's momentum. On the other hand, import of capital machineries have declined and L/Cs opened for this is showing negative growth. It is to be mentioned that the CPD in its budget reaction, pointed out that implied investment target for FY2008 would require an additional investment equivalent to 1 per cent of GDP over last year's benchmark. If the projected GDP growth rate is scaled down to 6 per cent from 6.5 per cent, assuming unchanged capital productivity, the gross investment requirement would vary between 22.4 per cent to 24.3 per cent of GDP. Latest available data shows that investment registration (both domestic and foreign) declined by about 30 per cent during the first nine months of 2007. FDI posted a negative growth and growth in the import of capital machineries has slowed down. However, investment scenario could improve in view of higher term loan disbursement and moderate working capital growth, during the first quarter. The CTG has initiated a number of steps to regain confidence among the business community, including formation of "Bangladesh Better Business Forum" (BBBF) to facilitate better interactions between the public and the private sectors and the RRC to dismantle the barriers inhibiting the smooth functioning of business and investment.

Every percentage fall in GDP growth would mean an unrealised potential incremental gain of US\$700 million. As it appears, it will be difficult for growth rates to match even those of the past year (6.5 per cent), not to speak of the envisaged 7 per cent under the PRSP. What will be important to monitor is the composition of the GDP growth. Every effort should be taken to focus on those sectors that are closely associated with employment, income distribution and the spatial distribution of poverty. To attain the PRSP targets for employment of 58 million in FY08, the government will be required to create new employment at the rate of 10.7 per cent between 2006 to 2008. This, a Herculean task, shows the challenge facing Bangladesh in ensuring job opportunity to its citizens. The CTG has been reluctant to take decision on large foreign investment proposals, perhaps considering it prudent to leave those for the next elected government to act on. Moreover, the implementation of public investment projects (ADP) has not been satisfactory, particularly in case of infrastructure projects. In view of large rehabilitation programme at hand, the overall investment must gain momentum over the rest of the fiscal year if a growth rate of 6 per cent is to be achieved.

3.2 A Mid-term Review and Restructuring ADP focusing on Rehabilitation Measures

While the large growth in budget deficit during the recent months can be attributed principally to the flood rehabilitation programme, financing requirements are likely to grow further in the coming months owing to rehabilitation programme associated with the cyclone. Since not much can be done with revenue expenditure, the CTG needs to cutback the ADP, freeze funds for approved but unimportant projects, freeze funds for approved but undisbursed projects, divert resources from block allocations and give priority to foreign aided projects. While scaling down, more focused expenditure should be targeted, with particular emphasis on Agriculture, Rural Development, Infrastructure Development, Education, Health and Power. The CTG needs to take a closer look at the ADP projects with a view to cancelling or suspending projects without approval, and projects with no or insignificant fund release. Instead, emphasis should be given on foreign aided projects.

Revenue expenditure budget for FY2008 kept Tk 2182.2 crore as block allocation, of which only Tk 5.2 crore has been spent during July-August period. The CTG should restrain itself from further expenditure of this allocation and use it in financing the rehabilitation programme for the floods and the cyclone. Therefore, a constant monitoring of the revenue and project expenditures decisions should be the path to be followed by the CTG. In view of this a mid-term review and reprioritisation of the ADP needs to be seriously considered by the CTG.

3.3 Ensuring Food Security and Adequate Social Safety Net Programmes

Ensuring food security and curbing inflation would be a major challenge in the coming months. Food security, at the supply level, has to be ensured through increased production in Boro season, increased import through public and private sectors, materialisation of commitments by foreign countries and international organisations to provide food aid. However, ensuring only food availability would not be adequate to ensure food security. For the under-privileged sections of the society, the government machinery should be fully geared to implement the Vulnerable Group Feeding (VGF) and Vulnerable Group Development (VGD) activities under the ADP. There is an allocation of Tk 1649 crore in the National Budget of FY2007-08 for VGD, VGF, Test Relief and Gratuitous Relief (GR) programmes. Post-flood and post-Sidr rehabilitation activities need to be integrated into the regular anti-poverty programmes of the government. Government has already taken some concrete steps in this regard. On 5 January 2008, the CTG declared that initially 20,000 tons of rice would be put on OMS (Open Market Sale) and the government would soon launch test relief (75,000 tons), food-for-work (85,000 tons), VGF (38,000 tons) and VGD (10,000 tons) programmes. On 6 January 2008, the meeting of the Council of Advisers decided to sell 45,000 tons of rice under OMS programme from January 2008, at Tk 25 per kg. The meeting also decided to provide food among 5.70 lakh families in poverty stricken areas across the country under the VGF programme for the next five months, in addition to 26 lakh families in Sidr hit areas. It is also known that the government imported 3.5 lakh tons of rice and has taken steps to expedite the process of importing another 6.5 lakh tons.

The CTG has good intentions and plans to distribute more through Public Food Distribution System (PFDS). Actual distribution of total foodgrains through PFDS in FY08 (July-December) was 15 percent less than the comparable months of FY07, while it was 9 percent lower for non-priced distribution (Food for Works, VGF, VGD, GR, TR, Others) of foodgrains (Table 7). It implies that there is a need to accelerate public distribution system to attain the planned food distribution. It is pertinent to mention here that the CTG sales through BDR outlets are not included in the above analysis. Considering the progress in implementation under PFDS, an independent monitoring mechanism should be put in place on an urgent basis, to ensure that the VGF and VGD beneficiaries are appropriately targeted, and that those in need are not overlooked. Regular feedbacks from this oversight exercise will enable the CTG to closely calibrate this programme to mitigate distress promptly and effectively, and also to avoid wastage and rent seeking in the distribution process.

Table 7: Public distribution of foodgrains (July-December'07): ('000 t)

| Distribution | FY07 (July-Dec) | | | FY08 (July-Dec) | | |
|--|-----------------|-------|-------|-----------------|-------|-------|
| | Rice | Wheat | Total | Rice | Wheat | Total |
| Priced (OMS, OP, EP, LE, Others) | 194 | 66 | 260 | 146 | 48 | 194 |
| Non-priced (FFW, VGF, VGD, GR, TR, Others) | 404 | 42 | 446 | 361 | 44 | 405 |
| Total | 598 | 108 | 706 | 507 | 92 | 599 |

A comparison of current price of rice and wheat in the international market revealed that rice prices can be reduced in the domestic market through immediate import. Cost of procuring rice from different countries to Bangladesh would be in the range of Tk 28.09 per kg to Tk 30.83 per kg (Table 8). In case of import of rice from India, with minimum export price of US\$ 500 per ton, cost of import will be Tk 35.56 per kg. On the other hand, if Indian government agrees to export rice to the CTG at the currently (January 7, 2008) prevailing wholesale market price in New Delhi (Rs 14,150 per ton; equivalent to US\$ 360), then cost (upto Bangladesh) will be Tk 25.84 per kg. Therefore, the CTG should put an extra effort to materialise the import of five lakhs metric tons of rice from India through state enterprises, at the currently prevailing market price in India.

Table 8: Current International price of Foodgrains

| Foodgrains | Type | FoB price (US\$/t) | Freight rate (US\$/t) | Cost (upto Bangladesh: C&F +Tk 1) (Tk/Kg) |
|--------------------------|--|-----------------------|--------------------------|---|
| Rice (Jan 7, 2008) | 25% broken (Pakistan) | 350 | 45 | 28.09 |
| | 15% broken (Thailand) | 355 | 45 | 28.43 |
| | Parboiled (Thailand) | 390 | 45 | 30.83 |
| | 15% broken (Vietnam) | 360 | 50 | 29.12 |
| | India (Min. Export Price) | 500 | 4 | 35.56 |
| | India (Delhi Wholesale Price) Permal rice | 360 | 4 | 25.84 |
| Wheat (Dec. 19, 2007) | Hard Red Winter | 389 | 95 (US gulf) | 34.19 |
| | Soft Red Winter | 352.55 | 95 (US gulf) | 31.70 |

Note: Exchange Rate: US\$ 1 = Tk 68.58

There are some encouraging signs as regards the import of foodgrains in January 2008 (Table 9). In response to the rapid increase in rice price in late December and early January, import of rice and wheat has increased.

Table 9: Import of Foodgrains in FY2008 (1 July'07 to 08 Jan'08)

In '000 mtons

| Category of Imports | Rice | Wheat | Total |
|---|---------------------|--------------------|---------------------|
| Public sector Import (including BDR) | 309.63 [15.60] | 172.76 [0.00] | 482.39 [15.60] |
| Private Import | 697.11 [94.05] | 871.64 [45.85] | 1568.75 [139.90] |
| Total | 1006.74 [109.65] | 1044.40 [45.85] | 2051.14 [155.40] |

Note: Figures in the parentheses indicate import in January (1-8), 2008

3.4 Curbing Inflation

Curbing inflation would be a major challenge for the CTG. The CPD reports have earlier contested the option of contractionary monetary policy. In view of the excess liquidity in the banking system, the thrust should be on restoring business confidence and stimulating investment and production to ensure larger amount of supply in the market, as a way of curtailing inflation. It is from this perspective that curbing food inflation is critical to addressing the current inflationary situation in the country.

3.5 Raising Efficiency in the Fertiliser Distribution System

Farmers are very concerned as regards the availability of urea fertilisers, and are scared that the situation might worsen within the next few months when the need for this input will increase substantially. The government must make arrangements to import about 700,000 tons of urea to meet the demand over the next three months. Monitoring and ensuring supply of Tripple Super Phosphate (TSP) and Murate of Potash (MoP) would also be required. To meet fertiliser demands for the Boro season, the government recently requested six foreign envoys of China, Russia, Saudi Arabia, Morocco, Qatar and the UAE, to help import 100,000 tons of TSP and an equal amount of MoP. This is a right initiative, but the government will have to materialize the wish through prompt import and distribution. Since phosphate and potash are used as basal, immediate supply would be necessary.

3.6 Adequate Agricultural Rehabilitation during Boro Season

Two consecutive floods in August and cyclone Sidr had a huge toll on farmers and on the overall agriculture sector. As part of post-flood rehabilitation programme, the government has planned to provide inputs, free of cost to the marginal farmers in aman and boro season. The Department of Agriculture (DAE) has a plan to distribute seeds and fertilisers free of cost to the flood affected regions. The plan targets to cover 37,300 ha for boro rice, 16,000 ha for wheat, 8,800 ha for maize, 7000 ha for pulses, 9000 ha for mustard and 6500 ha for vegetables. Such an investment of public resources is justified for both stimulating agricultural production in the affected region and mitigating the sufferings of the poor farmers. This effort on the part of the CTG needs to be commended. It is pertinent to mention here that the floods in 2007 were highly localised and for those who have been affected, the damage was very severe. Therefore, to make the rehabilitation programme more effective, it might be better if the government targets all farm households in affected unions (or villages if possible) for the rehabilitation programme. The government may distribute two bags of urea, one bag of phosphate and potash, and 10 kg of seeds of hybrid rice and hybrid maize for each household. It would be sufficient to cover needs of fertilisers and seeds for cultivation of two bighas of land for the two major profitable crops in the flood affected regions. It will effectively cover marginal farm households as well as provide some support to households with larger size of holdings.

Agriculture rehabilitation in the Sidr-affected areas would require assistance in the form of supply of critical inputs, such as quality seeds and tillage, irrigation services, timely availability of fertilisers and agricultural credit.

There is an acute shortage of working capital for agriculture, particularly in the flood and Sidr affected areas. The government should have a coordinated initiative, particularly involving the private sector banks, along with the specialised government banks to enhance inflow of credit in to rural areas. The NGOs providing micro-credit could play an effective role in this area. But the usual practice of recovering micro-credit in weekly instalments immediately after disbursement, will not work for the supply of agricultural loans. There is a need for devising appropriate delivery and recovery mechanisms for agricultural credit operations to be effective. During the consultations with the CPD-BRAC joint team, farmers reported their per acre cash requirement for cultivation as Tk 45,000 for potato, Tk 7,500 for maize, and Taka 6,000 to 12,000 for boro, depending on the mode of payment of the irrigation charge. Loan requirement for fish farmers was also high. They asked for loans of Tk 20,000 to 50,000 for fish cultivation in a one-bigha of

pond. Fish farmers informed that they can repay the loan over a period of two years in monthly instalments, after a four to six months grace period.

3.7 Raising Power Generation Capacity and Ensuring Energy Security

During the first half of FY2008, maximum average daily power generation was around 3552 MW while peak demand stood at 5200 MW per day. This shows that despite various reform plans undertaken by the government, there is about 1648 MW of daily power shortage. In view of the increased demand for power during the ensuing boro season, the CTG will need to ration power and make hard choices for redistribution. Till now the measures taken by the CTG remain limited to improve efficiency and reduce system loss in the existing production capacity. Only 19 per cent of the ADP allocation in the power sector has been realised until October FY2008. However, there is no alternative for adding new production capacities to meet the yawning gap. Along with the medium term plans that have been taken by the government and formation of National Steering Committee and Task Force, short term efforts are needed for immediate increase in power generation. Existing capacity of the public sector needs to be further enhanced through proper and timely maintenance, repair and installation of machineries. In view of ensuring the long term energy security, appropriate strategy also needs to be designed to develop the country's coal resources. Projections for energy demand indicate that Bangladesh will need to generate 9,300 MW power by 2012 and 41,900 MW by 2025 if an 8 per cent GDP growth is to be attained, which is required for achieving the MDGs.

3.8 Coping with Subsidies, Including Petroleum Price Subsidy

With the increased level of oil prices in the international market, government will need to spend an additional US\$ 650-700 million for import of oil, during the current fiscal year for the same volume that it had imported during the previous fiscal year. If price of petroleum, adjusted last in April 2007, is considered to be the parity price at the time, this additional amount will need to be borne by the state through subsidy, unless prices are readjusted upward. However, it is reckoned that given the current inflationary situation, it will not be advisable to pass the rise in international oil prices on to domestic consumers. Any readjustment is also likely to increase diesel prices with consequent implications for agricultural production. It is to be admitted that this will create huge budgetary pressure, seriously undermining fiscal discipline. The CTG wanted to deal with the problem through injection of about taka 7500 crore to the BPC in the budget for FY2007-8. However, it is felt that for the time being the subsidy to BPC will need to be continued, with any readjustment to be deferred to a later date.

4. CONCLUDING REMARKS

Macro-economic Performance in FY2008 (July-December): A Report Card

| Indicators of Hope | Indicators of Disquiet |
|---|--|
| 1. Reforms, including institutional reforms, establishment of Regulatory Reforms Commission (RRC), separation of judiciary, new policies and Acts (Consumer Protection Ordinance 2007, Coal Policy, Right to Information Act) | 1. High Inflation, particularly for food items could potentially undermine macroeconomic stability |
| 2. Successful relief operations after flood and Sidr in 2007 | 2. Reduction in agricultural production mainly due to damage by flood and Sidr |
| 3. Revenue increase particularly high growth in income tax | 3. Income Erosion due to high inflation and loss caused by natural disasters |
| 4. Foreign Exchange Reserves: Higher; provides comfort in view of the need for increased import in the coming months | 4. Low level of industrial growth |
| 5. Remittance: all time high, could approach US\$7.0 billion in FY08 | 5. Depressed Investment climate |
| 6. Improvement in management and operation of Chittagong Port | 6. Slow pace of ADP implementation |
| 7. Buoyancy in the Capital Market | 7. Sluggish export growth |
| | 8. Slow employment creation |

The next six months will be a critical period for Bangladesh, given the challenges that lie ahead. The increasingly open and globally integrated economy of Bangladesh is coming under rising pressure in the form of higher domestic prices, higher import payments, sluggish export performance, stalled investment growth and pressure on the balance of trade and balance of payments. These are likely to pose serious challenges for the achievement of the major macroeconomic targets set in the budget for FY2007-8. As the CTG sets its roadmap for holding free and fair elections in 2008, the performance of the economy will be important in terms of implementing the CTG's *election plus* agenda, and also for creating a favourable conducive environment for the newly elected government to take charge of the economy and get on with the task of moving the economy forward in 2009.