The Economy of Bangladesh: Present Performance and Challenges for the Future

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Abstract: The paper highlights certain inherent weaknesses of Bangladesh's economy as reflected in the low rates of savings, investment, and the growth of GDP, deceleration of industrial growth, the worsening revenue-GDP ratio that threatens the objectives of attaining greater self-reliance, acute financial sector crises afflicting the money and the capital markets, low and dwindling level of FDI, an unhealthy state of external sector imbalance and international reserves, and imprudent handling of international trade disputes. Despite strong policy pronouncements and commitments by Government to put the economy on the right track and stimulate the pace of economic growth, performance of the economy remains poor. Business environment is vitiated by inconsistent fiscal and monetary policies, lack of co-ordination among ministries and agencies responsible for policy implementation, bureaucratic sloth and hassle that delays decision making, deteriorating law and order situation, poor physical and institutional infrastructure, energy crisis, etc., all of which discourage investment in productive activities and pose serious threats to the future growth of the economy. The paper discusses some of these problems and recommends strong corrective measures in a wide range of areas that will be needed to arrest a further deterioration of the economic climate and for preparing the country to face the challenges of the intensely competitive world of the 21st century.

Introduction

The present Government after coming to power expressed a firm determination to give the highest priority to economic growth. In preparing the country to face the challenges of the 21st century, the Government have reiterated time and again their deep commitment to carry forward the ongoing process of market-oriented reforms with a view to creating an enabling environment for the private sector to flourish and contribute to the process of sustained growth. The Fifth Five Year Plan launched in July 1997

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reflects the Government's firm resolve to remove poverty through generation of productive employment, achievement of food self-sufficiency, development of human resources and physical infrastructure, expansion of social amenities, strengthening of the country's technological base, protection of the environment, and establishment of social justice through a more equitable distribution of income. The Plan also reiterates the Government's policy intention to make the private sector the engine of the economy that will spearhead the development activities so as to confront the challenges of the new millennium.

The Government's policy announcements have been widely acclaimed both within the country and abroad. Expectations of industry and the business community were also high as they believed that sound government policy would put the economy on the right track, enhance investor confidence, and stimulate the pace of economic growth. These expectations, however, do not seem to have fully materialized, as the performance of the economy during the recent months indicates. The trends in the macro-economic fundamentals do not appear very encouraging, and judged by such traditional indices as the level and the rate of growth of savings and investment, changes in the structure of GDP, growth of manufacturing value added and employment, the state of fiscal and external sector balances, international reserves, etc. by which a country's economic performance is usually measured, Bangladesh compares rather poorly with her neighbouring countries. While the deceleration of these traditional and familiar indices can be variously attributed to "historical" factors or structural constraints, there is a general feeling that inappropriate mix of policies, and indecision or lack of decision in matters of important economic issues have caused the lack-lustre performance of the economy as a whole and of the industries sector in particular.

This paper is intended to present an overview of the current state of the economy in light of the behaviour of principal macro-economic parameters and draw the attention of policy makers to a number of issues that need to be immediately addressed with a view to reactivating the major productive sectors, restoring economic discipline, and rebuilding confidence of industry and the business community.

Savings and Investment

A cause of concern for the country since the mid-1990s has been the stagnation, or even a decline, in the rate of savings. Domestic savings as proportion of GDP was 8.2 percent in FY95 but it declined to 7.7 percent in FY97. Gross national savings was 16 percent in FY95 but fell to 14.4 percent in FY97. Total investment increased only slightly from 16.6 percent of GDP in FY95 to 17.0 percent in FY96 and to 17.4 percent in FY97 (Table 1).

The movement of national saving ratios should be interpreted with care, however. In our country, gross national saving is computed as a residual of gross investment over current account deficits. Therefore, given the level of investment, any improvement in the current account deficit will mean a rise in national savings. This, however, means a fall in foreign savings which is tantamount to a reduced capability of the economy to absorb foreign resources.

In any case, the stagnant level of savings and investment is anything but encouraging particularly when the investment-GDP ratio is targeted to rise to 24.3 percent in the terminal year of the

Fifth Plan from 17.4 percent in 1996-97. Given the slow growth in investment consequent upon the problems of domestic money and capital markets, reduced availability of official aid, and the subdued state of net private capital inflow, there is no guarantee that the Plan's investment target will be easily achieved. Historically, private investment has been found to respond very slowly to macro-economic policy reforms. Moreover, even when investment starts to respond to market-oriented reforms, there is little ground for expecting that savings will grow spontaneously to meet the increased demand for investment. It is here that the banking system and the development financial institutions can be made to play a significant role.

Note, however, that at the present stage of the country's development and low level of per capita income, voluntary private savings can hardly be expected to rise very fast. An economic climate conducive to private savings takes time to develop, and hence for a time the Government budget shall remain the most promising source of domestic savings. Public savings have to be raised by raising tax and non-tax revenues and reducing current expenditures. At the same time, Government policy should be geared to creating conditions congenial for voluntary private savings. An active policy to stimulate private savings is necessary in particular to offset any crowding out effect that increased public savings may have on private savings. This the Government can do by securing reasonable monetary stability so that saving habits are not discouraged by continuing inflation.

Strategies should be devised to transform idle savings into productive investment. For that purpose, a disciplined stock market and the active intermediation roles of financial institutions should be of particular importance for the small saver for whom few uses for their personal savings exist beyond high-risk money lending or collection of valuables like gold. The inefficiencies and weaknesses of the banking system that have adversely affected savings mobilization in the country (e.g., through a high interest spread between deposit and lending rates) and also allowed bank loans to be illegally diverted to non-productive uses should be removed by appropriate financial sector reforms.

Growth of GDP

A matter of serious concern for both policy makers and the general public is the low rate of the country's GDP growth even though it is higher than the historical trend rate. In 1996-97 the GDP grew by 5.7 percent - just a 0.3 percent increase over the previous year (Table 1). This does not augur well for an economy which requires much higher growth rates if the Government's employment generation and poverty alleviation objectives are to be achieved. What is more worrisome is that the realized 5.7 percent GDP growth has been contributed exclusively by the agriculture sector that has registered an all time high growth rate of 6 percent (as against 3.7 percent in the previous year) while all non-agricultural sectors decelerated considerably. Thus, growth in the industrial sector, the most dynamic sector in the economy, declined from 5.3 percent to 3.3 percent, in construction from 4.0 percent to 3.6 percent, in electricity, gas, water and sanitary services from 9.9 percent to 5 percent, and in the rest of the sectors from 6.5 percent to 6.2 percent (Table 2).

The Government is, however, optimistic that a successful implementation of the reform measures for overall economic development and poverty alleviation that are currently underway would increase the growth in GDP in the coming years. Official Press releases claim that the reform activities initiated in 1996-97 have already started producing results in different fields of the economy. The expert opinion is, however, that in order to bring increased dynamism in the economy and achieve a higher growth rate, economic reforms must be accompanied by socio-economic stability and improved law and order situation in the country.

GDP Growth by Sector

Agriculture

Looking at the agriculture sector one would notice that its high growth during FY97 was possible not just by favourable weather conditions but was facilitated very greatly by conscious policy that ensured timely availability of agricultural inputs, in particular fertilizers, and cheap supplies of fertilizer, irrigation and agricultural credit, all of which had substantial elements of subsidy provided by the Government. Agricultural subsidies, however, have always been looked at with disfavour by the donor community, and the Government may not be able to withstand the donor pressure for long to eliminate or reduce such subsidies. Agricultural growth may then decline as a result. For this reason, careful attention should be given to ensure that any possible slack in agriculture does not negatively impact on the growth of the overall GDP. Larger ADP outlays for development of agriculture-related infrastructure with increased allocation to enable greater R&D effort particularly for improved crop development technologies, and better distribution of agricultural credit will be needed to achieve a sustained growth of the agriculture sector. The proposed agricultural credit foundation and the crop insurance scheme should also receive priority attention of the Government.

Industry

Most disappointing of all has been the slow growth of the industrial sector and in fact a diminution of the sector's share in the overall GDP in the recent years (Table 2). The deceleration of industrial growth necessarily acts as a brake on employment generation and poverty alleviation. It reduces imports and thus has a negative impact on revenue collection from import-related taxes. Likewise, with production shortfall, the collection of excise duties and domestic VAT will decline. All this will seriously impede the Government's revenue effort. Manufactured exports will fall leading to a rise in trade and payments deficits and a further depletion of the already thin foreign exchange reserves. There may be an upward pressure on the prices situation, too. Already, there are signs of CPI going up rapidly from the relatively comfortable situation that prevailed up to the end of the last fiscal year.

The causes of industrial deceleration should therefore be quickly identified and remedied. The slowdown in industrial growth can be attributed to a number of factors such as the crisis in the electricity sub-sector, production deficit in the gas sub-sector, labour unrest, and the shortfall in the expected levels of investment, both domestic and foreign.

According to the Bangladesh Bank Annual Report, new industrial investment registered with the BOI was much lower in 1996-97 (Tk.9261 crore) than in 1995-96 (Tk.11094 crore). What the country does in fact need is to attract and raise local and foreign investment by creating a favourable investment environment, remove all existing barriers to industrial investment like inconsistencies in rules and policies that discourage investors, develop essential infrastructure, expedite the process of denationalizing medium and large public sector industrial enterprises, extend encouragement and support to the private sector industry in line with the principles of free market economy, improve the labour situation: if necessary, by banning for a time period all trade unionism in industries offering high potential of job creation, and ensure easy availability of industrial capital from the banking system.

It is unfortunate that at a time when the need for much larger investment in the industrial sector is greater than ever, the volume of both sanctioned and disbursed term loans to this sector was lower in 1996-97 than in the previous year. In order to facilitate new investment and encourage new investors, increased availability of term loans is essential. If, as is claimed by the Government, there is no liquidity problem in the banking system, a mechanism for enhancing the availability of term loans should not be difficult to find.

Public Finance

It is a good sign that some spectacular successes have been achieved in the sphere of the country's public finance. As can be seen in Table 3, Government's revenue collection in 1996-97 was 10.5 percent higher than in 1995-96. Current expenditure on the other hand increased by only 6.1 percent. The rate of revenue collection having been higher than that of current expenditure, the surplus in the revenue budget during the year increased by 24.7 percent. The Government's overall fiscal deficit has narrowed down as a result, and the budget deficit as proportion of GDP came down to 5.7 percent in FY97 from 6.2 percent in the previous year. The share of domestic resources in financing the ADP has also increased from 42.3 percent in 1995-96 to 48.9 percent in 1996-97. The progress towards achieving greater self-reliance in financing development expenditure is impressive indeed if one considers the situation that prevailed ten years ago when the development budget had to be financed almost entirely with external resources.

The significant improvement in the country's fiscal management notwithstanding, the revenue-GDP ratio (which rose to 10.0 percent in 1996-97 from 9.4 percent in 1995-96) remains lower than in any other South Asian country, albeit lower than in many least developed countries. If the professed objective of achieving greater self-reliance is to be carried forward further, action will be needed on a number of fronts to raise the revenue-GDP ratio. The major challenge now facing the Government is to intensify tax efforts for raising the revenue/GDP ratio which is necessary not just for keeping the budget deficit within manageable limits but for increasing the Government's contribution to the growth of domestic savings as well.

At present the country's revenues are based predominantly on import-related taxes which make the economy susceptible to uncontrollable external developments. The value-added tax (VAT) has over the past few years had a positive impact on tax collection, but as much as 70% of all VAT collections are import-based. There is also evidence that the coverage of domestic VAT is fast approaching its limit. There is, therefore, an obvious need for diversifying the country's tax base, including an expansion of VAT coverage, to allow more revenues from direct taxes and from taxes based on domestic economic activity.

Imposition of selective supplementary duty on both import and domestic production as well as on luxury consumption can be a potent instrument for raising tax revenues. Direct taxes may be increased both to increase the tax/GDP ratio and to achieve greater equity in the tax system. There is also the scope of substantially increasing non-tax revenues the share of which in total revenue has fallen to 18 percent in the FY97 budget from about 22 percent in FY95. Such efforts will require, among others, a significant improvement in the performance of SOEs which now contribute virtually nothing to the Government exchequer in the form of profits and dividends. Instead, these SOEs and several other service sector agencies of Government incur huge losses year after year. Elimination of these losses could save about Tk. 20 billion of tax payers' money every year which could be put to more productive use. More disturbing is the inability of public sector corporations to meet their debt service liabilities. The estimated shortfall in FY98 in respect of interest payment by these corporations has been estimated at Tk. 31.5 billion. This shortfall is an indirect subsidy, and its magnitude is almost 5 times the amount of revenue the Government has proposed to raise in the FY98 budget by imposing new taxes and duties.

Financial Sector Crisis

Banking: The financial sector is in deep crisis. The loan defaults have been crippling the banking system which is now burdened with Tk. 130 billion or so of unrealised loans. That an acute liquidity crisis exists is evident from the inability of the banking system to extend the badly needed loans to business and industry. The authorities of the Bangladesh Bank, too, have more than once acknowledged the presence of the liquidity crisis. The Finance Ministry does not, however, admit of any liquidity crisis. It has announced more than once that there is no shortage of loanable funds with banks. A close look at the statistics published by Bangladesh Bank will, however, indicate that on average as much as 50 percent of the banks' liquidity is usually held in the form of Government bills/bonds. Since, however, there is very little demand for these low interest bearing Government bills and bonds in the secondary market, these cannot be called "liquid", and hence the so-called excess liquidity held by banks cannot be used for credit purposes.

Thus, while in the accounting sense banks might have excess liquidity, it does not mean that they have readily available loanable funds at their disposal. In fact, the Government's recent decision to float 'industrial development bonds' worth Tk.10 billion for purpose of lending to industries indirectly recognizes that there is a liquidity crisis in banks. There is, however, an insufficient appreciation of the fact that such bond issues at rates higher than the normal deposit rates might lead to a lowering of bank deposits and thus further worsen the liquidity problem.

If, as is widely believed, loan delinquencies and non-recovery are among the major causes of the current liquidity crisis, the major task for the Government should be to find appropriate solutions to the problem of loan defaults. It will be necessary to restore banking sector discipline, strengthen the legal framework for improving loan recoveries, ensure an accountable management and administration in banks, and make the central bank effective with complete independence and autonomy from the hegemony of the Finance Ministry.

Capital Market: The country's stock market faced a debacle in 1996 winter that resulted in huge losses to medium and small investors. Medium and small investors play a significant role in the stock market in every country, but in Bangladesh they have become casualties to a faulty system. The down-slide of share prices continues unabated, and the share price index today is less than a fifth of what it was in November 1996.

In such a state, the Government's apathy and inaction to institute reforms to restore confidence of the investors, despite assurances from the highest level of the Government, is difficult to understand. Government's ambivalence, indecision and ambiguous pronouncements from time to time have in fact confounded the general public and compounded the crisis. The all-share price index continues plummeting, but no intervention by Government is in sight. The Government's indecision on crucial issues like liberalization of ICB loans for investors and the lock-in period adds to the confusion. The ambiguity in the Government's announcement to establish a National Stock Exchange is equally confounding. It is no use dallying with utopian ideas; what is needed instead is to take meaningful action to revitalise the capital market. A high powered committee consisting of experts and professionals was formed to suggest solution and devise mechanisms to rejuvenate the stock market. Nothing is, however, heard about what actions have been taken so far to implement the report of that committee.

The gravity of the problems confronting the country's banking system and the capital market is very well within the grasp of the Government and hardly needs any renewed emphasis. Unless prompt action is taken to lift them out of their troubles, the financial sector will continue to act as a brake rather than as a facilitator of growth.

Foreign Direct Investment

Bangladesh's experience with FDI has been utterly frustrating even though investment incentives have been significantly widened over the past 25 years. In 1996-97, FDI inflow fell drastically to a mere \$329 million. FDI flow was \$1516 million in

1995-96, $729.4 million in 1994-95, and $804.2 million in 1993-94.

Reasons behind such a low level of FDI are inappropriate policies - be that in trade liberalisation, legal reform, or industrial deregulation - that discourage investment, whether local or foreign. Because of weak institutional capacity for project designing and implementation, and delays in making administrative decisions, projects lose viability, which in turn discourage investors. Though the BOI provides one-stop service in the EPZs in Dhaka and Chittagong, corruption and rent-seeking practices in government offices are common. Privatization of service providing enterprises may improve the situation. Labour unrest, poor law and order situation, energy shortage, and deficient infrastructure of roads, port and harbour facilities are other factors that seriously discourage foreign investors to invest in this country.

Because of the above-mentioned problems, foreign investors seldom feel inclined to invest in manufacturing activity. This is corroborated by historical evidence on the use of FDI in this country. Since 1977, when EPZ was first opened, EPZ was the main centre of location of FDI. An analysis of the FDI between 1977-1990 shows that only 24 percent of all FDI went to manufacturing, 7 percent to services, and 69 percent to trade. It is also noticeable that bulk of the registered FDI was derived from income from previous investments. Net inflow of FDI or import of capital goods was very small, only 12.8 percent.

At present trade is more lucrative than investment in real sector production. The only example of large investment in manufacturing in this country is the KAFCO which exceeded all investments in EPZs. In the most recent period prior to the stock market debacle, portfolio investment in the stock market exceeded all FDIs. It is reported that some four foreign companies played an instrumental role in the stock market crash that resulted in huge losses by small and medium investors. These companies in collaboration with some members of the Stock Exchange created an artificial crisis in the market and left with large profits. The withdrawal of the lock-in system was perhaps chiefly responsible for this capital flight. A lesson to learn from this episode is that the country needs foreign direct investment in productive activities, not investment of the portfolio type.

What the country now needs is an effective set of strategies both to attract FDI and to channelise it to productive activities and services rather than to trade. According to a World Bank report, several business partners of International Finance Corporation (IFC), a World Bank affiliate, have expressed their reluctance to invest in Bangladesh in the absence of a more decisive progress towards establishment of a sound business climate. They have expressed concern over the poor reform process that is going on in public administration, privatisation, the financial sector etc. and the poor state of the country's infrastructure. In short, the urgent need of the hour for attracting FDI is consolidation of political stability, sound law and order, a transparent and efficient bureaucracy, eradication of corruption, a fair legal system, depoliticisation of labour organisations, reforming the existing age-old tax system, a clear market oriented economic policy, and improved economic and physical infrastructure.

External Sector

The external sector witnessed a sharp deceleration in the growth of both imports and exports in 1996-97. Exports registered a record high growth rate of 37.1 percent in 1994-95 (Table 4). The growth rate fell to 11.8 percent in 1995-96 and then showed a modest recovery rising to 13.8 percent in FY97. Import growth, however, decelerated faster, from the unprecedentedly high rate of 39.1 percent in 1994-95 to 17.9 percent in 1995-96, and then to 3.5 percent in 1996-97. Owing to a much lower rate of import growth, the merchandise trade balance improved. The current account balance also registered an improvement in 1996-97 (the deficit falling from 5.1 percent of GDP in 1995-96 to 2.8 percent of GDP in 1996-97), thanks to an increase in worker remittances by $258 million (Table 1).

While the external sector performance thus looks apparently favourable, the heavy commodity concentration of the country's exports cannot but be a cause of concern. Export growth in 1996-97 was led chiefly by ready-made garments which has now substituted the earlier dependence on jute-related exports. Garments production is also highly import-intensive, with a value addition of less than 30 percent. Net export earnings in terms of local value added are thus much lower than what the official trade statistics indicates. Moreover, the growth of the RMG industry and exports has been a fortuitous event, made possible by the emergence of a reserved market as a result of the MFA quotas. Its prospects remain uncertain in the new quota-free WTO regime, unless the industry can be made truly competitive vis-a-vis the more efficient suppliers in the world market by improving quality, diversifying the product range, and adding more value locally by setting up appropriate backward linkage facilities.

Notice that the significant improvement in the country's current account balance has been the result of a slower growth of imports relative to exports coupled with a rise in worker remittances. Strangely enough, import growth has decelerated despite widespread liberalisation of import barriers. This can be construed as a weakness of the economy. The country's weak investment performance and slow growth of industrial and industry-related sectors have kept imports below their expected level. With a more favourable investment environment import growth would have been much higher and the improvement in balance of payments correspondingly lower.

For keeping the balance of payments deficits under control, effective measures will be needed to restrain the growth of non-essential imports (say, by imposing supplementary duty) and diversify exports. Strengthening the export base by expanding supply capacity, improving product quality, and introducing high value added products that have growing demand in the rich industrial country and emerging markets are, among others, steps that need to be given the highest consideration.

There is strong demand in some quarters for pursuing an aggressive exchange rate policy on the plea of maintaining export competitiveness. Already, the Taka has been depreciated a number of times in the recent months, but it must be understood that in a heavily import dependent economy like Bangladesh currency depreciation alone can hardly succeed in improving the balance of payments. It is true that devaluation generally increases the incentive for producing traded goods, but it seriously hurts production and investment in the rest of the economy through higher prices of imported inputs and capital goods. Even most of the country's export products other than jute goods have high import content of raw materials. Devaluation will adversely affect these exports, not to speak of the wide range of industries and agricultural activities that produce for the home market and whose domestic prices are not directly linked to world prices.

In fact, empirical studies conducted on Bangladesh's export performance have found little positive correlation between the depreciation of the Taka in the past and the growth of exports. For expanding exports, greater focus should be given to the diversification and expansion of the export base, increase in the local value added of exports through development of backward linkages, and removal of structural and policy-related constraints that impede the growth of exports.

Position of International Reserves

A sharp depletion in the country's foreign reserves has created a lot of furore in the recent months. Foreign exchange reserves fell from a high of $3070 million in June 1995 to $2039 million in June 1996 and to $1719 million at the end of June 1997 (Table 1). The current level of reserves can meet just over 2.5 months' import needs. With greater efforts for industrialisation, developmental imports will go up putting further pressure on the reserves.

Yet, while holding foreign reserves at a comfortable level is desirable, the Government should not get panicky at the sight of a temporary decline. Instead of trying to build or protect reserves by taking recourse to monetary policy, as has been attempted of late by the country's central bank, the Government should closely monitor the principal causes of the decline and address those causes. The depletion of reserves has been the result mainly of reduced inflows of net capital receipts (official aid) and foreign private investment. If the Government acts sensibly, these problems should not be difficult to overcome.

Intensive efforts will, however, be needed to attract private foreign investment through appropriate incentives, by accelerating the process of economic and administrative reforms, intensifying the process of privatisation, and developing and expanding the much needed infrastructure. All these will raise the inflow of FDI and also help enhance the availability of official aid from donor governments and multilateral agencies that are usually reluctant to extend aid to governments that hesitate to implement market-oriented reforms.

The Government of Bangladesh is currently negotiating with IMF for ESAF loan to improve the reserve position. The establishment of the Korean EPZ and potential FDI inflows in gas and energy sectors are expected to improve the situation further. The Government should therefore refrain from taking any impulsively hasty action to rebuild reserves which may cause more harm than good. For instance, the Bangladesh Bank has started pursuing restrictive monetary policy with a view to lowering import demand and thus raising the level of foreign reserves. Such a policy may, however, adversely affect the investment environment by raising the cost of funds for both new and working capital and thus obstruct industrialisation efforts and exports. Better results can instead be obtained from expediting the economic reform programmes that will encourage productive activities and help improve the reserve situation.

Worker Remittances

A favourable trend in the external sector has been that worker remittances after remaining stagnant around $1200 million during 1994-95 and 1995-96 increased to $1475 million in 1996-97 (Table 1). This depicts a growth rate of above 20 percent which is definitely a welcome development. There is, however, no scope for complacency. For a sustained growth of remittances, the incentive structure should be improved. Innovative arrangements for effecting prompt transfer of expatriate earnings through normal banking channels will prevent leakages and increase net receipts. More favourable exchange rates for individual remittances in excess of a given minimum may also serve as an incentive to transfer. The potential for exporting skilled, professional and technical personnel should be explored.

It has to be understood that job opportunities abroad depend upon the occupational needs of western multinational corporations. In order to be able to boost the export of manpower, the needs of these multinationals have to be assessed and arrangements made for imparting training in specific trades and activities according to their needs. In addition, the potential of exporting consultancy services abroad in fields like construction engineering, accountancy, management and economics may be tapped. The Government may extend useful help by providing timely information about the availability of such services abroad, facilitating contact with overseas authorities, and by giving prompt clearance for undertaking such jobs.

Retaining Market Access Facilities Abroad

Bangladesh has been under the threat of losing some of the hitherto assured markets for two of her important export products viz., knitwear and frozen foods for which both the exporters and the Government are to blame.

Frozen Foods

The European Union (EU) had imposed a temporary ban on the import of frozen shrimps and other fish products from Bangladesh which are the second largest export item of the country (export value US $321m in 1996-97) after RMG. The ban was imposed on grounds of "unsatisfactory physical and infra-structural facilities" at the fish processing plants. There was the added danger that the USA and Japan which imported about 50 percent of the country's frozen shrimps would follow the EU. Such action would have a disastrous effect on the industry if the issue were not properly settled. In the interest of the industry and for retaining the market access opportunity in the developed country markets the industry must be made to take prompt action to correct its shortcomings by improving the standard and hygiene quality of fish processing plants and developing the laboratory testing capacity to ensure the quality of the exportable items.

Knitwear Exports

An instance of most inept handling by the Government of a major trade crisis is that of the market access issue concerning Bangladesh's knitwear exports to EU. Bangladesh's knitwear products have the largest market in the EU where the country enjoys duty-free access under the GSP scheme. Also, unlike her major competitors like China, India, Pakistan etc., Bangladesh enjoys quota-free entry to the EU markets and thus stands to gain significantly vis-a-vis these competing countries. In order, however, to be able to avail of the GSP facilities, the EU Rules of Origin require a three-stage conversion in knitwear production which in effect means that the yarn used in knitwear production is produced domestically in the exporting country.

Most recently, a great uncertainty appeared in accessing the GSP facilities in the export of knitwear because of non-compliance by Bangladesh exporters with the three-stage process criterion and widespread abuse of the GSP through falsification of certificates of rules of origin by some of the exporters and the EPB officials. The EU Commission took the issue very seriously and demanded immediate cancellation of about 6900 GSP certificates issued by the EPB that were proved to be false and also demanded investigation into the genuineness of several thousand other certificates which "appeared" to be false. The Government of Bangladesh at first made strong lobbying with the EU authorities asking for derogation of EU rules of origin to allow a two-stage process criterion instead of three-stage, but all efforts and diplomatic offensive having failed, they had to yield to the EU pressure at the end.

To comply with the EU demand, the Government have so far (as of 9 October 1997) cancelled 13,584 false certificates and started investigation into 2,223 others that are alleged to be false. In any case, the manner in which the Government of Bangladesh have responded to the EU GSP dispute leaves much to be desired. It was unwise of the Government to ask for derogation to a two-stage process criterion instead of taking punitive actions against fraudulent and collusive acts of some unscrupulous exporters and a few corrupt EPB officials that led to the abuse of GSP, angered the EU authorities, and shattered the image of Bangladesh as an exporting nation.

The Government should have handled the EU-dispute prudently and with care, keeping in mind the long-term interest of the industry. The basic attractiveness of the EU GSP scheme is that it facilitates the building up of backward linkage in our textile industry by promoting yarn production in the country's spinning mills. But accessing GSP facilities by our exporters in a fraudulent manner has actually benefited other yarn producing countries (from which our knit producers import yarn), not the domestic yarn spinning mills of Bangladesh. There are also allegations that by taking the benefits of loans at a subsidised rate of 6.5 percent from the Export Development Fund (EDF) yarn is imported and sold in the domestic market, and finally these imported yarns are shown to have been purchased from domestic spinning mills in order to qualify for the three-stage value addition criterion. All this has caused a substantial loss of government revenue, misuse of EDF, and most importantly, a hindrance to the promotion of the country's spinning industry.

It goes without saying that for Bangladesh the pragmatic policy option would be to ensure backward linkage in the spinning sub-sector which would increase value addition and thus contribute to higher RMG export earnings. This strategy acquires an added significance because after the full implementation of the Uruguay Round Agreement in 2005 trade in textiles and clothing will be completely free of quotas, and Bangladesh will have to face severe competition from her highly established and efficient competitors. After the dismantling of MFA quotas in 2005 the only major obstacle to textile exports will be the tariff barriers in the developed country markets. Yet, since Bangladesh enjoys a tariff-free access to EU markets under GSP while none of her competitors are entitled to such facility, Bangladesh will have a clear competitive edge in the EU markets over her competitors.

In order, however, to establish Bangladesh's claim to GSP and thus ensure duty-free access to EU, Bangladesh must establish adequate backward linkages which are badly needed to achieve a sustained growth of the country's textile sector. For that to happen, the Government must extend all necessary incentives for encouraging investment in the textile industry and for harmonious development of all its sub-sectors. The derogation to two-stage conversion criterion, even if allowed by the EU, would at best bring only short-term benefit but cause incalculable damage to our textile industry in the long run. The Government should carefully consider this trade-off and take actions that will facilitate formation of backward linkages in the textile sector and prepare the industry to fully exploit the GSP advantage in a quota-free world of the future.

Overall Business Environment

The overall economy is not in a very good shape. Business environment is vitiated by inconsistent fiscal and monetary policies, lack of coordination among ministries and departments responsible for policy implementation, delayed decision making because of bureaucratic sloth and hassle, lack of security of life and property because of deteriorating law and order situation, growing incidence of looting and extortion, poor physical infrastructure, energy crisis etc. all of which discourage business and investment in productive activities.

Instances of policy anomalies abound. While the industry sector is starving of credit, tight monetary policy is making credit availability harder still. The growth of domestic credit has slowed down considerably, not least because of successive increases in the bank rate. On the other hand, for purpose of meeting the fiscal imbalance the Government have consistently raised its borrowing from the market, reducing the availability of bank funds for lending to industry. The growth of bank credit to private sector declined to 12.1 percent in FY97 from 21.5 percent in FY96, while credit to the public sector including SOEs increased by 17.8 percent in FY97, roughly at the same rate as in FY96 (Table 5). In the period January-May 1997 the Bangladesh Bank issued treasury bills as many as 19 times. Further sums amounting up to Tk.2000 crore were planned to be raised through the sale of industrial development bonds. All this would lead to a reduced availability of loanable funds with the banking system for lending to the private sector.

Inappropriate fiscal policies have harmed the growth of many of the country's promising industries. The deceleration in the industrial sector growth in the recent years can to a significant extent be attributed to the sharp reduction in protection accorded to domestic industry. No steps have been taken to protect the local industry from unfair external competition in the form of under-invoicing, smuggling, and dumping by exporting countries.Our industrial policy is being formulated in an information vacuum. The Government seem to be unconcerned about the fate of the 1700 sick industries that were registered with the Industries Ministry in 1991. Much more information is needed about the fate of over 700 industries disinvested over the past two decades. The policy makers must be in possession of key facts about varying performances across the industrial sector. Attempts should be made to identify the 'winners' that have growth prospects and can cater to local and international demand. Problems of large scale industries like jute and cotton textiles should receive priority attention. Adequate steps should be taken for rehabilitating the jute industry that was once the country's top foreign exchange earner. Policies should start right from the production stage of raw jute, to ensure fair price to the growers and make timely availability of funds for procurement of jute by traders, exporters and user mills. Incentives should also be provided to producers of jute and jute goods to avoid losing the international market.

Cotton textile mills have been hard hit by faulty fiscal policy and unfair competition from neighbouring competing countries. The industry has expanded in a lopsided manner. The expansion of RMG sector has not been accompanied by the growth of backward linkage facilities such as spinning, weaving and finishing units. As a result, value addition remains low, and the growth of the RMG industry has failed to create any dynamism in the textile sector as a whole. Yet, government policy for development of backward linkage is conspicuously absent, apart from nominally designating the textile industry as a thrust sector.

The most critical sector in promoting industrialization in the country is the physical infrastructure consisting of power, gas, water, sanitary services, transport, storage, communication, and port and harbour facilities, all of which need substantial improvement and expansion. Unless supply of these critical services is radically improved, the targeted double digit growth of the industrial sector will never be achieved.

The country's most important sea port, the Chittagong Port, has been facing a chronic problem in the recent years seriously affecting the country's export and import trade. A permanent cure of the ailments that intermittently afflict the Chittagong Port which handles the bulk of the country's export and import cargo should be found. The Port must be kept operational round the clock throughout the year. To that end labour unrest and the resultant impasse in the port must be removed.

Energy shortage with the resulting power outage and frequent load-shedding has been a nightmare for the industry. Average daily load-shedding now is about 400 MW which may increase in the drier seasons. About 38 percent of installed capacity is currently inoperative. A year ago the Energy Ministry assured the business community that power supply would soon improve and that there should be no power shortage after September 1997, but now it is said that another year or so would be required to bring normalcy in the power sector. Some effort has in fact been under way to separate generation, transmission and distribution of power in the country. The entire transmission system of the country will be taken over by the newly formed Power Grid Company of Bangladesh (PGCB) while the recently created Dhaka Electric Supply Company (DESCO) will distribute power in the Capital. DESA's responsibilities have been downsized and areas under its jurisdiction have been demarcated.

It is not, however, clear how the new institutional set-ups will improve the supply situation unless the generation capacity is appropriately increased. The existing operational capacity in the country is about 1800 MW. The Government plans to raise the total capacity to 4000 MW by 2000. About 1200 MW of the new generation will come from the private sector. Nothing is yet known, however, about when the private sector power plants will be set up and where the private investment will originate.

Much of the country's economic ills is the product of the burgeoning civil administration. Public administration employs over a million people which is too big for the country. Every ministry or department is overstaffed, inefficient and slow performing. Administrative reforms and downsizing the Government could drastically cut government spending and at the same time achieve accountability, transparency and efficiency in public administration.

Concluding Remarks

Some of the unwelcome features of Bangladesh's economy that pose significant threats to its future growth are delineated in the foregoing overview. The Government have adopted a planning approach to development aiming to remove poverty in the shortest possible time and achieve self-sustained growth. Success will however depend upon how skillfully the Government can remedy the problems that currently beset the economy. Strong corrective measures will be needed in a wide range of areas to arrest a further deterioration of the economic climate and for putting the economy on the right track. The economy has to be prepared to face the challenges of the intensely competitive world of the 21st century and utilize to advantage the opportunities that the relatively open and globalizing world economy would generate. For that purpose the Government will have to carry out significant reforms pertaining to public administration, deregulation and privatisation, banking and capital market, the legal system etc. and create conditions favourable to local and foreign investment.

Table 1: Some Macroeconomic Indicators

Items	1992-93	1993-94	1994-95	1995-96	1996-97(P)
1. GDP at Current Prices (Billion Tk)	948.1	1030.4	1170.3	1301.6	1402.6
2.GDP at 1984-85 Prices (Billion Tk) (annual growth rate in %)	560.2 (4.5)	583.8 4.2)	609.8 (4.4)	642.4 (5.4)	678.8 (5.7)
3. Worker Remittances (Million US $)	944	1089	1198	1217	1475
4. Current Account Deficit (Million US $)	618	420	1065	1637	902
5. Foreign Exchange Reserve (Million US $)	2121	2765	3070	2039	1719
As percent of GDP (at current prices)					
(i) Domestic Savings	7.0	7.5	8.2	7.5	7.7
(ii) National Savings	14.0	15.0	16.0	14.2	14.4
(iii) Gross Investment	14.3	15.4	16.6	17.0	17.4
(iv) Current Account Deficit	2.6	1.7	3.7	5.1	2.4

Source: Bangladesh Bureau of Statistics (taken here from Bangladesh Bank, *Annual Report 1996-97*).

Table 2: Sectoral Distribution of GDP (at 1984-85 Prices) and Growth Rates (percent).

Sectors	1992-93	1993-94	1994-95	1995-96	1996-97 (P)
1. Agriculture	35.9 (1.8)	34.6 (0.3)	32.8 (-1.0)	32.2 (3.7)	32.4 (6.0)
2. Industry (Manufacturing)	10.5 (9.1)	10.9 (7.8)	11.3 (8.6)	11.3 (5.3)	11.1 (3.3)
3. Construction	6.1 (4.8)	6.2 (6.0)	6.3 (7.0)	6.3 (4.0)	6.1 (3.6)
4. Gas, Electricity, Water and Sanitary Services	1.6 (13.4)	1.8 (14.0)	1.9 (11.3)	1.9 (9.9)	1.9 (5.0)
5. Others	45.9 (5.3)	46.6 (5.8)	47.7 (6.9)	48.2 (6.5)	48.5 (6.2)

Source: As for Table 1.

Note: Figures in parentheses indicate annual growth rates.

Table 3:Public Resources and ADP

Heads	1992-93	1993-94	1994-95	1995-96	1996-97
1. Govt. Revenue(Bn.Tk)	110.60	122.80	142.10	155.12	171.45
(Annual Change %)	(11.6)	(11.0)	(15.7)	(9.2)	(10.5)
(a) Tax Revenue(as % of Total Revenue)	81.6	80.5	78.2	78.9	82.1
(b) Non-tax Revenue (as % of Total Revenue)	18.4	19.5	21.8	21.1	17.9
2. Current Expenditure (Bn.Tk)	85.10	91.50	103.00	118.14	125.35
(Annual Change %)	(7.7)	(7.5)	(12.6)	(14.7)	(6.1)
3. Revenue Surplus(Bn.Tk)	25.50	31.30	39.10	36.98	46.10
(Annual change %)	(57.7)	(22.7)	(24.9)	(-5.4)	(24.7)
4. Resources for the ADP (Billion Tk)	81.21	96.00	111.50	104.47	117.00
(a) Internal Resources as % of ADP.	26.2	35.8	43.0	42.3	48.9
(b) External Resources as % of ADP)	73.8	64.2	57.0	57.7	51.1
5. Overall Budget Deficit (Billion Tk)	66.40	67.61	82.83	81.12	80.44
As percent of GDP					
(a) Total Revenue	11.7	11.9	12.1	11.9	12.2
(b) Tax Revenue	9.5	9.6	9.5	9.4	10.0
(c) Non-tax Revenue	2.1	2.3	2.6	2.5	2.2
(d) Revenue Expenditure	9.0	8.9	8.8	9.1	8.9
(e) Revenue Surplus	2.7	3.0	3.3	2.8	3.3
(f) ADP	8.6	9.3	9.5	8.0	8.3
(g) Overall Budget Deficit	7.0	6.6	7.1	6.2	5.7

Source: Ministry of Finance, Finance Division.

Table 4 :Some Indicators of External Sector Performance

Items	1992-93	1993-94	1994-95	1995-96	1996-97(P)
1. Exports (Million US $)	2383 (19.5)	2534 (6.3)	3473 (37.1)	3882 (11.8)	4418 (13.8)
2. Imports (Million US $)	4071 (15.8)	4191 (2.9)	5834 (39.2)	6881 (17.9)	7120 (3.5)
3. Merchandise Trade Balance (Million US $)	1688	1657	2361	2999	2702
As percent of Total Exports					
RMG (including Knitwear)	60.6	61.4	64.3	65.6	67.9
Frozen foods	7.2	8.7	8.8	8.1	7.3
Jute goods	12.3	11.2	9.2	8.5	7.2
Leather and Leather goods	6.2	6.6	5.8	5.5	4.4
Raw Jute	3.1	2.2	2.3	2.3	2.6
Fertilizer	2.1	2.0	2.6	2.4	2.4
Tea	1.7	1.5	0.9	0.8	0.9

Note: Figures in Parentheses denote annual percentage change. Source: Export Promotion Bureau; Bangladesh Bank.

Table 5:Availability of Domestic Credit by Sector (Billion Tk)

Particulars	1992-93	1993-94	1994-95	1995-96	1996-97
Total Domestic Credit : Annual Change (%)	292.74 (7.6)	306.95 (4.9)	360.85 (17.6)	434.52 (20.4)	493.97 (13.7)
Public Sector Total : Annual Change (%)	99.56 (7.4)	97.23 (-2.3)	100.28 (3.1)	117.93 (17.6)	138.92 (17.8)
of which: (a) Government :Annual Change (%)	39.22 (8.2)	46.82 (19.4)	46.14 (-1.45)	63.10 (36.8)	80.17 (27.0)
(b) SOEs :Annual Change (%)	60.34 (6.9)	50.40 (-16.5)	54.14 (7.4)	54.82 (1.3)	58.75 (7.1)
Private Sector : Annual Change (%)	193.17 (7.7)	209.72 (8.6)	260.58 (24.2)	316.60 (21.5)	355.05 (12.1)

Source: Bangladesh Bank; Bangladesh Bureau of Statistics.