



## Bangladesh

**S**ince the early 1990s, Bangladesh has been endeavoring to carry out a comprehensive set of structural reforms aimed at liberalizing the foreign trade and exchange regimes, restructuring the industry sector, strengthening fiscal and monetary management, encouraging private sector participation, and privatizing state-owned enterprises. As a result, a degree of macroeconomic stability was achieved: the inflation rate declined, fiscal and current account deficits narrowed, exports surged, and foreign exchange reserves increased. Despite these improvements, however, economic growth has remained modest. In many cases, the Government was unable to implement reforms on a wider scale and some of the reform agenda has gone unfinished.

Economic performance in 1995 was mixed. Investment increased and there were some signs of an upturn in private sector activities. However, many major macroeconomic indicators deteriorated – inflation rose, fiscal and current account deficits widened, and overall economic growth slowed down. While the sluggish economic growth was attributed to unfavorable weather conditions which adversely affected foodgrain production, the slower pace of structural reforms also aggravated imbalances in the economy.

The near-term outlook for the economy is clouded by the recent political uncertainty and by the impact of severe floods between June and October 1995. With appropriate fiscal and monetary policies and private sector initiatives, economic growth is expected to recover in 1997.

### Recent Trends and Prospects

*Growth, Investment, and Employment.* Growth of GDP contracted to 4.1 percent in 1995 from 4.2 percent in 1994 owing to a decline in agricultural output. Foodgrain production fell by 1.8 percent in 1994 and by 5.7 percent in 1995 partly because of unfavorable weather conditions and partly as a result of infrastructure bottlenecks and inappropriate public intervention in the fertilizer market. In contrast, other agricultural output, particularly livestock and fisheries that had been developed largely through private sector initiatives, showed robust growth of more than 8 percent in 1995. However, this was not enough to offset the drastic fall in foodgrain production. Thus, the agriculture sector as a whole suffered a contraction of 1.6 percent during the year.

Industrial output expanded by 8.5 percent in 1995 compared with 7.8 percent in 1994, the higher growth rate resulting primarily from improved performance in manufacturing, construction, and the power and gas industries. Stronger growth in manufacturing production reflected the higher levels of private investment in recent years. Ready-made garments, chemicals, leather, food processing, and basic metals industries all showed vigorous growth. On the other hand, output of cotton and jute textiles and tea declined. Construction activities remained buoyant in 1995 as many public and private projects were launched.

Output in the services sector rose by 5.9 percent in 1995, a slight improvement on the

**Table 2.14 Major Economic Indicators: Bangladesh**

		1993	1994	1995	1996	1997
Gross Domestic Product	% change	4.5	4.2	4.1	3.6	5.5
Agriculture	% change	1.8	0.3	-1.6	1.0	2.5
Industry	% change	8.0	7.8	8.5	5.5	9.5
Services	% change	5.3	5.8	5.9	4.3	5.4
Gross Domestic Investment	% of GDP	13.2	14.3	14.8	14.0	15.5
Gross Domestic Saving	% of GDP	6.4	8.4	6.8	5.8	7.2
Inflation Rate	% change in CPI	2.7	3.3	8.9	8.8	6.0
Money Supply Growth	% change	10.6	15.4	16.0	16.2	15.0
Merchandise Exports	\$ billion	2.4	2.5	3.5	3.9	4.6
	% change	19.6	6.3	37.1	12.0	18.0
Merchandise Imports <sup>a</sup>	\$ billion	4.1	4.2	5.8	7.0	8.5
	% change	17.5	2.9	39.2	20.0	22.0
Current Account Balance	\$ billion	0.2	0.3	-0.2	-0.9	-1.0
	% of GDP	0.7	1.1	-0.5	-2.8	-3.0
External Debt Outstanding	\$ billion	14.9	16.6	17.5	19.0	19.8
Debt-Service Ratio	% of exports	14.6	15.2	13.0	13.0	13.0

<sup>a</sup> Cost, insurance, and freight.

Note: All data are on a fiscal year basis. Data on inflation and trade may differ from the series contained in the Statistical Appendix (see Statistical Notes).

Sources: Data provided by the Government of Bangladesh, Bangladesh Bureau of Statistics; World Bank, *World Debt Tables 1996*, Vol. 2 (Washington, DC, 1996); and staff estimates.

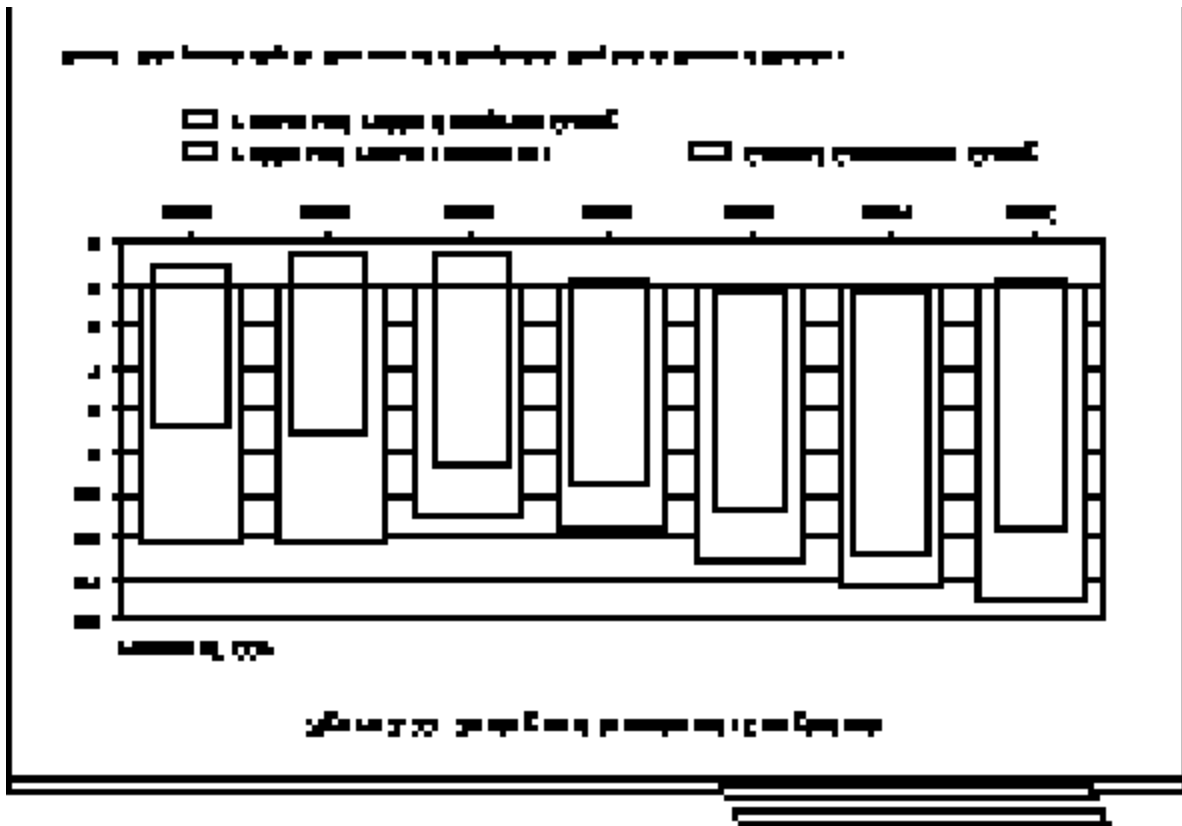
rate of growth achieved in 1994. There was increased activity in transportation and communications, banking, and insurance. An increase in trade services reflected growth in both imports and exports. In the financial sector, the Government approved seven new private banks, a new foreign bank commenced branch banking, and transactions on the Dhaka Stock Exchange doubled. The gains achieved by these activities were partly offset, however, by a slump in public administration services.

Gross domestic investment rose to 14.8 percent of GDP in 1995 from 14.3 percent in 1994 (Figure 2.17). Despite the country's fragile political situation, private investment continued to increase, partly reflecting the Government's liberal stance in its trade, exchange control, capital market development, and foreign investment policies. Credit expansion to the private sector, particularly in construction and trade activities, also stimulated investment. Meanwhile, public sector investment increased with the commencement of some large-scale public projects. However, total investment is still far below

its potential because of growing infrastructure constraints, financial sector inefficiencies, and sluggish implementation of crucial reforms.

For the past three years, gross domestic saving has averaged 7.2 percent of GDP per annum, a marked improvement on the average of 3.5 percent of GDP during the previous three-year period, 1989–1992. This reflects better control over the Government's current spending, significant augmentation of public revenue, and a steady rise in private saving, partly in the form of small savings instruments, such as the Grameen Bank (Box 2.5). Gross national saving is usually higher than gross domestic saving, mainly because of workers' remittances from abroad. Gross national saving averaged 11.5 percent of GDP per annum during the past three years compared with 7 percent over 1989–1992.

Providing jobs for the unemployed and 1.8 million newcomers annually in the labor market remains one of the most challenging tasks for policymakers. Among the approximately 60 million members of the labor force



in Bangladesh, 10 percent have regular jobs in the formal sector and 15 percent are classified as casual workers. The remaining 75 percent are either self-employed or unpaid family workers. Because of slow economic growth, demand for labor was low in 1995. The small share of the formal sector in total employment and the vast numbers of unemployed and underemployed have served as an incentive for labor to seek jobs outside Bangladesh. The gross number of migrants has increased in recent years and is currently nearly 250,000 per year. However, this level of labor export is still inadequate to significantly impact on the overall unemployment situation.

Economic prospects for 1996 are clouded by recent political uncertainties. First quarter data for 1996 showed that the macroeconomic situation had worsened. There was a record number of strikes during the first half of 1996 which had a severe impact on the economy in terms of lost working days. The investment climate was also seriously damaged. The consecutive floods between June and October 1995 adversely affected foodgrain production in the early part of 1996. Overall economic growth is expected to be 3.6 percent in 1996; however, this projection depends

on sectoral activities not being disrupted again by political events. A reduction in foodgrain production for the second year in a row is likely to be offset partially by strong growth in the livestock and fisheries sectors. Industrial growth is projected at 5.5 percent compared with 8.5 percent in 1995. The services sector is expected to expand by 4.3 percent. Economic growth is forecast to pick up further in 1997, assuming the political situation stabilizes, weather conditions improve, and private sector investment plays a more prominent role in the economy.

*Budget, Money, and Prices.* The Government's prudent budget management since the early 1990s has brought considerable improvements in revenue by broadening the coverage of the VAT and non-tax revenue sources. The Government exercised tight control over current expenditure which resulted in a current budget surplus. These savings enabled the country to finance one third of the Annual Development Program (ADP) and reduce the overall fiscal deficit from 7.4 percent of GDP in 1990 to 5.5 percent in 1994.

However, despite buoyant revenues, the overall fiscal deficit in 1995 widened to

6.5 percent of GDP. Increased revenues from the VAT and customs duties were offset by a surge in current expenditures, owing, in part, to an unbudgeted increase in government employees' wages. The sizable subsidies aimed at stabilizing food prices also added to the increase in current expenditure.

Although ADP expenditure fell short of the budgeted provision in 1995, it was nonetheless 16 percent higher than in 1994 and reached a record level of over 8 percent of GDP. The Government has introduced a number of measures to improve the quality of ADP spending by emphasizing social sector and infrastructure development. Allocations of ADP funds for poverty alleviation, education, population control, and the power, transport, and communications sectors all rose in 1995.

Broad money (M2) grew by 16 percent in 1995, substantially exceeding the target set for the year, largely because of the expansion in private sector credit. After four years of low growth, lending to the private sector expanded by 24 percent in 1995, reflecting a rise in private sector activities, particularly in construction and trade finance. The failure to reform state-owned enterprises, however, and their continued need for financial support meant that credit to the public sector for this purpose had to be increased. Some steps were taken in 1995 to improve banking regulation and supervision; however, more comprehensive and systematic structural reform measures are needed in the banking sector.

Both the expansionary fiscal and monetary policies and contraction in foodgrain output placed upward pressure on the price level in 1995. As measured by the new CPI, which is based on a nationwide price survey, inflation reached 8.9 percent in 1995, a sharp increase from the previous year's level of 3.3 percent. Foodgrain prices rose by 9.2 percent during the year as a result of the shortfall in rice production. The nonfood group price index also increased by 8 percent, led by rents and fuel, transportation, and communications prices.

The overall fiscal deficit for 1996 is expected to be slightly lower than in 1995 at 5.9 percent of GDP. Tax revenue is expected to grow at a lower rate than that of nominal GDP because of a reduction in customs tariffs and corporate income taxes. Although the growth of ADP expenditure may be checked, the elections are likely to lead to an expansion of other

expenditure sufficient to offset any saving that might be made. Broad money supply growth is expected to be contained at 16.2 percent assuming that the expansionary monetary policy in 1995 and the early months of 1996 is modified and the Bangladesh Bank acts more frequently, as it did in September and October 1995, to mop up excess liquidity of the commercial banks. Inflation is expected to remain high at 8.8 percent in 1996. Political disturbances and uncertainties during the general election period would have an adverse impact on consumer goods production and strengthen inflationary pressures. Fiscal conditions are expected to improve in 1997 and inflation could be reduced to 6 percent in that year.

*External Trade and Payments* To attain rapid economic growth based on more intensive use of Bangladesh's most abundant factor endowment – labor – the Government has continued to redirect its development policy toward a competitive export-oriented economy by liberalizing the trade and exchange rate regimes. Since 1990, nontariff barriers have been gradually removed and average tariff rates were lowered to 26 percent in 1995 from 58 percent in 1992. These measures have strengthened the country's external position as manifested by a strong export performance. Over the period 1991–1994, the current account, including grants, improved from a deficit of 1.2 percent of GDP to a surplus of 1.1 percent.

In contrast to sluggish overall economic growth, the external sector remained buoyant in 1995. Supported by strong world demand and an expanded role of the private sector in export activities, total exports increased by a remarkable 37 percent to \$3.5 billion compared with \$2.5 billion in 1994, and was mainly attributable to an increase of 44 percent in exports of ready-made garments. These now comprise over 50 percent of total exports. The low cost of wages, coupled with a supportive policy environment, is the main driving force that has led to the country's continuing success in the garments market. Other leading exports such as leather and frozen shrimp also performed well in 1995.

Merchandise imports also increased sharply by 39.2 percent to \$5.8 billion in 1995 from \$4.2 billion in the previous year. The strong growth in imports was evident for almost all

### Box 2.5 Grameen Bank

The Bangladesh institution that is most widely known internationally may well be the Grameen Bank, a semi-public bank created in 1976 to supply the rural poor with credit at reasonable interest rates. To encourage rural economic development and alleviate poverty, the Grameen Bank provides loans to the landless, illiterate, and especially female, rural poor who do not have traditional forms of collateral for conventional loans and whose only other alternative is to seek finance from local moneylenders. These local moneylenders often have considerable monopoly power among their largely immobile clientele. They charge usurious interest rates and, consequently, many potentially profitable projects are not undertaken.

The Grameen Bank approach deals with this principal-agent problem by providing an incentive for individual borrowers to monitor, assist, and insure each other. The Bank's more than 20 million members, of whom about 94 percent are women, are formed into groups of five or six of roughly equal status (same sex and similar social position) and given a joint credit rating so that, if one defaults, the others also lose their access to credit. Loans are scheduled sequentially for group members, and prompt repayment leads to an increased credit line for future borrowing. As a result, there is considerable peer pressure, and occasionally financial assistance, within each group to ensure repayment on schedule. The Bank's default rate has been exceptionally low.

In essence, the principal (Grameen Bank) transfers much of the cost of assessing credit risk, monitoring behavior and projects, and ensuring repayment by each agent (borrower)

to the other agents in the group, for whom these costs are presumably lower due to their greater knowledge of their neighbors. An individual's reputation, in effect, serves as collateral, with peer pressure acting as the motivating force for good repayment behavior.

The Bank encourages fiscal discipline among its borrowers even to the point of requiring them to save and repay debts simultaneously. As an economic development organization, the Bank does not seek to maximize profits and in fact has traditionally lost money. Through partial subsidization of some projects, and through information campaigns, the Grameen Bank also encourages birth control, small families, education, better health and nutrition, and women's employment and empowerment.

A number of studies have tried to assess the developmental impact of the Grameen Bank, which now has branches in more than half of the villages of Bangladesh. These studies found that the Grameen Bank tends to raise average income in the villages where it operates. It has had a small, but positive, impact on child literacy, especially in the case of females, and a small positive impact in lowering malnutrition.

On the other hand, the Bank's financial viability so far has relied on its access to funds at below-market rates to sustain its high operating costs. Its low level of savings mobilization means that it has required continued capital infusions. To continue addressing the developmental challenges of rural Bangladesh, the Grameen Bank must also take steps to ensure its own long-run financial viability.

major products. Imports of capital goods and intermediate products increased by over 30 percent, reflecting robust industrial activities. Foodgrain imports rose by 128 percent due to inadequate domestic foodgrain production. As a result, the current account, including grants, showed a deficit in 1995 at \$152 million or 0.5 percent of GDP.

Although FDI in Bangladesh is still very low compared with that in its neighboring countries, the Government has made great efforts to attract foreign investment through several policy measures and incentives. As a result, FDI has increased from \$70 million in 1992 to \$202 million in 1993 and \$175 million in 1994. However, nearly one quarter of

FDI during these three years was for a single project – the Karnaphudi Fertilizer Company Limited (KAFCO). With the completion of this project, FDI declined to less than \$100 million in 1995. Many foreign investors appear to have deferred their investment decisions because of growing infrastructure constraints and political instability. Foreign exchange reserves built up in the year from \$2.8 billion in June 1994 to nearly \$3.1 billion in June 1995. External debt outstanding increased from \$16.6 billion in 1994 to \$17.5 billion in 1995. The debt-service ratio, however, declined from 15 percent in 1994 to 13 percent in 1995.

The strong growth in domestic demand and the expected large-scale food imports

could lead to a further surge of imports in the remainder of 1996 so that, for the year as a whole, import growth is expected to be about 20 percent. The growth of total exports, on the other hand, is estimated at only 12 percent in 1996, reflecting a slower pace of growth in exports of ready-made garments and a decline in exports of frozen shrimp, leather, and jute goods. Infrastructure bottlenecks, especially the shortage of warehouses and inadequate cargo handling and berthing facilities at ports, are major impediments to the rapid expansion of exports. Based on the above projections, the current account deficit is estimated to deteriorate further to about 2.8 percent of GDP in 1996. With a recovery of economic growth, merchandise exports are expected to increase by 18 percent in 1997. The increase in merchandise imports will, however, remain at 20 percent as food-grain imports drop, assuming production improves from the poor performance in recent years. The current account deficit is projected to decline to 3 percent of GDP in 1997; the debt-service ratio is projected to remain at the 1995 level of 13 percent.

### **Policy and Development Issues**

The major challenge facing Bangladesh is to promote socioeconomic development while pursuing sound macroeconomic management policies. During 1991–1994, the country was successful in maintaining a degree of macroeconomic balance, in improving social indicators, and in achieving some success in structural adjustment reforms. However, the recent worsening of macroeconomic conditions shows that structural adjustments are far from complete.

The restoration of a greater degree of macroeconomic stability than has recently been evident and a resurgence in the pace of structural reform must be high priority tasks if the Government is to make progress with the major development challenge of reducing poverty. On the fiscal side, the budget deficit needs to be rapidly reduced and this requires much stronger efforts to enhance tax revenue, especially through more efficient administration and collection procedures and review of charges for utility and other services. Public expenditure also needs to be more firmly controlled and its efficiency and effectiveness rigorously appraised. This applies to current expenditure, for

example, consumer and other subsidies, and particularly to expenditure on ADP projects, for which more effective efforts are needed to establish realistic priorities. Also, the program for privatizing the many government commercial enterprises has languished in recent times and needs to be approached with renewed resolution.

Private sector involvement in the development process has improved in recent years although it has a much greater role to play. A crucial factor in achieving such involvement is the development and reform of financial markets and the creation of conditions, such as stability and transparency of the regulatory environment, that encourage both domestic and foreign investments. The Government has announced a comprehensive package of incentives while it has also opened up new areas for private sector participation. However, these efforts have not yet attracted a large amount of foreign investment because of the absence of a stable political environment, inadequate infrastructure support, shortages of skilled labor, and cumbersome bureaucratic procedures for investment approval.

Financial sector reform has not yet proceeded very far beyond interest rate liberalization, the introduction of some new monetary instruments, and prudential requirements for banks. Further action is needed, particularly to strengthen financial discipline in the banking sector, in particular through improvements in the monitoring and supervisory functions of the Bangladesh Bank. Thoroughgoing reform is necessary, especially the privatization of the state commercial banks, not simply to enhance their efficiency and competitiveness but also that of the financial sector as a whole.

A competitive environment for increased private sector investment would be incomplete without improved physical infrastructure and other related services. Bangladesh's physical infrastructure suffers from underinvestment and severe operational problems. During the recent past, there has been some progress in natural gas supply, flood control, irrigation, and the water and sanitation sectors. However, serious deficiencies remain, among other things, in power generation and supply, provision of roads and telecommunications networks, and availability of port facilities where more investment is urgently needed. The involvement of private investment in these areas should be seriously considered.