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BANGLADESH
Quarterly
Economic
Update

March 2008

Asian Development Bank

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Asian Development Bank
March 2008

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NOTES

- (i) The fiscal year (FY) of the Government ends on 30 June. For example, FY2008 starts on 1 July 2007 and ends on 30 June 2008.
- (ii) In this report, "\$" refers to US dollars.

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MACROECONOMIC DEVELOPMENTS

Highlights

- Gross domestic product (GDP) growth is estimated at 6% in FY2008.
- The country is heading toward a bumper *boro* crop.
- Industry sector rebounds as indicated by uptrend in export-oriented manufacturing.
- Revenue performance improves after several years of poor performance.
- Large subsidies pose a significant fiscal challenge.
- Higher external aid flows and workers' remittances provide a cushion to the external balance.
- Bangladesh, a net importer of food grains, is seriously affected by food price shocks.

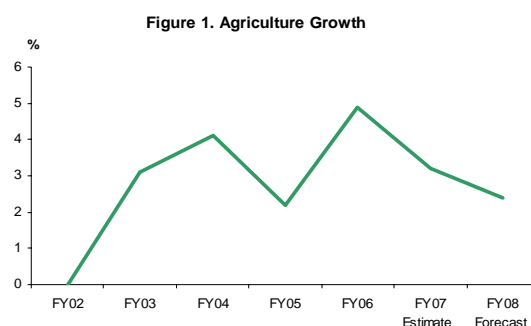
Sector Performance and Economic Growth

1. While severe floods, a cyclone, and low business confidence affected the economy during the first half of FY2008, the economy rebounded in the second half with timely and effective measures by the Government to restore business confidence and boost agriculture production. Although the *aman* crop was severely affected by the floods and cyclone, the country is heading toward a bumper *boro* crop. The industry sector rebounded as indicated by the uptrend in export-oriented manufacturing. The services sector is maintaining its growth momentum.

Agriculture

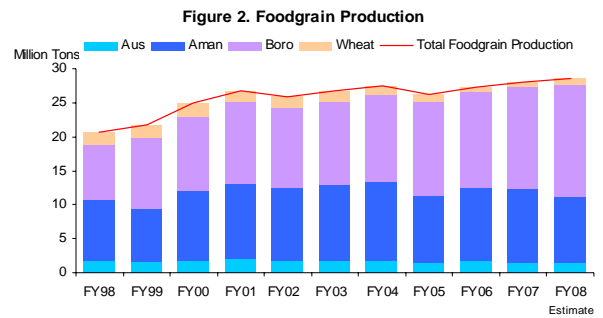
2. In FY2008, the agriculture sector faced a setback caused by disasters affecting crops, livestock, poultry, and fish farms. Sector growth in FY2008 is estimated at 2.4%, down from 3.2% in FY2007, mainly because of the adverse effects of the floods and cyclone (Figure 1). The domestic cost of rice production has increased even with subsidized agriculture inputs such as diesel and urea fertilizer.

3. *Aus*, the first rice crop of the fiscal year, was cultivated on 0.9 million hectares as in the previous year. Despite flood losses, *aus* production in FY2008 stood at 1.5 million tons, close to the actual FY2007 production. The second rice crop, *aman* (harvested during November–



January) was cultivated on 5 million hectares, less than the area cultivated in FY2007. Aman production was severely affected by the two devastating floods and cyclone. Production of aman rice is estimated at 9.7 million tons, 1.1 million tons lower than the preceding year (Figure 2). The effect of this on agricultural growth, food availability, and price was substantial with seasonality reinforced by successive floods and cyclone.

4. To compensate for the loss of the aman crop, the Government set the boro (harvested during April–May) production target for FY2008 at 17.5 million tons, 17% higher over the previous year’s actual production. The cultivation area was targeted at 4.5 million hectares, with 1.2 million hectares under the plantation of hybrid rice. Boro harvest has already started. The area targeted for boro cultivation was fully achieved. Boro production is expected to be 16.5 million tons, 10% higher than the preceding year. Several factors contributed to all time high boro production. Encouraged by higher prices of food grains and desperate need to recoup the aman loss, farmers across the country brought more land under boro cultivation. The yield is good due to the increase in land fertility following the floods and the weather remained favorable. The Government launched massive rehabilitation after the floods and cyclone to ensure adequate supplies of inputs, such as, credit, diesel, fertilizer, and seeds to farmers. Sugarcane, jute, and banana areas decreased; this land was used to plant boro rice. The number of irrigation pumps and area irrigated also increased.



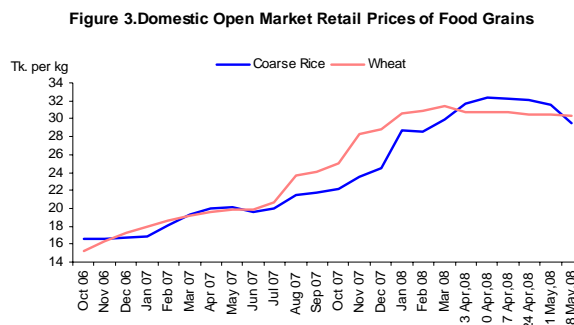
5. The present fertilizer distribution system needs to be improved to avoid delays in distribution and localized scarcity. The distribution system including production, import, and subsidization should be reviewed to ensure timely access of farmers' to this key input.

6. Production of other cereals, such as, wheat and maize, is promising. In FY2008, wheat is cultivated on 0.39 million hectares with estimated production of 0.83 million tons boosted by favorable weather conditions, particularly timely rain and prolonged winter season. The Department of Agriculture Extension conducted motivational programs for farmers and provided farmers with quality seeds, fertilizers, and necessary inputs to boost wheat production.

7. Among noncereal crops, potatoes, which could be a good supplement to the rice crop in the present food situation, was cultivated this year on 0.4 million hectares,

producing 6.6 million tons, 28.6% higher than the previous year due to favorable climatic conditions and timely supply of fertilizer. But inadequate cold storage capacity is depriving the growers of fair prices. Moderate growth is expected in the production of other noncereal crops, such as oilseed, jute, vegetables, and sugarcane.

8. Bangladesh, a net importer of food grains, has been seriously affected by food price shocks, driven by higher international prices and domestic production shortfall following successive natural disasters (paras. 45–61). Although upward price pressures somewhat eased by early May 2008, the prices of rice and wheat in the domestic market are still 50% higher than in FY2007 (Figure 3). The Government's selling price under open market sale was Tk25/kg as against the import cost of Tk30/kg. Since FY1991, food-grain production rose by 2.5% or 0.5 million tons a year. But food security remains elusive, particularly in years when production is affected by natural disasters. The food deficit remains sizeable, estimated at 0.34 million tons in FY2008. Although larger imports more than offset the food-grain production shortfall following the natural disasters, prices in the domestic market soared because of higher international prices. Despite a bumper boro crop, risks of a supply shortage are possible if the next aman and boro crops are affected by natural disasters or other factors. To deal with any possible food shortages in the coming monsoon or later, the Government is planning to build a stock of about 2 million tons of food grains under the public food grain distribution system.



9. Over the short-term, the focus of policy responses should be on targeted interventions to protect the poor and vulnerable in the face of rising food prices. With targeted support to the poor rather than general price subsidies, the Government will be able to ensure better coverage, free up resources, and minimize distortions in incentives for farmers. Over the medium to longer term, the focus should be on improving productivity by disseminating modern production technologies, developing rural infrastructure including reliable and expanded irrigation systems, providing extension services, improving marketing, producing quality seeds through public-private partnerships, and extending rural financial services.

Industry and Services

10. During the first half of FY2008, the industry sector was affected by sluggish investment and low export-oriented manufacturing activity. Erosion in business

confidence and slowdown in external demand for garments affected manufacturing. But in the second half of FY2008, the industry sector is rebounding as indicated by the uptrend in export-oriented manufacturing with effective measures taken by the Government to restore business confidence.

11. Measured by quantum indices, output of medium- and large-scale manufacturing rose sharply by 16.7% in January 2008 over the same month of the previous year, with average growth of 5.6% in the first 7 months (July–January) of FY2008 compared with the same period of FY2007 (Figure 4). The output of small-scale manufacturing, which caters mostly to the domestic market, expanded by 7% in the first half (July–December) of FY2008 over the same period of the previous year (Figure 5). Evidence of recovery in manufacturing activities is supported by increased imports of industrial raw materials, rebound in exports of garments, and increased private sector credit.

12. After a slowdown over several months, garment exports sharply rebounded in the third quarter of FY2008. This pulled up the overall export earnings growth to 12.4% during July–March of FY2008 (Figure 6). The comeback of the premier export industry, which makes up more than 75% of the country’s export basket, provided a major relief for the business community and other stakeholders (Figure 7). Improvements in compliance and labor relations, return of business confidence, and appreciation of currencies in major competing countries including India, People’s Republic of China (PRC), and Viet Nam are believed to be contributing to rising orders in Bangladesh.

13. The imposition of safeguard quotas (set to expire in 2008) by the European Union and United States (US) on shipments of textile and clothing products from the PRC provided Bangladesh with an opportunity to maintain growth and increase market share in these major markets. Despite intensified competition, Bangladesh successfully established itself as a globally competitive supplier of apparel products.

14. Although the PRC is a strong competitor in world markets, this does not preclude other developing nations like Bangladesh from succeeding. Over the years Bangladesh has attained increasing market share, and along with other Asian suppliers is finding niche markets where it does not necessarily have to compete head-to-head with suppliers from the PRC. Moreover, PRC suppliers of textiles and accessories play a complementary

Figure 4. Growth of Medium & Large Scale Manufacturing Production (Base: 1988-89=100, year-on-year)

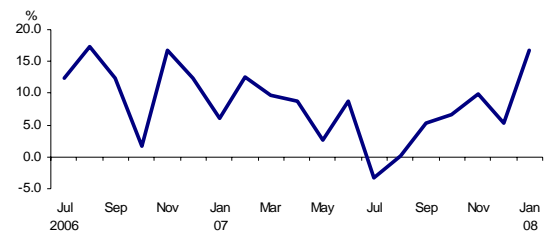


Figure 5. Quantum Index of Small Scale Manufacturing Production (Base: 1995-96=100)

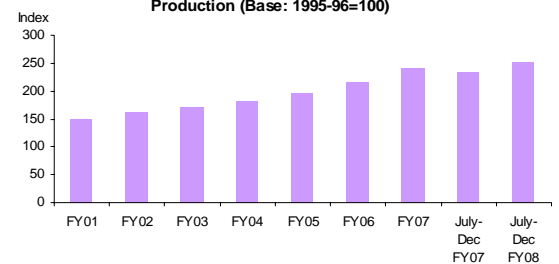


Figure 6. Growth in Exports

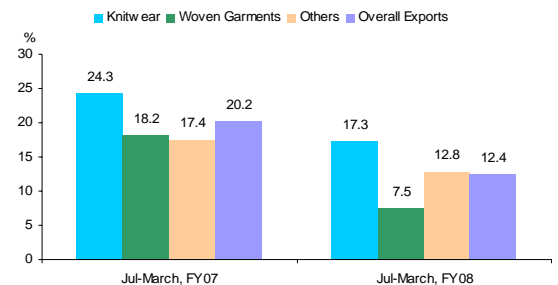
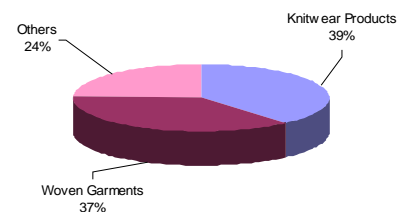


Figure 7. Share of Exports (Jul-Mar FY08)



role by providing Bangladesh with quality low-cost inputs that allow it to compete successfully in third country markets. Although Bangladesh is a major exporter of apparel, it owns limited textile production capacity, which restricts the real potential of the industry. India, Indonesia, Malaysia, Pakistan, and Thailand have significant capacity in textiles as well. But outward processing arrangements within the region have not materialized because of a general lack of initiatives and other barriers.

15. Complementary production-sharing relationships within South Asia could enhance its competitiveness in advance of the removal of safeguards on the PRC. The withdrawal of the textile safeguard quota on the PRC poses some risk for Bangladesh as the PRC has developed large and modern capacity to produce almost all categories of apparel products at highly competitive prices. It owns strong backward linkage and research and development facilities that are difficult to match. Bangladesh still depends on low-cost labor as its core competency. The woven industry relies heavily on imported fabric, which increases delivery times. The PRC exceeds Bangladesh in business-enabling infrastructure including power, transport, and other logistic support, which gives its producers an extra advantage.

16. Frequent power failure is a critical issue for the garment industry. While building and upgrading power plants can take years, the country must consider using energy more efficiently as a short-term solution. A recent study by German Development Cooperation (Deutsche Gesellschaft für Technische Zusammenarbeit) on energy efficiency finds that energy is one of the most costly inputs of the production process, accounting for about 20% of the final product cost. Most enterprises in Bangladesh use energy inefficiently because of lack of awareness and technical expertise. Energy consumption in a typical garment factory is predominantly divided between sewing operations and lighting. Lighting is important for productivity and working conditions as it directly affects visibility and product quality. Using energy-efficient lighting (e.g., using electronic ballasts instead of magnetic ballasts) can significantly conserve energy. The study estimates that an industrywide switch to electronic ballasts could save up to 75 megawatts of load demand. Although implementing this scheme will require up-front expenditure, a full return on investment can be expected in 1 year from significant power savings and reduced heat emissions. Given increasing global concerns for the environment, Bangladesh must start paying attention to ecological

efficiency to meet emerging compliance issues and remain competitive.¹

17. Construction, which maintained strong growth over past years, is likely to show a downtrend in FY2008 because of a sharp increase in the price of construction materials including mild steel rod, cement, brick, bitumen and paint. Increased costs of raw materials contributed to the higher prices of key construction materials, creating an adverse impact on construction activities. A vibrant construction subsector contributes to the economy in terms of employment generation and production of goods and services. Any setback has a direct impact on the economy and employment of many workers. Many residential plot owners and developers postponed construction of houses and/or apartments because of higher prices of construction materials. Rising prices affected implementation of the Government's annual development program (ADP). The Government has decided to adjust prices of construction materials, which inflated project costs beyond previous estimates. It will pay compensation to contractors on construction materials, such as mild steel rods, steel materials, bricks, and bitumen, which will exert additional pressures on the ADP spending.

18. The growth in services has picked up and is continuing its past growth momentum. The volume of cargo (export and import together) handled by Chittagong Port and bank advances to the trade and transport subsectors trended up significantly. Other indicators, such as postflood and postcyclone reconstruction, continued strong growth in workers' remittances, rapid growth in the mobile phone market (paras. 62–83), and healthy signs in aviation industry (Box) indicate steady growth in services activity.

¹ Deutsche Gesellschaft für Technische Zusammenarbeit. Eco Efficiency through Energy Efficient Lighting System: National Stakeholders' Seminar. 2008. Dhaka.

Box: Aviation Industry

Bangladesh is experiencing a rapid increase in aviation and tourism activity. Labor migration and workers' remittances are rising sharply, and arrivals of tourists and expatriate professionals are increasing. As a result, demand for air transport is increasing. The aviation industry, which was once dominated by a state-owned monopoly, has gathered much participation and investment from private sector operators. Biman Bangladesh Airlines, the national airline, started operations in 1972 and remained the sole operator for about two decades. But it now faces heavy competition as several private companies entered the market since the late 1990s.

Biman remains the largest airline of the country. It flies to about 18 international destinations—major cities in Asia, the Middle East, and Europe—and several domestic destinations. It operates with a fleet of four wide-body DC10-30s, three midrange Airbus A-310-300s, and four F-28 regional jets.^a Biman recently decided to procure several wide-body Boeing aircrafts, including Boeing 777s, within the next few years; this entails investments of over a billion dollars. The Government restructured Biman into a public limited company to increase management efficiency and gradually release it from state-ownership by selling shares through the capital markets. The Biman board of directors was restructured. If the airline can be successfully privatized and put under full commercial management it will ease a significant portion of the Government's budgetary burden and may eventually turn the airline into a commercially viable company. Because of inefficient public sector management, the airline has been a major loss-making state-owned enterprise. High maintenance costs for old aircrafts, inefficient staffing and operations, lack of transparency and accountability, and a general absence of commercially competitive drives are some of the major reasons for its accumulated losses over the years. The rise in oil prices aggravated the situation for Biman, which owes huge payments to Bangladesh Petroleum Corporation (BPC) for fuel. These overdue credits are a major concern for BPC, which is another major loss-making state enterprise responsible for importing petroleum products.

Among the private sector companies, GMG Airlines, which commenced operations in 1998, is the largest. In addition to domestic routes, it flies to several international destinations including Bangkok, Kolkata, New Delhi, Dubai, Katmandu, and Kuala Lumpur; and plans to expand its network to other Asian and Middle-Eastern nations and to the United Kingdom (UK).^b The airline operates with a fleet of seven aircrafts; and recently entered into a billion dollar agreement to buy several large Boeing aircrafts to support the expansion. Several other carriers entered the market in the past few years including Aviana Airways, Best Air, and United Airways. Best Air, which started domestic cargo operations in 1999, obtained a passenger service license in 2006 to operate domestic and international flights. The company's international destinations will include major cities in Asia and the Middle East; followed by Europe and US at a later stage. The increasing number of labor migrants has created huge opportunities for aviation companies. But because of daunting capital needs, fees, and regulatory burden, many of the carriers are unable to operate on a full scale.

Bangladeshi operators that operate internationally or intend to enter the market face ruthless competition from large international carriers with much greater resources and more efficient management. Major airlines that travel to Bangladesh include British Airways, Emirates, Gulf Air, Indian Airlines, Malaysia Airlines, Qatar Airways, Saudi Arabian Airlines, Singapore Airlines, and Thai Airways. With so many competitors, new carriers will have difficulty gaining significant market share unless they develop a sound business plan and generate some comparative advantage. As huge up-front investment is required in this business, strategic focus areas must be developed before committing resources. With the increase in labor migrants from Bangladesh, the demand for international flights has been rising. Many passengers have to be waitlisted or delayed because of inadequate flights, particularly to the Middle East. New local carriers could cater to this market, provided they maintain competitive pricing and service.

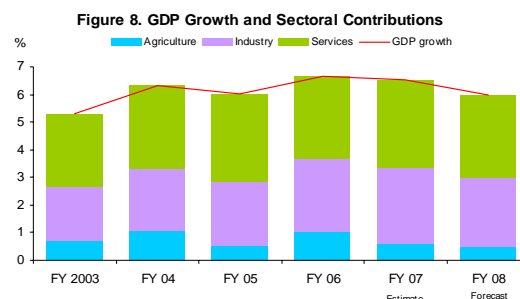
Aviation activities are currently supported by three international and five domestic airports. Civil Aviation Authority of Bangladesh (CAAB) functions as the regulatory body for all aviation-related activities in Bangladesh. It is also the aeronautical service provider, air traffic controller, and custodian of all airfields and air navigation facilities. With the entry of several private sector carriers, CAAB needs to maintain operations that provide public and private operators with equal opportunities. In this difficult and competitive line of business, companies need to be provided full regulatory support; otherwise the industry may not grow to its full potential. Several short takeoff and landing airports exist in remote locations of the country, but are not in service. These facilities may be developed for domestic operations. This will boost air transport connectivity and generate better business and investment opportunities in those regions. A new domestic airport is under construction in Bagerhat in the southwestern region.

^a Biman Bangladesh Airlines. 2008, 19 March. Available: www.bimanair.com.

^b GMG Airlines. Information. 2008, 19 March. Available: www.gmgairlines.com.

Economic Growth

19. GDP is expected to grow by 6% in FY2008, down from 6.5% in FY2007 because of moderating agricultural growth following the extensive flooding and cyclone (Figure 8). The fear and uncertainty among the investor community, apparently created by the Government's comprehensive anticorruption drives, have started to ease. But the country faces several downside risks in its near- to medium-term prospects. These include political uncertainty in the lead up to the general elections scheduled by the end of December 2008 and infrastructure constraints. Weak infrastructure, including serious power shortages and transportation bottlenecks, hamper investment, exports, and transport integration with its neighbors. Bangladesh's vulnerability to natural disasters also poses a risk. Externally, volatility in oil and food-grain prices poses significant risks.



20. Despite these challenges, Bangladesh has the potential to grow by 7% or more a year. A major global report identified 13 emerging economies including Argentina, Bangladesh, Egypt, Iran, Malaysia, Nigeria, Pakistan, Philippines, Poland, Saudi Arabia, South Africa, Thailand, and Viet Nam as having the potential to grow significantly faster than the established Organization for Economic Cooperation and Development countries.² It concludes that long-term prospects for these countries are upbeat in addition to major emerging economies including Brazil, India, Indonesia, Mexico, PRC, Russian Federation, and Turkey.

21. The report projects real annual GDP growth rates for Bangladesh during 2007–2050 at 7% in dollar terms. Although Bangladesh is projected to be the smallest of the economies considered in 2050 because of its very low starting point in terms of average income, it has high potential. Projections for Bangladesh are contingent on avoiding major natural disasters, notably those associated with long-term rising sea level due to global warming. The country will need to accelerate the pace of technological progress to catch up with other countries.

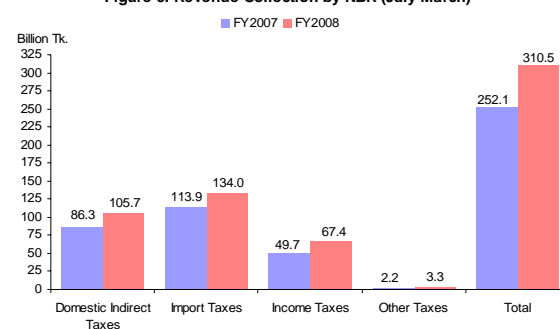
22. The global center of economic activity is already shifting to India, the PRC, and other large emerging economies; this trend is likely to continue. Bangladesh must make all efforts to capitalize on its comparative advantages to benefit from this global paradigm shift.

Fiscal Management

23. Revenue improved after several years of poor performance. But large subsidies for fuel and fertilizer, and flood and cyclone rehabilitation expenditures pose significant challenges in fiscal management. Government revenue collection by the National Board of Revenue (NBR) rose by 23.1% in July–March FY2008 over the corresponding period of FY2007 (Figure 9). Sustaining this improvement will depend on the rebound of private sector activity, and strengthening of tax administration. The focus should be on improving the tax system including streamlining and simplifying laws, broadening the tax base, and reducing tax exemptions and evasion.

24. Import-based taxes during July–March FY2008 grew by 17.7%, underpinned by customs duty (7.7%), value-added tax (26.1%), and supplementary duty (42.8%)

Figure 9. Revenue Collection by NBR (July–March)



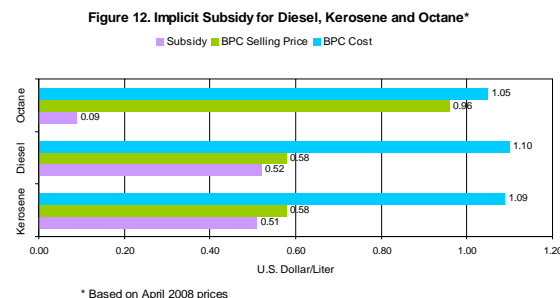
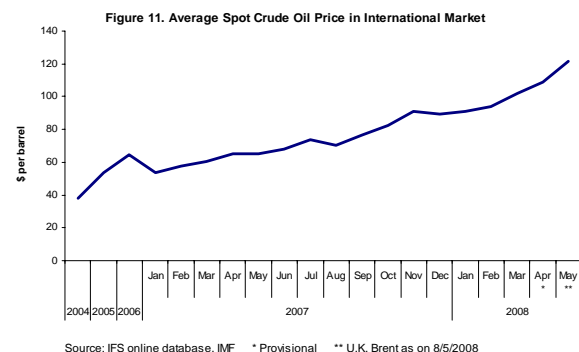
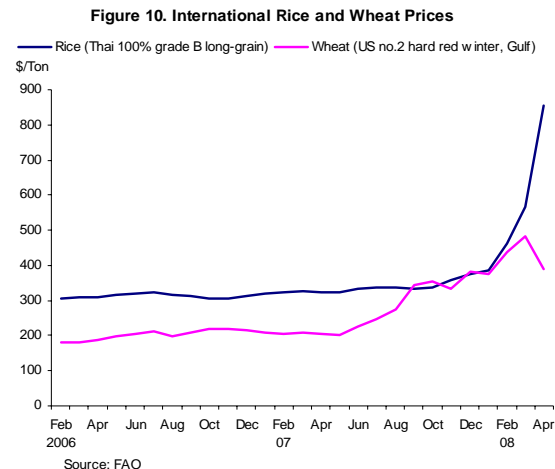
² PricewaterhouseCoopers. 2008. *The World in 2050: Beyond the BRICs: A Broader Look at Emerging Market Growth Prospects*.

collection at the import stage. Reduction or exemption of customs duty on some imported food items, mainly rice, wheat, and edible oil, continues to moderate the growth of customs duty collection. Domestic indirect taxes grew by 22.4% during the same period, driven by value-added tax (19%) and supplementary duty (28.3%).

25. Income tax collection posted robust growth of 35.6% in July–March FY2008. Tax-reform efforts including intensive supervision and monitoring, provision of an opportunity for a limited period to legalize undisclosed income with a penalty on top of the normal tax rate, and concerted drives against tax evasion sustained momentum in income tax collection. But the tax laws have fundamental structural weaknesses, including extensive tax incentives and exemptions. These issues need to be addressed in tax legislation to establish a simple and transparent tax system.

26. The fiscal deficit in FY2008 is likely to increase to 4.8% of GDP compared with 3.2% in the preceding year. Pressures on the fiscal balance increased because of flood and cyclone relief and rehabilitation expenditures; and a sharp rise in subsidies following the rise in fuel, fertilizer, and food-grain prices in international markets (Figure 10). Administered prices of fuel and fertilizer continue to generate substantial fiscal and quasi-fiscal cost to the Government. Prices of oil in international markets reached over \$120/barrel at the beginning of May 2008 (Figure 11). But the Government has not raised domestic prices after the last adjustment of 21% for diesel and kerosene and about 16% for octane and petrol in April 2007. It increased the price of domestic compressed natural gas from Tk8.5/cubic meter to Tk16.8/cubic meter at the end of April 2008. BPC's liabilities to four state-owned commercial banks (SCBs), Islamic Development Bank, and Bangladesh Bank including Customs Authority and Gas Fields amounted to \$1.6 billion in mid-April 2008. If BPC fails to meet these obligations, the Government is liable for them. Based on the average domestic and international prices of diesel, kerosene, and octane at the end of April 2008, the implicit subsidy for diesel is \$0.52/liter, for kerosene \$0.51/liter, and for octane \$0.09/liter (Figure 12). BPC's loss in FY2008 is estimated at \$1.1 billion.

27. Food subsidies, because of higher international prices and domestic production shortfall, amplified fiscal pressures. The fertilizer subsidy is increasing the fiscal burden with a sharp rise in urea prices in international markets. The fertilizer subsidy in FY2008 is estimated at \$700 million. Food subsidies including on inputs of



production, such as diesel and fertilizer are estimated at \$1.3 billion or 1.7% of GDP in FY2008. With a focus on targeted food subsidies rather than general price subsidies, the Government will be able to ensure better coverage as well as free up resources and minimize distortions in the incentives for farmers.

28. The FY2008 budgeted outlay for the ADP has been slashed to Tk225 billion from the projected Tk265 billion. Greater scrutiny of projects following the anticorruption drive; sharp rise in the cost of construction materials; successive natural disasters; and higher than expected current expenditures, including large subsidies, undermined implementation of the ADP (Figure 13). The Government adopted new guidelines, including procurement time limits for projects, to speed up implementation and bring qualitative changes in the ADP. The Government also decided to compensate contractors for the increased price of construction materials (para. 17).

Monetary and Financial Developments

29. Broad money growth declined to 15.2% in February 2008, down from 20% in February 2007 (Figure 14). This was caused by a decline in the growth of domestic credit to 16.7%, mainly credit to the Government (16.5%). But private sector credit growth increased to 19.6%, showing significant pickup in credit to trade and industry sectors (Figure 15). The net foreign assets of the banking system increased by 30.2% because of the continuous increase in workers' remittances. The growth of reserve money fell to 9.3% from 27% over the same period, caused by a sharp decline in net domestic assets of the central bank. Outstanding stock of Government treasury bills, bonds, and national savings directorate certificates stood at Tk751.9 billion at the end of March 2008 up from Tk644.5 billion at the end of March 2007.

30. Bangladesh Bank continues to maintain an accommodative monetary policy stance allowing sufficient room for projected FY2008 budget financing and private sector recovery without accelerating inflationary pressures. The major policy rates and reserve requirements remain mostly unchanged. The weighted average yield of 28-day treasury bills has remained stable at 7.3% since December 2006 (Figure 16). Reverse repo (repurchase agreement) rates for 1–2 day maturity remain unchanged at 6.5% since October 2006, up from 6% in June 2006. Despite excess liquidity in the banking system of Tk134.9 billion at the end of February 2008, some banks faced liquidity shortage in recent months reflected by the repo auctions for 1–2 day

Figure 13. ADP Implementation (July-March)

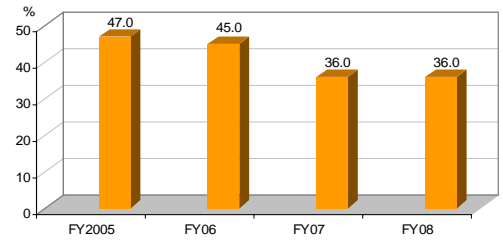


Figure 14. Growth of Broad Money & Domestic Credit

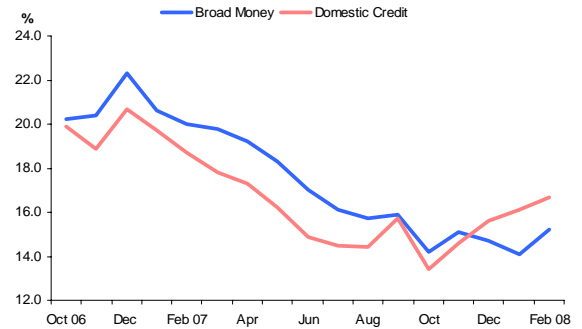


Figure 15. Growth of Domestic Credit Components

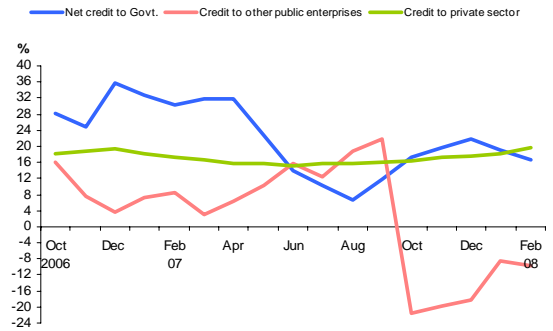
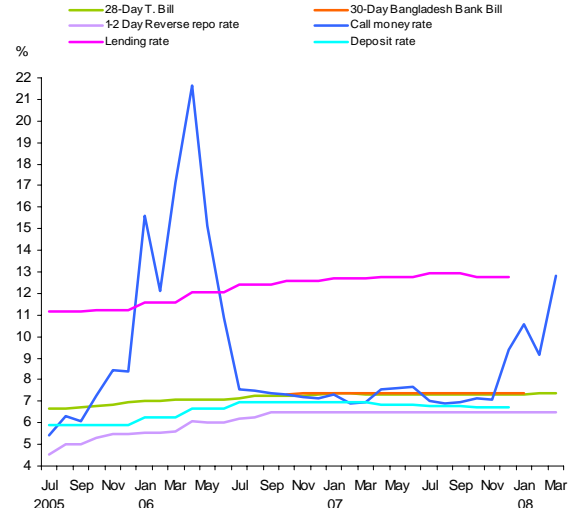


Figure 16. Selected Interest Rates



maturity since December 2007. Increased monitoring of the day-to-day liquidity position in the money market by the central bank helped the call rate to decline to 9.2% in February 2008 from 10.6% in January 2008. But in March, the rate again increased sharply to 12.8% because of the liquidity problem of some banks and reflected again by the repo auctions for 1–2 day maturity.

31. Gross nonperforming loans (NPLs) of all banks remained almost unchanged (13.2%) at the end of December 2007 compared to the end of December 2006 (Figure 17). But the NPLs of SCBs at 29.9% and specialized banks at 28.6% remained high because of frequent government interventions and lack of efficiency and competitiveness. The risk-weighted capital asset ratio (RWCAR) for all banks increased to 7.4% in December 2007 from 5.3% in December 2006. The RWCAR of SCBs was minus 7.2%, compared with the needed 10%. All other banks met the needed RWCAR. Profitability measures for banks, namely, the return on assets ratio, improved while the return on equity ratio marginally deteriorated (figures 18 and 19).

32. Disbursement of industrial term lending by banks and nonbank financial institutions gained momentum in the first half of FY2008 with growth of 64.8% over the corresponding period of FY2007 (Figure 20). Bank advances show significant growth in credit for transport and communications, trade, industry, and working capital financing during January–March FY2008 compared to January–March FY2007 (Figure 21).

33. The weighted average lending rate was 12.8% at the end of December 2007. The weighted average deposit rate remained at 6.8% and is likely to continue negative values in real terms because of rising inflation. The interest spread of the banking system remained high at 6% showing banking system inefficiencies and market segmentation, which needs to be contained.

34. Bangladesh Bank continues its efforts to lower lending rates, increase competition among the financial intermediaries, raise institutional banking efficiency, and strengthen regulation and supervision to withstand any setback. While the primary market for government securities has improved, development of the secondary market is necessary for a broader bond market. Restructuring and divestiture of four SCBs proceeded slowly and the sale of Rupali Bank (one of four SCBs) has been canceled as the highest bidder remained unresponsive.

Figure 17. Gross Nonperforming Loan Ratios by Type of Bank

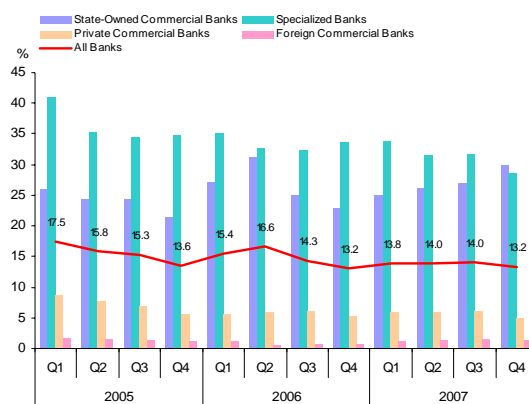


Figure 18. Return on Assets of Banks

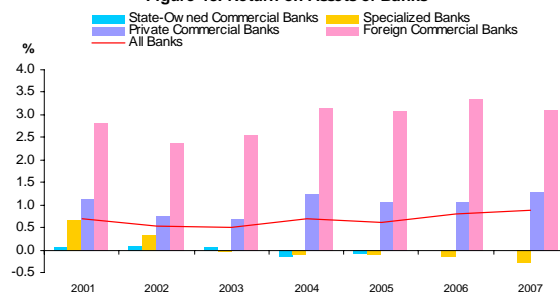


Figure 19. Return on Equity of Banks

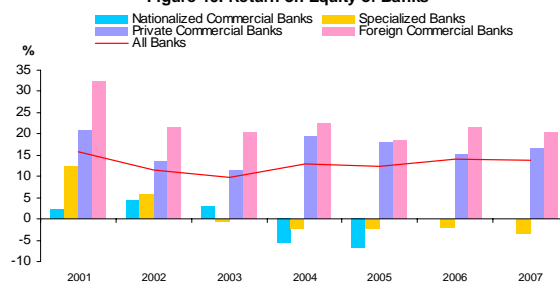
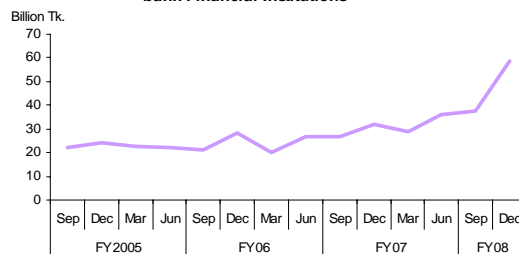


Figure 20. Disbursement of Term Loans by Banks and Non-bank Financial Institutions



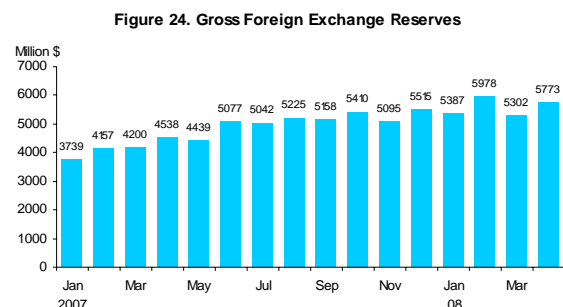
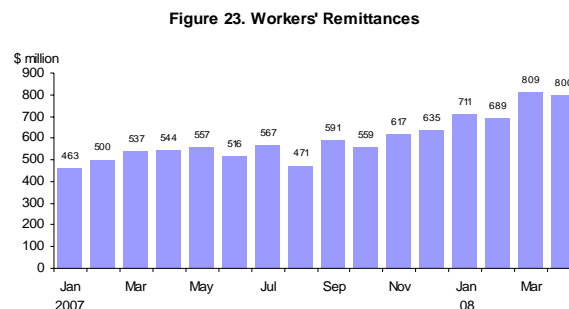
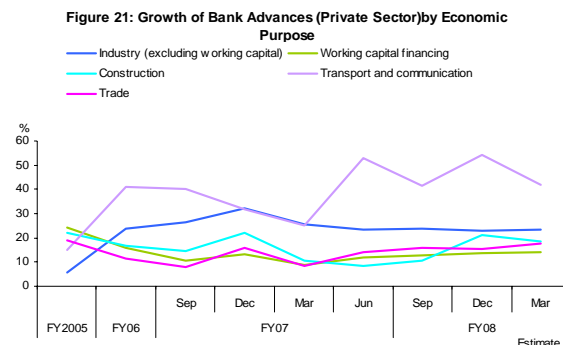
Balance of Payments

35. Exports rebounded with the recovery in garment exports. Growth in total exports during July–March FY2008 reached 12.4%, driven by woven garments and knitwear with a 76% share of total exports (Figure 22). Despite potential, the share of other products such as frozen foods, leather, raw jute, and jute goods remains limited.

36. Imports during July–February FY2008 rose sharply by 21% over the corresponding period of FY2007. This was underpinned by higher imports of food grains, other food products, and consumer and intermediate goods. Based on opening of letters of credit during July–March FY2008, imports grew by 36.1% compared with the same period of the previous year, and imports of food grains increased substantially. Imports of other consumer products, intermediate goods, industrial raw materials, and capital machinery increased.

37. Higher import bills amplified by rising international commodity (fuel and food) prices, pushed the trade deficit to \$3.2 billion during July–February FY2008, up from \$2.1 billion during July–February FY2007. Despite a surge in the trade deficit, a sharp rise in current transfers, particularly workers' remittances, resulted in a surplus of \$328 million in the current account. The surplus in the overall balance (including sizable negative errors and omissions) lowered to \$222 million during July–February FY2008 because of a deficit in the financial account. Higher external aid flows and workers' remittances provided a cushion to the external balance in the face of rising food-grain and fuel prices. The workers' remittances posted record growth of 31.5% during July–April FY2008 (Figure 23). Higher remittances are helping expatriates' family members mitigate hardships arising from the food-price upsurge. But sustaining the growth in workers' remittances requires improved remittance processing through legal channels and exploring diplomatic channels for increasing human resource exports including the migration of more semiskilled and skilled labor.

38. Although pressures on the current account are mounting, the foreign exchange reserve increased to \$5.8 billion at the end of April FY2008, up from \$5.1 billion at the end of June FY2007 (Figure 24). Higher net foreign aid receipts of \$765.4 million during July–February FY2008 compared with \$181.4 million in the corresponding period of FY2007 helped the buildup of foreign exchange reserves.



Inflation and Exchange Rates

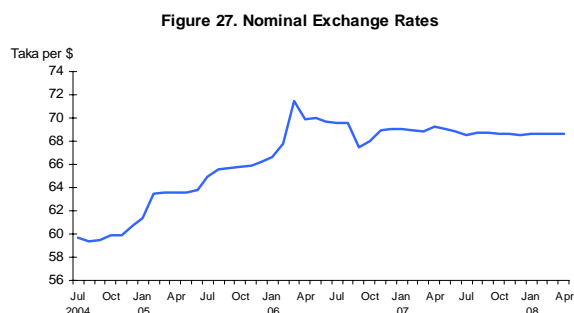
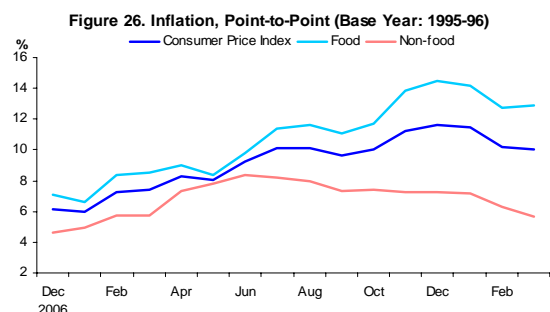
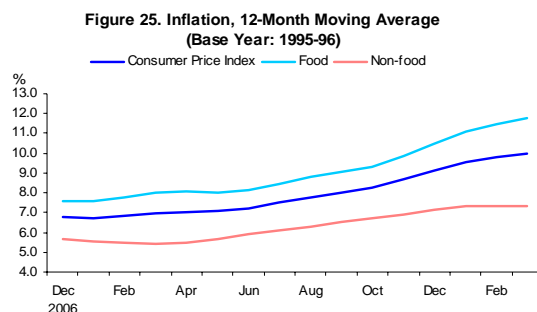
39. Higher international food and nonfood commodity prices and shortfall in domestic food-grain production heightened inflation. Bottlenecks in the distribution and retail management chain, monetary accommodation of previous years, hoarding, and panic buying also pushed inflation higher. On an annual average basis, the inflation rate reached 10% in March 2008, up from 7.2% in June 2007 (Figure 25). Food inflation increased to 11.8% from 8.1% during this period. But on a point-to-point basis, inflation marginally eased to 10.1% in March 2008 from 11.6% in December 2007 (Figure 26). Rapidly growing prices, especially for food, seriously eroded the purchasing capacity of people not only those living below the poverty line but also government employees, industrial workers, and others with fixed incomes. Curbing inflation remains a major challenge.

40. With large foreign exchange reserves, Bangladesh Bank continues to maintain the taka value stable against the dollar in the interbank market by increasing the supply of dollars. The weighted average nominal exchange rate remained stable at Tk68.6:\$1 since November 2007 (Figure 27). This is helping dampen inflationary pressures partly by cutting import costs, especially for food items.

Capital Market Update

41. The capital market registered a bullish trend during the first quarter of 2008—turnover remained strong while share prices rose. The Dhaka Stock Exchange (DSE) General Index scored 3,016.4 points at the end of March 2008; while the capitalization to GDP ratio reached 16% (Figure 28). Chittagong Stock Exchange followed a similar trend during this period—highlighted by a 13% increase in market capitalization and 11% increase in selective categories index between January and March (Figure 29). The market was largely driven by strong investor demand for shares, including some rise in demand from foreign portfolio investors.

42. Investors Chronicle, a UK-based market and investment research organization, in a recent report, short-listed Bangladesh as one of the important emerging markets with the potential to attract more foreign investment. The other emerging markets, according to the report, are Egypt, Kazakhstan, Nigeria, Pakistan, Ukraine, and United Arab Emirates (UAE). The report predicts a large inflow of global funds into the \$12 billion stock market that is expected to exceed \$15 billion by mid-2008 as more



initial public offerings (IPOs) and privatizations occur.³ Although market capitalization to GDP remains low in Bangladesh by emerging markets' standards, the combination of reforms and rapid selling of state enterprises is spurring interest. International investor participation is growing fast. The report forecasts strong economic growth to continue, but underscores the need for diversification of manufacturing and investments in infrastructure.

43. The outlook of the market can be bolstered by creating an enabling environment for quality IPOs. The main impediments to increasing the number of new listings are the inefficient pricing mechanism, owners' concern over poor corporate governance, and high cost of listing. For primary market development, the IPO approval process and pricing methods need to be improved, and the capacity of merchant banks enhanced. The legal framework for corporate mergers and acquisitions also needs to be brought in line with international best practice. Relaxing margin lending, and borrowing and lending of securities; and introducing other products can increase market participation. Financial sector development is critical to support sustained growth. The primary market for government securities has improved significantly, but development of the secondary market is necessary for a broader bond market that is needed to finance growth.

44. Despite recent improvements, market supervision and capacity of major market players including stock exchanges, brokers, dealers, and asset managers remain low. DSE's recent upgrading of the automated trading system to double its capacity was an encouraging move. But there are not enough securities, products, and services; transparency is inadequate both in trading and in the quality of information provided for listed companies; and the introduction of technology to support market infrastructure has been slow. Strengthening the capacity of the regulator and market participants is a prerequisite for comprehensive capital market reforms. The Securities and Exchange Commission must improve its capacity to carry out its operating and development mandates. It remains understaffed; and existing staff are poorly trained. Remuneration and career progression constraints make attracting and retaining competent candidates difficult. Recent global financial market turmoil has had only a small impact on Bangladesh because of its limited linkages with international financial markets. But as the economy

Figure 28. Dhaka Stock Exchange: Market Capitalization and General Index

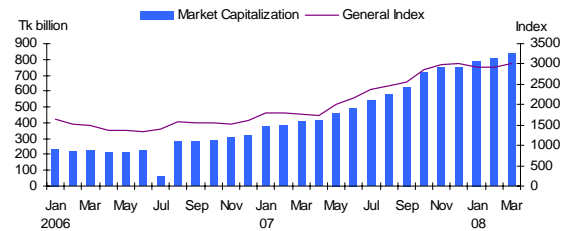
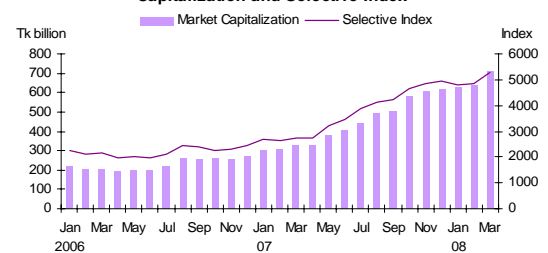


Figure 29. Chittagong Stock Exchange: Market Capitalization and Selective Index

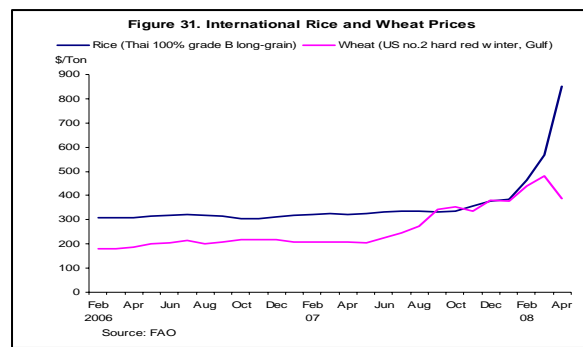
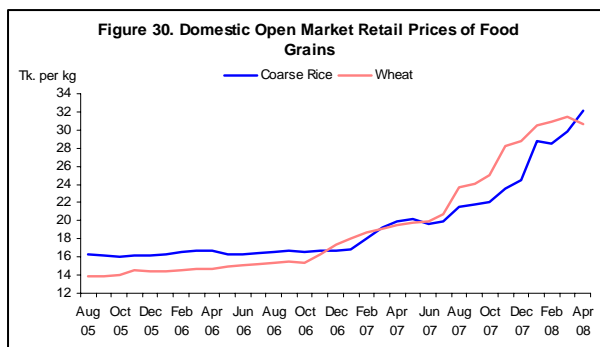


³ Investors Chronicle. 2008, 24 March. Available: www.investorchronicle.co.uk.

develops, financial markets will become increasingly integrated and exposed to global markets. Therefore supervisory and regulatory capacity must be improved to keep pace with global developments. The management of the stock exchanges needs strengthening to regulate and supervise members' activities effectively. Trading and surveillance systems and standards must be up-to-date and compatible with international benchmarks.

RISING FOOD PRICES: IMPLICATIONS AND POLICY RESPONSES

45. Food prices in international and domestic markets have reached all-time highs (figures 30 and 31). Over the past year, the price of rice in the international market rose by 165% (from \$322/ton in April 2007 to \$853/ton in April 2008). Wheat prices in the international market rose by 89% (from \$206/ton in April 2007 to \$389/ton in April 2008). In the domestic market, the price of rice increased by 61% to Tk32.1/kilogram (kg) in April 2008 from Tk19.9/kg in April 2007, while the price of wheat increased by 56% to Tk30.6/kg from Tk19.6/kg over the same period. Prices of all other major food commodities surged in the international and domestic markets. Soaring food-grain prices caused serious concern around the globe. In Asia, about 1.2 billion poor people have been seriously affected. The eroding of their purchasing power places them at greater risk of hunger and malnutrition. In many countries, soaring food prices are undermining the gains in poverty reduction and can push large numbers of people back below the poverty line.



46. Falling stocks, increased demand, high energy and fertilizer prices, steep depreciation of the dollar, and trade restrictions imposed by some countries amplified the price surge of food grains. In the face of a shortfall in production, attempts to build stocks heightened price pressures. Though some of the cyclical factors, such as weather-related impacts, are likely to fade, strong structural factors are pushing up prices of food and these have some mutually reinforcing effects. The era of cheap food prices appears to be over, and the world has stumbled upon an era of scarcity. Food-grain prices are expected to moderate somewhat eventually because of the supply response of farmers. But the structural factors are likely to dominate cyclical factors causing high prices to persist for the foreseeable future.

Underlying Causes of Rising Food Prices

47. Cyclical factors, such as, unfavorable weather conditions, mainly droughts and flooding, contributed to production shortfall in some countries. Recent financial market turmoil also exerted a cyclical effect. Investors turned to commodities with higher expected rates of return in contrast to poor returns from equities, bonds, and money market instruments. Depreciation of the dollar against currencies of major Asian rice exporters contributed to raising dollar prices. Precautionary demand for food stocks in many countries is contributing to food-grain price rises as private traders and public agencies replenished stocks of rice and wheat. Major rice exporters, such as, the PRC, Pakistan, India, and Viet Nam, have banned or restricted rice exports, contributing significantly to the surge in rice prices.

48. Structural factors are much more prominent in explaining the rise in food-grain prices. World rice and wheat stocks are now about 200 million tons, down from 350 million tons in

2000. Over the past years, production growth of food grains failed to keep pace with the growth in consumption, contributing to dwindling global food-grain stocks. Growth in yields slowed significantly. The surge in energy prices, driven by structural factors, with resultant rise in prices of fertilizers, irrigation pumps, and transportation costs fed into the production cost, further raising the food-grain prices.

49. Urbanization and competing demand for land for commercial as opposed to agriculture purposes and growing scarcity of fresh water for agriculture adversely affect production growth. The diversion of cereal use from food to produce biofuel also contributed to the food crisis. Rising income in emerging countries steadily increased demand for food-grain consumption. With higher income, the demand for meat and dairy products increased. Production of meat and dairy products requires large amounts of grain for livestock feed. In many countries, policy inadequacies, weak institutions, and lack of needed investment inhibited the growth of the agriculture production.

Food Price Shocks in Bangladesh

50. Bangladesh, a net importer of food grains, has been seriously affected by food price shocks, driven by higher international prices and domestic production shortfall following successive natural disasters. Although upward price pressures somewhat eased by early May 2008, the prices of rice and wheat in the domestic market are still 50% higher over the past year.

51. Since FY1991, annual food-grain production in the country rose by 2.5% or 0.5 million tons. But food security remains elusive, particularly in years when production is affected by natural disasters. The food deficit remains sizeable, estimated at 0.34 million tons in FY2008 (Table 1). The severe flooding and cyclone during the first half of FY2008 seriously affected the aman rice crop; production is estimated at 9.7 million tons, 1.1 million tons lower than the preceding year. But with the anticipation of a bumper boro rice production of 16.5 million tons, food-grain production in FY2008 is estimated at 28.5 million tons, higher than the 28.1 million tons in FY2007. Although larger imports (estimated at 4.4 million tons) in FY2008 compared with 2.4 million tons in FY2007 more than offset the food-grain production shortfall, prices in the domestic market soared because of higher international prices and seasonality reinforced by the floods and cyclone. The market surplus of available food grains⁴ is estimated at 3.6 million tons in FY2008, higher than in recent years (Table 1).

52. Bottlenecks in the distribution and retail management chain, hoarding, and panic buying by consumers aggravated the domestic price situation. The Government's administrative actions, such as antihoarding measures were counterproductive and failed to arrest upward trends in prices. The domestic cost of rice production has increased even with subsidized agriculture inputs such as diesel and urea fertilizer. Responding to the market signals, driven by soaring international and domestic prices, the Government fixed the boro rice procurement price at Tk28/kg, 56% higher than the last boro season. Boro procurement would run from 16 April to 31 August. Although domestic food-grain prices are expected to moderate somewhat, high food prices are expected to persist in the foreseeable future. Despite a bumper boro crop, risks of a

⁴ Market food grains availability in Bangladesh may be defined as follows:

$$FA=NP+OT+PI-DP$$

where FA = market food grains availability; NP = net production (0.9 × domestic gross production); OT = government off-take; PI = private imports; and DP = government domestic procurement. This definition includes stocks held by private traders that may not reflect immediate availability for consumption. Data about the private food-grain stocks are not available.

supply shortage are possible if the next aman and boro crops are affected by natural disasters or other factors. In that case, the shortfall will have to be offset by buffer stocks through higher imports. The boro procurement target of the current season is 1.2–1.5 million tons (in terms of rice equivalent), which is 50%–80% higher than average boro procurement in the last 5 years and 7%–9% of expected boro rice production of the current fiscal year. The budgetary implication for this procurement is \$600 million.

Table 1: Food-Grain Situation in Bangladesh

Indicators	FY2000	FY2006	FY2007	FY2008^E
a. Population (million)	129.80	138.80	140.60	142.40
b. Per Capita Requirement (kg/year)	178.50	178.50	178.50	178.50
1. Rice (kg/year/capita)	158.32	158.32	158.32	158.32
2. Wheat (kg/year/capita)	20.18	20.18	20.18	20.18
c. Total Requirement (axb, million tons)⁵	23.17	24.78	25.10	25.42
3. Rice (a × 1, million ton)	20.55	21.97	22.26	22.54
4. Wheat (a × 2, million ton)	2.62	2.81	2.84	2.88
d. Domestic Gross Production (8+9, million tons)	24.91	27.28	28.05	28.50
5. Aus (million tons)	1.73	1.75	1.51	1.51
6. Aman (million tons)	10.31	10.81	10.84	9.66
7. Boro (million tons)	11.03	13.98	14.96	16.50
8. Total Rice (5+6+7, million tons)	23.07	26.54	27.31	27.67
9. Wheat (million tons)	1.84	0.74	0.74	0.83
e. Deduction (10%) for Seed, Feed, and Wastage (10+11)	2.49	2.73	2.81	3.42
10. Rice (8 × 0.1, million tons)	2.31	2.65	2.73	3.32
11. Wheat (9 × 0.1, million tons)	0.18	0.08	0.08	0.10
f. Availability for Consumption (d–e, million tons)	22.42	24.55	25.24	25.08
12. Rice (8–10, million tons)	20.76	23.89	24.58	24.35
13. Wheat (9–11, million tons)	1.66	0.66	0.66	0.73
g. Production–Demand Gap (f–c, million tons)	-0.75	-0.23	0.14	-0.34
14. Rice Production–Demand Gap (12–3, million tons)	0.21	1.92	2.32	1.81
15. Wheat Production–Demand Gap (13–4, million tons)	-0.96	-2.15	-2.18	-2.15
h. Market Availability of Food Grains (f+16+17-18, million tons)	24.58	27.12	27.79	28.97
16. Government Off-Take (million tons)	1.90	1.25	1.48	1.39
17. Private Imports (million tons)	1.23	2.27	2.21	3.30
18. Government Domestic Procurement (million tons)	0.97	0.95	1.14	0.80
i. Market Surplus (h-c, million tons)	1.41	2.34	2.69	3.55
j. Coarse Rice Price (Tk/kg)	13.94	16.28	17.79	32.09
k. Wheat Price (Tk/kg)	8.51	14.37	17.50	30.62

E = Estimates.

Notes: 1. For FY2008 a 12% deduction for seed, feed, and wastage is considered because of successive natural disasters.

2. Prices for coarse rice and wheat in FY2008 are monthly average prices in April 2008.

Sources: Bangladesh Bureau of Statistics, Ministry of Food and Disaster Management and staff estimates.

53. At the beginning of FY2008 the public food distribution system had a stock (inclusive of transit stock) of 0.6 million tons of food grains compared to the 1 million tons required by the existing national food policy. Despite higher imports compared to the previous year, food-grain

⁵ The total food grains requirement calculation has several limitations including non-availability of point data on population. Also per capita requirement of rice does not consider the variety of rice (fine, medium and coarse) consumption and the substitutability between rice and wheat.

stocks of the public food distribution system had depleted to 0.5 million tons at the end of March 2008 caused by higher off-take for targeted distribution and the safety net. Rice could not be procured during the aman season because of production shortfall and higher prices. The stock in public food distribution is expected to rise to 1.1 million tons by the end of June 2008, aided by higher imports and domestic boro procurement.

Macroeconomic and Poverty Impacts

54. Soaring food prices seriously affected Bangladesh with significant macroeconomic and poverty implications. Impacts of the rise of food prices on the key macroeconomic variables are assessed using a computable general equilibrium model.⁶ The model is calibrated to a social accounting matrix for Bangladesh for 2005. Two simulations are carried out: one for a 20% rise in the price of food items, and the other for a 60% rise. A rise in food price transmits to the domestic economy by impacting general prices, real wage, aggregate demand, supply, and thus production or real income. The results are summarized in Table 2.

Table 2: Impact of Food Price Rise

Item	Simulation of 60% Rise	Simulation of 20% Rise
General Price Level	2.16 percentage points	0.59 percentage points
Real Household Income	(1.612)	(0.501)
Welfare (equivalent variation)	(0.905)	(0.314)
Real GDP	(0.787) percentage points	(0.231) percentage points

() indicates a negative number.

Source: SANEM.

55. The immediate effect of rising food prices is on inflation, fiscal outlays, and external balance. Fiscal outlays to subsidize food consumption heighten budgetary pressures. Pressures also mount for upward adjustment of money wages. Monetization of the fiscal costs with accelerating wage increases may trigger further inflation. Failure to contain inflation could seriously undermine macroeconomic and political stability of the country.

56. The surge in food prices (58.8% weight in the consumer price index [CPI]) is pushing inflation higher. CPI inflation rose to 10.1% on a point-to-point basis in March 2008, up from 7.4% in March 2007. During this period, food inflation rose to 12.9% from 8.5%. The fiscal implications of subsidies on food and related inputs into food production, such as, fertilizer and fuel for irrigation, amplified by recent price rises, are sizeable. The Government's selling price under open market sale was Tk25/kg as against the import cost of Tk30/kg. Food subsidies, including inputs of production, such as, diesel and fertilizer are estimated at \$1.3 billion or 1.7% of GDP in FY2008. The fiscal deficit in FY2008 is likely to rise to 4.8% of GDP (foreign financing 2.5% of GDP), from 3.2% of GDP (foreign financing 1.2% of GDP) in the preceding year. The fiscal pressures will be heightened in the FY2009 budget because of the planned buildup of a huge buffer stock of food for price stabilization and safety net programs, and increased subsidies for agricultural inputs, such as, fertilizer and diesel. Higher food prices significantly contribute to a surge in the trade deficit (estimated at 6% of GDP in FY2008). But the balance of payment impact of higher food prices has been partly offset by higher aid flows and workers' remittances.

⁶ Developed and maintained by South Asian Network on Economic Modeling (SANEM).

57. Rapidly growing prices of food, mainly rice, seriously eroded the purchasing capacity of people living below the poverty line and government employees, industrial workers, and others with fixed incomes. Rice comprises 71% of the total calorie intake/person/day in rural Bangladesh and 60% in urban areas.⁷ The share of food in total expenditures for the poorest 30% is about 69%. Both urban and rural households of Bangladesh face welfare losses in the short term even with a 10% increase in the price of rice.⁸ The losses are higher in the lower quintiles. Households in the poorest rural quintile earn on average 63% of their income from on- and off-farm wages. The majority are net food buyers; only 12% are net food sellers. These characteristics show that the poorest households are highly vulnerable to food price increases and experience high welfare losses. Marginal farmers and sharecroppers did not get their due share of the price rise because of poverty and consequent need to sell their crops to landowners.

Government Responses

58. The Government responded to higher food-grain prices in several ways including cutting the import duty on food items, raising food-grain imports, launching an extensive flood and cyclone recovery program, focusing on higher boro rice production, and widening social safety net programs in various poverty-prone parts of the country. The Government banned export of nonaromatic varieties of rice for 6 months. Bangladesh Bank is following a more flexible approach in exchange rate management to contain the pass-through of rising international prices to domestic prices. It is encouraging banks to provide credit facilities on softer terms to new importers, easing letter of credit margins for food items, and extending the time limit for importers.

59. The Government is planning to build a stock of about 2 million tons of food grains under the public food-grain distribution system to face any possible food shortages during the coming monsoon or later. Increasing food-grain stocks will require additional funds and strengthening of the public food-grain distribution system to reduce leakage, improve pricing, and enhance the effectiveness of the safety net program to reach targeted beneficiaries. Another problem is storage capacity; the readily available and useable storage capacity in the public food grain distribution system is only 1.2 million tons.

60. Addressing the hardship of poor people affected by higher food prices remains a challenge. The Government is considering introducing a guaranteed employment program for rural people during the season when employment opportunities are limited. This program will be developed in line with the Indian National Rural Employment Guarantee Scheme. Meanwhile, the Government has already started a Tk1 billion project in rural areas to provide work to the unemployed for a daily wage of Tk150. The size of various ongoing safety net programs, such as, food for work, vulnerable group feeding, vulnerable group development, test relief, and open market sales will be expanded so that more people can benefit.

Looking Forward

61. Over the short-term, the focus of policy responses should be on targeted interventions to protect the poor and vulnerable in the face of rising food prices. With targeted support to the poor rather than general price subsidies, the Government will be able to ensure better coverage

⁷ Household Income and Expenditure Survey 2005, Bangladesh Bureau of Statistics.

⁸ Food and Agriculture Organization. 2008. *Growing Demand on Agriculture and Rising Prices of Commodities*. United Nations. Available at www.fao.org.

as well as free up resources and minimize distortions in the incentives for farmers. Farmers must be ensured adequate and affordable access to agriculture inputs (seeds, fertilizer, and irrigation water) to spur a strong supply response for forthcoming crop cycles. The Government needs to increase its capacity to operate a public food distribution system in collaboration with the private sector to stabilize prices and assist the poor and vulnerable groups. Over the medium to longer term, the focus should be on improving productivity by disseminating modern production technologies, developing rural infrastructure including reliable and expanded irrigation systems, bringing ecologically disadvantaged areas under cultivation, providing extension services, improving marketing, producing quality seeds through public-private partnerships, and ensuring rural financial services.

TELECOMMUNICATIONS: PROSPECTS AND CHALLENGES

62. The telecommunications sector in Bangladesh is undergoing rapid structural change and dramatic economic growth. The national monopoly, which dominated the industry, is now facing increasing competition from the private sector. Under the stimulus of an open market and changing technologies, new services are constantly being developed. This shift in momentum is caused by the growing dynamism of the global telecommunications market, propelled by rapid technological development and an increasingly liberal policy environment. Over the last few years, many Asian economies, including those in South Asia, undertook massive liberalization of telecommunications, resulting in significant expansion of networks even in some less-developed countries. While the timing of reform and liberalization differs among countries, certain commonalities exist in the reform process: all countries have introduced the element of competition in telecommunications to improve quality and reduce the cost of services.

63. With the liberalization of telecommunications in Bangladesh in the 1990s, issuance of licenses to private sector operators and demand for subscriptions increased rapidly. Competitors are now prompting sharp reductions in prices of basic and value-added telecommunications services. Like many other emerging economies, new providers of private sector mobile phone services are increasing the pace of entry into local service markets, supplying services to consumers who have been waiting for fixed lines to be installed. This is dramatically increasing the country's teledensity. High growth in telecommunications during the last decade, particularly in the mobile phone sector, has enabled subscribers in urban and rural areas to access most of the basic and value-added services. Voice; text messaging; Internet; e-mail; and other online services such as e-business, health, education, banking, and entertainment information are now available via mobile phones. The country made a significant paradigm shift in telecommunications facilities following deregulation of the sector and the subsequent entry of several large multinational telecommunications companies investing in the mobile phone infrastructure.

Deregulation

64. Since independence of the country in 1971 and until the liberalization of the telecommunications sector in the 1990s, the Government's Bangladesh Telegraph and Telephone Board (BTTB) had a virtual monopoly on telecommunications business. The cost to private subscribers to secure fixed lines was high and often included unofficial payments. Waiting time to get connected was long—often exceeding 1 year. The quality of connection was relatively poor, characterized by frequent service disruptions and long delays in repairs. But after deregulating the industry, the Government authorized the private sector to enter the mobile and fixed-line telecommunications business. Massive investments from domestic and foreign investors took place during the last decade in the public switched telephone network (PSTN) and mobile technologies. As a result, access to telecommunications increased rapidly and quality of service soared. Introduction of competition in a sector once considered a natural monopoly spawned the need for an independent regulator. Bangladesh Telecommunication Regulatory Commission (BTRC) was established under the Bangladesh Telecommunication Act, 2001, to regulate the operators. BTRC started functioning from 31 January 2002, fortifying the Government's commitment to separate responsibilities for policymaking, regulation, and operations of the sector.

65. BTRC is responsible for regulating six mobile phone operators and 15 licensed PSTNs. Nationwide teledensity increased to 26.8% in 2008 with 37.6 million telephone subscribers, compared with only 3.5% and 4.7 million subscribers in 2004 (Table 3). This astounding growth

revolutionized the information and communications industry, providing low-cost access to telecommunications and other electronic services in rural and urban areas, generating business and investment opportunities, and creating employment in other sectors.

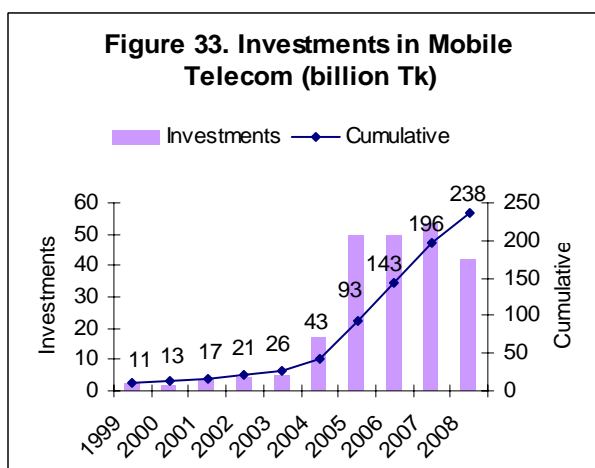
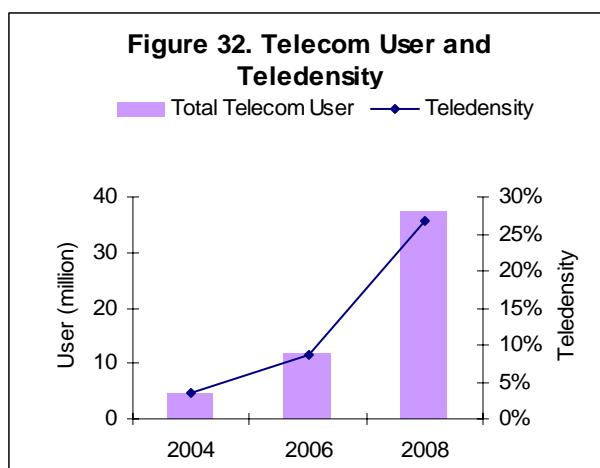
Table 3: Telecommunications Indicators in Bangladesh

Item	2008	2006	2004
Population (million)	140.6	138.8	135.2
Mobile Phones (million)	36.4	11.0	3.8
Fixed Lines (PSTN) (million)	1.2	1.0	0.9
Total Telecom Users (million)	37.6	12.0	4.7
Teledensity (%)	26.8	8.6	3.5

Source: Bangladesh Telecommunication Regulatory Commission, January 2008.
Available: www.btrc.gov.bd.

High Growth in Mobile Communications

66. The telecommunications industry gives impetus to the growth of emerging markets and is considered the most effective technology to bridge the digital divide. Mobile phones have been the key contributor to rapid growth of telecommunications in Bangladesh. Multinational mobile phone companies are providing private sector telecommunications infrastructure in the country. The mobile network currently covers about 85% of the geographic area and 97% of the country's population. Rising teledensity is a major indicator of its contribution—in 1997 teledensity in Bangladesh was only 0.4%, this increased to 26.8% with 36.4 million mobile subscribers in January 2008—propelled by 100% annual growth in subscribers in 2006 and 65% in 2007 (Figure 32). Although the PSTN network remained stagnant and largely failed to reach subscribers in remote areas, astronomical growth in mobile phones with nationwide coverage reversed the otherwise dim telecommunications scenario.



Source: Association of Telecom Operators of Bangladesh and Bangladesh Telecommunication Regulatory Commission (January 2008).

67. Six mobile phone companies are currently operating: Aktel, Banglalink, Grameenphone, Citycell, and Warid Telecom are private sector operators; and Teletalk is a public sector operator. Large foreign telecommunications companies, including Telenor (Norway), Telekom Malaysia, Orascom Telecom (Egypt), SingTel (Singapore), and UAE-based Warid Telecom, have major shares in these companies. Grameenphone (62% owned by Telenor) is the dominant operator with about 46% market share in terms of subscribers, followed by Aktel and

Banglalink (Figure 34). Increased demand for mobile phones, aided by affordable service from multiple operators is the key driver of growth in the industry. The significant fall in prices of handsets and reduction in duties and connection fees during the last few years enabled low-income groups to afford mobile phones. Intense competition has gradually driven call tariffs down, much to the relief of frugal consumers—reducing the digital divide between the rich and poor. According to a recent report *Mobile Benchmark Studies in South Asia and Latin America*, published by LIRNEasia, Bangladesh has the lowest average monthly cost for mobile telephone use at all levels of use (low, medium, and high) for prepaid and postpaid tariff plans; followed by Pakistan, India, and Sri Lanka. Bhutan, Maldives, and Afghanistan have considerably higher average monthly mobile costs among the South Asian countries considered (Table 4).⁹

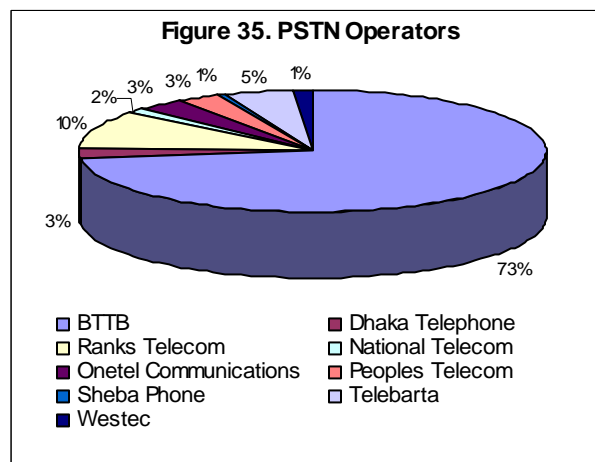
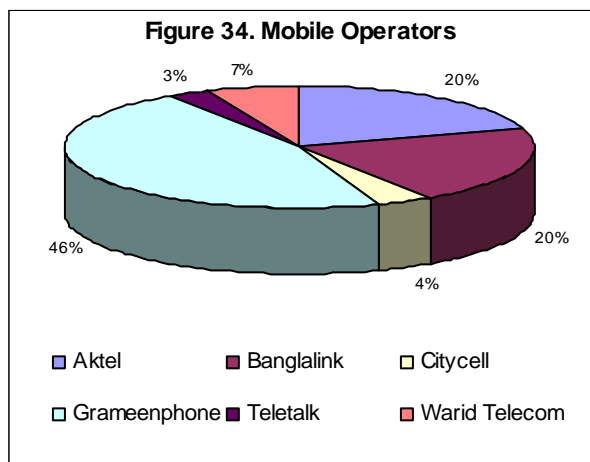
Table 4: Comparison of Monthly Costs of a Low User (for prepaid mobile)

South Asia			Latin America		
Country	\$	\$ PPP	Country	\$	\$ PPP
Bangladesh	2.46	11.66	Argentina	15.28	45.53
Pakistan	3.34	10.57	Chile	16.42	23.98
India	3.72	15.04	Mexico	20.02	27.97
Sri Lanka	3.83	13.39	Colombia	20.12	56.82
Nepal	5.25	21.55	Peru	29.07	58.02
Bhutan	5.46	17.25	Brazil	29.99	47.60
Maldives	5.48	17.05			
Afghanistan	8.33	32.93			

PPP = Purchasing Power Parity.

Source: LIRNEasia, March 2008. Available: www.lirneasia.net.

68. Mobile telecommunications have been the major area of foreign direct investment in Bangladesh. Cumulative investments in this area is set to exceed Tk238 billion or \$3.4 billion in FY2008 (Figure 33). The industry directly employs more than 15,000 and indirectly creates jobs for 650,000. Collaboration with multinational companies with broader exposure has helped the industry bring more modern technologies and business management expertise. This has translated into reasonably good quality service and robust turnover.



Source: BTRC, January 2008. Available: www.btrc.gov.bd.

⁹ LIRNEasia is an ICT research organization based in Colombo, Sri Lanka. The report was downloaded from www.lirneasia.net on 23 March 2008.

69. Availability of phones in rural areas has created new opportunities for income generation through self-employment by providing villagers with access to modern information and communication technologies (ICT). This helps boost the income of poor households by providing real-time business and market information, promoting health care awareness, developing agribusiness, and raising social status. It enables migrant family members working internationally to stay in touch with relatives and friends. Innovative value-added services such as community information centers—providing Internet access, voice communications, videoconferencing, and other information services in rural areas—have facilitated improved connectivity and faster access to information. Health information services offered by some operators, which allow registered subscribers to consult a licensed physician for general or emergency medical advice, are adding huge benefits to customers living in areas with inadequate health care facilities. Other information such as listings of medical centers and pharmacies, and short messaging of pathology/radiology test reports from selected diagnostic centers are making life easier for many. Telecommunications has also broadened rural access to banking, education, and entertainment services.

70. With high growth in profit, large mobile phone companies are playing a key role in promoting a socially responsible corporate culture. Major operators support community education programs (i.e., offer scholarships); patronize arts and culture (i.e., organize cultural events); sponsor national sporting events; and advocate for a clean environment, road safety, public health, preservation of heritage, and other programs. Currently mobile phone companies are among the largest corporate taxpayers of the country.

Challenges

71. The main objective behind liberalizing telecommunications was to create a competitive environment by establishing a market-oriented regime and appropriate sets of regulations, standards, procedures, and investment climate so that the users have multiple choices of different services, systems, and carriers at a competitive and reasonable price. Actions have been taken to meet the objective, though the environment is not as fully conducive as envisaged. Some of the remaining barriers creating regulatory burdens for new and existing business are yet to be addressed.

Supportive Regulatory Regime

72. Telecommunications is a capital intensive industry; a stable and predictable policy regime is necessary to safeguard large investments from local and foreign investors. Frequent or abrupt changes in policies, taxes, and fees not only jeopardize ongoing investment plans, but make preparation of future plans difficult. An unpredictable regulatory environment dampens investor confidence and destroys the country's reputation. Interconnection charges among public and private operators need to be harmonized and rationalized to lower call tariffs. Regulators need to ensure that wireless local-loop (WLL) technology is used only in licensed regions and is not abused to provide mobile services outside of the jurisdiction. The market for international voice communication needs to be more transparent and open to intense competition. A supportive and enabling business climate, easing regulatory burdens can boost investments in the sector.

Improving Investment Climate

73. Licensing regulations, import duties, and other operating guidelines for providing service need to be rationalized to promote a compatible investment climate based on standards of other

South Asian countries. This will help reduce costs to subscribers as well as encourage other foreign companies to invest in Bangladesh. The mobile phone industry, which is growing much faster than PSTN and providing telecommunications services nationwide, has been the largest foreign direct investment recipient sector in recent years. It holds the potential to continue with this trend if backed by a supportive business environment.

International Voice Communication

74. The Government took a prudent decision by giving legal existence to the voice over Internet protocol (VOIP) business, which expanded rapidly during the last decade. The monopoly of international voice communication, which was thought to be productive in terms of government revenue collection, turned counterproductive with the emergence of underground VOIP business, resulting in a huge revenue loss for the Government and depriving customers of low-cost international communication services. BTRC recently announced the International Long Distance Policy 2007, which invites bids for licenses to run international gateways and VOIP services. It granted license to two VOIP companies. The international long distance market, which was largely catered to by illegal VOIP operators, is finally gearing up for legitimate competition. Licensed VOIP businesses can now offer cheap international communication legally, which will generate huge revenue earnings for the Government treasury. This business needs further liberalization and participation from more private sector operators to produce greater benefits.

Improving Services

75. With six cellular phone operators catering to 36.4 million subscribers, regulators are now facing the challenge of managing spectrum allocation to the growing number of operators. Efficient management of spectrum allocation and harmonization with international best practice is critical to improve services. Mobile phone companies need to broaden their coverage of community information service centres, kiosks, and other outlets to cater to the demands of rural subscribers. Outlets equipped with computers and Internet access can be used as distribution hubs for workers' remittances to strengthen remittance flow through the formal channel. A huge amount of remittances still enter the country through informal channels, primarily because of inadequate bank branches in rural areas, depriving the economy from their benefits. The Philippines has had major success in implementing a mobile phone-based remittance distribution system, which can be adapted in Bangladesh. This can ensure safer and faster delivery of remittances through the legal system and reduce illegal transfers.

Potential of PSTN Services

76. Despite impressive development of mobile telecommunications, Bangladesh is struggling with inadequate PSTN infrastructure with more than 95% homes lacking a fixed-line telephone. About 80% of the fixed lines are in the four main cities, while 80% of the population lives in some 86,000 rural villages. Until recently, fixed-line services were mostly provided by the state-owned BTTB, which required a long waiting time to provide new connections.

77. The establishment of BTRC has encouraged private sector participation in PSTN services, which somewhat increased fixed-line teledensity in the country, but at a very slow pace compared with mobile phones. BTRC has authorized PSTN in four regions through the private sector and the aim is to add 1.2 million fixed phones in 2–3 years. BTRC requires that 5% of the telephones be deployed in rural areas under PSTN. It allows WLL technology in remote areas to provide access at a low cost. But despite initiatives, not much growth took place

in PSTN subscriptions during the last decade. Currently about 15 private sector PSTN-licensed carriers operate in Bangladesh (six national and nine zonal). But the state-owned BTTB still holds the majority market share of 73%, while private sector operators cater to the remaining 27% of the market. Ranks Telecom, Telearbata, Onetel Communications, Peoples Telecom, and Dhaka Phone are among the major private PSTN operators (Figure 35).

78. BTRC has taken several initiatives to boost private sector participation in telecommunications. Absence of an effective interconnection regime was one of the major weaknesses. Service providers were prone to predatory pricing and refusal of access to competitive operators. But after much delay, an interconnection regime has finally been put in place with performance, service quality, and network availability. Following resolution of the interconnection issue, the fixed-line network was opened to market competition. BTRC is pushing new initiatives to open up competition in local loop services, rationalize the spectrum policy, and establish formal controls over interconnection to stimulate penetration and improve quality of service. Other important initiatives include the restructuring and corporatization of BTTB; and comprehensive technical assistance for BTTB, BTRC, and Ministry of Post and Telecommunications. Although BTTB remains the dominant operator, the benefits of introducing competition in PSTN will appear in the near future.

Call Centers

79. In a recent move, BTRC is issuing licenses to eligible applicants to establish call centers in the country. Call centers are centralized offices used for receiving and transmitting large volumes of requests (e.g., customer service, order taking, application processing, complaint handling) by telephone. It is a booming business; large companies from developed countries typically outsource this service to developing countries to cut operating costs. Several Asian countries including India, Philippines, and Sri Lanka are reaping large profits from this business by using their low-cost and well-educated workforce, strong ICT-base, and state support. With improvements in telecommunications facilities, Bangladesh has the potential to be a competitive destination for call center services. But it needs to invest in quality education and training.

Moving Forward

80. The Government is expected to continue pursuing the deregulation process vigorously as expanding the national telecommunications infrastructure remains a priority. To complement the rapid growth in mobile phones, fixed-line subscriptions should increase at a proportionate rate. A supportive regulatory environment followed by rapid investments can boost PSTN growth in the country. BTTB as the oldest and national carrier still enjoys certain advantages, which need to be shared with private operators to ensure fair competition. Recently the Council of Advisers approved the Bangladesh Telegraph and Telephone Board (Amendment) Ordinance 2008 to remake the state-owned BTTB into a public limited company. Following corporatization of BTTB, the state-owned monopoly is expected to move to more market-oriented operations with the mindset of competing with other carriers, which will improve its service quality as well.

81. So far Bangladesh has committed licenses to only a few private sector PSTN operators to supply domestic long distance and local voice services as well as transmission facilities. International long distance is still heavily regulated by the state. Entry restrictions in telecommunications are difficult to justify given technological progress and the benefits of competition. Legalizing VOIP (for international calls) and granting licenses to two operators has opened up opportunities for increased private sector participation. VOIP is an excellent mode of low-cost communications from which customers should not be deprived. At a time of rapid

globalization and regional integration, Bangladesh cannot afford to be marginalized because of poor ICT infrastructure. The country must create a business-enabling environment not only to strengthen its technology base but also to boost other sectors of the economy.

Conclusions

82. As market forces gain a foothold in the Bangladesh telecommunications sector, they are fundamentally transforming its structure and the way services are traded. A market that was once characterized by monopoly of a national fixed-line operator supplying basic telecommunications is now being replaced by competing companies. This transformation is already leading to the replacement of a simple, straightforward market structure with an exceedingly complex structure and a wide array of service providers operating at various levels. Technologies and service practices once considered marginal are becoming mainstream, legitimate, and increasingly significant components of trade in telecommunications. Services based on mobile technologies are growing at such rates that their economic importance has surpassed that of fixed-line services.

83. To channel more investments into telecommunications, the regulators need to foster a rational and transparent regulatory regime and an investment-friendly climate. Policies need to be consistent and predictable to create equal opportunities for all operators in the public and private sectors. Setting up the BTRC was a positive step. As the watchdog, BTRC needs to ensure that a stable and enabling environment is maintained, and rapid policy changes that discourage investments are not made. While the mobile phone business generates high revenues and employment in the country, it also calls for large and continuous investment in network infrastructure and technology development. An encouraging sign is that the major companies are reinvesting to finance expansion and growth to provide better services. With this encouraging growth in the mobile sector, the telecommunications density of Bangladesh will continue to increase, stimulating the growth of other businesses.

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