



Bangladesh

While economic growth has accelerated, inflation has slowed down, and fiscal and current account balances have improved, unemployment has remained high. Despite the currency turmoil in Asia, Bangladesh's taka has remained relatively stable.

RECENT TRENDS AND PROSPECTS

The most striking macroeconomic development in 1997 was the upturn in economic growth, with much lower inflation and improved fiscal and current account balances. GDP grew by 5.7 percent in 1997, the highest rate in the 1990s to date. The agriculture sector performed impressively, with a growth rate of 6 percent. The services sector also performed well, growing by 6.2 percent. The weakness in the economy was the industry sector, whose growth was sluggish and was the lowest in the decade, mainly because of supply bottlenecks in the power sector and low private investment. The slow pace of financial sector reforms and further deterioration in the performance of state-owned enterprises were further factors that hindered the growth rate.

The savings rate rose from around 6 percent of GDP in 1992 to 9 percent in 1997, a reflection of better control over current government spending and improvements in private saving. However, this was less than in 1994 and 1995, when savings was about 13 percent of GNP. Despite a drastic decline in inflows of foreign finance, the country was able to maintain the steady increase in the investment rate, which rose from 12.1 percent of GDP in 1992 to 17.4 percent in 1997. Part of this was due to increased private investment in response to the

government's efforts to encourage private sector activities.

Although the open unemployment rate based on official statistics is low, estimates indicate that about 40 percent of the labor force is underemployed. While Bangladesh's labor costs are probably among the lowest in Asia, this cheap labor cannot be matched by adequate capital investment, and labor productivity is low.

While the overall fiscal deficit remained high, it showed some improvement in 1997. The collections of major tax revenue items, including customs duties, value-added tax, and income tax, largely met targets. On the expenditure side, revenue expenditure slightly exceeded the budget target because of unexpected interest payments on domestic debt and increased subsidies to public enterprises. However, this increase was largely offset by below target capital expenditures caused by slow progress in aid disbursement and project implementation. As a result, the overall budget deficit was 5.5 percent of GDP in 1997, about half a percentage point lower than in the previous year.

The money supply expanded modestly, with broad money supply (M2) growing by 10.8 percent in 1997, up from 8.2 percent in 1996. Net credit to the private sector rose by only 12.6 percent, compared with an average of 22.8 percent per year in 1995-1996, partly reflecting the crowding out effects

of the rapid expansion of credit to the government, and also the commercial banks' more cautious approach toward extending new credit, as well as their increased efforts to recover overdue loans.

Sufficient food crop production and moderate monetary expansion kept inflation under control. Food prices only increased by a modest 1.3 percent. The inflation rate was 3.9 percent during 1997, lower than the 4 percent recorded in 1996. Transport, communications, and health care prices recorded the largest price increases.

Since 1990, measures to liberalize trade and payments have included reducing tariff and nontariff barriers, simplifying import procedures, introducing export incentives, and liberalizing foreign exchange controls. The authorities lowered the unweighted mean tariff from 89 percent in 1991 to 23 percent in 1997, and reduced the number of items subject to quantitative restrictions from 315 in 1990 to 23 in 1997. As a result, the external trade position has improved considerably in recent years. Export earnings remained buoyant in 1997 at \$4.4 billion, although growth commodity was varied. Ready-made garments exports contributed more than half of the earnings, and grew by 14.8 percent. Imports grew slowly at 3.0 percent, mainly because of a decline in foodgrain purchases. Worker remittances from abroad surged by 21 percent. These factors brought down the current account deficit from 5.2 percent of GDP in 1996 to 2.6 percent of GDP in 1997.

However the deterioration in the capital account outweighed these improvements. Food and commodity aid decreased and many project aid disbursements were behind schedule. Net private capital outflow amounted to \$120 million, and consisted largely of an outflow of foreign portfolio investments.

Despite the recent turbulence in Southeast Asian currency markets, the taka has so far remained relatively stable. The following factors contributed to this stability: (i) the taka's convertibility on the current account rather than on the capital account; (ii) the government's pursuit of a flexible exchange rate policy (from June 1996 to the end of 1997 the exchange rate devalued by more than 11 percent); (iii) the relatively low current account deficit compared with that of other Southeast Asian countries; and (iv) the foreign capital inflow to Bangladesh, which to date has been minimal, so that the subse-

quent outflow has not had any major financial consequences.

Nonetheless, the recent currency turbulence in Southeast Asia could have some adverse impact on Bangladesh's economy in the future. The economy is particularly vulnerable in the following areas: (i) its official foreign reserves stood at an uncomfortably low level of \$1.6 billion in December 1997, equivalent only to 2.4 months of imports of goods and services; (ii) the competitiveness of Bangladesh in labor-intensive exports such as garments and frozen foods could be reduced because of the sharp depreciation of currencies in Southeast Asia; (iii) the level of potential foreign investment from East and Southeast Asian countries into Bangladesh could be depressed because of these countries' financial problems; and (iv) the demand for Bangladeshi overseas workers could be reduced, which would dampen workers' remittances to the country.

The medium-term outlook also depends critically on the pace of economic reforms. Based on the assumption that the government implements major structural reforms in a timely manner and maintains macroeconomic stability, projections indicate that GDP growth will rise slightly from 5.7 percent in 1998 to 6 percent in 1999. While the growth in agriculture may slow down somewhat compared to its impressive achievement in 1997, the industry sector could rebound from its disappointing performance. However, to achieve this, adequate infrastructure, including energy, roads, ports, and telecommunications, must be developed. This growth scenario assumes substantial increases in the domestic savings and investment rates, which in turn depend on timely implementation of comprehensive banking sector and capital market reforms, as well as further fiscal consolidation. Efforts to attract investments from the private sector, both domestic and foreign, need to be intensified through accelerated implementation of reforms in infrastructure and public enterprise restructuring.

As a result of the expected increase in tax collection, the fiscal deficit is forecast to decline from 5.5 percent of GDP in 1997 to about 5 percent in 1999. It will remain high in 1998, as the recent pay increase for the public sector will raise public expenditure. In line with the general expansion of economic activities, the money supply will increase by around 12.2 percent per year. Appropriate restruc-

turing of the banking system and capital markets will be needed to ensure that adequate funds are available to the private sector. The inflation rate is projected to average just over 5 percent during 1998 and 1999.

In the next two years, the government should intensify its efforts to maintain robust exports. Export growth is projected at 15 percent in 1998 and 16 percent in 1999. The current account deficit is forecast to be about 3 percent of GDP in the next two years. An increased amount of foreign investment is expected in power generation, gas exploration, telecommunications, and cement production.

CRITICAL ISSUES IN SHORT-TERM ECONOMIC MANAGEMENT

Bangladesh must weather the adverse economic winds set in motion by the crisis in Southeast Asia. Despite improvements, its macroeconomic stability remains fragile. The two areas of short-term economic management that are particularly important are fiscal and monetary policies and external trade and the balance of payments.

Fiscal and Monetary Policies

To maintain macroeconomic stability Bangladesh must reduce its budget deficit. At the same time it

must mobilize resources for funding essential public services and productive investment. Therefore, the government must adopt appropriate policies to reduce nonessential expenditures, especially as the implementation of the National Wage Commission's recommendations will lead to substantial increases in expenditures. In addition, hidden deficits arise from loss-making public enterprises and banks that must be eliminated. On the revenue side, given the low tax-to-GDP ratio, there is much scope for raising tax revenues by enforcing income tax laws, expanding the base of value added tax, and making customs administration more transparent and efficient.

While monetary policy should be noninflationary, the supply of credit to the private sector could increase somewhat from the 12.6 percent rate in 1997. Greater provision of credit and liquidity to promising and soundly managed firms is necessary to maintain the growth momentum. However, for such monetary and credit policy to be a realistic option, the government must carry out the financial reforms discussed below without delay.

External Trade and the Balance of Payments

Bangladesh's policies of trade liberalization and export promotion have so far been relatively

Table 2.12 Major Economic Indicators: Bangladesh, 1995-1999
(percent)

Item	1995	1996	1997	1998	1999
Gross domestic product growth	4.4	5.4	5.7	6.0	6.2
Gross domestic investment/GDP	19.1	17.0	17.4	17.2	18.0
Gross domestic saving/GDP	12.8	7.5	9.0	8.6	8.8
Inflation rate (consumer price index)	5.2	4.0	3.9	5.5	5.0
Money supply (M2) growth	16.0	8.2	10.8	12.0	12.5
Fiscal balance/GDP	-5.1	-5.9	-5.5	-5.5	-5.0
Merchandise exports growth	37.2	12.2	13.7	15.0	16.0
Merchandise imports growth	39.4	17.8	3.0	8.0	10.0
Current account balance/GDP	-2.7	-5.2	-2.6	-3.1	-2.7
Debt-service/exports	10.3	12.1	11.4	10.7	10.5

Sources: Asian Development Bank (1997c), Bangladesh Bureau of Statistics, Bangladesh Bank, and staff estimates.

successful; however, the export base remains narrow. This, together with the possible slowing of the inflow of emigrants' remittances, means that the balance-of-payments position remains fragile. The temporary assurance of garment exports in major markets through quotas and the Generalized System of Preferences agreements should not lead to a false sense of security. (The Generalized System of Preferences is an agreement to give preferential access to the markets of certain of the industrial economies of exports of some low-income countries.)

The export processing zones can continue to play an important role in promoting trade and attracting foreign investment. With the establishment of new export processing zones and the intensification of the activities of existing ones, continuing to improve the balance of payments without substantial depreciation in the value of taka should be possible.

POLICY AND DEVELOPMENT ISSUES

Bangladesh's primary challenges into the next century will be to reduce poverty and improve living conditions. In this context, three significant areas of ongoing policy efforts are of strategic importance: financial sector reforms, governance reforms, and environmental protection. Together, these policies can bring Bangladesh closer to maintaining a sufficient and sustainable growth rate to achieve its development goals, barring the impact of any adverse developments in the world economy.

Financial Sector Reforms

For many years, inefficiency, poor quality intermediation, and a lack of accountability have characterized Bangladesh's financial system. To facilitate adequate economic growth Bangladesh must accelerate improvements in the efficiency and flexibility of financial markets. Without efficient financial markets the mobilization of additional resources for development will slow down. Therefore, the implementation of comprehensive capital market and banking reforms should have the highest priority.

In terms of banking sector reform, supervision and regulation by the Central Bank—reported to be lax, particularly in enforcement—must be brought up to international standards. Capital

adequacy requirements, criteria for asset classification, and prudential regulations must be implemented quickly and uniformly. The authorities should vigorously accelerate loan recovery, restructure private banks, and privatize weak nationalized commercial banks. In addition, they should implement strong loan recovery measures, such as the amended Financial Loan Court Act, impartially.

The problems of the capital market are deep-rooted. The Securities and Exchange Commission is largely an ineffective regulatory and supervisory agency. In operation only since 1993, it has not had a well-established system of monitoring and surveillance. Partly because of this, the stock market shows excessive volatility.

If Bangladesh is to attract domestic and foreign savings through its equity and bond markets, the government must exert considerable efforts to develop a fair, transparent, and efficient capital market. The recently reorganized Securities and Exchange Commission should have wide discretionary powers of surveillance. Separation of the management of stock exchanges from the brokers must be maintained without exception. In the future, improved prudential regulation and incentives for channeling capital to productive enterprises will enable the financial sector to facilitate investment better.

Governance Reforms

After initial steps such as reviewing the size and functions of government departments and setting up the Efficiency Unit in the prime minister's office, the reform process should accelerate.

The Public Administration Reform Commission needs to be reorganized and given adequate support for carrying through reforms to enhance the efficiency of public sector management and administration. A new incentive structure based on merit and productivity is needed. The strategic emphasis should be on establishing mechanisms to improve transparency and accountability in all areas, including budgeting, the regulatory environment, and the government's day-to-day operations.

In terms of devolution of power, local governments should be strengthened and given financial powers to use local resources. The development of human resource and technical capacities at the local level is also urgently needed.

Environmental Protection

Finally, the government must pay attention to maintaining environmental quality. Air and water pollution and other environmental problems need to be monitored and actions taken to prevent further deterioration. The environmental issue must be addressed immediately if sustainable development is to be a realistic goal. The reduction of public expenditures should not mean abandoning preliminary efforts in this direction. On the contrary, by making the environment a priority, gains

from public sector reforms could more easily be used to contain ecological damage and improve the environment.

Some specific areas where the government needs to sustain and deepen its efforts are providing protection from floods and cyclones, managing forestry, reforesting mangrove swamps, restocking fish populations, and improving environmental management in the industry sector. With international support the government should be able to take further steps toward implementing the National Environment Management Action Plan.