

EXECUTIVE SUMMARY

This paper briefly presents the macroeconomic trends of Bangladesh since the 1970s. The analyses presented in the paper provide first hand information about the potentials as well as the constraints and challenges for the economy. The macroeconomic fundamentals are as follows:

Real Sector

- The GDP growth rate of Bangladesh started picking up since the 1990s and over the last 5 (five) years has maintained a growth rate of around 6%. It is recognized that the economy has the potential to grow at an even higher growth rate if the growth constraints such as poor governance, rampant corruption, infrastructure bottlenecks, underdeveloped financial markets and failure to attract FDI are removed.
- Over time, there has been structural transformation in the economy with a shift from predominantly agriculture-led economy towards industry-led economy; the contribution of agricultural sector to GDP was 38% in early 70s but declined to 21% in 2007-08, while the contribution of industrial sector increased from 15% to 30% during the same period of time.
- Investment remained stagnated until the 1980s but started picking up since early 1990s, mainly attributable to the openness of economy and the introduction of a liberal policy environment; creating increased opportunities for private investment. The investment-to-GDP ratio during 2006-2008 period stood at around 24% of GDP, but it should be in the neighbourhood of 30% in order for the economy to reach two-digit growth trajectory.
- About 75% of the population lives in rural areas, out of which 44% live below the poverty line. Therefore, investment in agriculture and rural economy needs to be high on the development agenda.
- The policy biases in the distribution of public resources have created disparity between the eastern and the western regions of the country. Appropriate policy intervention is needed to correct the imbalance.
- During the last three years, the national savings grew to 28.6% on an average. The mobilisation of domestic resources and the transforming of national savings into investible surplus are critical for the continued growth of the economy.
- The inflation for the first time touched double-digit in 2007-08 mainly due to supply shocks arising from substantial increases in the international prices of fuel, fertilizer and food items as well as natural calamities caused by cyclone SIDR and floods. However, in the recent months the inflation rate has come down and in December '08 it stood at 6.03% on point to point basis.

Fiscal Sector

- Over time, the average Revenue-to-GDP ratio improved gradually and increasing to 10.8% during the 2006-2008 period from 7.5% in 1973-1980 period. However, the Revenue-to-GDP ratio of Bangladesh still remains one of the lowest in the world and even lower compared to that of Nepal.

There have been structural changes in the revenue structure replacing pre-dominance on customs duties by income taxes and VAT.

- As a percent of GDP, public expenditures increased from about 10% in 1972-73 to a peak of about 18% in 1999-00. The ratio declined to 13% in 2003-04 and remained under 14% to 2006-07. In 2007-08, it increased to 16%. The expenditure-to-GDP ratio in Bangladesh lags behind compared to other developing countries, as in the case for the revenue-to-GDP ratio.
- Over the years, expenditure on subsidies and current transfers, pay and allowances, interest payments and goods and services has increased gradually. However, the rate of increase in expenditure on subsidies and current transfers, interest payments and goods and services is much higher than others particularly from 2005-06 onwards.
- Over the years, the share of subsidy among different sectors/areas have changed significantly, with increased focus in the area of fertilizer.
- The fiscal deficit has remained within a tolerable limit. In 2007-08, the budget deficit stood at 4.9% of GDP including BPC liabilities and 3.5% of GDP excluding BPC liabilities.
- The budget allocation for the social safety net programmes increased from 8.4% to 16.9% of total budget during 2004-05 to 2008-09.

Monetary and Financial Sector

- Financial deepening measured by the ratio of broad money to GDP increased steadily from 11.5% in 1973-74 to 46% in 2007-08 implying that the economy is being increasingly monetized.
- Private sector credit as percent of GDP grew to 35% in 2007-08 compared to only about 3% in 1973-74.
- The share of private sector credit to total domestic credit increased from 24% in 1973-74 to 74% in 2007-08.
- Time deposit increased from 40% to 76% from 1973-74 to 2007-08.
- Market capitalisation of all shares and debentures listed in the Dhaka Stock Exchange stood at 14.6% of GDP by June 2008 compared to 8.7% of GDP at June 2007.

Development of Government Bond Market

- Government has initiated reforms in the area of debt management since 2005. It has enacted the Bangladesh Government Treasury Bonds (BGTB) Rules, 2003 under which treasury bonds are being marketed on a regular basis. Development of a primary market for buying and selling of government bonds of varying maturity (5 year, 10-year, 15-year and 20-year) to raise funds from the domestic market is one of the significant achievements of these reform initiatives.

External Sector

- Average export growth increased to around 18% in the 2006-2008 period from 7% in 1981-1985 period.

- In the total export basket, RMG accounts for 76%, Frozen Food 4%, Jute and Jute Goods 3%, Leather and Leather Goods 2% and others 15%.
- The import items include capital machinery (36%) and major primary goods (17%).
- Remittances from expatriate Bangladeshi workers stood at US\$ 7.9 billion in 2007-08 reflecting 32.4% increase over the previous year representing about 10% of GDP.
- FDI as percent of GDP shows a decreasing trend and stood at 7% during 2007-08.
- Foreign Exchange Reserve stood at US\$ 5.6 billion as on February 3, 2009.

Recent Global Financial Crisis: Bangladesh Context

The global financial crisis triggered by US subprime mortgage debacle in 2007 severely affected the world economy putting it into a recession. The possible areas that could affect the economy of Bangladesh include **exports, remittances and foreign investment**. The real impact is however, not visible at this stage. The degree of such impact will depend on how deep and prolonged the recession is.

Challenges and Policy Responses

In order to face the challenges identified, the new government needs to come up with a set of appropriate policy interventions. The challenges identified and the suggested policy responses are categorized in three groups:

1. Immediate challenges and policy responses
2. Short and mid-term challenges and policy responses
3. Long-term challenges and policy responses

Immediate Challenges and Policy Responses

- Ensure effective market monitoring, removal of market barriers for key essential commodities
- Rationalize and prioritize projects and maximize ADP implementation
- Operationalise Agricultural Endowment Fund and Climate Change Fund
- Increase domestic revenue mobilization through the expansion of tax-net
- Expedite recent initiatives for power generation
- Boost up energy sector through Public-Private Partnership (PPP)
- Diversify exports in terms of both regions and items
- Ensure smooth supply of fertilizer at a reasonable price
- Ensure food security
- Expedite implementation of the 100 days Employment Generation Scheme
- Ensure early implementation of ongoing reform programs in Public Financial Management, Insurance Sector, Financial sector and other relevant areas
- Expand credit support to SME, IT, Agriculture and rural economy

- Check any sort of manipulation in the capital markets
- Ensure proper utilization of IT Equity Fund

Short and Medium-term Challenges and Policy Responses

- Minimise the losses of and subsidies to SOEs
- Maintain a tolerable limit of budget deficit
- Maintain stability in the financial markets
- Ensure proper policy intervention in terms of resource allocation to mitigate regional disparity, especially modernization of Mongla Port to utilize its full potential
- Improve quality of education both at secondary and tertiary level
- Establish a Skill Development Foundation to provide training to enhance the skill base of the prospective expatriate workers
- Strengthen Bangladesh Bureau of Statistics (BBS) to enhance its capacity to provide real sector data
- Widen the coverage of Medium Term Budget Framework (MTBF) to all ministries/ divisions

Long-term Challenges and Policy Responses

- Ensure good governance to accelerate economic growth
- Restructure civil service to ensure a well-balanced ratio of officers and staff within the government
- Restructure government institutions to support ongoing reform agenda
- Establish venture capital through Public-Private Partnership (PPP) to promote IT sector to realize the vision of Digital Bangladesh
- Manage the risks of climate change
- Expand communication network particularly railways and water ways
- Develop comprehensive land use and land management policy including planned township
- Explore natural gas and increase its supply
- Reduce regional disparity