Macroeconomics Policies and Performance in Bangladesh

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Unit highlights:

- ⇒ Political environment of Bangladesh
- ⇒ Change of economic ideology
- ⇒ Policies and strategies in international trade, finance, money, banking, agricultural and industrial sector
- ⇒ Growth of Bangladesh economy

Lesson-1: Political Environment and Changes in Macroeconomic Policies in Bangladesh.

Lesson Objectives:

After reading this lesson you would know the following:

- The political environment in which Bangladesh economy operated
- The change of economic ideologies.
- Internal and external demand and supply shocks

Political Environment and Changes in Macroeconomic Policies in Bangladesh.

In order to understand the macroeconomic scenario of Bangladesh and its change over time more comprehensively we should take into account the following : (1) change of economic ideology, (2) a series of real supply and demand shocks of domestic and international origin and (3) shift of policies during 1972 to 1994.

It should further be noted that of the past three decades or so, Bangladesh was either under military or civilianised military rule for about half of the period. After liberation in December, 1971 Bangladesh started with a parliamentary form of government and four avowed state principles e.g. nationalism, socialism, democracy and secularism, which lasted for a brief period. The parliamentary form of government revived again in 1991.

Bangladesh had a very short regime of state ownership of major means of production in the manufacturing and financial sectors and pervasive state control of and intervention in economic activities. Bangladesh however gradually moved to a market economy dominated by private sector.

Bangladesh's economic policies claimed to be based on socialist economic ideology were formulated in the early 1970s. As a consequence government was able to intervene in all the major spheres of economic activity through ownership of means of production in manufacturing, banking, insurance, trade, transport and communication and control over distribution of subsidized output (especially food and consumer goods) and inputs. Maximum ceiling was imposed on the amount an individual could invest. After 1975 the socialistic principles were abandoned and the economy gradually moved to a market-oriented economy. From 1980 onward structural adjustment policies were adopted in several phases as described later. However the policies adopted from 1987 onward marked a clear distinction from the past programmes. These policies were supposed to augment the growth of the economy through improved allocation of resources along with better resource balance.

Shocks of both internal and external origin affected Bangladesh economy. Important among those are flood, crop failure and oil crisis during 1974/75, severe drought in 1979, oil crisis in early 1980s, political turmoil in 1986, flood in two consecutive years 1987-88 and 1988-89, gulf war in 1991, political crises in 1990-91 and 1995/96, twin tower tragedy in September 2001 and subsequent involvement of the USA in armed conflict first in Afghanistan and then in Iraq and severe flood in 2004.

Even before 1975 Bangladesh adopted stabilization programme by an arrangement with the IMF which contained elements of structural adjustment of the economy. In 1980 Bangladesh entered into an agreement with the IMF for balance of payments support over a period of three years. This support was discontinued in 1981 as Bangladesh failed to meet certain conditions set in the agreement. This was followed by an agreement with the IMF for a concessionary lending under its Structural Adjustment Facility (SAF) for a three year period 1987-1989. In 1991 Bangladesh contracted a 3 year loan programme with the IMF. Both the programmes required sector- and institution -specific reforms to be carried out by the Government of Bangladesh. Furthermore, Bangladesh entered into an agreement with International Development Agency (IDA) under the Import Programme's credit which involved sectoral adjustment policies of various kind. The Policy Framework Paper required by Structural Adjustment Policy included predetermined targets for macroeconomic parameters and policy reforms. The World Bank and the IMF along with Government of Bangladesh jointly developed the paper and provided a device for Bank-Fund coordination on economic management.

Some scattered elements of structural adjustment of the economy can be traced in the early 1980s as well as in the 1970s. But a more comprehensive structural adjustment programme involving reforms in different sectors and aid commitments based on agreements between the Government of Bangladesh and the IMF and the World Bank started in 1987

Broad areas of reform since 1987 include trade liberalization, privatization of state owned enterprises (SOEs), reduction in public consumption, increased domestic resource mobilization, withdrawal of subsidies on food grain and agricultural inputs, financial sector reforms and pro-private sector investment policy.

Even during the early 1970s some SOEs were privatised. The new Industrial policy of 1982 envisaged denationalisation of SOEs and restricted future public sector involvement in the industrial sector. Only six categories of industries were opened for private sector investment. These industries/ activities had remained within the domain of the public sector since liberation. Industrial policy of 1986 put forth more prominently the possibility of joint public private ventures in industrial fields for which the private sector could not procure adequate funds. It also restated and elaborated the programme of converting the public corporations into public limited holding companies and consequent offering of shares to the private sector of up to 49% of enterprises under the sector corporations.

Denationalization that took place before 1986, was not a part of a comprehensive programme imposed and/or approved by donors while privatization and restructuring carried out since 1986 till date are component of a comprehensive donor approved programme. Until recent past certain institutional reforms and contingent measures like increasing public sector efficiency, eliminating inefficiency in administrative system, improving public services, ensuring law and order situation, quick settlement of industrial disputes, taking safety measures for displaced workers were not given due consideration.

From 1980 onwards structural adjustment policies were adopted in phases as we have noted earlier. However, the policies adopted from 1987 onwards marks a clear distinction over the past programmes. Policies formulated and implemented since 1987 were aimed at increasing the growth rate of the economy through improved allocation of resources and better resource balance. For examining the evolution of policies and macroeconomic performance we will consider the period 1972-2003 for which relevant information pertaining to different sectors is available. This period can be subdivided into a shorter nationalisation phase (1972-1975) and a longer denationalisation phase (1976-2003). The later phase can again be subdivided into two time spans- 1976-1986 (pre- adjustment period) and 1987-2003 (post- adjustment period). It may be recalled here that Bangladesh has a parliamentary form of government since 1991.

Lesson- 2: Policies and Strategies in Different Sectors.

Lesson Objectives:

After studying this lesson you should know the following:

- Policies and strategies in external sector
- Policies and strategies in finance, money and banking sector
- Policies and strategies in agricultural and industrial sectors

External Sector:

A. International Trade

After liberation Bangladesh continued Import Substitution Strategy which had been practiced in undivided Pakistan. Bangladesh had little foreign exchange reserves to start with. It deployed an amazing number of protectionist instruments. A large number of tariff and non-tariff barriers were imposed and exchange rate at that time was overvalued. These also affected export since some export items used imported inputs. The control over import was made pervasive through the use of foreign exchange allocation system, import policy orders, import licensing system and operation of the state trading agencies including the Trading Corporation of Bangladesh.

In the 1970s Government of Bangladesh severely restricted import since import substitution strategy continued to be used after the liberation and foreign exchange reserve was very low. Some incentives were provided to encourage export which suffered a major set back due to war of independence.

While the government's emphasis was on restriction of import, it undertook certain measures such as Export Promotion License, Cash subsidy, Raw materials Replenishment Scheme and rebate of various indirect taxes and income tax in order to accelerate the growth of export.

Trade policy of Bangladesh took a U- turn in the early 1980s following governments' signing of an agreement with the IMF in 1980. Economic liberalisation manifested in removal of price distortions through elimination of trade barriers and exchange rate control, lifting of subsidies etc. Limiting the governments direct participation in economic activities through privatisation and stabilizing the economy through contraction of money supply was accepted as the corner stone of government's economic policy.

Following the industrial policy of 1982 levels of quantitative restrictions were reduced, rates, and dispersion in the rates of tariff were reduced too. Import licensing system was removed during 1983/84. Trade liberalisation programme made an effective start when the government entered into an agreement with the IMF under its Structural Adjustment Fund (SAF). Some progress was made during the late 1980s in removing quantitative restrictions on imports, decreasing tariff levels, rationalizing tariff structure and simplifying trade procedures.

Since early 1980s import trade was liberalized through elimination or reduction of tariff and quantitative restrictions, removal of control over the use of foreign exchange and simplification of trade procedures. Different measures were taken to encourage export as well.

Following a 3 year contract (1991-93) between the Government and the IMF trade liberalisation activities were significantly intensified. List of banned or restricted import items was drastically reduced. Customs duty rates were brought down along with number of different custom duty rates. As a consequence of tariff restructure trade weighted nominal protection rate declined. However, few industries like edible oil, milled cloth, wood and wood products still enjoyed effective protection rate exceeding 100 percent. Besides, the coefficient of variation in the nominal effective protection rate across different industries increased.

Bangladesh switched off to unitary system from a multiple exchange rate system- the currency was pegged to the pund sterling and could float vis- a- vis other currencies as pound sterling were allowed to float.

Import clearance procedure were simplified. Import License requirements were completely removed in 1993. Voluntary Pre- Shipment Inspection System was introduced whereby foreign pre-shipment inspection firms could certify valuation of imports for tariff purposes. In the recent past distortional multi- rate sales tax on imports and domestic production was replaced by uniform value-added tax. These measures also helped exporters who import raw materials and inputs from abroad. A number of measures were taken to specifically encourage the exporters. These include Export Performance Benefit Scheme, Duty Drawback Scheme, Bonded Warehouse Facility, Export Processing Zones, Export Credit Guarantee Scheme, Export Development Fund.

B. Exchange Rate

Following liberation there occurred a transition from the multiple exchange rate system of Pakistani era to a unitary system which required Bangladesh currency to be pegged to the pound sterling. As a result Bangladesh currency floated vis-a-vis other currencies as pound sterling was allowed to float. Substantial devaluation of currency compared to pre-liberation time occurred when Bangladesh fixed the external value of taka in January 1972. Another major devaluation of taka of the order 58% took place in May, 1975.

Bangladesh shifted to a system of managed floating exchange rate system in 1980. Introduction of WES in 1979 lead to a dual exchange rate system which disappeared as official exchange market and secondary exchange market were unified in 1992

Introduction of Wage Earners Scheme (WES) in 1979 gave rise to a dual exchange rate system. Bangladesh economy shifted to a system of managed floating exchange rate in 1980. The exchange rate was based on a secret basket of currencies; the US dollar was used as the intervention currency. The official exchange market and secondary exchange market (through which import based on remittances of wage earners living abroad could be affected) were unified in January,1992. This was possible as more imports were shifted to the secondary market from official exchange market and the differential between WES rate and official exchange rate tended to coincide. In October, 1993 taka was made fully convertible on the current account. Market forces now have a relatively more free play. The foreign exchange dealers now can fix their own buying and selling rates. But some control on exchange is still retained since Bangladesh Bank sets its generally inflexible reference rates for conversion of US dollars into taka.

REER was more favourable for imports rather than for exports and more favourable for non traditional exports rather than for traditional exports.

The exchange rate has been devalued more frequently in the recent past (in late 1990s) ostensibly for keeping the real effective exchange rate competitive. Real Effective Exchange Rate (REER) measures real cost (or earning) per unit of import (or export) based on exchange rate and inflation rates. REER seems to be more favourable for imports than for exports. REER has been more favourable for non traditional exports than for traditional exports. But the exchange rate incentives provided to non traditional exports vis-a-vis traditional exports have been modest. Government introduced market based floating exchange rate system in May, 2003. Following this no significant instability in the exchange rate has been observed since now.

The Financial and Money sector:

A. Money Supply

Money supply growth rate has been much lower in most of the years in post-adjustment period compared to pre-adjustment period.

Narrow money supply (i.e. notes and coins in circulation plus demand deposit, usually called M-1) grew at an average annual rate of 17.89 % during the Pre-adjustment period. The growth rate declined to 11.59 % during 1987-1996. The reduction is more spectacular in case of broad money supply. Average annual growth rate of broad money supply, M-2 (i.e. M-1 plus time deposits) declined to 8.24% from a high 16.88% observed in the pre-adjustment period. Income velocity of circulation of money has not remained static over the period 1972-1996 it has experienced a trend of decline though during last three consecutive calendar years (1994-96) it remained stable. During 1996-2001 annual growth rates of money supply (both M-1 and M-2) increased to be around the pre-adjustment level. After that period the growth rate of money supply (both M-1 and M-2) has declined substantially. This along with the fact that rate of inflation has somewhat increased and growth rate of GDP has remained more or less stable suggests that income velocity of circulation of money has increased in recent years.

B. Interest Rate

Real interest rate needs to be positive and sufficiently high in order to attract substantial savings. The average inflation rate during the pre-adjustment period was 16.15 %. Major restructuring of deposit and lending rates was done in 1974 and 1980. Bank rate had been raised from 5% to 8% in 1974 and later it was raised to 10.5% in 1980. As is evident, those rises were inadequate to generate positive real rate of return on deposits.

In the early 1980s attempts were taken to reduce the role of the public sector in the financial sector. Two nationalized commercial banks (NCBs) were denationalized and another one was partially privatized. Private banks were allowed to enter the market.

On the basis of recommendations of the World Bank and the IMF, the government initiated in 1990 a five year financial sector reform project (FSRP) with a broad agenda. One of the objective of the project was to eliminate controls on interest rates with the purpose of developing lending. A band of interest rates on bank deposits and advances is set within which banks are free to fix their own rates. The spread between interest rate on deposits and that on advances has increased since 1990/91. The weighted average of interest on scheduled bank's advances has not declined much. During 1997-98 interest rate paid on savings deposits by the NCBs ranged between 7.5 % -8.0 %. Interest rate charged on term loan was 14.5 % in case of the NCBs and 12.0 % - 16.5 % in case of private banks. So in the late 1990s depositors had unattractive (zero or very small positive or even negative) rate of return from savings as well as fixed deposits held in the NCBs in view of the prevailing 7% - 8.5% inflation rate and tax on interest earning.

A five year Financial Sector Reform Project with a broad agenda was introduced in 1990. Interest rates have been lowered and the differences between interest rates on bank deposits and those on bank's advances have increased since 1990/91. Post tax real interest rates on deposits provide little or no incentive to the public to keep their deposits in

At present rate of interest paid on saving deposits is only 4.5% and rate of interest on term deposits ranges from 6.25% to 7%. Rate of interest on loans and advances ranges from lowest 7% (export sector) to highest 15%. Current inflation rate is a little over 5%. So on this account people have little or no incentive for having deposits in commercial banks. Recent drastic reduction of rates of return from Savings Bonds and Pension Deposit Scheme adversely affects the savers belonging to middle or low income class.

C. Banking System

Other objectives of the FSPR were to enhance greater competition in the banking system through privatizing some more NCBs and allowing private sector to open banks, to improve management, operation and supervision of the banking system and to improve the financial health of industry. Nothing substantial could be done in the way of recovery of overdue debts of astronomical amount. Private banks are also reported to be engaged in extending substantial proportion of its deposits as loans to its directors. Donors, at present, do not show much enthusiasm about privatizing more NCBs. Central bank of Bangladesh seems to be lacking in authority and autonomy in managing and supervising the banking system of the country.

Industrial Policy

During 1972-75 industrial policies of Bangladesh aimed at public sector led industrial development, gradual policies of opening up areas for private sector investment and promotion of import substituting industries.

From 1982 onwards private sector was assigned the key role to play in rapid industrialization of the country. Privatisation programme achieved major success during early part of Ershad's regime- since then privatization activities have almost stood still

We discussed earlier how denationalisation process started even during nationalisation phase (1972-1975) and how areas open for private investment expanded during the same period. Though major improvement in institutions and mechanism for privatisation has taken place in the 1990s most of the privatisation was accomplished in the early part of Ershad's regime. Privatisation activities have almost stood still since then. Ceiling on private investment was however eliminated long ago in the 1980s. During 1975-1982 investment sanctioning procedures were relaxed, stock market was revived and a number of export promotion measures were undertaken. New Industrial Policy of 1982 emphasized export- oriented growth which necessitated substantial changes in the regime of trade and industrial incentive structure with emphasis on export diversification and import liberalisation. From 1982 onward private sector was assigned the key role to play in rapid industrialization of the country. The Revised Industrial Policy of 1986 retained the objectives and spirit of the earlier industrial policy. More export incentive instruments were made available to the entrepreneurs. Import was, also deregulated through reduction of number of items on the negative list.

Fiscal Sector

Domestic resource mobilisation is considered to be the major objective of fiscal policy in Bangladesh. Different governmental transfer payments, progressive tax rate structure applied to direct taxes and specific pro-poor projects financed by the government are some of the means to reduce income disparity, in the arena of fiscal sector.

The major policy shifts in this sector took place in the mid-1980s. As foreign aid availability reduced and counterpart local fund was required to ensure flow of foreign fund in different projects, need to reduce fiscal and trade deficit and increase saving rate became all the more important. Revenue /GDP ratio of Bangladesh, one of the lowest in the world improved significantly in the first half of the last decade mainly due to introduction of value-added-tax (VAT). Since then the coverage of VAT has continually been expanded. In recent years income from VAT seems to have stagnated.

The country still depends too much (about 80%) on indirect taxes. In Bangladesh agricultural income remains almost untaxed. There was some improvement in the area of fiscal discipline probably at the cost of lower level of economic activity in the first half of the last decade. In late 1990s the situation seems to have worsened. The introduction and broadening of the base of VAT enabled the country to somewhat cushion its tax revenues from tariff reforms. Government adopted an over -zealous expenditure policy in the early 1980s. The development expenditure/GDP ratio stagnated in the late 1980s and early 1990s. Revenue expenditure/GDP ratio has increased over time. However in the revenue budget the share of expenditure on social services (such as education and health) though declined in the late 1980s, has increased in the subsequent period. Fiscal deficit/GDP ratio improved during the post-adjustment period. But it worsened somewhat in late 1990s due to failure to attain revenue collection target. It should be noted that non attainment of revenue target is a perennial problem faced in Bangladesh economy. Government resorted to internal borrowing both from commercial banks and the Central bank to finance the deficit. This practice has been continued in the present decade too. During 1999- 2000 government's internal loan was about 2.8% of GDP. Budgetary situation has somewhat improved during last three years or so. Government has set an ambitious revenue collection target for the year 2004-2005. Because of recent devastating flood and political turmoil further improvement in the budgetary situation and reduction of internal borrowing may turn out to be a formidable task.

In Bangladesh there are too much dependence on indirect taxes and a large scale evasion of direct taxes. Revenue/GDP ratio and Fiscal deficit /GDP ratio improved for a short period in the first half of the past decade and during last 3 years. Maintaining this improvement in the near future seems to be a formidable task. Expenditure on social sectors as a proportion of GDP has improved over

Agricultural Sector

Subsidies on agricultural inputs were gradually withdrawn but not absolutely eliminated. Government still controls food grain prices through different means

After the liberation Bangladesh switched to small scale irrigation and flood control projects from large scale irrigation and flood control projects. The BADC (Bangladesh Agricultural Development Corporation) was relieved of fertilizer distribution - this task was handed over to private sector. Subsidies on agricultural inputs were gradually withdrawn and the import, procurement and distribution of irrigation equipment, pesticide and fertilizer was transferred to private hands. Cost of crop production increased while relative price of food grains declined. Import and export of food grains was made open for private entrepreneurs around mid-1990. Minimum price on jute was also withdrawn. Government however still interferes in the food grain market through procurement, ration off take and open market sale to control the price of rice. Coverage of food grain rationing system has been reduced and limited to vulnerable population groups through a number of targeted programmes like Test Relief, Food for Work and Vulnerable Group Development, and some special classes (such as army, police and ansars).

Subsidies in agriculture were recovered to some extent during the previous government's regime. The present government in power first reduced it drastically but increased the amount of subsidies in agriculture later on.

Lesson - 3: Performance of Bangladesh Economy

Lesson Objectives:

After reading this lesson you would learn the following:

- Growth of Bangladesh economy

- Change of the structure of the economy
- Employment and price situation
- Contribution of external sector
- Investment and saving performance of the economy

Economic Growth

The Gross Domestic Product of the economy grew at a compound rate of 3.5% per annum during 1973-1995. The economy experienced an average annual growth rate of 3.8% during 1974-1986. During 1987-1995 average annual growth rate was 4.1%. The country however achieved more than 4% annual growth rate in last consecutive four years. Annual growth rate improved to over 5% in most of the years during 1996-2004. There were however temporary set back during 1998/99 due to severe flood and during 2001/02 due to demolition of twin tower and the political development and economic crisis all over the world that followed the incident.

In recent past the economy has an annual growth rate over 5%.

Agriculture:

Agricultural output grew at a compound rate of 2.1% per annum during 1974-1995. The average annual growth rate of agricultural output was 1.5% during 1987-1995 compared to 2.3% during 1974-1986. The decline in growth rate was due to slow growth rate (0.8%) experienced by the crop sub-sector. Apart from natural calamities, exhaustion of easy sources of irrigation water, agronomic constraints, increase in fertilizer prices and decline in the relative price of food crops are believed to account for this slow growth. On the other hand, forestry, livestock and fishery experienced 4% - 10% annual growth rates in the late 1990s. During 1997-2004 growth rate of output of the crop sub-sector fluctuated severely (-2.4% to 8.1%) and the fishery sub-sector experienced a decline in growth rate. On the other hand growth rate of forestry output remained more or less stable and livestock output growth rate improved during the above period.

Industry:

Industrial output grew at a compound rate of 3.1% per annum during 1973-1995. The average annual growth rate of industrial output was 5.8% per annum during 1987-95. During 1974-1986 average growth rate was 4.9%. Output of large scale manufacturing sector grew at a compound rate of 5.6% per annum. There was no

mance of ricultural specially the crop tion sub- ctor) and al sector cially the facturing or) in the ast is not isfactory significant change in the growth rate in the adjustment period. Small scale manufacturing sector achieved an average annual rate of 1.1% during 1974-1986. During 1987-1995 this rate rose to 2.9%. During 1996-2004 annual growth rate of output of small scale manufacture rose and moved between 6% and 8%. On the other hand annual growth rate of output of big and medium industries ranged between 4% and 7% during the same period- in 5 out of 8 years the growth rate was less than 5%. The performance of both agricultural sector and industrial sector is not at all satisfactory.

Other sectors:

The average annual growth rate of construction sector was 8.1% during pre adjustment period. It declined to 7.0% during 1987-1996. During 1997-2004 this sector experienced a more or less stable annual growth rate over 8% but less than 9%.

Power and gas sub-sectors had spectacular growth rates during late 1980s and early 1990s. The growth rates sharply declined in the subsequent period as no major investment took place in those sub-sectors.

Power, Gas, Water and Sanitary services sector had a compound growth rate of 15.3% per annum during 1974-1995. Substantial improvement occurred in the growth rate of this sector during 1987-1997. From an average annual growth rate of 14.7% in the pre adjustment period, the sector grew at an average annual rate of 19.1% during 1987-1996. During 1997 - 2004 growth rate of output of this sector declined sharply- it came down to 6% to 8%. This was so because no major investment took place in gas and electricity sub-sectors.

Banking and insurance sector had the second highest compound rate of growth (10.5%) of output during pre-adjustment period. During 1987 - 1997 growth rate of output of this sector declined to 2.3%. This decline may be attributed to high proportion of delinquent loans, inefficiency, and lack of discipline reported to be prevailing in this sector. During 1998-2004 the growth rate of output in this sector increased substantially. This rise in growth rate may be accounted for by the emergence of private banks and insurance companies and reduction of trade union activities.

Transport, storage and communication sector, Trade services sector and Public Administration and defense sector grew at compound annual growth rate of 4%, 5% and 6% respectively during 1974-2004. There was insignificant difference between respective growth rates achieved during pre-adjustment and adjustment period.

Change of Structure of the Economy

In 1973 agriculture and industry respectively contributed about 50% and 14% of GDP and other sectors combined together contributed the remaining 36% of GDP. These proportions changed to 41%, 16% and 53% respectively during 1986, the last year of the pre-adjustment period. In 1995 the share of agriculture, and all other sectors except industry combined together was 33% and 48% respectively. During 2002-2003 agricultural sector combining crop production, livestock, forestry and fishery contributed about 23.5% of GDP, industry contributed only16% and the remaining sectors accounted for about 50.5% of GDP. Share of manufacturing sector has not increased by any significant extent - which is a big concern for policy makers as well as academicians. Manufacturing sector is considered to be the more dynamic part of industry. Its share in GDP fluctuated around 10% during post-adjustment period. Almost similar share for manufacturing sector was observed in the late 1970s and early 1980s. The share is now a little over 11%. Besides ready-made garment industry has been dominating the industrial activity since the 1980s which means that the industrial sector has not been able to diversify itself. Share of agriculture in GDP has fallen- but low rate of growth of output in this sector in the recent years poses to be a serious threat in sustaining the growth rate of GDP over 5% in near future.

Composition of GDP has changed over time. But the industrial sector failed to raise its share in GDP by any significant amount while agriculture's share declined persistently.

Employment Generation

In Bangladesh agricultural sector still remains the largest sector in terms of employment. Number of persons employed in agriculture rose from 33.3 million in 1990/91 to 34.4 million in 1995-96. This sector absorbed 66.4 % of labour force in 1991. This ratio slightly declined to 63.2% in 1995/96. Number as well as proportion of workers (to total labour force) engaged in industry declined. According to Labour Force Survey, 1995 - 96 only 7.5% of labour force were engaged in the manufacturing sector. It is also noted that growth rate of employment in service sector was a little over 14% during 1990/91 - 1995/96.

According to Labour Force Survey 1999 - 2000 62.3% of labour force (6.03 crore = 3.75 male + 2.28 female) were absorbed in agriculture and only 7.5% of labour force were engaged in the manufacturing sector

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The bulk of employment generation in Bangladesh has occurred in the informal sector. The share of informal sector in total employment generation was around 60% during 1988/89 - 1995/96. Employment in the informal sector increased from 45.3 million in 1988/89 to 47.9 million in 1995/96. But more than 79% of those employed in the informal sector in 1995/96 had been either in the class of unpaid family workers (46% of informal workers) or that of self employed (33% of informal workers).

Price Situation

The average annual rate of inflation in the pre- adjustment period was 16.15%. The economy experienced a very high rate of inflation during 1972-75 - the rate was as high as 70% in 1975. During next two years the economy experienced deflation. The first spell of inflation was caused by crop failure, decline of industrial output and trade due to dislocation caused by war, increase in money supply, increase in oil price in the international market and a major devaluation (about 58%) in May, 1975. The subsequent deflation may be accounted for by demonetisation of hundred taka notes and relatively better performance of sub-sector of crop production. The country experienced double digit inflation during the remaining years of pre-adjustment period with the exception of the year 1983.

Since 1988 Bangladesh did not experience double digit inflation rate. During last ten years the annual rate of inflation was less than 5% in most of the

During the adjustment period double digit inflation rate was experienced only in the first year i.e. 1987. The average annual rate of inflation during 1987-1995 stood at 6.36%. Not only the mean rate but also the dispersion in inflation rate declined in that period. This improvement was accomplished through reduction in money supply, rise in growth rate, improvement in financial discipline and better implementation of government's food policy. During 1996/97 - 2002/03 annual rate of inflation was well, below 5% in most of the years. The rate was however 9% in 1997/98 and 7% in 1998/99. The former may be explained by big devaluation (more than 6%) and the latter by the devastating flood. At present the annual rate of inflation is well over 5% but less than 6%.

External Sector Performance

Rise of trade/GDP ratio from 17% in 1973 to over 30% at present indicates increasing openness of the economy. During pre-adjustment period export grew at 7.4% per annum but imports grew at a much faster rate. During 1987- 1997 exports grew at a rate of 17% per annum. The average annual growth rate of import has been only 11.2%. There was fluctuations in both imports and exports. Though export growth rate is quite high, export trade since mid 1980s is dominated by the single item, ready made garments while during the first decade and half or so after the liberation, raw jute and jute products dominated Bangladesh export.

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Bangladesh had negative balance of trade as well as deficit in the current account every year during the period 1972- 2001. Bangladesh had trade deficit in 2001/02 and 2002/03. But that was more than offset by transfers in current account in those years. This surplus in current account was mainly due to remittances of Bangladeshis from abroad. This surplus is likely to be repeated in 2003/04 too.

Generally current account deficit is much lower than the import-export gap due to positive private transfer mainly composed of remittances of Bangladeshi workers abroad. Current Account deficit is more than offset by flow of foreign aid so that there was net capital inflow every year during the period under consideration. As a result foreign exchange reserves kept on rising. During the period 1990-96 flow of foreign aid stagnated or declined. During first two years of this period import expenditure declined, then rose slowly for next two years and then rose sharply during the last two years. High amount of foreign exchange accumulated during this period mainly due to high growth rate of export supplemented by workers remittances from abroad. During 1995 foreign exchange reserve rose to 3.07 billion US $ (June, 1995). The reserve drastically fell from 1996 onward due to a significant rise in import. During last three years or so foreign exchange reserves have increased - the reserves reached a record high level of 3.23 billion US $ on the 4th September, 2004. This can be explained by a significant increase in remittances of Bangladeshis living abroad.

Foreign exchange reserves are positive because chronic current account deficits are more than offset by flow of foreign grants and loans. This reserve rises when import grows at a lower rate and/or flow of remittances rises at a high rate.

Bangladesh did not devalue its currency as much as other countries did during the 1980s and early 1990s. This combined with the fact that Bangladesh went for a much faster import liberalization compared to India resulted in a dramatic trade deficit with India. Bangladesh however cannot rely much on devaluation for raising its export because investment and manufacturing activities in Bangladesh are extremely import intensive. Bangladesh should take aggressive measures to make its exports more competitive and diversified. It should look for export markets outside the industrialized West as well. Bangladesh should try to find ways of improving trade balance with India by negotiating better export access to the vast Indian market.

Rapid import liberalization and minor devaluations by Bangladesh led to present dramatic trade deficit with India.

Investment Performance

During the 1970s, Bangladesh had an average investment rate of about 6.6% during 1972/73 - 1975/76 - but this rate rose to 11.4% during 1976/77 -1978/79. In the pre -adjustment period a short investment boom occurred during 1979/80-1981/82 generating an average investment rate of 15.66%. Rise of Investment / GDP ratio in the late 1970s may be accounted for by removals of restrictions and ceilings on private investment. The short lived investment boom that occurred during 1979/80 - 81/82 may be explained by free flow of foreign aid, adoption of a strategy of private sector development based on direct government controls along

ent/GDP remained ess static und 12% 1983/84- nce early the ratio dily at a ace. The could not gnificant f foreign estment. t decline f interest s to have failed in with a very liberal dispensation of cheap credit and protection of domestic industries. To a large extent the present problems regarding the so called sick industries and large scale default of bank loans originated from that action. The investment boom disappeared due to subsequent decline of development financing institutions (DFIs), reduction of the flow of external aid and a sharp decline in the country's terms of trade.

Investment as a proportion of the GDP had a long period of stagnation at around 12% during 1983/84-1991/92. From 1992/93 onwards a persistent upward trend in the investment/GDP ratio was observed. This ratio reached about 20% in 1995/96. During the next 8 years investment / GDP rose steadily although at a very slow pace. The ratio stood at about 23.5% during 2003/04. Public investment as a proportion to GDP fluctuated during this period and was less than 6.5% in most of the years. On the other hand private investment as a proportion of GDP rose to 17.5% during 2003/04 from 13.6% during 1995/96.

Domestic saving ratio rises when there occurs an improvement in the budgetary situation resulting from either a big rise in revenue earning or slow growth of public expenditure. National saving ratio is always greater than domestic saving ratio due to the flow of a significant amount of remittances by Bangladeshis living abroad. The short fall between investment ratio and national saving ratio is met by flow of foreign

Bangladesh has very low investment / GDP ratio and saving / GDP ratio compared to other developing countries. The country has not been able to attract a significant amount of foreign direct investment (FDI) though it has a liberal investment policy. Bulk of the foreign private investment came into gas and power sector. Some of such investment has also come into telecom sector. Inflow of foreign private investment in Export Processing Zones has been quite small. FDI situation looks even poorer when net inflows rather than gross inflows are considered.

Recently rate of interest has been reduced significantly. But that measure appears to have failed in raising the investment level by any significant amount. Commercial banks of Bangladesh are reported to have excessive amount of idle reserves (more than one thousand crore taka) for which they have only to bear the burden of interest payable to the depositors. It may be noted here that the legal minimum reserve deposit ratio in Bangladesh is much higher than that in industrially advanced economies. Non-government development organizations and professional money lenders and mahajans charge much higher interest rates in rural areas. The stock markets still remains poorly managed. The dismal law and order situation, bureaucratic red tapism, poor infrastructure, high cost of having electricity, telephone and gas connection are considered to be major problems in enhancing the growth rate of investment

Savings Performance

Bangladesh has a depressingly low rate of domestic saving (private saving + public saving) rate. The rate was negative or less than one percent in the early 1970s due to chronic budget deficit. It was around 2% in the remaining years of the decade except the year 1976/77 when the saving rate rose to 6.0 %. During 1980s saving rate was around 2.0 % in most (6) of the years, less than 1% in two years and more than 3% in remaining two years. Domestic saving ratio significantly increased during 1990/91-1995/96-it ranged between 4.1 % to 8.3%. This was possible due to increase in revenue earning in the early 1990s. Rate of national saving (domestic saving plus net factor income from abroad) ranged between 9% - 15% during 1987-1996. The short fall between investment and national saving was met by flow of foreign aid and grants. Domestic saving ratio steadily rose from 14.9% in 1995/96 to 18.3% in 2003/04. During the same period national saving ratio rose from 20.2% to 24.5%.

The importance of foreign aid in financing development expenditure has declined over time mainly due to decreasing availability of such aid, lower growth rate of import, higher growth rate of export and increasing flow of remittances of Bangladeshis living abroad. There has been a continuous decline of debt service liability as a proportion of export earning during the 1990s.

Concepts for Review

Structural Adjustment Programme
Privatisation
Import Substitution Strategy
Export-oriented Growth
Real Effective Exchange Rate
Nationalised Commercial Banks
Denationalisation
Trade Liberalisation
Wage Earners' Scheme
Value-added Tax
Export Processing Zone
Financial Sector Reform Project

Short Questions:

1. What are the major demand and supply shocks experienced by Bangladesh economy?
2. State how the dominance of public sector in the economy has declined over time.
3. What are the major problems encountered in the fiscal sector?
4. Examine the need for foreign assistance by looking at investment - saving and import - export gaps.

5. What sort of structural transformation of Bangladesh economy has occurred in the past three decades or so?
6. Evaluate the performance of the industrial sector.
7. Why was inflation rate so low in the 1990s as compared to the price rise situation in the 1980s and 1970s?
8. Why is current account deficit, at present, is much lower than the import - export gap in Bangladesh?
9. What measures were taken in the past to liberalise trade?
10. What role the donour agencies play in formulation of economic policies and economic strategies of Bangladesh? (Present your view by considering at least two sectors of the economy)
11. Some industries are likely to be benefited by devaluation while some are likely to be harmed by devaluation. Identify those two categories of industries and explain why you have so categorised them.
12. State the evolution of exchange rate system of Bangladesh.
13. Evaluate the performance of Agricultural sector of Bangladesh.
14. What, in your view, are the problems for Bangladesh economy and why?
15. Do you think that there are some economic activities which must be performed by the state? Why is an improvement in law and order situation a prerequisite for economic development in Bangladesh?