

Slow growth of investment

The Centre for Policy Dialogue on Monday published an analytical review of Bangladesh's macroeconomic performance in 2011-12. The following is the third part of the executive summary.

STAR BUSINESS DESK

INVESTMENT targets set forth in the SFYP faced a major hurdle in view of the slowing investment growth in the second year of the plan period in FY12 (7.6 percent vis-à-vis 9.9 percent in FY11).

Indeed, as mentioned earlier aggregate investment-GDP ratio along with its two components may experience a reduction in FY12.

It is reckoned that slow growth of investment, rising inefficiency in the use of capital, unutilised productive capacity and adversarial business environment may emerge as major challenges that could undermine the prospect of attaining investment targets earmarked for the rest of the period of the sixth plan.

The impact of investment on GDP growth is determined to a large extent by the respective roles played by public and private sector investment through the interplay of 'complementary' and 'competitive' roles, 'crowd out' and 'crowd in' effects, and short and long term influence on private investment.

Whatsoever, both public and private investment in Bangladesh is higher than the average levels applicable for low income countries but is lower than that of the middle-income countries.

The size of the public investment in Bangladesh has not experienced any significant rise over the recent past, rather it often in real terms (e.g. between FY06 and FY09) shrank. RDP, in terms of inflation adjusted value, has registered a rise of only 6.3 percent between FY09 and FY12 as against an increase of 26 percent in current market value.

Over the recent years, local sources are being increasingly used for financing the RDP from 56 percent (FY09) to 63 percent in (FY12). Within the local sources, bank borrowing has emerged as the major source of financing of the ADP up from a share of 74 percent in the total local finance in July-March, FY09 to 93 percent in July-March, FY12.

If commercial banks do not have sufficient amount of 'excess liquidity', this rise in public borrowing may have a 'crowding out' effect on private investment.

However, the fluctuation of the excess liquidity in banks (from as high as 45 percent of total liquid assets in June, FY2009 to 30.7 percent in January, FY2012) cannot always be explained by additional public borrowing.

This is perhaps also related to other financial market issues such as collapse of the capital market in December, 2010, irregularities related to transactions in the capital market, anomalies in the transaction of credit in the commercial banks, and transfer of fund for unproductive purposes etc.

Analysis of a Vector Error Correction model conducted by the CPD shows that public borrowing may not have significant 'crowd-out' effect on private investment in Bangladesh.

Public investment's 'complementary' role is likely to create a 'crowding in' effect with respect to private investment. In the context of Bangladesh, this possible nexus needs to be examined not only in terms of the volume of public investment, but also from the perspective of quality of these investments including appropriateness, effectiveness and timeliness etc.

Taking into cognisance the medium and



STAR

The government is expected to increase subsidy for the energy sector in the budget.

long term development priorities, the present government has put special focus on a few selected sectors particularly in the power and transport sectors, and also in the rural development sector (45 percent of the RDP in FY2012).

However, some of the qualitative aspects related to these investments have led to question the extent of their 'crowding in' effect for the private sector investment.

After a significantly high investment in diesel operated quick rental and peaking power plants, additional electricity generation has only been to the tune of about 50 percent of the newly installed capacity.

Low level of project implementation has been a recurring weakness with regard to public investment. This has reached a new low in FY2012 (55 percent during July-April, 2012).

An exercise of Vector Autoregressive (VAR) model carried out by CPD found insignificant crowd-in effect of public investment with respect to private investment (only significant relationship was found in case of public investment in industrial sector).

Private investment has been slowing down in FY2012 which is reflected in low capital flow in agricultural and manufacturing sectors as well as in insignificant level of foreign direct investment (FDI) in Bangladesh.

Figures relating to disbursement of agricultural credit shows that it has decelerated at a fast pace in July-March period of FY12 in comparison to its preceding year, i.e. from 16.6 percent to 6.2 percent.

Industrial term loan disbursed during July-March, 2012 was a mere 2.3 percent higher compared to the same period of the previous year.

Low level of disbursement of industrial credit, particularly to the manufacturing sector got reflected in slow growth, if not negative growth of import of raw materials, intermediate inputs and capital machineries.

It seems investment recession will continue for some time as the value of opening of letters of credit (LCs) for import of industrial machineries (including for textile sector) and raw materials has been lower during July-

January of FY12 as compared to that of in FY11, with the notable exception of import of petroleum.

FDI flow was declining during July-January, FY2012 registering a negative growth of -3.5 percent when compared to the corresponding period of the previous year. If the outward transfers are deducted, net inward FDI flow will be negative, i.e. (-)\$51 million.

A huge amount of outward transfers in the form of profit, dividend and royalties and other incomes of foreign-owned companies in recent years -- \$565 million, \$553 million and \$593 million in July-March period for FY2010, FY2011 and FY2012 respectively -- indicate lack of reinvestment interest on the part of the existing foreign-owned companies.

It may be also noted that, the capital market is in a volatile state since its collapse in December, 2010. Number of new IPOs offloaded in the market and their public offers in July-March, 2012 are less (10 and Tk 7,521 million) compared to the same period of the previous year (15 and Tk 18,478 million).

Various kinds of market stabilising initiatives undertaken during the last one year, by and large, have not been able to restore discipline and stability in the market.

Lack of implementation of appropriate measures by the regulatory authority to address the structural and operational problems and weaknesses is the main reason for the obtaining situation.

Adversities in business enabling environment are mostly responsible for slowing down of private investment in developing economies.

In the context of present Bangladesh, this is perhaps related to inadequate supply of electricity and gas, poor physical infrastructure, high inflation, high lending rates of commercial banks, and loss of exchange value of local currency etc.

During FY09-12, overall power generation capacity has increased by 3,380 MW thus creating a total generation capacity of 6,807 MW. However, effective supply of electricity has increased only about 50 percent of the

newly installed capacity.

Generation-installed capacity gap has increased in the country over the years; indeed the gap has doubled between FY09 and FY12 (from 1,557 MW to 3,028 MW).

The reduction in the generation capacity is mainly because of regular maintenance of power plants, low level of gas pressure, limited supply of fuel and a number of other factors.

Given the limited supply, demand for gas has been adjusted by shifting a part of supply mainly from one particular sector (e.g. fertiliser production) to other sectors. However, such activities did not raise the supply to industrial sector by any significant amount.

The national, regional and district level highways/roads were not in good condition since average roughness index of these roads has significantly increased in FY2010 compared to the previous year.

Meanwhile, the upward trends in inflation and interest rate and the exchange rate depreciation have led to an increase in the cost of production.

In the Executive Opinion Survey 2012, which is carried out by the CPD during February-April, 2012, top three problematic factors are found to be increasingly becoming more important factors for businesses.

Poor infrastructure is regarded as the most important problematic factor followed by high level of corruption which has elevated to the second position since 2011. Difficulty with regard to 'access to finance' is the third most problematic factor which has elevated this year.

These adversities are likely to cause high cost of production with consequent negative implication for competitiveness of business both in local and foreign markets. This is perhaps also reflected in the weak credit repayment performance of the private sector in the recent past.

The objective of self sufficiency in food production requires rice production to grow in a manner that matches the growth in population of the country. No doubt Bangladesh has been successful in adopting new technologies in agriculture including high yielding

varieties (HYVs), chemical fertilisers and irrigation.

The track record in terms of foodgrain production has led Bangladesh to attain self-sufficiency in rice production. However, continued import of foodgrains along with surplus production poses somewhat of a paradox and has raised questions as regards reliability of relevant data including the actual size of population.

Whether the growth record of the recent past years could be sustained in the future and whether Bangladesh has reached a technological frontier, are also questions that are being asked. The issue of long term food security has thus remained as a concern for the policymakers.

Increase in Aman production in FY12 has been insignificant and this was a concern. Although cultivated area for Aman was down by 1.1 percent, a somewhat positive growth (albeit of only about 0.05 percent) in production was achieved thanks to the productivity growth of about 1.2 percent.

The early estimate of Boro shows a growth of about 0.3 percent. However, there are indications that actual production of Boro will be higher than the early estimate. Import of foodgrains was low in FY12 compared to earlier years.

During July-March FY2012, total import of foodgrains was 2.38 MMT, which was about 44 percent lower than that of the last year. Since FY06, annual rice consumption has always been lower compared to the net production in Bangladesh indicating a net surplus in availability.

According to a CPD estimate, in FY12 a total amount of 5 MMT rice was available as production surplus which was 5.7 MMT in FY11.

Low coverage, delayed start of government procurement (partly due to lack of storage space) along with relatively low market price in the post-harvest season in FY12, may create a disincentive for farmers in this year.

The government undertook a number of projects under the ADP to increase storage capacity through construction of new silos. However, thus far, no new storage capacity has been added in the last three years.

In this backdrop, a failure to reach the procurement target could push the price of paddy/rice further down and thereby, could seriously undermine farmer's interest and create disincentive for them.

Upward adjustments of administered prices of such inputs as fertilizer, diesel and electricity and the increasing labour cost were major contributing factors which pushed up the cost of Boro production this year.

A CPD field visit survey revealed that, the production cost of Boro was 18 percent higher this season compared to that of the last year.

In the present context, it is quite unlikely that farmers will get the financial return that they were hoping for and, in view of the procurement price and prevailing market price, farmers could even suffer losses.

The government decided to procure 900,000 MT of rice (at 28 Tk/kg) and 150,000 MT of paddy (18 Tk/kg) from May 3 which will continue until September 30. The procurement price of rice (or paddy) is just enough to meet the cost of production.

Regrettably, in general, farmers in Bangladesh do not have the capacity to sell their crop directly to the government. As a result, at present on an average the farmers have to incur a loss of Tk around 150 per maund of paddy.

TO BE CONTINUED

Budgetary proposals for 2012-13

AKBARUDDIN AHMAD

THE impact of the economic downturn in Europe and USA has impacted the Bangladesh Economy. Bank borrowing by the government has increased substantially. The growth in revenue collection was less than the growth in public expenditure.

Bangladesh Bank continued with its credit squeeze for the unproductive sector. Foreign direct investment (FDI) has shrunk for the current fiscal that has caused a setback for rapid economic growth.

Financial pressure: The massive import of fuel oil to run rental power stations has caused the fuel import bill to rise from \$3 billion to \$7 billion. Budget deficit may remain at present 5 percent of gross domestic product, though the financing of this deficit has become a major issue.

Fiscal issues: Income tax - the tax exemption limit currently stands at Tk 180,000. This slab may be enhanced to Tk 250,000 for all male assesses. This slab may, however, be increased to Tk 300,000 for women and disabled persons.

Loss of revenues: The creation of a position in the Ministry of Finance for monitoring transfer pricing and money laundering issues that accounts for loss of government revenues of around \$2 billion annually has been a step in the right direction.

Black money to be whitened/ legalised: In the current context where FDI and general investment has slowed down, it is worthwhile to allow undisclosed wealth to be legalised through a payment of 10 percent to 15 percent tax.

Farming sector: This includes agriculture, horticulture, fish farming, poultry and allied activities which as a whole should be treated as a major thrust sector. Government subsidies for the agricultural sector should continue for the next five years till such time as the agricultural sector becomes resilient.

Tax holiday for at least 10 years may be considered for all agro-based units.

Information and communication technology: Entrepreneurs should be given the incentive for zero tax for all ICT companies involved in software developments, research, marketing, development and exports.

Small and medium enterprises: Substan-

tially increased allocation is needed for the equity entrepreneurship fund (EEF) to cover all labour intensive sectors.

Energy and power sector: Government should prioritise on medium (100-200MW) and large (500 MW) base load power plants instead of smaller oil based rental and quick rental ones to shed off subsidy burden and to resolve power crisis.

Poverty alleviation: The government needs to identify the poorer segment of the society in different geographical locations and allocate funds for the safety net programmes that should be in excess of Tk 20,000 crore for the budget year 2013.

Railway: A review of the railway train fare structure fixed in 1992 needs to be reviewed. This sector needs major budgetary allocation for improvement of the BR system.

Sea/river system:
i) Budgetary allocation for the dredging of the heavily silted river system is essential to ensure efficient riverine communication.
ii) The Chittagong and Mongla ports require further development to handle larger volumes import-export business.

READ MORE ON B3

অভিনন্দন



বিশিষ্ট ব্যবসায়ী, সমাজ সেবক ও নর্দার্ন জেনারেল ইন্স্যুরেন্স কোঃ লিঃ-এর পরিচালনা পর্ষদের সম্মানিত চেয়ারম্যান আলহাজ্ব নাসির উদ্দীন সোস্যাল ইসলামী ব্যাংক লিমিটেড পরিচালনা পর্ষদের চেয়ারম্যান নির্বাচিত হওয়ায় আমাদের প্রাণঢালা অভিনন্দন ও শুভেচ্ছা।

নর্দার্ন জেনারেল ইন্স্যুরেন্স কোঃ লিঃ এর পরিচালনা পর্ষদ, সকল কর্মকর্তা ও কর্মচারীবৃন্দ।