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# Development trends ...

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in calculating the value. In reality, the unemployment rate is higher than what is depicted in Graph 1.

**INFLATION**  
Estimation of historical changes in monetary policy (MP) and their subsequent impact on the economy, raise the difficult question of how changes in MP affect inflation, output, exchange and interest rates (Sargent and Sims, 2011). Commitment to a nominal anchor like inflation rate itself says nothing about what economic variables are best suited to play that role. Should

a negative correlation between the real rate of interest and credit growth.

Graph 2 shows the relationship between the real growth of interest and private sector credit growth. The low interest rate does not automatically result in credit growth. There are periods when relatively low interest has not lead to high credit growth and vice versa. In effect, the current monetary policy framework should go beyond the conventional wisdom-based approach by broadening its scope to take into account aspects such as the concentration of employment in agriculture and informal sectors; asymmet-

increased employment and purchasing power of the poor. On the supply side, the monetary policy can remove the impediments of the access to finance faced by the poor. So the role of SME enterprises, expansion of agriculture credit and financial inclusion must be duly emphasised.

**EXTERNAL SECTOR**  
The effect of the global financial crisis of 2007 on Bangladesh has been insignificant due to the prudent policies of Bangladesh Bank and the steady performance of the external sector. Graph 4 shows the growth of imports and exports. The negative balance of trade is offset by steady inflow of foreign remittances from migrant workers. Remittance steadily grew from USD 10.9 billion in November 2009 to USD 14 billion in FY 2014. Foreign exchange reserves also grew steadily from USD 10.7 billion in November 2009 to around USD 22 billion in March 2015. The external balances remain comfortable even with weak export growth and strong imports. Deficit in the current account emerged at USD 1.3 billion in July-January of FY 2015 compared to a USD 2.5 billion surplus during the same period in FY 2014. The deficit resulted from a weak export growth of 2.1% and a strong import growth of 16.4%. Slow

**CHALLENGES IN FISCAL MANAGEMENT**

Fiscal performance and expenditure management has been weak in Bangladesh in recent times. Despite increasing budgets from one year to the next, very little has been done regarding the control of unsustainable government spending and borrowing and the need to increase revenue sources. The government is facing budgetary constraints and is running up the deficit. Total borrowing from the financial system as of FY 2011 was USD billion, of which USD 2.2 billion was from the domestic banking system. This amount represents a 40% increase over 2010. A significant portion of the government budget has been allocated to subsidies, which could put a dent in fiscal sustainability efforts if there are no price adjustments.

Revenue mobilisation has also been inadequate. Tax revenue mobilisation in this case is very low. The tax system, despite recent reforms, is still poor. Mobilisation of revenue is one of the lowest in the world, while old policies and rigid administrative practices mean that the system has been very slow in bringing in new income-generating activities within the tax net. Such weaknesses mean that a significant portion of activities remain untaxed in addition

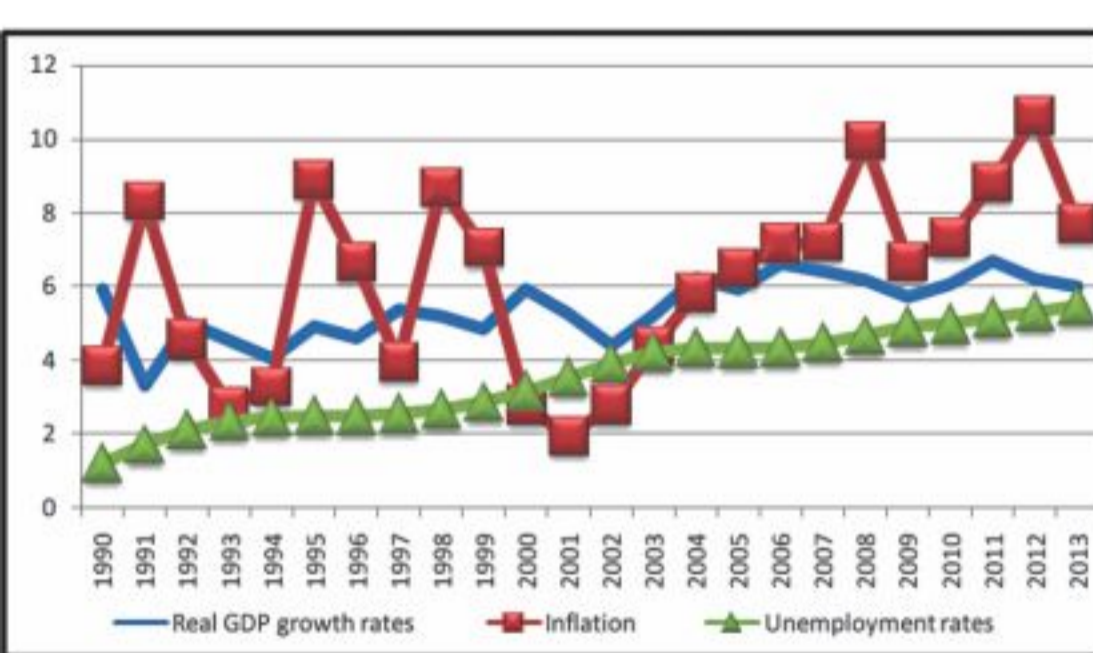
state-owned banks, deserve special attention with respect to fiscal mismanagement. In the medium term at least, the government needs to commit to a budget that excludes certain forms of unnecessary spending and transfers. Revenue mobilisation has to take greater precedence, both from tax and non-tax sources. Total domestic savings as a percentage of GDP have remained stagnant, which means that not enough savings are being generated for investment, one of the few alternatives against which is to resort to public financing through borrowing. More effective financial regulation has to be put in place to ensure that credit/funds are being channelled into the productive sectors of the economy and are not concentrated in the hands of the select few.

**MILLENNIUM DEVELOPMENT GOALS (MDGS)**

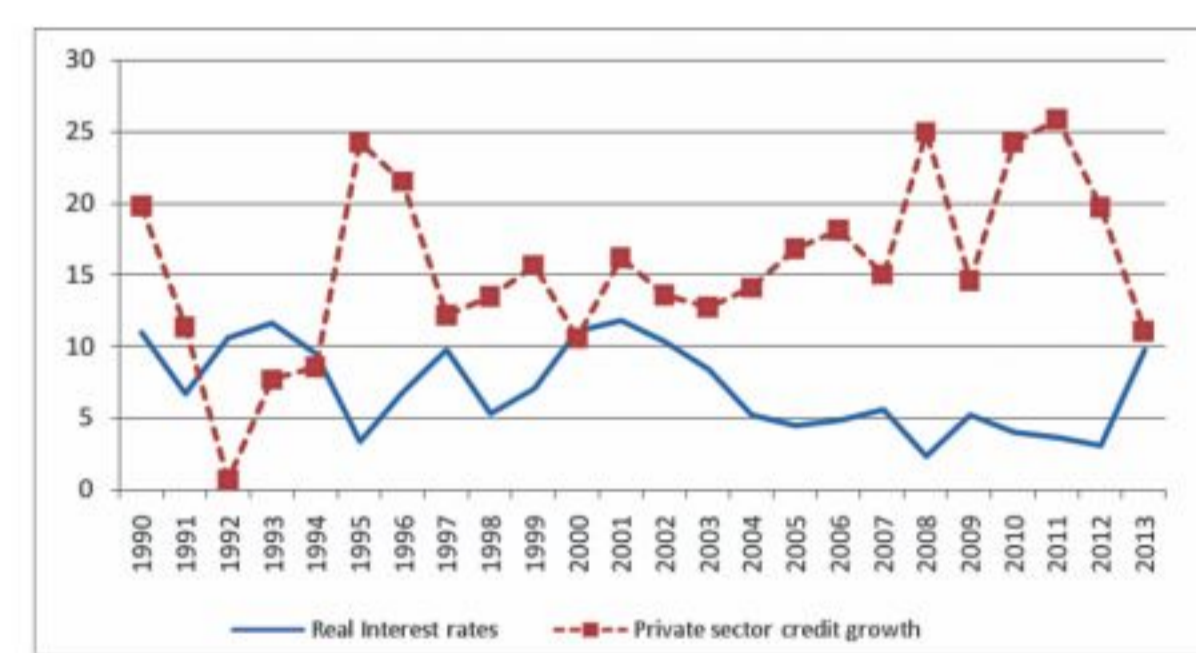
The global poverty reduction efforts now rest on interrelated aspects:

- Achieving MDGs by 2015;
- Moving forward with social protection and safety nets for the poor.

Bangladesh has attained satisfactory progress in achieving the MDGs. The areas where Bangladesh achieved the targets include Goal 1: Eradicating extreme poverty and hunger; Goal 2: Achieving universal primary education; Goal 3: Promoting gender



Graph 1



Graph 2

it be money supply, exchange rate, CPI or a combination of all? With the emergence of floating exchange rate, many emerging economies, including Bangladesh, have chosen the inflation rate as a nominal anchor for MP.

In Bangladesh, the major issues are:

- Inflation acceleration in 2011-2012 led by food prices;
- Inflation affected by global prices of food commodities and prices of fuel, raw materials and intermediate goods (used in manufacturing industries);
- Growth of reserve money, broad money, credit to the private sector and to the government being more on the high side vis-à-vis growth and inflation rates. Government borrowing from the banking sector and Bangladesh Bank (which is alarmingly high) has not only created a "crowding out effect" in private sector investment, but has also created inflationary pressure because government expenditure is not always used for "real sectors".
- Over the last two decades, inflation has been somewhat contained. Recently, global prices of fuel and commodities have fallen, which may attribute to containing inflation.

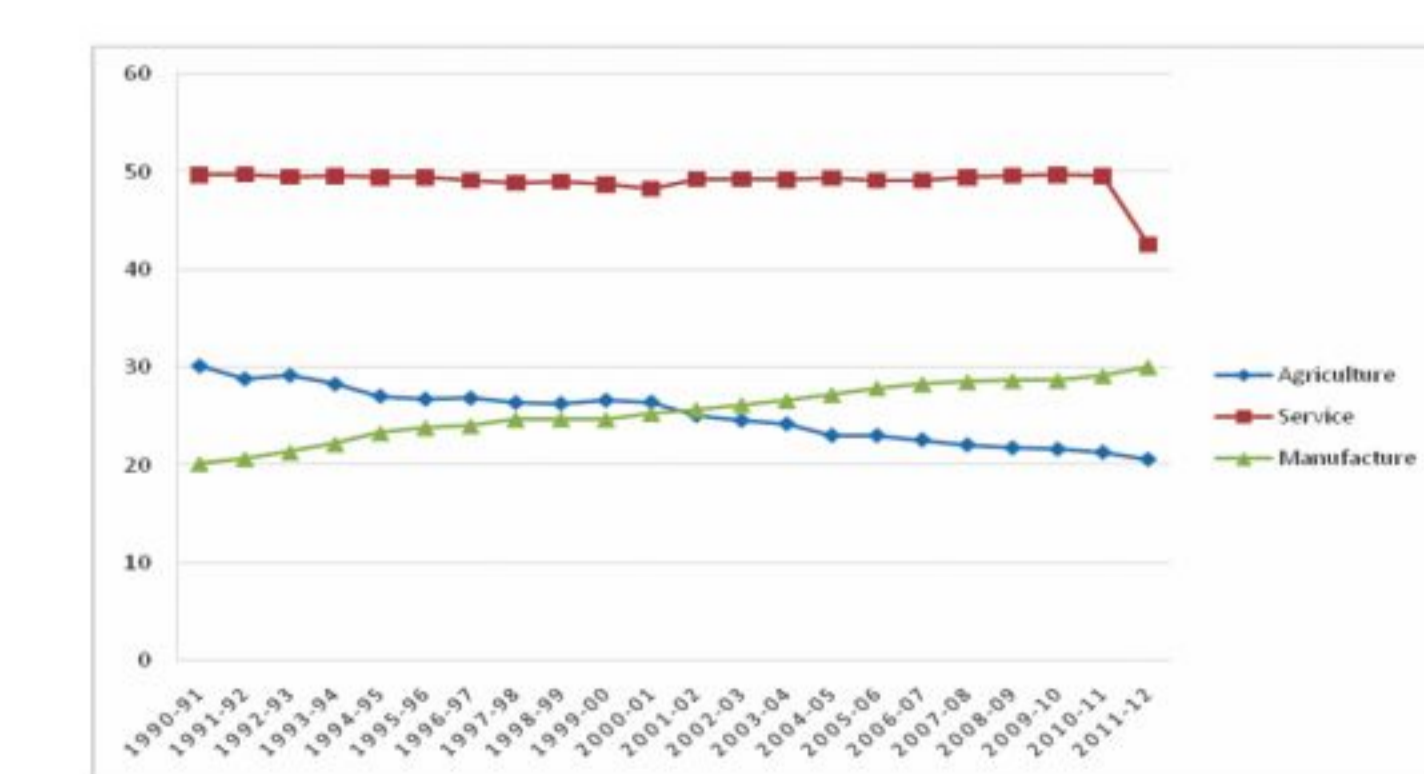
**PRIVATE SECTOR CREDIT GROWTH**

Conventional wisdom says that there is

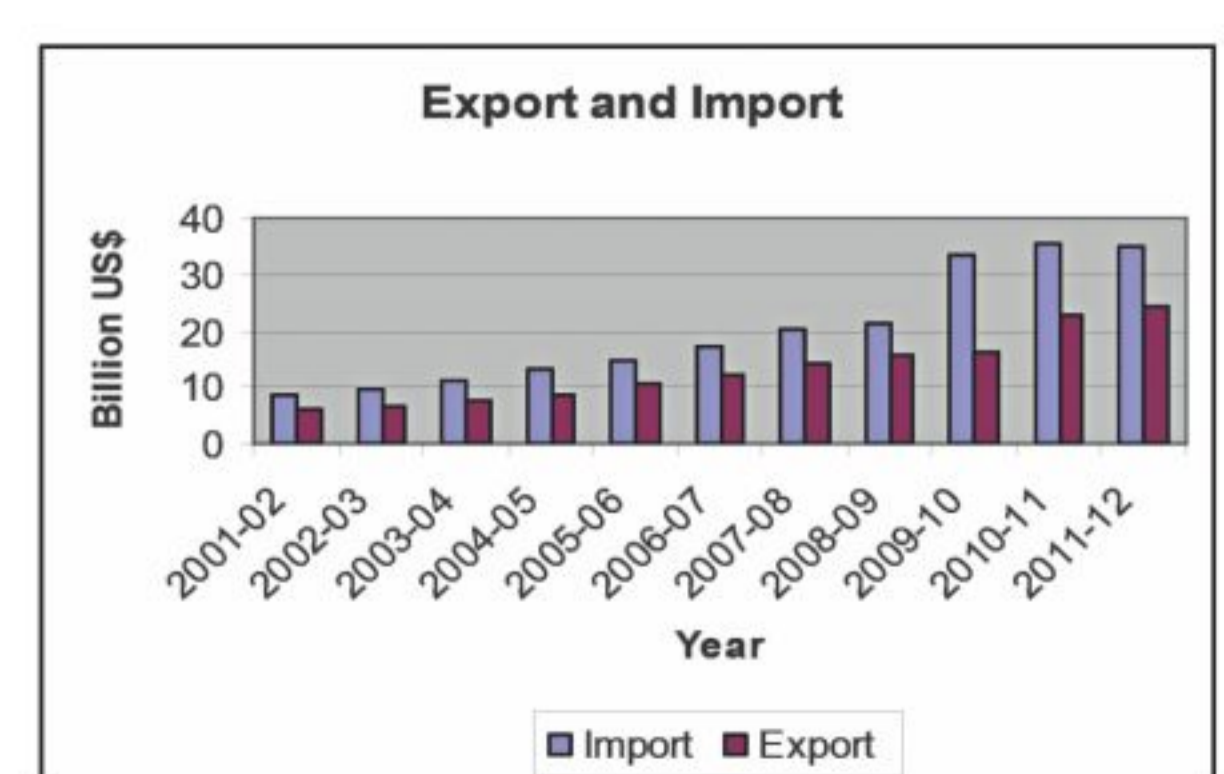
ric information flows; significant transaction costs; high risk premiums; and general lack of incentives on the part of the banks that limit availability of credit in employment-intensive sectors and activities. This will require the monetary policy to be broadened beyond monetary aggregates covering low inflation and stabilisation.

If we look at Graph 3, the share of agriculture declined from 30% in 1990 to 19% in 2013. The share of industry and service sector steadily increased. As mentioned earlier, an increasing amount of people are now employed in industry and other sectors, especially the non-farming sector. If the macroeconomic policy is to accelerate the pace of poverty reduction in Bangladesh, the development of non-farming enterprises (large, medium, small) should be accelerated so that a large portion of poor people can benefit.

For these processes to be effective, the macroeconomic policy has to focus on both the demand and supply sides. For example, the monetary policy should create a favourable condition for investment and consumption demand in order to boost the production. This in turn will result in



Graph 3: Shares of GDP of major sectors



Graph 4

export growth reflected the adjustment of the garment industry to stricter labour and safety standards (especially after the GSP suspension by USA and the Rana Plaza Tragedy) and slowed down demand from importing countries. The nominal taka-dollar exchange rate has been relatively stable, mainly due to interventions by Bangladesh Bank, although the real effective exchange rate (REER) has appreciated by about 33% since its trough in 2011.

to rampant tax evasion. Bangladesh has the lowest tax revenues to GDP ratio in South Asia. Tax revenues have exhibited a very slow upward trend over 2004-2009. Compared to the world average of 13.5%, Bangladesh can collect revenues amounting to only 8.6% of GDP. Massive leakage in the form of wasteful public expenditure and corruption also pose significant challenges for fiscal sustainability in Bangladesh. The Hall Mark incident of Sonali Bank and massive irregularities in Basic Bank, both

equality and empowering women; Goal 4: Reducing child mortality rate; and Goal 6: Combating HIV/AIDS, malaria and other diseases. Experts found that Bangladesh has some weaknesses in Goal 5: Improving maternal health, specifically maternal mortality rate, and does not have any control over Goal Ensuring environmental sustainability and Goal 8: Developing a global partnership for development.