

# **Balancing the Imbalances**

*A Pre-budget Analysis of the State of the Economy 2009-10*



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# Balancing the Imbalances

## *A Pre-budget Analysis of the State of the Economy 2009-10*

The government is at a crossroad to strike balance, through budgetary policies and allocation, between meeting the targets it had set out in the election manifesto, for which it was voted to power and the multiple challenges it is currently confronting on the economic front. The inherited investment slump, inflationary pressure, and short supply of energy from the previous interim government have not been abated. Export sector, which is mostly readymade garment, has fetched a negative growth. The much-vaunted lack of institutional and administrative capacity and the rent-seeking behaviour of certain sections have impeded public investment, including low implementation of annual development program. The government has continued to seek refuge to domestic borrowing. Besides the above, with the prevailing gap in the demand and supply of resources and the lagged impact of the global crisis, the government has to adopt countervailing policies for the economy to enhance productive capacity and welfare measures to augment growth, decrease unemployment, and reduce reversal of reduction in poverty.

This article seeks to present the balances that the economy requires to attain the goals and target that the government had set, through analysis of the existing situation of the various sectors of the economy, including macroeconomic developments, sectoral performances and issues relating to poverty and equity.

### **GDP Growth**

The government, in the manifesto, targeted to increase the rate of growth of gross domestic product (GDP) to 8% by 2013 and 10% by the year 2017.

The government projected growth rate of 6% whereas the IMF forecasted 5% and the ADB and the World Bank projected 5.5%. Given the average growth rate of GDP by 0.338% over the period of 1992 to 2009, the government needs to come up with radical policy options to in order to achieve the target growth of 8% within the year 2013, which means the share of industry in GDP has to be around 40% from the current rate of 30% and the decline of the agriculture sector has to be reversed.

### **Poverty**

The government's promise is to reduce poverty from 25% to 15% within 2013 to 2021. To achieve this target, it had committed to implement millennium development goals (MDGs) fully by 2017 and approved the second PRSP. The government has also approved the first-ever Perspective Plan and is in the process of drafting the Sixth Five Year Plan.

In the HIES (House Income and Expenditure Survey) of 2005 (i.e. the most recent available nationwide statistics that provide poverty data, amongst others), the national head count poverty index was 40% and the compound poverty reduction rate per year was recorded at 1.8 %.

The recent perception survey, Welfare Monitoring Survey (WMS), 2009, conducted by the national statistics agency, Bangladesh Bureau of Statistics (BBS), states that 37.0% people have reported that the poverty is increasing while 40% reported that the situation had remained the same. The WMS reveals that lack of land is the main reason of being poor in Bangladesh (60%) as the landlessness is growing, putting the government in urgency to move towards land reform, while also addressing the other larger question of land fragmentation, which may inhibit the agriculture productivity due to lack of economies of scale. The respondents also cite "want of

work” as the second most important reason of poverty (36.8%). The other important reasons are lack of capital/ loss in business (18.4%), lack of education/ training (17.2%), large family size (15.9%).

Moreover, 39.8% people are still under food insecurity and 80.8% of them are faced with long term food crisis. Furthermore, the inflation rate is on the rise (8.78% in March 2010), while food inflation recorded at 12.07% in urban area and 8.81% in rural area.

### **Employment**

The aim of the government is to reduce unemployed to 2.4 million by 2013 and to 1.5 million by 2021, from estimated 2.8 million in 2008. Several measures were proposed in the budget of FY2010. An allocation of Tk.1120 crore was made to benefit 11.2 million people according to the poverty map of 2009 for the programme, ‘Employment Generation for the Hardcore Poor’ (EGHP). In the budget, the government proposed to bring 578400 families under the programme of ‘One Household One Farm.,’ targeting to benefit 29 lakh people directly or indirectly. The main targets of the programme are female headed households, marginal farmers (maximum 0.5 acres of land) and wage labourers. The government launched the first National Service Pilot Project (NSPP) in all 9 upzilas of Kurigram and 5 upzillas of Barguna.

The Monitoring of Employment Survey, 2009, conducted by the BBS, indicates that the labour force has increased by 8.48 % in comparison to the Labor Force Survey of 2005-2006. The rate of unemployment has increased to 5.1%, the highest during the last several years, implying that the employment generation is lagging behind the actual rate of inclusion of active labor force, placing the government on a huge challenge.

The contribution of service sector in GDP in fiscal year 2008-2009 was 49.67 % but the employment in this sector is very low, only 19.8 million people belong to this sector, with sluggishness in manufacturing. So, the government alongwith private sector need to create balances amongst the sectoral employment, since with declined gradual share in national output agriculture continues to host highest sectoral employment, making it the flashpoint of continuance of poverty.

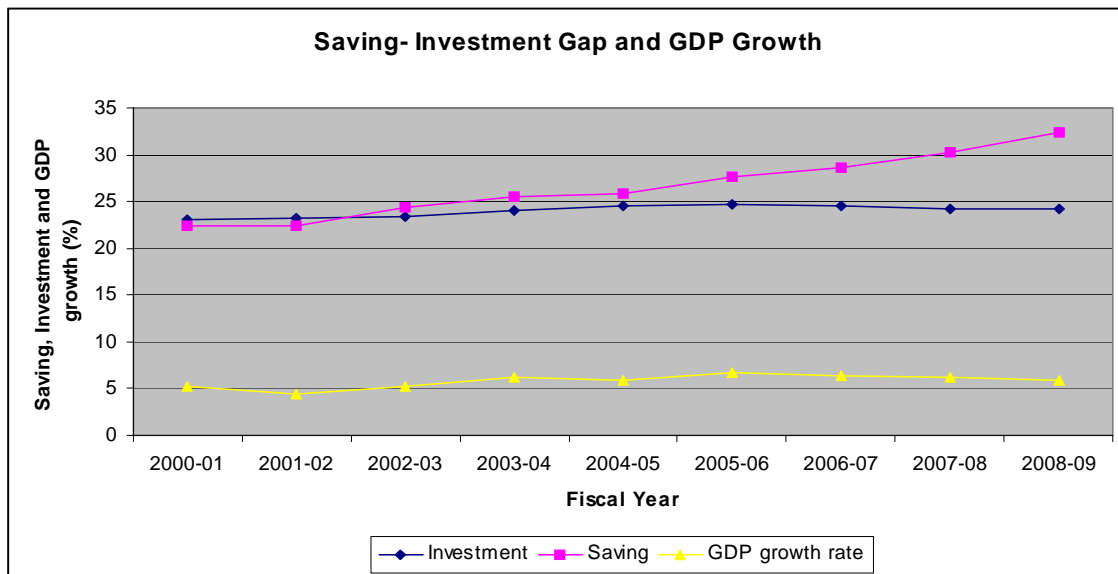
### **Employment and Unemployment**

<b>Categories</b>	<b>MES- 2009</b>	<b>LFS:2005-2006</b>
<b>Economically active Population (million)</b>	53.7	49.5
<b>Employment in major occupation (million)</b>	51.0	47.4
<b>Labor Force participation rate (%)</b>	59.3	58.5
<b>Unemployment Rate (%)</b>	5.1	4.3

Source: BBS

### **Savings and Investment Growth**

Achieving 8% targeted growth rate would require investment rate of 35% to 40%, which is a huge challenge for the government, as the investment hovers around 25 %. The gap between the saving and investment shows a rising trend. With the fall in investment, GDP growth rate also witnessed a downward trend after the mid of 2005-06.



Bangladesh has a saving-investment ratio which lags behind the countries, such as Malaysia and India with 36% and 39% respectively, as the country aspires to become a middle-income one.

Public-Private Partnership is a concept added to the budget increase investment. Tk. 2,100 crore was allocated for PPP. It has not been implemented.

There has been a rapid decline in the amount of foreign direct investment. The impact of global financial crisis has moreover lingered the pace of foreign direct investment in the economy.

The capital mobility in the economy has been negatively affected by factors such as infrastructural constraints, political variables, international financial linkages and fiscal policy coordination.

For Bangladesh the “comprehensive socialization of investment” as called by John Maynard Keynes, is necessary to a certain extent for augmenting productive investment, aggregate demand, employment and output.

### Public Finance Balance

The government has to increase revenue expenditure this year for adopting supportive measures against the global recession and the prevailing power sector crisis. The increments in the pay scale of government employees have further enhanced the pressure on the revenue expenditure.

The budget of 2009-10 had targeted a revenue collection of Tk. 61000 crore. The collected revenue up to March 2010 is Tk. 41648 crore (NBR) which indicates a growth of 18.31% over the revenue earning of the corresponding period of the last fiscal year. Up to March, 2010 approximately 69% of the total revenue target of Tk. 61000 crore has been collected. In case of revenue generation by NBR over the last few years, there has been a fluctuation in the growth.

The tax-GDP ratio of Bangladesh is very low compared to some other countries. It is only 8.54% (NBR), whereas it is 17.7%, 15.3% and 10.6% in India, Sri-lanka and Pakistan respectively.

## ADP Utilization

With the objective of reducing infrastructural constraints and increasing local and foreign investment, the government in its budget of 2009-10 had the ambition of maximum implementation of annual development expenditure. With this objective, the government targeted the ADP expenditure to be Tk. 30,500 crore, which is 4.5% of the GDP.

Over the years highly ambitious targets have been set for ADP, but utilization has fallen far short than the target. The laggard pace of the implementation has led the governments to revise the size at the end of each fiscal year, and it tends to continue this year too. It was reduced to Tk. 28,500 crore.

From the statistics of Ministry of Planning, the ADP expenditure is Tk. 16,501 crore in the first ten months of the current FY of 2009-2010. It is 57.89% of the revised ADP. Of the ADP expenditure, Tk. 10,228 crore was provided from the local sources.

The poor implementation of the annual development programme has remained a perpetual problem. For the current government, it is of a heightened interest as it aspires to uplift the economy from the slump that it inherited and to jump upwards as a MIC, which warrants capital expenditure to grow at a high proportion to ensure crowd in of the private sector.

## Public debt

The persistent budget deficits have raised considerable concern. Total budget balance as percentage of GDP has remained negative throughout the decade.

**Table: Debt liability as % of GDP**

years	Total budget balance	Net Government's total internal debt	Net Government's total external debt
2000-2001	-6.1	2.8	1.8
2001-2002	-5.1	2.7	2.02
2002-2003	-4.4*	1.3	2.07
2003-2004	-4.2*	2.2	1.23
2004-2005	-4.2*	1.8	2.08
2005-2006	-3.9*	2.2	1.72
2006-2007	-3.7	1.9	1.51
2007-2008	-6.2**	2.6	1.73
2008-2009	-4	1.6	1.37
2009-2010 (P)	-5.0	3	2

\* According to government real calculation total budget deficit as % of GDP is 3.5%,3.4%,3.5% &3.7 % in FY 2002-03,2003-04,20004-05,2005-06, 2006-07 and 2007-08

\*\* Excluding grant and including BPC

Source; Bangladesh Economic Review 2009, Ministry of finance,

The debt- GDP ratio in Bangladesh has seen a rising trend over the last few years. A major share of the earned foreign exchange thus go for debt payment, resulting in non-productive use of foreign exchange of the economy. Another concern with the increasing debt payment is that it reduces the resources available for development expenditure. The government has projected its

bank borrowings for budgetary support at Tk 15,680 crore for the financial year, which is 81 per cent higher than that of the last financial year's revised budget.

Government's increased borrowing from the commercial banks reduces capital available for investment, which result in crowding out of private investment in the economy. As the economy is already suffering from lack of investment, this increasing debt is a further threat. The central bank raised the cash reserve requirement for banks from 5.5 per cent to 6.5 per cent in May, which might result in shortage of credit flow from the commercial banks. A higher borrowing of the government, if added in the next budget, would pressurize the credit flow, having negative impact on investment.

### Trade Balance

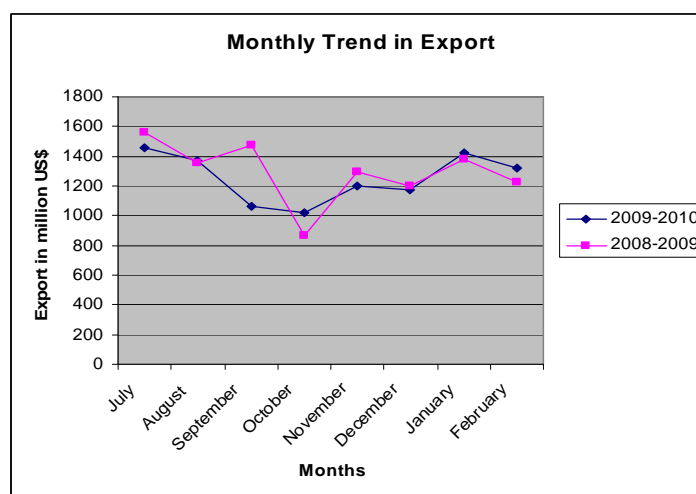
The overall trade balance is showing negative growth, with downward export and import volume. This is an undesirable situation.

**Table: Trade balance**

(in million US \$)

	2008-09 July-March	2009-10 July -March	% Changes Over Time
<b>Export f.o.b ( including EPZ)</b>	11654	11556	-0.84
<b>Of which : RMG</b>	9215	8907	-3.34
<b>Import f.o.b ( including EPZ)</b>	-15716	-15485	-1.47
<b>Trade Balance</b>	-4062	-3929	-3.27

Source: Statistics Department Bangladesh Bank



Source: Bangladesh Economic Review, Bangladesh Bank.

**Figure 9: Monthly Trend in Export.**

The economy of Bangladesh has been observing a declining trend in the volume of export in FY2009-10 compared to FY2008-09. This trend may continue if the prevailing situation of the power crisis continues and government fails to disburse and implement its announced stimulus package to the affected sectors, especially the RMG sector. Moreover, if the export sector is not diversified soon and present negative growth trend in the RMG sector continues, the economy may soon end up in a precarious situation with a volatile export sector. Under the situation, with a view to diversifying the export sector, jute, frozen food and leather sector need to be included in the support package programme.

Another problem is that export market is concentrated in small number of countries including the USA, EU, which make it more susceptible to the global shocks. A positive export growth is observed in case of Italy, Japan, Turkey and India, which indicate the future potential markets for knitwear, woven and leather goods. Japan can be a promising market for chemical products and frozen food, while increasing export of raw jute and jute goods, frozen food and chemical products in India reveal the future potentials.

The Bangladesh Bank reports suggest that the import cost has declined in this fiscal year due to less import and fall in international price. The volume of food import and capital machineries has dipped in first five month of FY10. But there is a significant increase in opening of import LCs for consumer goods and industrial raw materials, capital machinery during July-January, 2009-10 compared to the same period of the previous year. However, opening of import LCs for intermediate goods declined during July-January, 2009-10 compared to the same period of the previous year.

Reduction in import of raw materials indicates a downfall in new investment in the economy, especially in manufacturing sector. Moreover, the decline in imports of raw materials of textiles and garments (e.g. cotton, yarn, and other products) indicates slowing down in these sectors. Due to the fall in import of food along with a shortfall of production of Aman paddy, an upward pressure on rice price has been created in recent time.

## **Real Sector**

### **Agriculture**

Real agricultural growth rate showed a positive trend after 2005, even though investment in agriculture did not grow. The poor investment in agriculture is reflected from the poor performance of agriculture during the period. The present government, after assuming power has undertaken various measures for enhancing support to the sector. But questions remain regarding the sufficiency of the allocated budget for the agricultural sector, implementation status of these measures and the actual benefits accrued by intended beneficiaries.

In its election manifesto, the government had pledged to enhance subsidy and credit availability for the agricultural sector. The lending procedure has been proposed to be simplified for the farmers. Keeping these in view, the government has undertaken measures to distribute input cards to farmers, provide subsidy for input procurement etc. An important measure for the disbursement of agricultural credit is the allocation of Tk. 500 crore by the Bangladesh Bank for the sharecroppers.

The sufficiency in the allocation for agriculture is concerned with the allocation in real terms that is after it has been adjusted with the inflation. ADP implementation in the agricultural sector has been significantly low for the last few years. In the July - April period of current fiscal year, the ADP implementation is only 59% of allocation for agriculture and extra Tk. 756 crore is added in revised allocation.

The concern of agricultural credit and subsidy does not rest upon the amount rather on the efficacy of its use. It is claimed that the subsidy disbursed does not benefit the real beneficiaries, rather it is going to the large farmer those are cultivating HYV and/or Hybrid as well as to traders' pocket e. g. fertilizer traders.

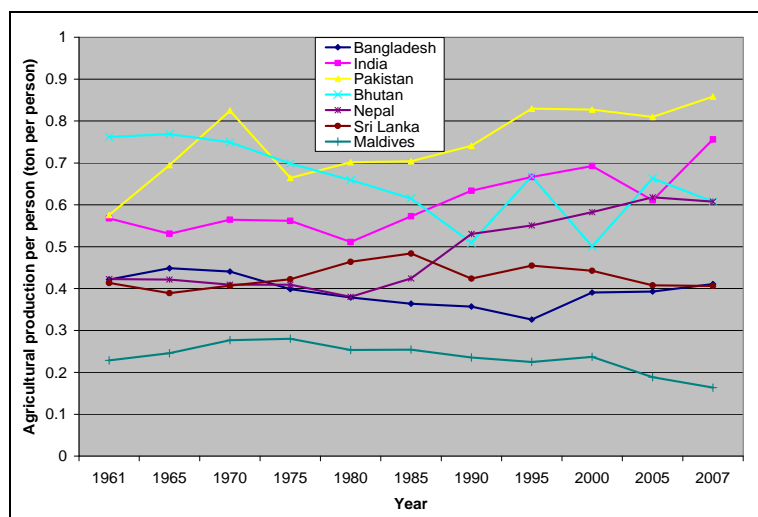
The amount of subsidy that is provided to the agricultural sector is very insufficient, less than 1% of agriculture output whereas neighbouring India is giving around 9% subsidy to its agriculture.



Another problem associated with agriculture is the quality of the subsidized inputs provided to the farmers. Adulterated seeds, fertilizers and pesticides are supplied to the farmers by a section. As the farmers are becoming more dependent on chemical fertilizer for their production, such actions are adding to the miseries of the poor farmers.

It has been observed from a study by Unnayan Onneshan that fertilizer application in Bangladesh increased 890 times in same piece of land. Fertilizer application in 2007 was above 298 kg whereas it was 0.36 kg in 1975-76 for an hectare of agricultural land. Fertilizers create a force to increase productivity of land, which decreases soil fertility due to the use of huge amount of chemical fertilizers, which is a threat to sustainable agriculture. This has also reduced the farmers' profitability.

It has been observed that farmers in the remote rural areas are deprived from the assistance of the government through procurement drive carried on after the harvest. There is a section of middlemen and dealers, who appropriate a large part of the price of output in between the process.



Source: Titumir and Basak, 2010

**Figure 13: Agricultural Production for every person in South Asian countries**

Agricultural production for every person in Bangladesh is very low compared to other South Asian countries. A study of Unnayan Onneshan on the effects of increasing temperature on rice production in Bangladesh and its implication on food security shows that food security in Bangladesh is faced with significant challenges. Huge population size, extreme population density and high levels of poverty impose challenges to sustain food security in the country.

#### Food Security in Bangladesh: Some Compelling Facts

- Within 2020, Bangladesh may face a significant level of food shortage if the present trend in population growth continues.
- In 2050, more than 29 million people will face food shortage in Bangladesh, which is equivalent to 10 percent of the projected population in 2050.
- There has been an increase in food production but it did not come in a sustainable way, rather it has been the result of increased use of ground water, pesticides, fertilizers etc.
- Fertilizer application in Bangladesh during the period of 1975 to 2005 has increased 890 times.

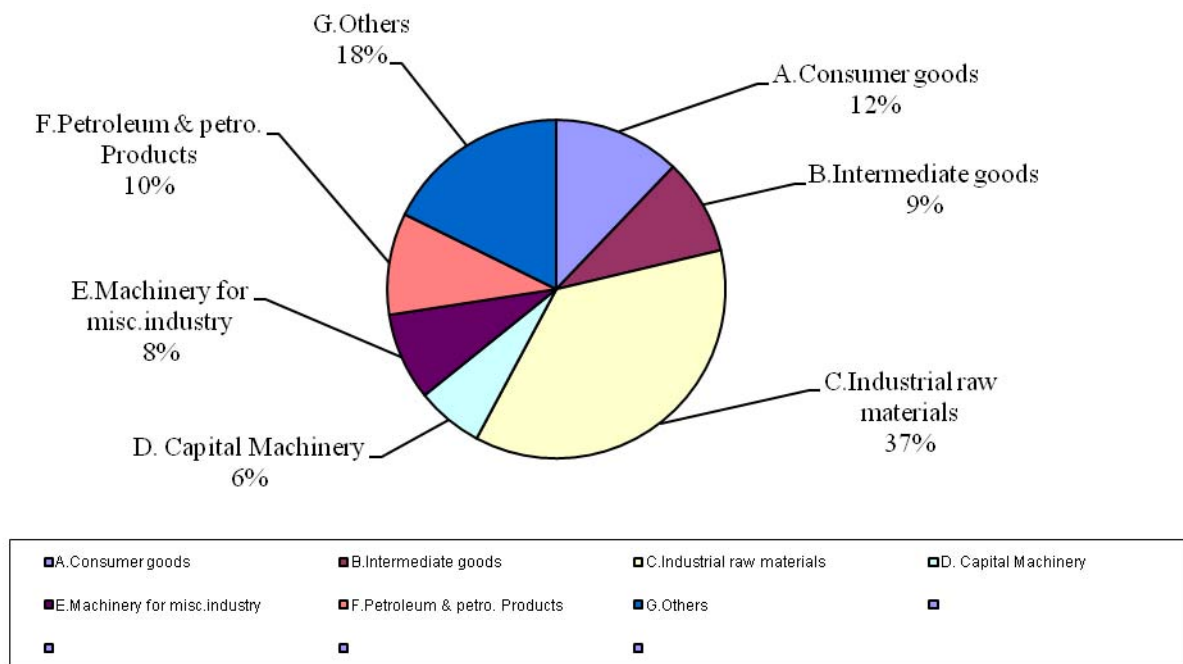
## Industry

The present government's aim is to increase the contribution of the industrial sector to GDP from 28% (FY 2008-09) to 40% by the year 2021. To achieve this goal a sustainable growth in industrial sector is needed. This growth depends on industrial production and increase in value addition of the intermediate products. The manufacturing sector was growing till 2005-06, but after that a declining growth rate was observed. The manufacturing sector has been hard-hit by the global recession, the power crisis added to the downfall.

The industrial expansion and its growth in Bangladesh depend on capital machinery and raw materials imported from foreign countries. The opening of letter of credit (LC) and its settlement for consumer goods are increasing, while the industrial raw materials and capital machinery LC settlement is declining than that of the previous FY2008-2009 indicating that industrial production is not on course.

The import statistics of FY2009-2010 suggest higher level of consumer products and lesser amount of raw material, machinery, reflecting the sluggishness of the industrial sector.

**Sectoral distribution of LC settlement in July-March 2009-10**



Source: Foreign Exchange Policy Department, Bangladesh Bank.

## Power

The present Awami League-led government vowed to provide 7000 megawatts of electricity by 2013 and 20000 megawatts by 2021. The government promised to make electricity available for all by 2020. Till the end of 2009 (after completion of one year), only 47% of total population has access to electricity. Recently another mega plan of adding 9,500 megawatt of electricity has been unveiled.

Over the last few years, a significant portion of ADP has been allocated for the power sector, but the record of implementation remains poor. Only 33% of total ADP allocation has been utilized in the power sector during July- March period of 2009-2010, which can be said as “less than necessary.”

### ADP Implementation in Power Division (2009-2010)

(Tk. in lakh)

Division	ADP Allocation	Taka Released	% Of Allocation	Total Expenditure	% Of Allocation
Power Division	313320.00	64156.56	50%	103007.98	33%

Source: IMED

There has been very negligible foreign investment in this sector. Most power plants in Bangladesh are fueled by gas. Gas shortage causes lack of power generation by 500 to 700 MW. It has now become crucial to explore alternative sources for generation of power.

Additional Tk. 5000 crore as subsidy is needed for compensating high cost of electricity arisen out of rental power plant (New Age 31.05.2010). An alternative way is to compensate the high cost with increased tariff.

## Social Sector

### Health

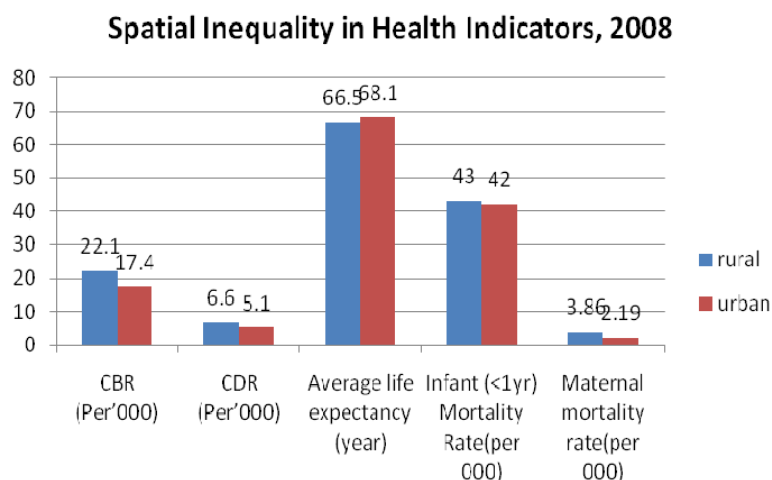
Public investment in health, population and family welfare sector has marked negative growth during most of the period between fiscal year 2001-02 and fiscal year 2004-05. But investment growth increased since fiscal year 2005-06 and posted 0.80% in 2008-09.

The negligence of the public investment reflects the poor quality of the public health system across the country, both in urban and rural areas. If the government can appropriately allocate the committed amount (from 7% to 12%) of national budget in the health sector, the better health indicator could be attained.

The fiscal year 2009-10 reflects low allocation of national budget (6.15%) in the health sector. This decreasing allocation occurred in a time when the government has committed to enhance allocation from 7% to 12% of the national budget in the draft of National Health Policy.

The decreasing public investment (ADP) combined with declined foreign assistance may result in lower achievement of Millennium Development Goals.

The countryside faces severe shortages of health services and health workforces.



Source: BBS Data collected from Bangladesh Economic Review, 2009.

## Education

In the election manifesto Bangladesh Awami League-2008 targeted to achieve 100% net student enrolment at primary level within 2010 but the education minister reset the deadline for 2011. The budget proposed Tk. 14,387 crore for the education and technology sector, with Tk. 6,611 crore for mass and primary Education ministry, Tk. 7,395 crore for the education ministry and Tk. 381 crore for the ministry of science, information and communication technology.

Public investment in the education sector has not been satisfactory in Bangladesh. There has been declining trend in the growth and share of public investment in education as percentage of GDP. The education ministry spent Tk. 3,840 crore which is 51.9% of its total allocation of Tk. 7,395 crore during July-December 2009, taking steps to distribute stipends and educational materials including textbooks in time. The ministry of education has spent Tk. 775.79 crore during July-April period of FY 2009-10 which is 54% of the allocation.

The Ministry of Primary and Mass Education spent 69% of its allocated budget during the same period. If the trend continues, the milestone to achieve 100% literacy within 2014 will be a matter of concern for the government.

As the draft of Education Policy suggests extension of primary education up to class VIII and secondary level up to class XII, it would require a huge investment if the new system is introduced. The draft of Education Policy shows an estimate of Tk. 22,530 crore for the FY 2010-2011 to achieve objectives and priorities. So, the government needs to allocate Tk. 8,183 crore in education sector more than previous FY's allocation.

## Gender

'Gender-sensitive budget' or 'gender budget' is not the budget only for women. It is about ensuring mainstreaming gender issues in all national policies. It is observed that, when a budget

is gender sensitive, it not only empowers women but also increases country's economic progress and human development. The gender related expenditure is very low, 16.43%, 23.08% and 29.74% respectively in FY 2007-08, 2008-09 and 2009-10.

### **Gender Related Expenditure**

FY	Proposed	(%) of Total Budget	(%) of GDP	Revised
2007-08	18707	16.43574447	2.724069139	22049
2008-09	26272	23.08226219	3.825666565	27914
2009-10	33850	29.74020155	4.929157019	

Source: Ministry of Finance

### **Regional Disparities in Poverty**

The issue of reducing regional disparity stems from the prevailing differences in the poverty level in the western and eastern region of the country as articulated by the World Bank, which was given thrust in the FY 10 budget. Research carried out by the Unnayan onneshan reveals that there is significant variation in the economic performance and changes in the well being in the different regions. The overall poverty situation in Bangladesh cannot be explained division-wise as argued by the World Bank. If the head count rate (HCR) of poverty among different districts is analysed, poverty varies in different districts, though the division-wise scenario is better.

The districts of Rajshahi, Chittagong and Dhaka divisions are above the average HCR level, meaning that districts where lower poor people are more than 28.37% belong to these divisions. This finding doesn't reflect the idea of the World Bank in which the Bank has divided the country into two regions according to the poverty situation - east and west. So poverty in Bangladesh cannot be determined at division level. A more precise picture can be obtained from micro level observation, such as district level. Though HCR in Chittagong and Dhaka divisions are 16.1% & 19.9% respectively (HIES, 2005), but the districts where poverty is more than average also belong to these two divisions.

The trend in per capita public expenditure in the eastern and the western regions suggest that the poverty level to some extent is related to the government expenditure carried out in these regions. Thus, one of the reasons for region-wise poverty situation is the reflection of distribution of the public fund.

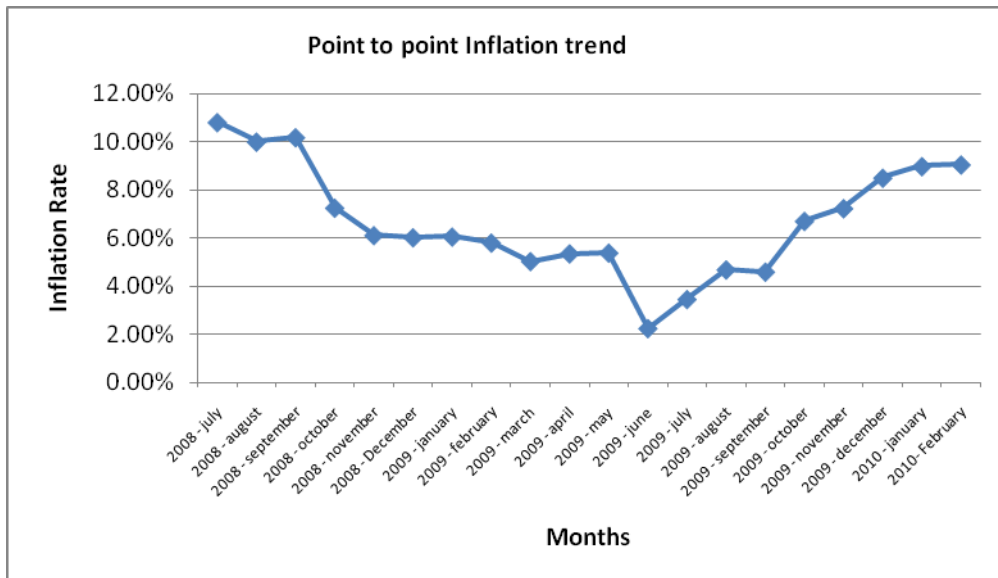
If one looks into the ADP expenditure of 2008-09 in different districts, biasness is observed. For example, on average per capita ADP expenditure of the districts is Tk 1.659188 thousand. There are only 21 districts where per capita expenditure is greater or equal to this amount. Among them 13 of the districts belong to Chittagong and Dhaka divisions. This indicates that the government is not particularly focused on need-based expenditure and thus development cannot be achieved equally among the various regions.

### **Inflation**

Ensuring food security by containing inflation was a major concern in Awami league's manifesto. They provide highest priority to the production of domestic commodities, arrangements for timely import to ensure food security. Price reduction and stability were given importance.

There was a downward trend in price of commodities from January to October 2009. An upward pressure has been noticed from November 2009. The food inflation has surged to 12.07% in urban areas in January 2010 from 11.08% in December 2009. It was 8.81% in January 2010 in rural areas. Non-food inflation has slightly declined to 6.53% in January from 7.04% in December 2009.

Food price hike reduces the purchasing power and has a negative impact on food availability and food accessibility. The rapidly increasing food price has created difficulty for the poor, low- and middle-income group to have access to food.



Source: Bangladesh Bank

The growth of money supply is one of the major reasons behind this inflation. The monthly update of Bangladesh Bank reveals an upward trend in reserve money and board money base as a result of the rapid buildup of net foreign assets (NFA) stemming from continued large remittance inflows and the decline in import payments. This excessive liquidity pushes the interest rate down and creates an inflationary pressure. On the other hand, low interest rate gives disincentives to savings and everyone may prefer to hold the money.

The poor yield of Aman paddy, coupled with lower import of rice has triggered the rice price. The production of Aman paddy has declined this season, the production was about 1.15 crore tonnes, lower than the production target. Moreover, there is a drastic fall in rice import. There has been an insufficient supply of rice to meet the demand and this it pushes the rice price up.

Temporary disruptions in supply due to seasonal and other factors, inadequate storage and warehousing facilities, transportation bottlenecks, and other factors are considered as major reasons behind domestic supply shocks.

To contain the inflation the Bangladesh Bank has taken some measures to mop up the excess liquidity. The BB has commenced selling 30-day Bangladesh Bank Bills on March 8 and raised the interest rates on government securities particularly bonds and BB bills to woo banks and financial institutions to buy the instruments.

The impact of the Bangladesh Bank's measures to extract the excess liquidity may have the interest rate up. This upward pressure in interest rate may impede economic growth through reducing investment. Consequently the high interest rate may give incentive to save that might reduce consumption putting negative impact on national income. Therefore it is recommended that Bangladesh Bank could curb the inflation through haul out the excess liquidity without raising the interest rate too high to crowd out private investment (the lending rate is already one of the highest in the world). Since the major chunk of the inflation originates from cost relating to food, the government on the one hand need to increase the purchasing power by stimulating aggregate demand, on the other hand needs to think through to curb the middlemen to lower the differences between farmgate and retail prices. A combination of fiscal and monetary policy may be used to curb rising inflation.

It can be said without much ado that the orthodox way of thinking has not helped the government address the systematic failures it inherited. A change in development strategy is required to achieve targets so as to bring about a transformation in society. This government came in power with the 'promise of change'. Therefore, an 'alternative' development strategy is needed to materialise the promises.