Year-end Assessment of Bangladesh Economy: Trends and Challenges

Bangladesh Economic Update

December 2016

উন্নয়ন অন্বেষণ

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1. Introduction

The country has been missing opportunities to capitalise on its resources and potentials in the medium term. The causes of elapsing prospects are more institutional. The gradual corrosion of institutions has constrained allocation of resources to channel efficiently into the productive sectors in order for the economy to get higher returns in terms of expanded productive capacity. The lack of farsightedness in policymaking, stemming from political expediency, has caused institutional fragility. As a result, in 2016-17, a number of medium-term challenges are looming large in the economy.

The stagnation in the ratio of private investment to gross domestic product (GDP) and ever increasing rise of capital flight, coupled with regulatory unpredictability in economic management have appeared to be the major challenge in the economy. This has hampered the growth of real sector. The capacity to generate employment in the formal sector, particularly in manufacturing has shrunk, and there has been further concentration of export in one sector, risking the economy to high vulnerability and shocks. The paralyzed policy process has failed to induce and unleash the capacity of the private sector in expanding and diversifying into more competitive products.

The fiscal balance is in shambles. The immediate past year, statistics for which have been released recently, witnessed another year of no sign of improvement in the tax-GDP ratio, pushing the country towards a deeper debt trap. There has been increasing reliance on debt and further accumulation of debt on account of payments for principal and interest.

The country's quest for self-reliance based upon domestic resource mobilization has been marred by the policy shift towards 'debt-financed-debt-trapped development financing.' The current year witnessed the same level of debt dependence due to failure in providing strategic direction in overhauling the domestic resource mobilization to expand and increase the tax base.

The people at large also do not feel encouraged to be part of the tax-base as they do not find the fiscal allocation is anchored to its mandate of serving the public interest. Citizens find public resources are prone to corruption by way of amassing the resources through apportionment of manifold more than standard required expenditure while the public services for the citizens have degenerated into a chaos. For example, the public are flooded with graphic details of disproportionately high earmarked allocation for the infrastructure projects in Bangladesh vi-a-vis similar projects in other countries as well as with examples of multiple upward revisions of such expenditures during the process of implementation and deliberate ploys of delays for increasing allocation. This does not resonate that citizen's tax revenue is spent for the provision of public service.

Debt financing is not a problem if it is spent rightly – efficiently in productive sectors and in building both social and economic infrastructure. However, it is not the case here. The ever-increasing debt is also not developmental, causing also enormous distress on the social sector development, particularly on the marginalized section of the society. There has been a mounting of debt due to manifold increase in the non-development expenditure while the ratio of the increase in annual development programme (ADP) has remained nominal. The rise in debt has increased the payments for principal and interest, which has emerged as the number one expenditure in the national budget, and reduced the fiscal space for allocation in social sectors such as education, health and social protection. Therefore, the national budgets demonstrate sliding rates of increase in allocation for education, health and social protection.

In addition to proportionately less public investment for education, health and social protection relative to the size of the budget, the poor and the disadvantaged section of the society has further been marginalized due to the regressive nature of the tax structure, heavily biased towards such regressive tax as value-added-tax (VAT), a tax that is indifferent to the level of income. The government has expanded the jurisdiction of VAT to maintain it as the major source of revenue collection at the cost of general masses.

The political expediency has dogged the financial sector miserably. The current year, like in the previous years, witnessed a monumental rise in writing off of loans, meteoric rise in the default loans and nose-dive in risk and capital adequacy ratio. The public in general has to pump their tax money to rescue the stripped nationalized commercial banks through recapitilsation due to loots in these banks. The culture of impunity extended since the capital market scam continues to reign, with culprits hardly brought to justice. The new banks have also been infected with such diseases while shares of some private banks are traded in the bourse with less than the face value, costing the shareholders with missed dividends at the backyards of the regulators.

The real sector is marred with failure to diversify products and markets. The rate of growth in export has slowed down. The manufacturing is chocked by deficits in infrastructure. This has been further held back by lack of business confidence. There has been no significant breakthrough in agriculture as regards innovation and technological advancement in the post-green revolution period. The service sector is facing a critical shortage in supply of skills. The short supply in the required levels of skills has led to hiring of documented and undocumented professionals and workers from abroad, resulting huge sums of outflow of remittances. This huge outflow and declined levels of inflow of remittances are serious causes of concern. The lack of strategic direction in human resource and skills development has not only aggravated the outflow of hard currency, but also has not been able to employ the country's human resources as has been observed by the rising unemployment in general and increasing unemployment amongst the youth, particularly the educated youth.

The lack of business confidence causing declining private investment and consequential lull in real sectors, fiscal shambles resulting into infrastructure deficits, debt overhang, reduced social sector investment, are resulting into jobless growth, decline in the rate of poverty reduction and widespread inequality. The sustainability of the economy is at risk. These have accentuated due to the lack of accountable politics and governance. The old problems have remained unabated over the years, while new ones have been added as time elapsed.

This report attempts to address the issues of squeezed investment due to fiscal composition and deficit financing, declining rate of growth in revenue collection, inefficiency in public spending, volatility in external sector coupled with high youth unemployment, and implications of lack of business confidence in the economy. This assessment begins with a brief description of fiscal management.

2. Fiscal Management

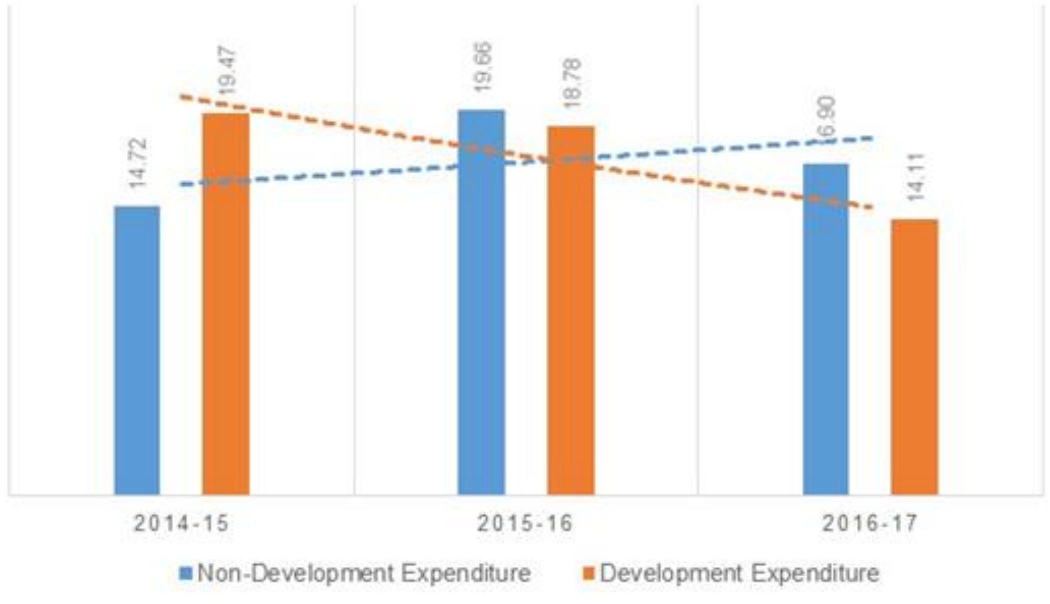
Expediency in fiscal mismanagement along with the central bank's imprudence in adoption of policy measures caused low investment demand in the economy. The macroeconomic policy measures thus failed to channel adequate resources to the productive sectors. This was further aggravated by the supply constraints, primarily those of infrastructure. Consequently, the trend in growth in agriculture and manufacture, which together comprise half the total sectoral contribution of GDP, has recently been assuming a declining trend causing the growth of GDP not to accelerate substantially.

2.1. Expenditure

The non-development expenditure increased from Tk. 134449 crore in FY 2013-14 to Tk. 154241 in FY 2014-15, Tk. 184559 crore in FY 2015-16 and Tk. 215744 crore in FY 2016-17, representing 14.72 percent, 19.66 percent and 17 percent increase in FY 2014-15, FY 2015-15, and FY 2016-17 respectively. Meanwhile, development expenditure increased from Tk. 72275 crore in FY 2013-14 to Tk. 86345 in FY 2014-15, Tk. 102559 crore in FY 2015-16 and Tk. 117027 crore in FY 2016-17 representing 19.47 percent, 18.67 percent and 14.11 percent increase in FY 2014-15, FY 2015-15, and FY 2016-17 respectively.

In the case of non-development expenditure, usually the highest allocation goes to interest payments to both domestic and foreign sources. In FY 2014-15, the total expenditure on interest payments stood at Tk. 298 billion, that is, in FY 2015-16, total expenditure on interest payments increased by 17.8 percent. In FY 2016-17, total expenditure on interest payments is estimated Tk. 39,951 crore of which domestic interest payments would be Tk. 38,240 crore and foreign interest would be Tk. 1,711 crore.

Figure 1: Trend in Expenditure



Source: Ministry of Finance, 2016a

However, the total government expenditure increased by 12.83 percent during July-September of FY 2016-17 compared to the same period of the previous fiscal year. Against the target of Tk. 123346 crore as ADP expenditure in FY 2015-16, 19.13 percent (Tk. 23594 crore) of the total allocation was implemented during the first five months (July – November) of the current fiscal year, whereas implementation of ADP during the corresponding period of FY 2014-15 and FY 2015-16 the preceding fiscal year was 20 percent and 17 percent respectively.

2.2. Revenue

Revenue earnings of government largely depend on the collection of taxes. Although an increasing trend of collection in tax revenue continues in nominal terms, the country still lags behind other developing countries in collecting taxes. Of the total revenue collection targeted at Tk. 2,42,752 crore in FY 2016-17, Tk. 2,10,402 crore is supposed to be collected from taxes and Tk. 32,350 crore is supposed to come from non-tax revenues.

Thus, in FY 2016-17, total revenue is expected to be scaled up to 12.4 percent of real GDP. This figure is only 2.1 percentage points higher than the revised budget estimates of FY 2015-16. Total collection of revenue during the first quarter (July – September) of the FY 2016-17 stood at Tk. 43539 crore against the target of Tk. 60688 crore. The rate of growth in revenue mobilization has declined substantially from the level of the FY 2011-12.

Figure 2: Revenue Collection

Source: Ministry of Finance, 2016b

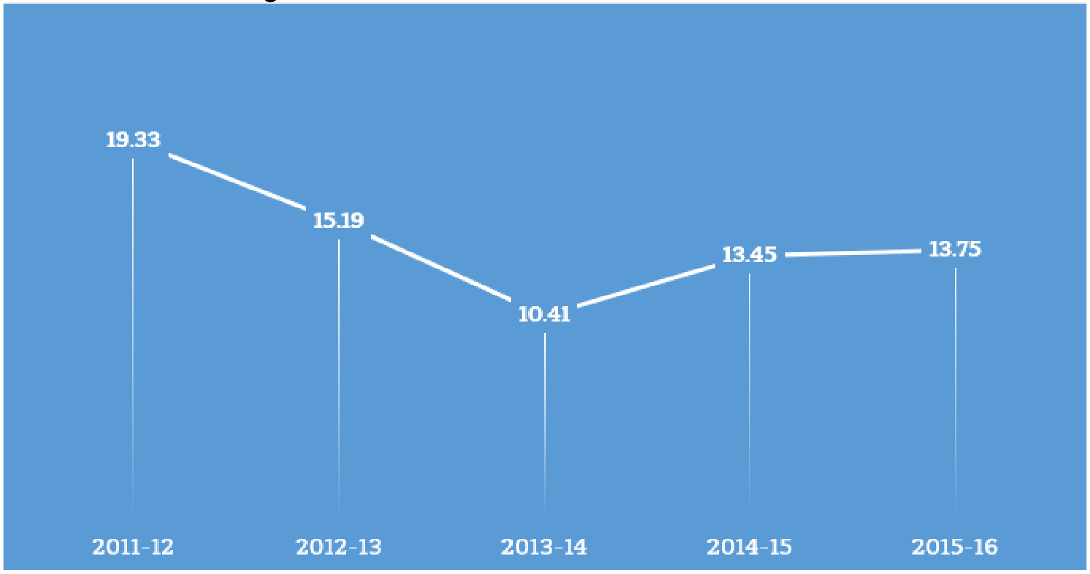
Revenue has been falling short of target continuously since FY 2011-12 due to mainly fall in domestic consumption, sluggish economic activities and political uncertainty. In the present fiscal year the gap between the target and the actual may be further widened.

First, domestic consumption has been falling for three years. In FY 2010-11, the domestic consumption was 79.30 percent down to 77.96 percent in FY 2012-13, to 77.91 percent in FY 2013-14, to 77.84 percent in FY 2014-15 and to 76.11 percent in FY 2015-16. Second, the sluggishness in private investment along with tiny public investment slows the GDP growth.

The rate of growth in revenue mobilization has been on the decline since FY 2011-12. Actual mobilization of total revenue grew by 19.33 percent in FY 2011-12, whereas the rate of growth declines in the subsequent years and stood at 15.19 percent, 10.41 percent, 13.45 percent, and 13.75 percent in FY 2012-13, FY 2013-14, FY 2014-15 and FY 2015-16 respectively.

Furthermore, it is estimated that Bangladesh has the potential to increase the mobilization of its revenue up to 22 percent of gross domestic product (GDP) whereas the total revenue mobilization as percentage of GDP stood at 10.89 percent, 11.65 percent, 11.66 percent, 10.78 percent, and 10.26 percent in FY 2011-12, FY 2012-13, FY 2013-14, FY 2014-15 and FY 2015-16 respectively

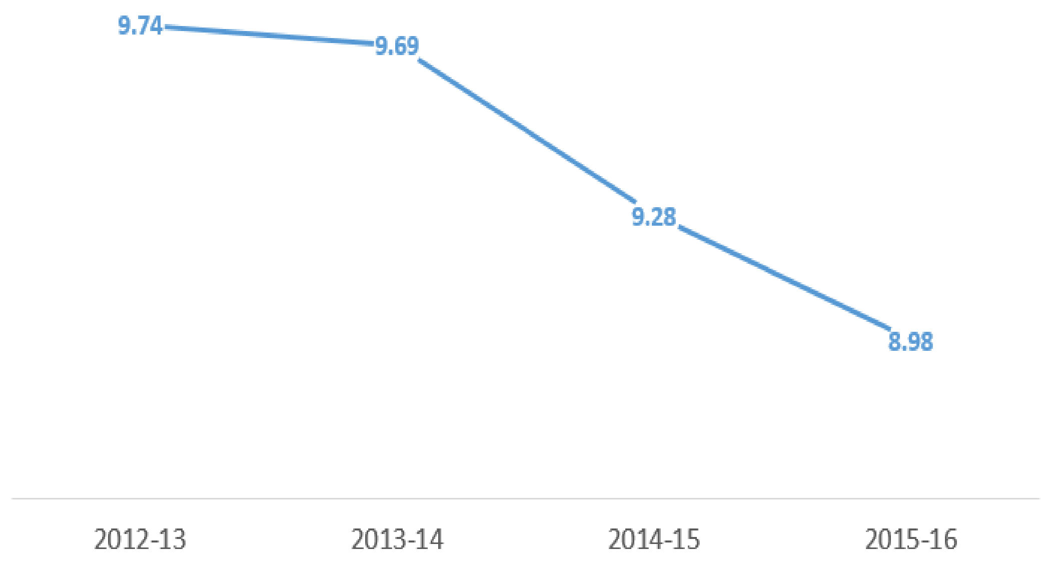
Figure 3: Rate of Growth in Revenue Collection



Source: Ministry of Finance, 2016b

Tax-GDP ratio of a country shows the financial capability of the government to finance its expenditure. Low tax-GDP ratio implies stringent financial constraint for the government, shrinking public investment. Low per capita income, corruption and inefficiency in tax management system keep the tax collection low and unsatisfactory. To increase the contribution of tax in GDP the collection of tax must be accelerated through proper management in tax collection and tax policy reform.

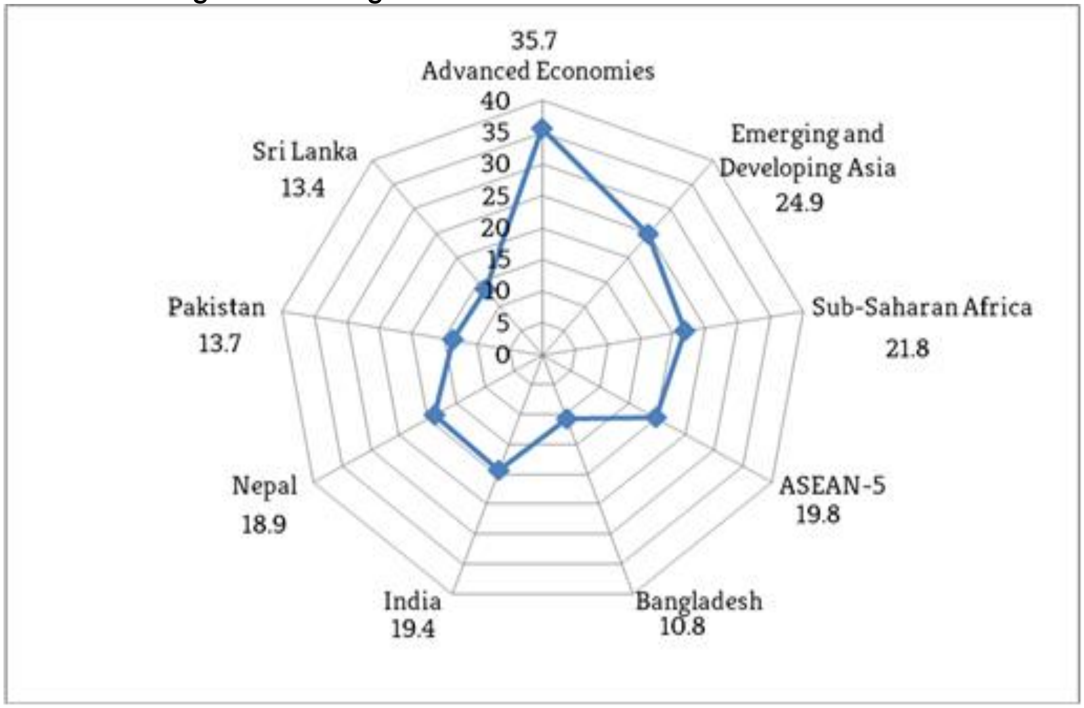
Figure 4: Trend in Tax-GDP Ratio



Source: Ministry of Finance, 2016b

In view of its low tax-GDP ratio, Bangladesh lags far behind other developing countries in terms of the total general government revenue as a percentage of gross domestic product (GDP). The revenue-GDP ratios during 2010 - 2014 as percentage of GDP was 35.7 percent in advanced economies, 24.9 percent in emerging and developing Asia, 21.8 percent in Sub-Saharan Africa, 19.8 percent in ASEAN-5, 19.4 percent in India, 18.9 percent in Nepal, 13.7 percent in Pakistan, and 13.4 percent in Sri Lanka, whereas in Bangladesh, the average total government revenue as percentage of GDP for the corresponding period was only 10.8 percent. It was 35.7 percent of GDP in advanced economies.

Figure 5: Average Total Revenue as % of GDP for 2010-14



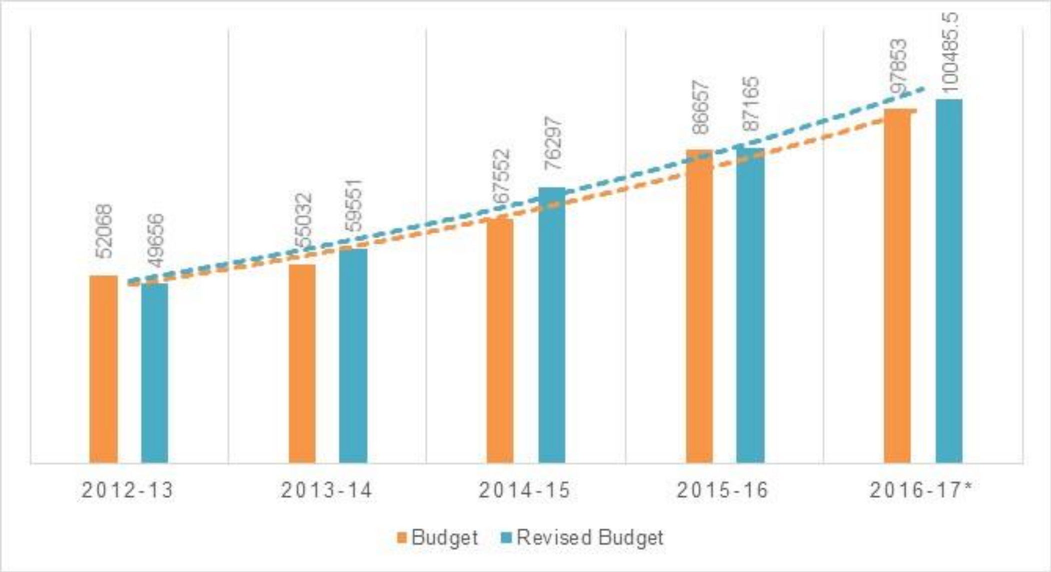
Source: Ministry of Finance, 2016c

2.3. Fiscal Deficit

The overall budget deficit in FY 2016-17 has been estimated at Tk. 97,853 crore (excluding grants), which is five percent of GDP. In financing the deficit, Tk. 30,789 crore will be collected from foreign sources, whereas Tk. 61,548 crore will be collected from domestic sources. As far as the domestic sources of financing deficit are concerned, Tk. 38,938 crore will be collected from the banking system and Tk. 22,610 crore will be collected from the non-banking source (of which Tk. 19,610 will come from savings certificates and Tk. 3,000 from other sources). The projected revised deficit in FY 2016-17, however, stands at Tk. 100485.5 crore.

In order to finance the deficit, the government relies on both domestic and foreign sources. In FY 2016-17, deficit in Budget is estimated at Tk. 97,853 (excluding grants) crore, of which Tk. 61,548 crore is supposed to come from domestic sources and Tk. 30,789 crore is supposed to come from foreign ones (including grants). Borrowing from banking sector is planned at Tk. 38,938 crore in FY 2016-17.

Figure 6: Trend in deficit



Source: Ministry of Finance, 2016b

There are two sources of debt financing: one is external and another is internal. Bangladesh bank, scheduled banks, and non-bank financial institutions and the domestic credit market are the main sources of the domestic borrowings. In FY 2016-17, total public borrowing from banking sector is estimated to be Tk. 38,398 crore and this amount is Tk. 7302 crore higher than that in the budget of previous fiscal year. This high public borrowing from the banking sector signals that capacity of deficit financing through revenue collection is not increasing sufficiently. Furthermore, implementation of the budget of Tk. 340605 crore in the FY 2016-17 tends to increase domestic borrowings by a larger amount than the proposed amount since financing the deficit from foreign sources may not reach the targeted amount, thereby causing higher inflationary pressure in the economy on the one hand and retrenchment of allocation from social sectors on the other. So far, total interest payment increased by 4.87 percent during the first quarter of the current fiscal year compared to that in the corresponding period of the previous fiscal year.

2.4. Taxation

Collection of revenue from Value Added Tax (VAT) has been the main source of total revenue collection in the country, whereas two other sources of tax revenue are income tax and import and supplementary duty. In the FY 2016-17, the government has targeted income tax as the main source of revenue earning, though the indirect sources of revenue (i.e. VAT and import and supplementary duty) comprise the greater amount of revenue earnings. In the budget of FY 2016-17, an estimated Tk. 71,940 crore of revenue will be earned from income and corporate tax, whereas Tk. 72,764 crore as revenue earning will come from VAT and Tk. 52,525 crore will be earned from import and supplementary duty. These statistics, however, show that the government collects large revenue from the indirect sources vis-à-vis the direct sources. This regressive tax structure is, however, not up to the mark of addressing income inequality and acts as barriers to wealth creation in the economy.

The basic challenge has been an enormous range of exemptions, incentives and special regimes, with hardly any link to the induce expansion of productive capacities. This directly weakens revenue collection, and also equally complicates administration, undermines equity in the system as well as introduces significant scope for officials to engage in corruption in exercising their discretions in both policy and administration.

The end result of these weaknesses is a tax system characterised by an extremely high degree of informality and discretion, and by the corresponding prevalence of negotiated tax liabilities and corruption. While large businesses submit tax returns to the government, they are emphatic that these tax returns represent merely a starting point for subsequent negotiations with tax officials. Over time, most firms accept this reality, and enter into implicit agreements with tax officials that involve regular informal payments and the informal negotiation of liabilities between tax officials, lawyers and auditors. The most notable feature of experiences in Bangladesh is, however, thus not the nature of the challenges, but the near total absence of reform despite widespread acknowledgement of the problems. Whereas major tax reforms have occurred across much of the developing world in recent decades, the same problems have persisted for decades in Bangladesh.

The most striking fact that has to be considered in reforming the tax system is to provide recognition to the general public as tax payers. General public, in addition to paying direct taxes, has to pay large amount of VAT as consumers. As a result, a large portion of indirect taxes comes from the pockets of consumers, exerting immense pressure on their purchasing power. This also puts downward pressure on aggregate demand and hence adversely affects growth. In this circumstance, in addition to the recognition of tax paying public, supply of services to them must be ensured in the form of subsidies for basic needs, including social security.

3. Macroeconomic Management

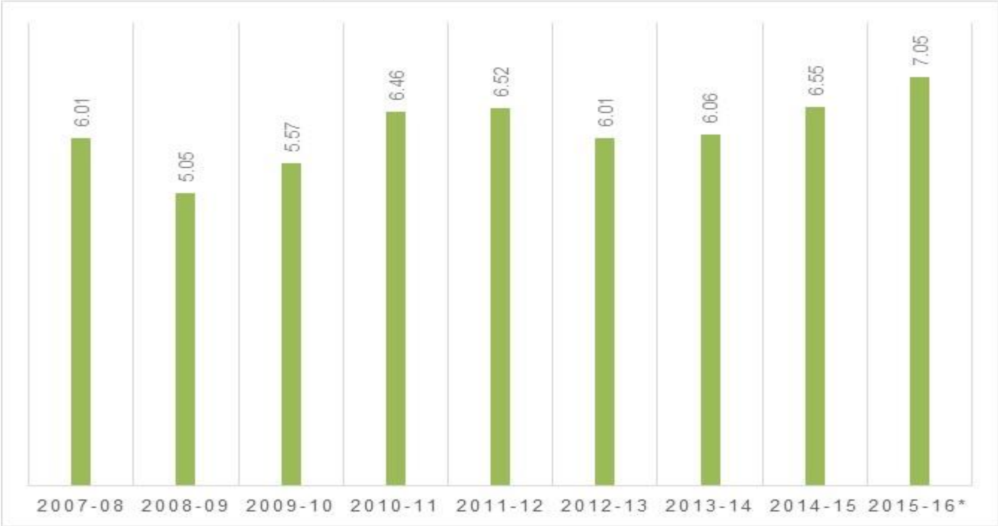
The macroeconomic management of the economy has been fraught with lack of farsightedness in policy making, besides the recent contested terrain of politics which augments lack of confidence in investment decision.

As regards the other indicators of macroeconomic development, the economy is experiencing a trend of downturn vis-à-vis the previous fiscal years as well. The growth of export has tended to decelerate in recent period. The rate of inflow of remittance has also decelerated recently posing serious challenges to the consumption in rural economy since remittance comprises almost one fifth of the total income of rural households. The economy also lags far behind in attracting Foreign Direct Investment (FDI) vis-à-vis the economies of the same structural characteristics due mainly to inadequate infrastructural and utility services along with current political uncertainties in the country.

3.1. Growth in Gross Domestic Product

Several policy-induced macroeconomic challenges have restricted sustainability of the rate of growth in the recent fiscal years and the continuation of progress in different social sectors. The challenges have partly been the result of lack of farsightedness and creativity in policy making, and partly the outcome of adhocism and expediency of the political class.

Figure 7: Rate of Growth in GDP



Source: Ministry of Finance, 2016b

The target of growth in the budget for FY 2016-17 has been set at 7.2 percent. This target appears to be ambitious like the previous year's target of growth because of several reasons. First, the historical track record shows that the government has not only failed to achieve such high rate of growth in its previous budgets, but also the country has been experiencing a decelerating rate of growth in the last three fiscal years. The target of growth of 7.0 percent in FY 2011-12 has been missed by 0.8 percentage points and 7.2 percent in FY 2012-13 by 1.19 percentage points. The same thing also happened in FY 2013-14 and FY 2014-15, when the country's actual rate of growth fell short by 1.08 and 0.79 percentage points from the targeted 7.2 and 7.3 percent growth. Second, with regard to the provisional growth estimate of 6.51 percent in FY 2014-15, the target of growth for FY 2016-17 would require an increase in rate of growth by 0.69 percentage point whereas the highest increment in the last 10 years has been observed at 0.8 percentage points in FY 2010-11. The achievement of lower rate of growth than target is due primarily to the supply side constraints in the economy caused mainly by poor infrastructural facilities and lack of business confidence. In FY 2014-15, the growth rate in GDP target was 7.3%, where 6.55% is achieved; shortfall of 0.75 percentage point. In FY2015-16 target was set to7%, achieved where the actual was 7.05% and for FY 2016-17 target is 7.2 percent

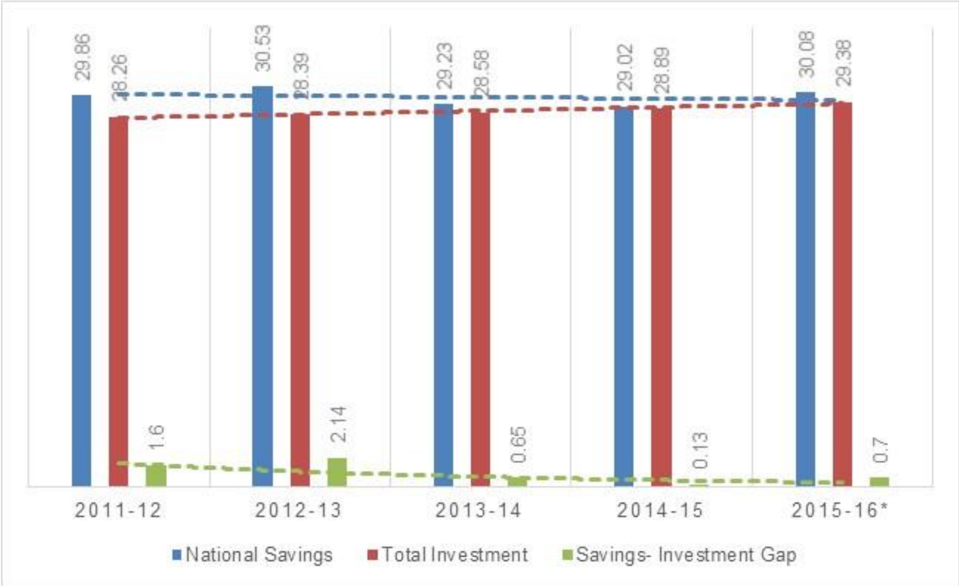
The achievement of a lower rate of growth than the target is due primarily to the supply side constraints in the economy caused mainly by poor infrastructure facilities and lack of business confidence. In FY 2014-15, the target GDP growth rate was 7.3%, whereas 6.55% was achieved – a shortfall of 0.75 percentage points. In FY2015-16 the actual growth was 7.05% against the target of 7.2 percent.

3.2. Savings, Investment, and Illicit Capital Flow

The rates of savings and investment to the GDP have remained stagnant over the years and the gap between savings and investment has assumed an increasing trend lately, suggesting that the macroeconomic strategies of government fall short of converting the savings into investment, resulting large amount of capital flight. In the FY 2011-12, the gap between savings and investment was calculated as 1.6 percent of GDP, whereas the gap reached 2.14 percent, 0.65 percent, 0.13 percent, and 0.7 percent of GDP in the FY 2012-2013, FY 2013-14, FY 2014-15, and FY 2015-16 respectively. Under the Medium Term Macroeconomic Framework (MTMF) of 2014-18, the target of investment has been set at 34 percent of GDP comprising the private investment of 25.6 percent and the public investment of 8.5 percent by the FY2017-18, and the domestic savings were projected to increase to

24.2 percent of GDP by the FY 2017-18 from the present 20.9 percent, whereas the national savings were projected to reach 33.3 percent of GDP by FY 2017-18 from the present 27.6 percent.

Figure 8: Savings-Investment Gap



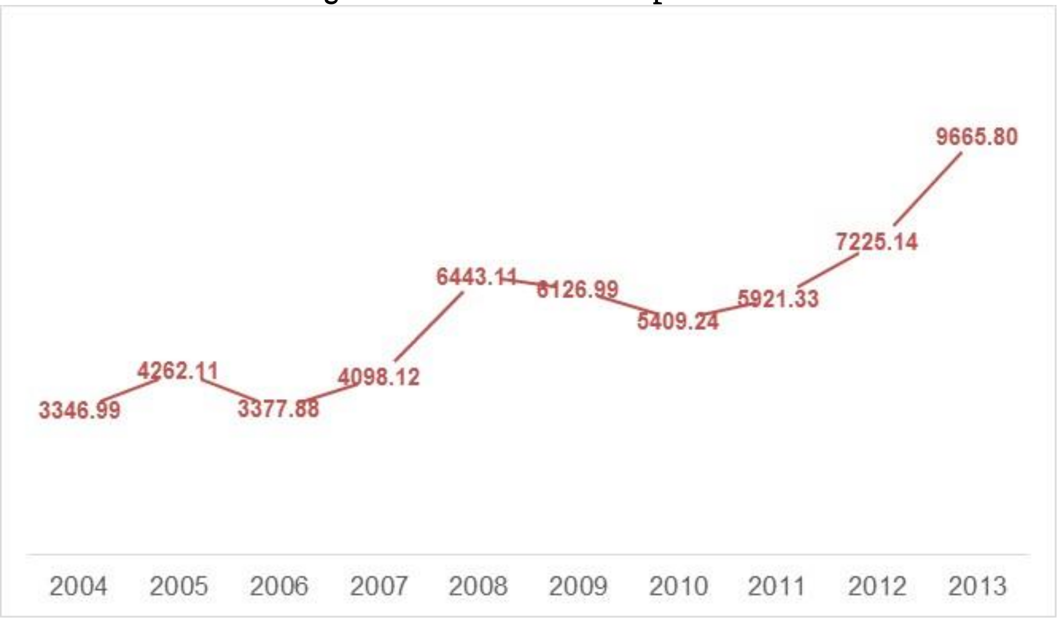
Source: Ministry of Finance, 2016b

These seem to be unachievable in the present circumstances of low savings and investment. Total national savings stood at 29.23 percent of GDP in FY 2013-14, 29.02 percent in FY 2014-15, and 30.08 percent in FY 2015-16, and warns that such trend may induce national output to decline. Private investment has been remaining stagnant and has stood at 22.07 percent of GDP in FY 2014-15 and 21.78 percent in FY 2015-16, while increase in public investment from 6.82 percent in FY 2014-15 to 7.6 percent in FY 2015-16 has not succeed to create much needed crowding in of private investment. Thus, there is a downward pressure on aggregate demand which may induce a fall in national output or growth slow down, especially if growth in exports decelerate.

In the FY 2001-02, the rate of total investment was 23.15 percent of GDP, in which the shares of public and private sectors were 6.37 and 16.78 percent respectively. The rate of national investment increased to 24.65 percent of GDP in the FY 2005-06, whereas it came down to 24.46 percent of GDP in the FY 2006-07. In FY 2008-09, and FY 2009-10, the investment slightly increased and reached 26.19 percent and 26.23 percent of the GDP, whereas in the FY 2010-11, it fell down further and became 27.39 percent of the GDP. Later on, in the FY 2013-14, provisional estimation indicates a slight increase in investment by 28.58 percent of GDP vis-à-vis the investment of 28.39 percent in FY 2012-13 and 28.26 percent in the FY 2011-12. It is, however, conspicuous that the government has not been able to achieve the investment target of MTMF in each revised MTMF (Ministry of Finance, 2015).

In addition, the lack of adequate capital formation due to large scale illicit capital outflows every year causes national savings and investment not to rise significantly.

Figure 9: Trend in Illicit Capital Flow



Source: Global Financial Integrity, 2015

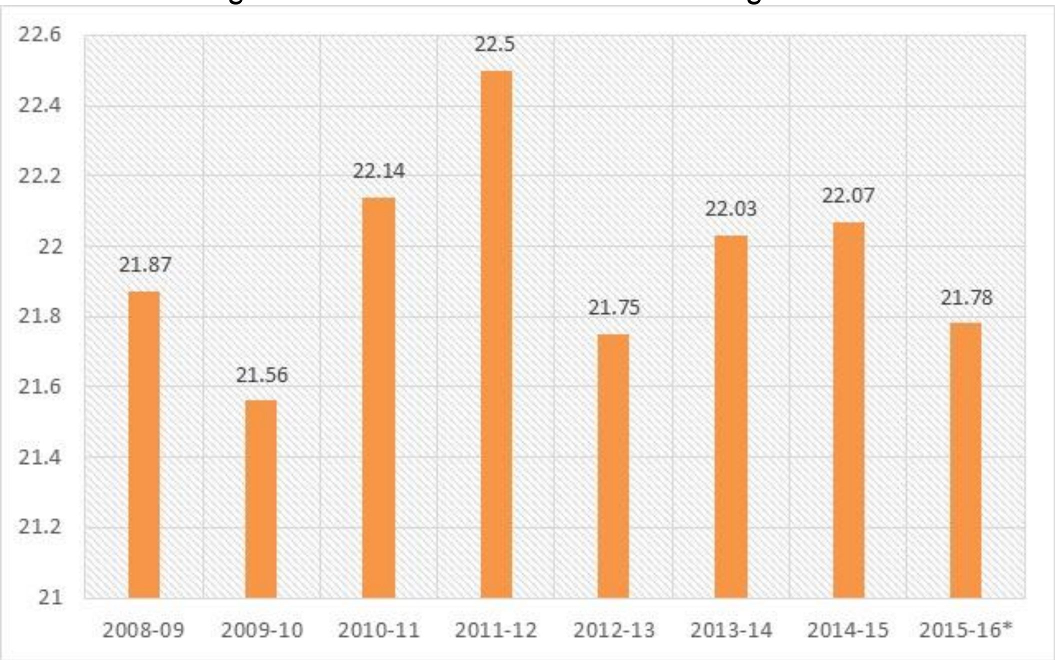
Statistics suggest that during the period of 2004 to 2013, illicit capital outflow amounted to USD 5587.67 million every year on average. In 2010, the amount of illicit capital flow was USD 5409.24 million whereas the amount increased to USD 5921.33 million in 2011, USD 7225.14 million in 2012 and USD 9665.80 million in 2013.

3.3. Public Investment, Private Investment and ICOR

Not only the quantity, but the quality of investment has not been satisfactory in the country either. In comparison to countries like China and India which have posted rate of growth in double digit in the last decade, the investment is acting as a limiting factor for future growth prospect. In the case of investment, the rate of total investment as percentage of GDP has been increasing, though the share of private investment has been on decreasing trend since the FY 2011-12. In FY 2011-12, total investment was 28.26 percent of GDP, whereas investment reached 28.39 percent, 28.69 percent, 28.97 and 29.38 percent in FY 2012-13, FY 2013-14, FY 2014-15, and FY 2015-16 respectively.

Investment in private sector, however, occupies the primary role, which has traditionally accounted for more than 70 percent of total investment. While investment in the private sector has been stagnant since FY 2011-12, the investment in public sector has increased from 5.76 percent in FY 2011-12 to 6.64 percent in FY 2012-13, and then further increased to 6.55 percent in FY 2013-14, 6.90 percent in FY 2014-15, and 7.6 percent in FY 2015-16.

Figure 10: Private Investment as Percentage of GDP



Source: Ministry of Finance, 2016b

However, this increase could not raise the total rate significantly as the share of public sector in total investment is meager and is largely spent to meet the non-development expenditure. Continuous sliding down of private investment from 21.75 percent in FY 2012-13 to 21.39 percent in FY 2013-14 to 22.07 percent in FY 2014-15 to 21.78 percent in FY 2015-16 implies that public investment from 6.64

percent in FY 2012-13 to 6.55 percent in FY 2013-14, to 6.90 percent in FY 2014-15 and to 7.6 percent in FY 2015-16 has failed to create much needed crowding in of private investment.

Moreover, the Incremental Capital Output Ratio (ICOR) of the country has deteriorated continuously in the past few years, indicating that the country has not been able to boost productivity of investment. The government would require total investment to rise at approximately 35 percent of GDP in FY 2016-17 in order to achieve the proposed rate of growth of 7.2 percent if the ICOR remains constant at the previous fiscal year's level.

4. External Sector

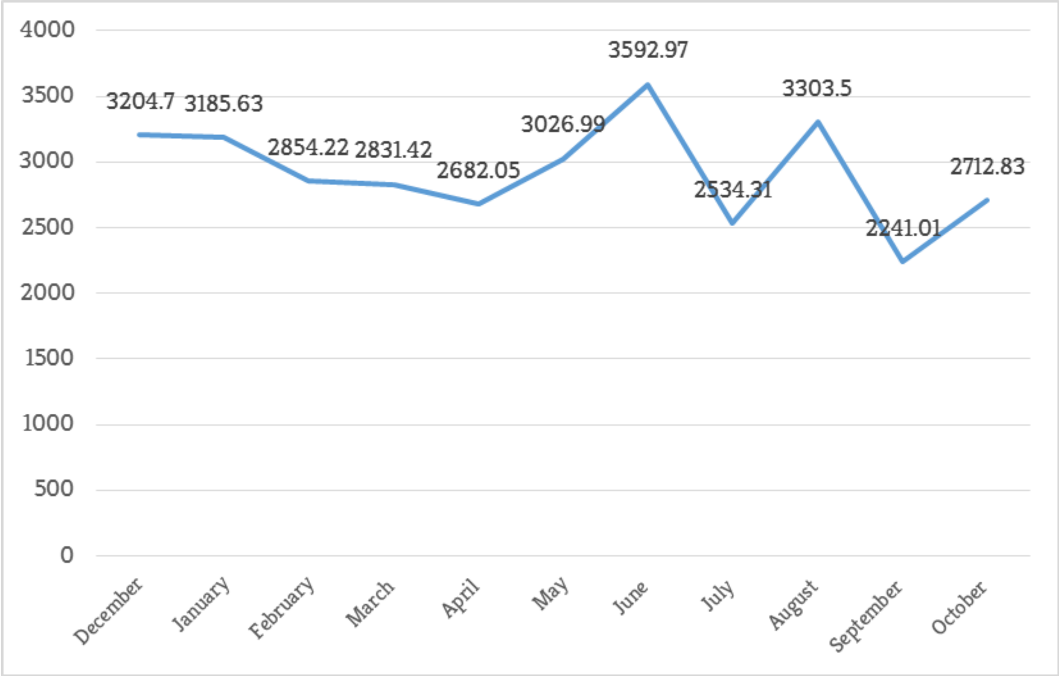
Declined growth in export shipment in the starting months of FY 2016-17 is likely to exert immense pressure on the country's balance of payments. In addition, decrease in remittance and export of manpower, increasing deficit in service and trade balance are likely to impede the rate of growth of the economy. Inflows of remittance has become negative in recent times mainly because of the decline in labour migration in major markets of the Middle East countries. This declining inflow of remittance is likely to exert adverse impact on rural economy since consumption and expenditure of people living in rural areas are largely contingent upon remittance sent by their household members living abroad.

4.1. Export Earnings

Characterized by the lack of product diversification, merchandise export in October 2016 nonetheless increased by USD 0.47 billion or 21.05 percent at USD 2.71 billion compared to USD 2.24 billion in September 2016, according to Export Promotion Bureau data. It is also 2.84 percent higher than the target of 2.63 billion.

Total merchandise export during July-October 2016 increased by USD 0.66 billion or 6.53 percent at USD 10.79 billion compared to USD 10.13 billion during July-October 2015. Actual performance of merchandise export shipments during July-October 2016 was lower by 6.84 percent than the Strategic target of USD 11.58 billion.

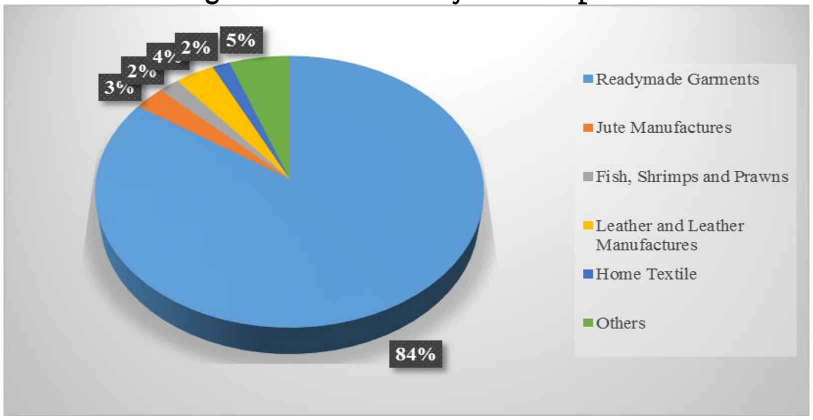
Figure 11: Export earnings in December 2015 – September 2016 (in million USD)



Source: Bangladesh Bank, 2016a

In addition, lack of product diversification in export is posing serious challenge to the commitment toward maintaining a healthy balance in external sector. Data for the period of Jaunary-March'2016 suggests that the dependence on readymade garments for export earning has been rising day by day. As high as 84.6 percent of the total export earnings came from readymade garments during this period implying the challenge of putting all eggs into one basket.

Figure 12: Commodity-wise Export



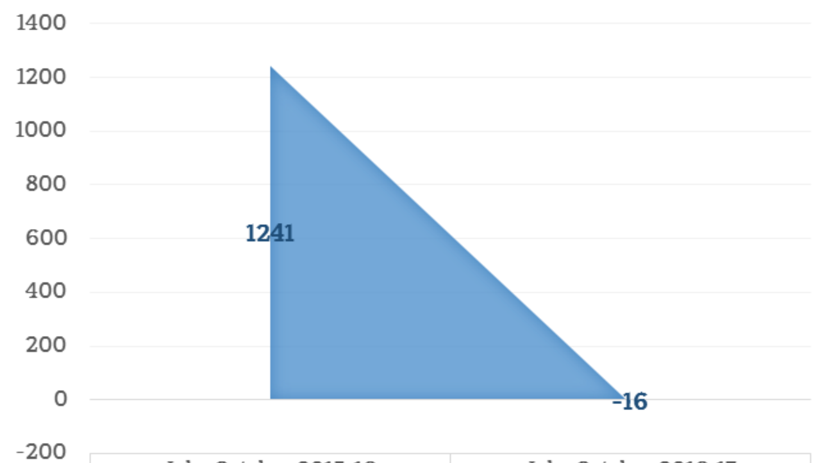
Source: Bangladesh Bank, 2016b

4.2. Current Account Balance

Trade deficit increased by 12.52 percent to 2777 million USD in July-October 2016 from 2468 million USD in July-October, 2015. Export increased by 6.78 percent whereas import increased by 7.93 percent during July-October 2016.

As a result of deterioration in the balance of all four components of current account – trade balance, services, primary income and secondary income, the current account balance declined substantially in July-October 2016 compared to the corresponding period of the previous fiscal year. The current account balance exhibited a surplus of 1241 million USD in July-October 2015, whereas it shows a deficit of 16 million USD in July-October 2016.

Figure 13: Trends in Current Account Balance (in Million USD)



	July-October 2015-16	July-October 2016-17
Current Account Balance	1241	-16

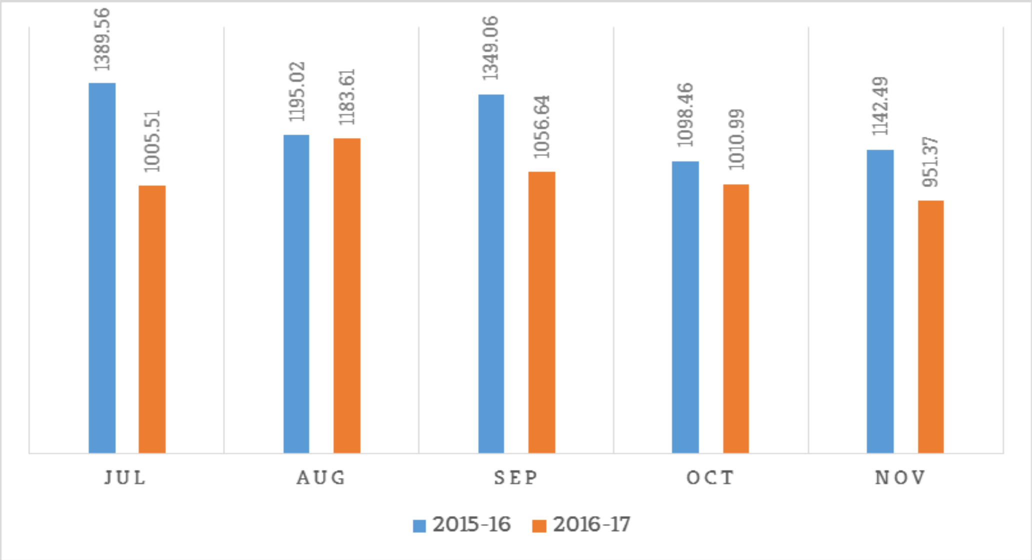
Source: Bangladesh Bank, 2016b

4.3. Remittances

A declining trend is observed in the inflow of workers' remittance in the first five months of FY 2016-17 compared to the corresponding period of the previous fiscal year. Inflow of workers' remittance declined by 15.65 percent to 5208.12 million USD in July-November 2016 from 6174.59 million USD in July-November 2015. In November 2016, inflow of remittance declined by 16.73 percent to USD 951.37 million from USD 1142.49 million in November 2015. Receipts of workers' remittance inflow in October 2016 decreased by 8.56 percent and stood at USD

1.01 billion as compared to September 2016. It also decreased by 11.88 percent in September compared to August 2016 and by 22.69 percent compared to the corresponding month of the previous year. Total receipts of workers' remittance decreased by 15.43 percent during July-October, 2016 and stood at USD 4.26 billion as compared to the same period of the previous fiscal year. The inflow of remittance declined by 27.64 percent and amounted to USD 1005.43 million in July 2016 compared to the corresponding month of 2015. In addition to decreasing inflows of remittances, recent incidences of restriction to overseas employment of Bangladeshi unskilled workers is likely to aggravate the declining remittance growth and adversely impact the country's external balance.

Figure 14: Trends in inflows of remittance (in million USD)



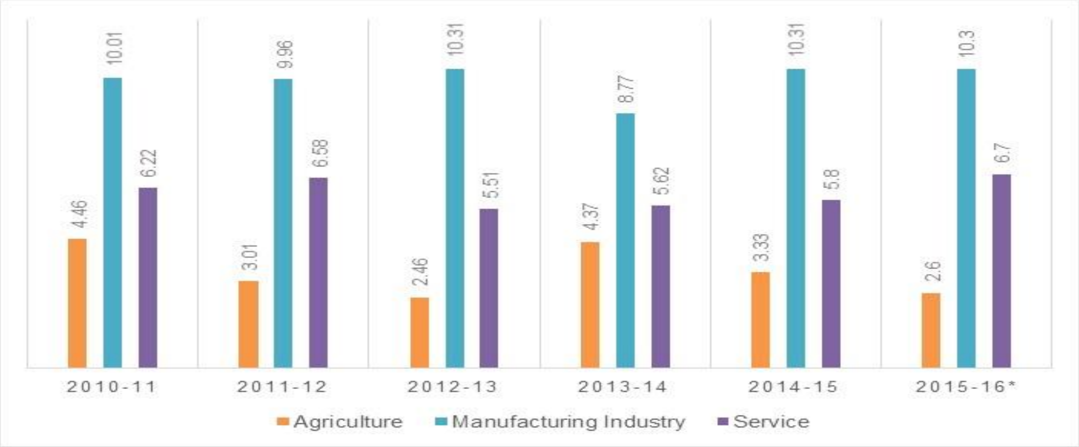
Source: Bangladesh Bank, 2016b

5. Real Sector

Although there was an increasing trend in growth in agriculture from 1990 to 2010, the rate of growth has been falling since the FY2010-11. The rate of growth in agriculture was 4.46 percent in FY2010-11, whereas in FY2011-12, FY2012-13, FY 2013-14, FY 2014-15 and FY 2015-16 the rate was 3.01 percent and 2.46 percent and 4.37 percent and 3.33 percent and 2.60 percent respectively. This falling growth in agriculture has been causing the share of agriculture in GDP to decline over the recent years. For instance, in FY2010-11, the share of agriculture in GDP was 18.01 percent, whereas in FY2011-12, FY2012-13, FY2013-14, FY 2014-15, and FY 2015-16 the share was 17.38 percent, 16.78 percent, 16.50 percent, 16.00

percent, and 15.33 percent respectively. This should not have been a source of concerns had it been matched by a rise in the growth of a dynamic industrial sector to absorb surplus labour from the agriculture sector. In that case, that would have resulted in a dynamic structural transformation with rapid declines in poverty. The rate of growth in industrial sector has been falling. Whereas in FY2010-11, the rate of growth in manufacturing sector was 10.01 percent, the rate came down to 9.96 percent in FY 2011-12 and then reached 10.31 percent in FY 2012-13 and again fell to 8.77 percent in FY 2013-14, have get an increment in FY2014-15 at 10.31 percent and further declined in 2015-16 reaching at 10.30 percent respectively. As a result, the share of industrial sector in GDP is increasing at a decelerated rate. In FY2010-11, the share of industrial sector in GDP was 9.02 percent, while in FY2012-13, FY2013-14, FY 2014-15 and FY 2015-16 the rate became 29.00 percent, 29.55 percent, 30.42 percent, and 31.28 percent respectively.

Figure 15: Growth Rate in Agriculture, Industry and Service



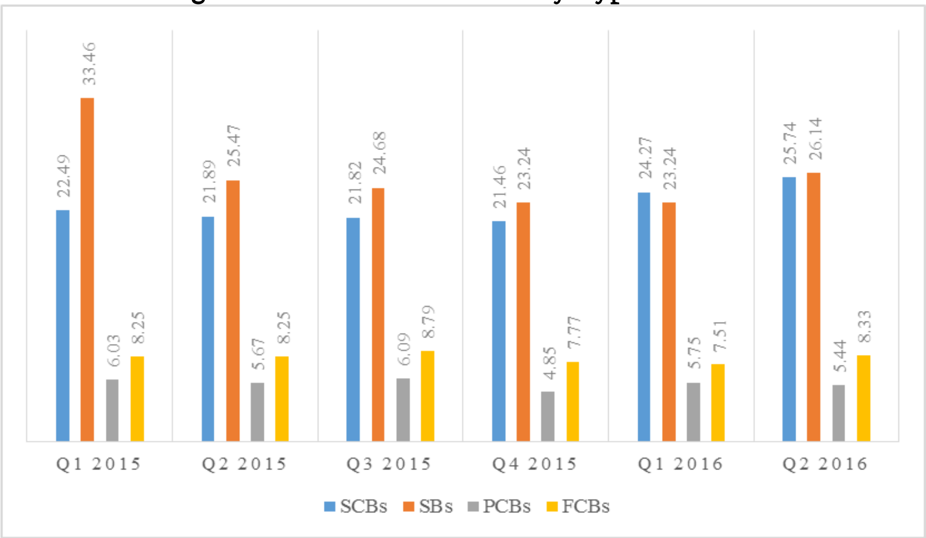
Source: Ministry of Finance, 2016b

6. Banking Sector Management

Of late crisis in the banking sector has made the financial sector in Bangladesh worst among the emerging Asian countries reflecting the poor risk management ability of the central bank. A strong financial system is needed for successful implementation of monetary policy. The running crisis in the banking sector mainly due to increase in default loan reflects the institutional weakness of the financial system in the country. Recent consecutive heists in banking sector again shake the financial system as well as the economy. Continuous default loans, scams, and heist cause increased cost of fund and shortfall in capital in the banks.

This situation is more upsetting in the State Owned Commercial banks (SCBs) and Development Financial Institutions (DFIs) for which they face huge capital shortfall every fiscal year. Government recapitalizes the shortfall with taxpayer's money instead of correcting the faults of the institutions, which not only increases the burden on taxpayers but also causes a loss to the economy. The banking sector indicators showed some concerns during the last quarter of FY 2015-16 compared to that of the preceding quarter. The ratio of gross Non Performing Loan (NPL) to total outstanding loans of the banking sector increased from 9.92 percent at the end of third quarter of FY16 to 10.06 percent at the end of the fourth quarter of FY16. However, the ratio of net NPL decreased from 2.88 percent at the end of March 2016 to 2.81 percent at the end of June 2016. The provision shortfall position of the banking sector deteriorated during fourth quarter of FY16 and stood at BDT (-) 44.5 billion from BDT (-) 41.2 billion at the end of March 2016.

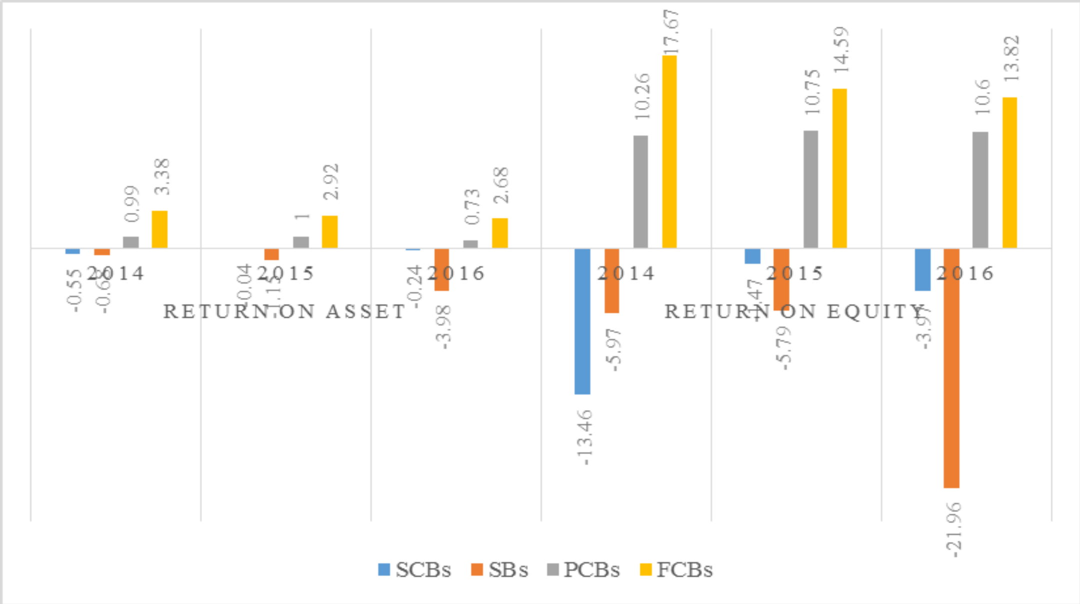
Figure 16: Gross NPL Ratios by Type of Banks



Source: Bangladesh Bank, 2016b

The gross NPL ratio for SCBs, Specialized Banks (SBs), and Foreign Commercial Banks (FCBs) increased from 24.3 percent, 23.2 percent, and 7.5 percent respectively at the end-March 2016 to 25.7 percent, 26.1 percent and 8.3 percent respectively at the end-June 2016. However, the ratio of PCBs marginally decreased from 5.8 percent to 5.4 percent during the same period.

Figure 17: Profitability Ratios by Type of Banks



Source: Bangladesh Bank, 2016b

Return on assets (ROA) declined from 0.77 percent in December 2015 to 0.44 percent in June 2016. The ROA for SCBs, SBs, Private Commercial Banks (PCBs) and FCBs decreased from (-) 0.04 percent, (-) 1.15 percent, 1.00 percent, and 2.92 percent respectively in December 2015 to (-) 0.24 percent, (-) 3.98 percent, 0.73 percent, and 2.68 percent respectively in June 2016. Similarly, return on equity (ROE) of the banking industry decreased remarkably to 6.74 percent in June 2016 from 10.51 percent in December 2015. The ROE for SCBs, SBs, PCBs and FCBs decreased to (-) 3.97 percent, (-) 21.96 percent, 10.6 percent and 13.82 percent respectively in June 2016 from (-) 1.47 percent, (-) 5.79 percent, 10.75 percent, and 14.59 percent respectively in December 2015.

In addition, disbursing loans aggressively and thus violating the Bangladesh Bank rules and regulations, defaulted loans in nine newly-established banks increased by 782.74 per cent to Tk 392.29 crore in the first half of this calendar year. Data from the central bank suggest that as of June 30, 2016, classified loans at Meghna Bank increased to Tk 17.43 crore from zero non-performing loan as on December 31, 2015, at Midland Bank from Tk 13.97 crore to Tk 13.99 crore, at Modumoti Bank from zero NPL to Tk 14.77 crore, at NRB Bank from Tk 2.21 crore to Tk 18.36 crore, at NRB Commercial Bank from Tk 5.87 crore to Tk 82.40 crore, at NRB Global Bank from Tk 13.24 crore to Tk 17.05 crore, at South Bangla Agriculture and Commerce Bank from zero NPL to Tk 2.30 crore, at The Farmers Bank from

Tk 9.06 crore to Tk 223.28 crore and at Union Bank from Tk 0.09 crore to Tk 2.71 crore.

7. Investment in Infrastructure and Inefficiency

Although government has proposed a deficit budget in FY 2015-16, the key issue remains that such deficit has not been meant to augment investment in infrastructure to remove supply side constraints of the economy; rather the deficit has financed consumption. This continuation of present deficit has its roots in the maverick decision to install rental and quick rental power plants at the cost of long run solutions. In addition, government's reliance on expensive oil-based quick rental power plants in purchasing electricity is due to its inability engage in production and efficient use of gas and coal. Consequently, frequent hikes in the power tariff haunt the consumers in the economy. In the wake of less availability of resources due to servicing debts and subsidy payments, the capacity of government to invest in physical and social infrastructure has also decreased. A large portion of development expenditure – 26.7 percent of total development expenditure – has been allocated for transport and communication sector in FY 2016-17 compared to 23.8 percent in FY 2015-16 in order to finance the ongoing mega infrastructure development projects. Increase in allocation implies rising cost induced economic rent which has made the public investments inefficient. For instance, Bangladesh spends Tk. 59 crore (proposed) to build one kilometre of 4-lane highways whereas China and India spend Tk. 13 crore and Tk. 10 crore respectively.

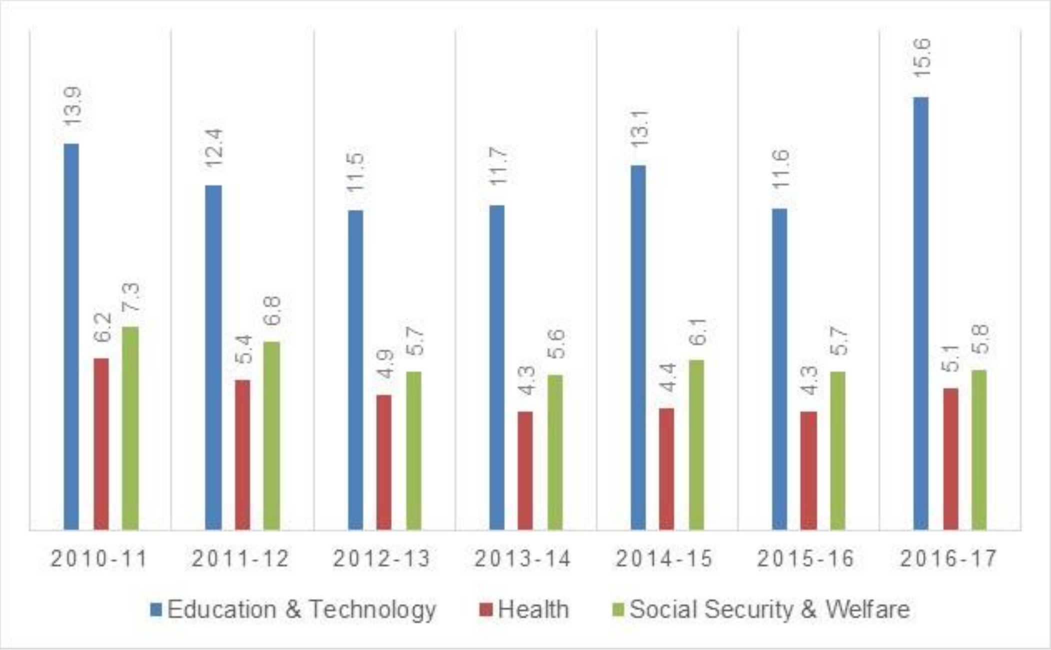
In terms of budgetary allocations, although the infrastructure sector has seen one of the highest increases in recent times, the effectiveness of this amount, however, would depend on how the money is capitalised. If the money is used to build new roads, railways, etc, the possibility of a greater fiscal multiplier would be created, through positive spill-over effects and crowding-in of private investment. Moreover, one flaw in the government's infrastructure development plan is its reliance the Public Private Partnership (PPP) initiatives, which have already failed to produce real results.

In FY 2016-17, total amount allocated to this sector is Tk. 17486 crore. The proposed allocation for health sector in FY 2016-17 is 5.1 percent of total budget. In FY 2015-16, total amount allocated to this sector was Tk. 127.25 billion. The proposed allocation in health sector for FY 2015-16 was 4.3 percent of the proposed budget while it was 4.4 percent of the proposed budget in FY 2014-15.

This decreasing allocation for the health sector in terms of percentage of total budget may pose a challenge to providing adequate health facilities to the population as the doctor-population, doctor-nurse, nurse-population ratios are still far away from acceptable levels. As a consequence, the provision of health services to society may remain inadequate.

The proposed allocation for the education and technology sector in FY 2016-17 is Tk. 52,914 crore which is 15.6% of the proposed budget. However, in the budget for FY 2015-16, the proposed allocation to this sector was Tk. 343.78 billion, which represented 2.59 percent increase compared to the previous fiscal year. Because of insufficient fund, the progress in the education sector more or less has been limited to the increase of enrolment in primary education or to the increases of literacy rate. Moreover, educated unemployment is on the rise as quality of education is not improving.

Figure 18: Allocation for Social Infrastructure



Source: Ministry of Finance, 2016a

In FY 2016-17, the proposed allocation for the Social Security and Welfare sector is Tk. 19,880 which is 5.8 percent of the budget outlay. In FY 2015-16, the proposed allocation for the social safety-net and welfare sector was estimated at Tk. 169.55 billion, which represented only 5.7 percent increase over the amount in the previous budget. The proposed allocation for the social security and welfare sector, which was Tk. 14113 billion in FY 2014-15, was already considered to be inadequate for the population of the country as about three of every ten people are living under poverty line. Such a low allocation was attributed to the diversion of expenditure from the social sector to meet the rising payments on account of principal and interest for high public borrowings to finance budget deficits in the recent years. Moreover, in Bangladesh, social safety net programmes (SSNP) have been developed and evolved on an adhoc basis. The major shortcoming of these SSNPs is that they are short-term in nature and only designed to address post-disasters situations.

8. State of Poverty and Unemployment

The proportion of poor in the population declined considerably between 2000 and 2010. The incidence of poverty decreased from 49.8% in 2000 to 40% in 2005 then to 31.5% in 2010 and 25.6% in 2015. Despite considerable thrust on poverty alleviation in all plan documents since the independence of Bangladesh, a significant number of people are still living below the poverty line. The rate of unemployment in the country, particularly youth unemployment is rising at a significant rate. In addition, casual work constitutes almost two-thirds of wage employment in Bangladesh (International Labour Organization, 2016)

With a growth rate of 3.88 percent (from 1995-96 to 2010), the number of total civilian labour force in 2010 increased to 57.1 million out of which 40.2 million was male and rest 16.9 million was female. In 1995-96, the total civilian labour force was 36.1 million out of which 30.7 million was male and only 5.4 million was female. A total of 34.8 million were employed and 1.4 million were unemployed in 1995-96, which increased to 54.5 million and 2.6 million respectively in 2010 (BBS, 2011).

The number of unemployed population increased at an annual rate of 5.29 percent during the period of 2000-2010 and increased from 1.70 million in 2000 to 2.60 million in 2010 while 10.6 million people were day laborers who did not have job security. Taking this trend into account, it is calculated that the country needs to increase employment opportunities by two percent in order to enter the middle income group by 2021.

When underemployment is taken into account in assessing the status of the labor force in Bangladesh, the perception of the labor market significantly changes. The information on hours worked shows that a total of 10.99 million (which is about

20.31 percent of the employed labor of 54.1 million) were underemployed in 2010. This shows an extremely high level in the number of the people who work less than 35 hours per week. Also the information shows high incidence of underemployment in rural areas and among the female labor force.

Another disappointing aspect is working poor. A large number of people, both in the formal and informal sector work at a wage rate far below the poverty line. While 32 percent of the population fall below the USD1.90-a-day international poverty line, 80 percent of the population falls below the USD 3.10-a day poverty line. And, there is very little difference between those 32 percent at the bottom, and those 48 percent just above them. These working poor are vulnerable to any shocks to the economy or to their personal life – they risk falling into extreme poverty.

9. Conclusions

In order to get rid of the outlined bottlenecks, the country has been waiting for a medium-term strategy that generates increment in the productive capacity and provides avenues for the poor to obtain an increased share. The adoption of such a growth strategy necessitates a prudent economic management. It warrants harmonisation of fiscal and monetary policy in order to stimulate the expansion of productive capacity and the fall in the rise of inflationary pressure.

A vigilant look into the falling investment demand is pressing since any further decline in the private investment is assumed to significantly slow down the pace of growth in the economy. The private domestic expenditure may be dampened, if a decline in expenditure happens. The growth of export as well as increased private investment should, therefore, be emphasised in order to escape further downturn in the economy. Macroeconomic stimuli are required to be initiated in order to ensure pro-poor growth through generating employment opportunities in the economy. Besides, an increased allocation of resources and implementation of development programmes in health and education sectors must be ensured, while the social safety net programs institutionalised into of a sustained system of social security.

The proposed actions in various macroeconomic plans and strategies are inadequate to bring fiscal discipline in the management of deficit, debt and subsidy one the one hand and to increase income in the absence of radical reforms in the tax system on the other. The regressive tax structure is ridden with low base, avoidance and evasion. There is huge missing of distributive justice, characterised by widening income, spatial and male-female inequalities, driven by jobless growth.

There is need for a pro-active state. As experienced in the recent past, policies that focus mainly on stabilisation, but pay little attention to proper allocation and distribution is more likely to even fail in stabilisation of the economy as well. Second, numerous un-coordinated seemingly less than effective programmes relating to social safety nets need to shift its emphasis on social protection through innovation in social policies. Third, given the vulnerabilities existing in the external sector, breaking into the high-value global supply chain has become important to the country.

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