ADB

QUARTERLY ECONOMIC UPDATE BANGLADESH

June 2004

Asian Development Bank

Bangladesh Resident Mission

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June 2004

MACROECONOMIC DEVELOPMENTS

Highlights

- For FY2004 (ending 30 June), GDP growth is estimated at 5.5%, driven by steady growth in agriculture, and export-oriented industrial production.

- Despite a steady increase in imports, the current account of balance of payments remains favorable due to rebounding exports and firmer growth in workers' remittances.

- Even with a shortfall in revenue collection, fiscal deficit has been contained mainly due to underperformance in development spending.

- The rising trend in prices has been contained with inflation declining to 5.6% in May 2004.

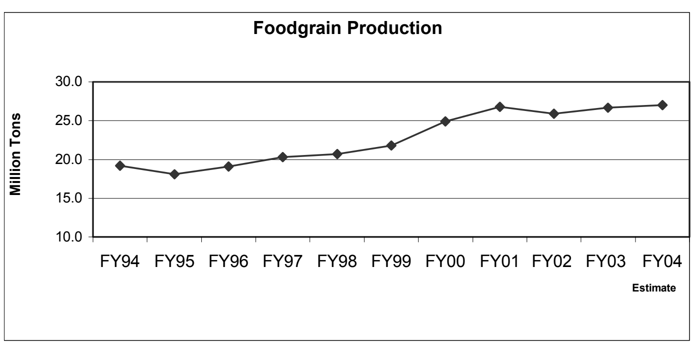
- Poor infrastructure inhibits export-led growth and investment, and limits the country's transport integration with other countries.

Agriculture

Agriculture shows a steady growth of 2.7%, which is lower than FY2003

1. The agriculture sector during FY2004 showed steady performance due to strong crop harvests – benefiting from favorable weather conditions and continued expansion of HYV acreage. The agriculture growth rate is estimated at 2.7%, slightly lower than 3.1% in the preceding year.

2. Higher production of food crops and animal farming largely contributed to an expansion of agriculture outputs. Total production of food crops is currently estimated at 27 million tons, implying an increase of 0.3 million tons over last year. While *aus* output was slightly lower than last year, *aman* production – the second major crop of the year was exceptionally good with 3.6% growth relative to the last year. The *aman* output was 11.5 million tons compared with 11.1 million tons during FY2003. While the HYV and local transplant *aman* acreage increased, the total *aman* area (5.7 million hectares) remained about the same as in the previous year. Although excessive rainfall and floods adversely affected *aman* plantation in some parts of the country, timely rainfall in most places favored better yields. The combined yield rates for all varieties of *aman* increased by 3.7%



Aman production was bumper with a 3.6% increase

compared with the previous year. Encouraged by good *aman* output, farmers brought more land under *boro* cultivation. The *boro* plantation was initially affected in many parts of the country due to inferior seeds, fertilizer crisis, and inadequate irrigation. In some parts of the country, *boro* plantation was also affected by a moderate drought. Despite these impediments, *boro* harvest is expected to increase by 1.5%. Wheat production, however, suffered a setback due to an unusually lengthy dry spell and consequently many farmers switched over to more profitable maize cultivation.

3. The production of minor crops (20% of the total output of the crop sub-sector), which include pulses, spices, sugarcane, fruits, vegetables and tobacco, are expected to remain the same as that of the previous year. Jute production is likely to be lower than the preceding year. The output of animal farming sub-sector increased notably due to expansion of production of poultry farms. Production of fish, particularly marine fish, and forest and related services is likely to register robust growth relative to last year.

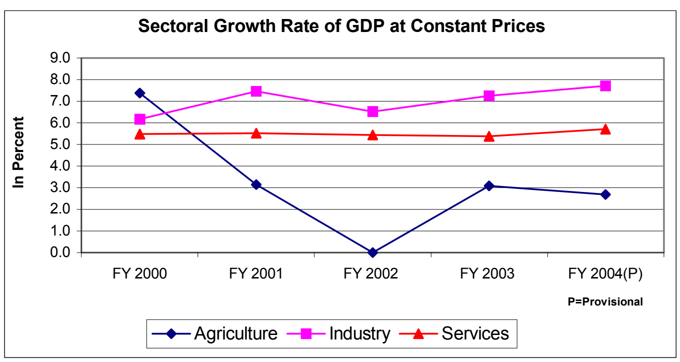
Industry

Industry rebounds with a 7.7% growth

4. Industrial growth sharply rebounded mainly due to a surge in export-led manufacturing production and domestic construction activity. The growth in industry in FY2004 is likely to be 7.7% compared with 7.3% during FY2003.

Manufacturing growth is led by export expansion

5. Aided by growing external demand, growth of the manufacturing sector in FY2004 is estimated at 7.4% relative to 6.8% in the previous year. Manufacturing augmentation is supported by the expansion in exports, imports of industrial raw materials, and industrial credit. Production of large and medium scale industry, in particular, garments, knitwear, soft drinks, footwear, tea, tobacco, drugs and pharmaceuticals, ceramic, cement and plastic products maintained steady increases. Robust and sustained demand in industrial countries resulted in higher growth in the production of garments and knitwear. The growth of small-scale industry was broad-based covering rice milling, knitwear, wooden furniture, printing and publishing, fabricated metal products, and food products.



Energy registers strong growth

6. Electricity (8.1%) and gas (8.5%) are also likely to register strong growth. Independent Power Producers (IPPs) now account for 38% of electricity generation. The construction sector (8.3%) is also likely to show

steady expansion, mainly due to increased private sector construction activity.

Services

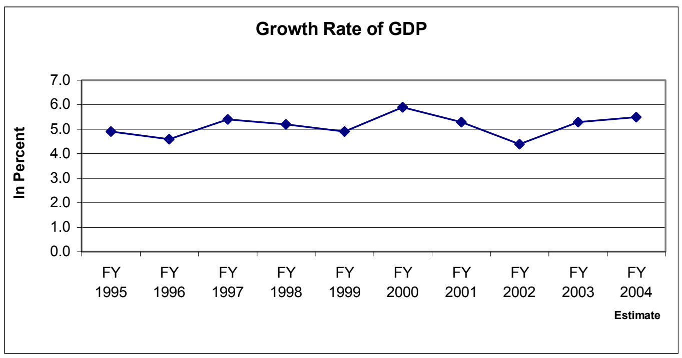
Services show robust growth

7. During FY2004, the services sector is expected to show strong growth of 5.7% as against 5.4% in the preceding year. Increasing agriculture production, industrial output and merchandize imports particularly contributed to higher services sector activity. Services sector activity showed steady progress in the areas of wholesale and retail trade, transport, storage, communication, real estate, and public administration and defence.

Economic Growth

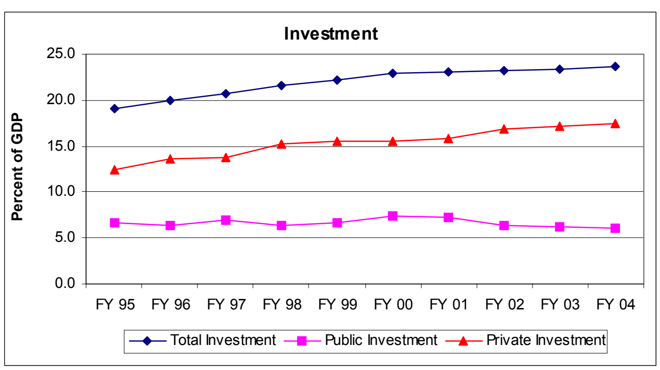
GDP growth increased to 5.5% in FY2004

8. The GDP growth rate for FY2004 is estimated at 5.5% as against 5.3% growth achieved in FY2003. The growth performance is underpinned by steady growth in agriculture and industrial production, reflecting further expansion in both domestic and external demand. The growth in part was driven by a rebound in exports, and solid increases in government and private consumption. Bangladesh, however, continues to perform below its potential. In addition to infrastructure constraints, political disruption, particularly *hartals,* and poor law-and-order, hampered growth and investment in the country.



Investments continue to be low

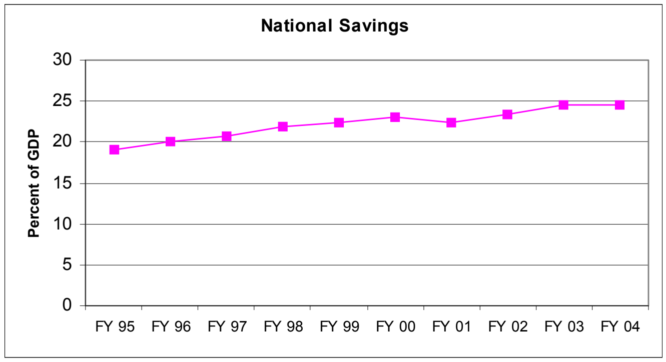
9. Both foreign and domestic investments in the country continue to be very low. Total investments marginally increased to 23.6% of GDP in FY2004 from 23.4% in the previous year. Over this period, private investments slightly increased to 17.5% of GDP from 17.2%. In the same period, public investment declined to 6.1% of GDP as against 6.2% on account of underperformance of development spending. The national savings was 24.5% of GDP during FY2004, the same as the previous



year. It is worrisome that investment and savings have virtually stagnated over the past few years.

Investment and savings rates need to be stepped up

10. The savings and investment rates need to be stepped up substantially to move the country on to a higher growth path. Achieving the Millennium Development Goals (MDGs) of a 50% reduction in the poverty incidence by 2015 will require increasing the GDP growth to at least 7%. The growth of this magnitude needs investment increasing to at least 28% of GDP. Poor governance, including weak enforcement of law-and- order and corruption makes doing business difficult and inhibit investment. Transport constraints limit the opportunity for industries to compete in international markets. The port of Chittagong, which caters for 85% of imports and exports, is inefficient and a source of major delays to shipments. Transport links to the port from Dhaka, the largest industrial center, suffer from lack of capacity, congestion and operating constraints.



Infrastructure needs to be improved significantly

11. Without improved infrastructure, accelerated growth will not occur. Experiences in countries like Republic of Korea show that building infrastructure for the future can itself be a catalyst for accelerated growth. There are a number of other preconditions for accelerated growth. These include an improvement in the general investment climate to attract local and foreign investments. Accelerating human capital and infrastructure development, improved governance and reduced regulatory and administrative burdens will be required for rapid growth. In the transport and energy sectors, this translates into a need to remove constraints on infrastructure and services developments, improve sector governance and involve the private sector in order to reduce costs and increase customer focus. The distortions created in key sectors through government ownership and the control of prices and services must be overcome. Initiatives for improved sub-regional cooperation will give a boost to the economy both through the stimulation of trade and the impact of transit traffic from neighboring countries. Given the huge potential for the country for export-led growth, significant improvements are required at the ports, road, rail and the waterways and in the provision of energy and information and communications and technology (ICT).

MFA phase-out may adversely affect garments industry

12. The prospect for the country's garment industry is clouded due to the impending phase-out of multifiber arrangement (MFA) by end-2004. Based on a recent IMF study, Bangladesh could face significant pressures on its balance of payments, output, and employment when

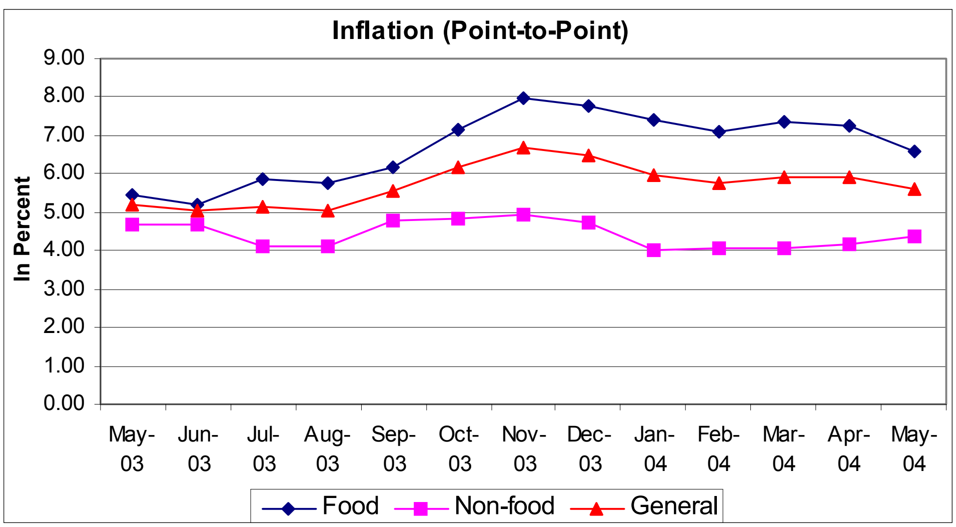
the quotas are eliminated[1]. Sustaining competitiveness of the garments industry in a quota free environment will also depend, to a great extent, on addressing the key infrastructure constraints in the country. The IMF study also points out that together with weak governance, the country's poor infrastructure—e.g., unreliable power supply, expensive telecommunications networks, congested roads, and inefficient seaport management— have imposed substantial costs on its export industry.

Inflation and Exchange Rates

13. Higher import prices for both inputs and finished products, and an increase in nominal wages owing to strong economic activity partly contributed to relatively higher inflation during FY2004. The rising trend in inflation has, however, been contained. On a point-to-point basis, inflation increased to 6.7% in November 2003 from 5.1% in July 2003, mainly due to a rise in food prices. Thereafter, inflation declined steadily to 6.5% in December 2003, 6.0% in January 2004 and 5.6% in May 2004 with declining trends in food prices. The exchange rate remained broadly stable with the US dollar trading within a band of Taka 59.25 and Taka 61.47 in the formal inter-bank market on 30 June 2004. The exchange rate also remained steady in the informal curb market, with the prevailing rates a little higher than the inter-bank rates. On June 30, the curb market rate varied between Taka 61.0 and Taka 61.2 to a dollar.

Rising trend in inflation noted during the first half of the year halted

Exchange rate remained broadly stable



Fiscal Management

14. Although revenue collection in FY2004 grew by 13.7% over FY2003, it fell below the original target for the year. The lower collection from the National Board of Revenue (NBR) and Non-NBR taxes, as well as from non-tax revenue resulted in the lower than targeted revenue intake for the year. In FY2004, collection from taxes under NBR, which accounts for 96% of tax revenue and 76% of total revenue, is estimated to

Although increasing, revenue collection falls below target

[1] The End of Textiles Quotas: A Case Study of the Impact on Bangladesh, IMF Working Paper, IMF, June 2004.

increase by 10.1% over the previous year. Based on provisional estimates of actual collection, compared with the previous year, income tax is expected to increase by 8.9%, customs duty by 6.1%, VAT by 11.2% and supplementary duty by 18.7%. Most of the major taxes under NBR posted lower than projected growth, in addition to the growth rates being lower than the corresponding growth rates of FY2003. Frequent *hartals,* to some extent, also resulted in the depressing revenue performance. Given the ambitious revenue target for FY2005, it would be essential to undertake an aggressive revenue mobilization drive and institutional strengthening of the revenue machinery.

ADP implementation was poorer than planned

15. In FY2004, total expenditure was 5% below the budgeted target, with current expenditure falling below the budgeted amount by 3.3% while the annual development program (ADP) estimate was revised downwards by 6.4%. Due mainly to the restraint imposed to keep inflation under control, current expenditure posted a low growth of 5.9% in FY2004 over FY2003, which was also much lower than the nominal GDP growth of 10.6% for the year. In FY2004, the ADP is projected to increase by only 11.1% compared with the budgeted growth of 18.7% due to the slow implementation of projects.

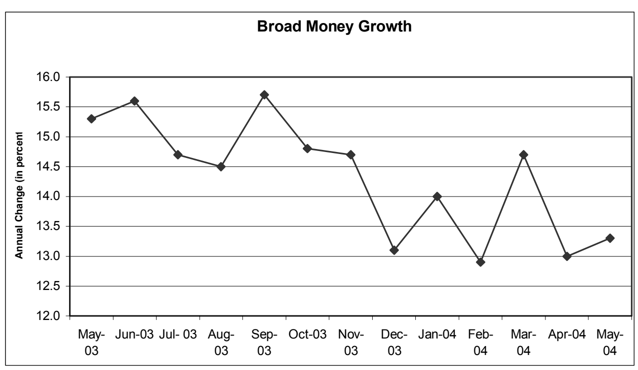
Fiscal deficit contained to 4.2% of GDP

16. At 4.2% of GDP in FY2004, the actual fiscal deficit fell below the projected level of 4.8% of GDP. In spite of the large slippage in revenue mobilization, the low fiscal deficit was caused by the lower than projected levels of both current and ADP expenditures. Domestic resources financed 1.8% of GDP and external resources 2.4% of GDP. Domestic financing was lower than the targeted amount with bank borrowing falling below its target by 51% and net foreign financing, both loans and grants, falling short of the budgeted amount by 14.1%.

Monetary Developments

Private sector credit increases while government borrowing falls

17. Monetary policy continues to be prudent. During FY2004 (up to May), domestic credit grew by 10.4% compared with 9.3% during the same period of the previous fiscal year. Credit to the Government registered a negative growth (-5.5%), as Government was able to repay earlier loans to the banking system due to lower levels of financing requirements. Some borrowing however appears to have taken place before the end of the fiscal year (end – June 2004) due to the delay in anticipated availability of the Development Support Credit II from the World Bank. Private sector credit grew by 14.2% compared with the 13.8% growth observed during the same period of FY2003, indicating stable performance of mainly the domestic manufacturing and service

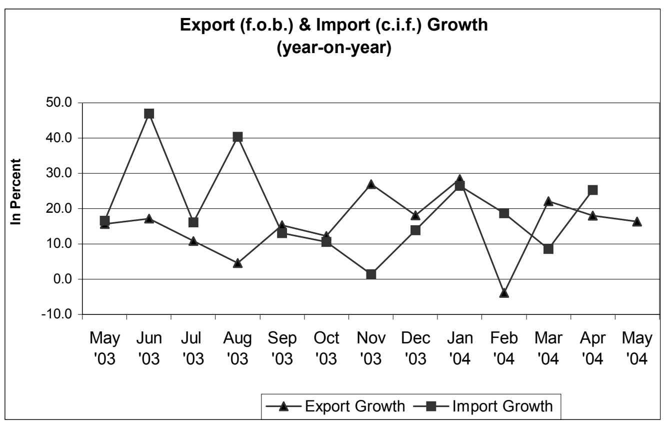


sectors. Credit to the "other public sector" increased by 12.1% due mainly to borrowings by the state-owned Bangladesh Petroleum Corporation to finance imports of petroleum and Bangladesh Jute Mills Corporation for the purchase of raw jute, compared with a decrease of 1.4% in the same period of FY2003. Growth of net foreign assets of the banking system decelerated from 19.8% during July-May of FY2003 to 16.4% during the corresponding period of FY2004 reflecting a moderation in the growth in migrant worker remittances, contributing to the lower broad money growth of 8.8% as against 11% growth in the previous year. The decrease in the money growth rate was accompanied by an increase in reserve money by 7% as the increase in net foreign assets of Bangladesh Bank more than offset the small decline in net domestic assets. Bangladesh Bank conducted routine auctions of treasury bills with the yield on 28-day treasury bills staying around 4% since January 2004. Call money rates mostly remained in the single digit during the period indicating availability of adequate liquidity in the market.

Balance of Payments

Exports rebound

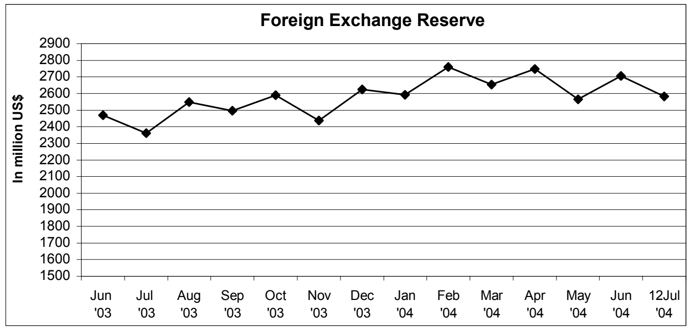
18. Exports rebounded due to steady external demand for the major products. Merchandize exports during the first 11 months of FY2004 increased by a robust 15.2% compared with 8.6% during July-May of FY2003. With a relatively shaky start early in the fiscal year, export growth steadily picked up since November 2003. High growth in exports was supported by growth in frozen food, agricultural products, chemical products, petroleum products, garments and knitwear exports.



Imports continue to rise

Year-on-year imports have also grown at a high rate of 16.4% during the first ten months of FY2004 to US$8,803 million (c & f basis) compared with the 8.4% growth experienced during the same period of the previous fiscal year. There have been large increases in imports of rice and wheat, oil seeds and edible oil, fertilizer, chemicals and dyeing and tanning materials. Significant increases were also observed in imports of raw cotton, yarn, staple fiber—all textile sector inputs, indicating steady performance of the sector. Imports of capital goods also recorded notable growth. The latest data for imports (in terms of L/C's opened) during July-May of FY2004, suggested a larger growth in imports, 18.6% over July-May of FY2003. This includes a 34.9% increase for non-food grain consumer goods, a 21.8% increase for intermediate goods, 22.2% increase for industrial raw materials, 33.5% increase for petroleum products, and a 15.2% increase for capital machinery.

19. As a consequence of these developments, the trade deficit during July-April of FY2004 recorded an increase of 21.2% to US$1,954 million from US$1,612 million during the same period of FY2003. In view of a higher trade deficit and a more moderate growth in worker remittances (a 9.9% year-on-year increase), the surplus in current account of the balance of payments



(excluding official grants) during July-April 2004 declined to US$277 million, from US$438 million during the corresponding period of the previous fiscal year. Coupled with a lower surplus in the capital account and a higher deficit in the financial account, the lower current account surplus led to a reduced overall balance of payments surplus of US$168 million as against a surplus of US$269 million in the corresponding period of FY2003. The foreign exchange reserves increased to US$2,747 million at the end of April 2004 from US$1,874 million at the end of April 2003. The latest available data indicate that foreign exchange reserve which was $2,705 million at the end of June 2004 declined somewhat to US$2,582 million as of 12 July 2004, due to the ACU payments of US$267 million in early July 2004.

Current account continues to record surplus

Political Developments

20. The political situation continues to be confrontational and tense. However, after a long boycott, the main opposition political party Awami League (AL) joined the budget session of the Parliament. The Parliament passed the Constitution (14th Amendment) Bill, 2004 incorporating a range of new provisions including 45 reserved seats for women, and the national budget for FY2005. The opposition political parties enforced several days of national and localized *hartals.* Two by-elections were held, BNP won one by-election while the newly formed Bikalpa Dhara Bangladesh (BDB) won another by-election. The law-and-order situation continues to remain a concern, and there has been a number of incidents of law-and-order breakdown.

THE FY2005 BUDGET

Overview

21. On 10 June 2004, Mr. M. Saifur Rahman, the Finance Minister, presented his tenth budget and the third of the present Government to the Parliament. The FY2005 budget, which became effective on 1 July 2004, was passed with certain amendments to the tax proposals on 30 June 2004. The budget renews the emphasis on comprehensive reforms in economic, administrative and institutional areas to establish good governance for acceleration of economic growth and rapid reduction of poverty. For implementing the Government's pro-poor economic development strategy, the budget is built around the following main features:

- Although not clearly linked through its presentation, to the National Strategy for Economic Growth, Poverty Reduction and Social Development (NS-EGPRSD), the expenditure programs of the budget could conceptually be categorized into groups of activities that support the movement of the economy towards achieving specific NS-EGPRSD objectives.

- In the backdrop of the weak revenue performance of FY2004 and low utilization of external resources, the budget seeks to raise public investment through additional domestic resources and utilization of greater amounts of concessional external resources while maintaining macroeconomic and fiscal balance, keeping domestic borrowing and the fiscal deficit under control.

- To expand supply side actions for increasing food production and ensure greater availability of goods essential for dampening inflationary tendencies and creating jobs, the budget places considerable emphasis on agricultural and small and medium enterprises through facilitating easier access to cheaper credit and initiating actions to lower input prices.

- Enhanced importance is attached to rural infrastructure to raise productivity and output in agriculture and agro-based industries, and create an environment for mutually supportive growth of farm and non-farm activities.

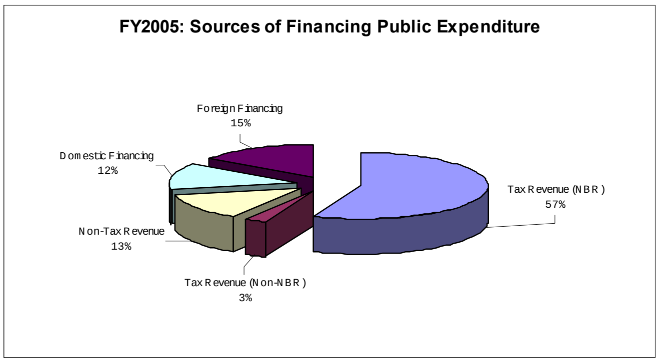
- While maintaining the main thrust on economic growth for bringing the poor into the mainstream of economic activity, the budget widens social safety nets and housing programs to address survival needs of the hardcore poor and disadvantaged groups.

- The budget recognizes the centrality of sound law-and-order, the urgency of improving economic management capacity of the ministries and ensuring good governance for implementing the Government's development programs for rapid growth and poverty reduction in the country.

- The budget takes steps towards unifying the revenue and development programs through undertaking development activities under the revenue budget, attaching priority to projects with poverty reduction potential by dropping non-priority projects and emphasizing the need for increased private investment through infrastructure development and financial sector reforms.

- In the wake of globalization trends, the budget places reduced reliance on trade taxes and more on domestic based income and goods and services taxes and highlights the need for radically revamping the revenue machinery and reforming revenue laws and instruments.

22. The budget corresponds to the second year of the NS-EGPRSD, with a medium term macroeconomic framework updated in the light of key macroeconomic indicators of the past year. The budget remains alert to the possibility of revising the framework in case of shortfalls in revenue and external assistance and development of undesirable inflationary trends.



FY2005: Sources of Financing Public Expenditure

Budget At a Glance

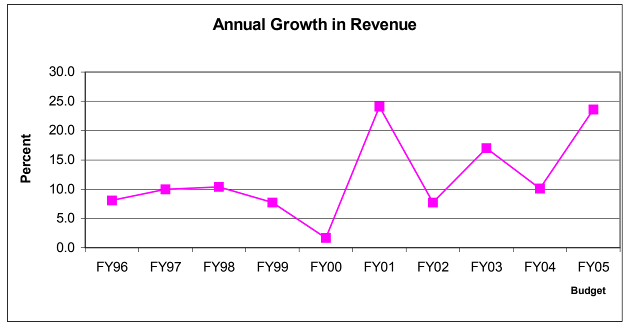
(Billion Taka)

Description	FY2005 (A)	FY2004 Revised (B)	FY2004 (C)	A/B%	A/C%
Total Revenue	413	354	362	117	114
Tax Revenue	336	283	291	119	115
Non-tax Revenue	77	71	71	108	108
Total Expenditure	572	494	520	116	110
Current Expenditure	305	268	277	114	110
ADP	220	190	203	116	108
Other Expenditures	47	36	40	131	118
Fiscal Deficit	159	140	158	114	101
Financing of Deficit	159	140	158	114	101
External Resources (Net)	89	80	93	111	96
Foreign Grants	19	27	26	70	73
Foreign Loans	70	53	67	132	104
Domestic Resources	71	60	65	118	109
Domestic Bank Borrowing	26	15	30	173	87
Domestic Non-Bank Borrowing	45	45	35	100	129

Revenue Measures

23. Rationalization of customs duty, supplementary duty and income tax and expansion of income tax and VAT coverage are expected to cause a 16.7% increase in

total revenue collection in FY2005 relative to the revised estimates for FY2004. Tax revenues are projected to increase by 19% and nontax revenues by 8.4% compared with the revised estimates for FY2004. This will lead to increase in the ratio of revenue to GDP to around 11% of GDP in FY2005 from an estimated 10.5% in FY2004. The target appears a little ambitious considering the fact that in FY2004, there was a 13.7% growth in revenue, with a tax revenue growth of 13.4% and nontax revenue growth of 15%. Increased collection drive and administrative efforts will be needed to achieve this target. Measures adopted in the budget to enforce discipline in tax management by proper application of tax laws with increased monitoring and supervision are, therefore, steps in the right direction. The Office of the Tax Ombudsman, likely to be set up in the near future, will also bring more transparency in the operations of the tax departments and promote voluntary tax compliance.



Tax and Tariff Policy Reforms

Income Tax

24. Greater importance has been attached to income tax, alongside VAT as major sources of revenue in view of the expected decline of trade taxes in the wake of globalization. Reforms have been initiated to simplify the income tax system through expanding the scope of self-assessment, reducing discretionary powers and improving the tax paying culture. Instead of raising rates in an attempt to increase collection, efforts have been made to improve management and bring greater service orientation in tax administration with a view to raising more revenues through promoting voluntary compliance. A notable feature of the income tax measures (see box) in the FY2005 budget is the emphasis on stability of the tax regime exemplified by the relatively limited number of new measures and changes in the rate structure in the budget, in addition to making the tax-rate schedule of assessment year FY2005 applicable to assessment year FY2006. The reduction of corporate tax on the textile industry along with measures reducing duty rates on textile raw materials, machinery and spares ahead of the phase out of the multi-fiber arrangement (MFA), will encourage needed investment in the textile sector. The reduction in the rate of deduction of tax on approved securities and bonds is a timely step to encourage the development of a secondary market for securities and bonds while the reduction of tax rates on income from capital gains out of transfer of stock and shares of private limited companies is conducive to the inflow of greater foreign investment. Measures to enhance submission of returns including penal measures are likely to encourage submission of a larger number of returns with a positive impact on revenue.

25. The increase in the personal income tax exemption limit will provide relief to low-income earners especially in view of the prevailing inflationary trends while additionally raising the level of income for the highest slab of 25% will promote greater tax compliance, through reducing the top marginal rate of tax. Surveys to identify new taxpayers need to be strengthened by deriving insights from the analysis of the findings

of the Household Income and Expenditure Surveys of the Bangladesh Bureau of Statistics.

Major Tax and Tariff Measures

Income Tax

- Exemption limit of personal income tax, which was raised from Taka 75,000 to Taka 90,000 in the last fiscal year, has been raised further to Taka 100,000.
- To provide greater stability in the tax regime and to facilitate forward drawing up of financial plans and assessment of tax liabilities by the taxpayers, income tax rate schedule for FY2005 will also remain applicable FY2006.
- To encourage foreign direct and joint investment, the tax rate on income from capital gains arising out of the transfer of stocks and shares of private limited companies was reduced from 15% to 10%.
- For removing anomalies in the rates of taxation between textile and jute industries and for providing some tax relief to them, the tax rate has been reduced to 15% from 20% and 37.5% respectively.
- To expand the tax base and minimize tax avoidance, submission of income tax returns has been made compulsory for individuals, firms, companies or institutions holding taxpayers' identification numbers (TIN) and submission of expenditure statement has been made compulsory for all individual assesses. In addition, submission of tax returns for tax assessment on net income has been made compulsory for all clubs in metropolitan cities and urban areas with restaurant and rest house facilities. Furnishing of TIN has been made mandatory while applying for membership of such clubs.
- To encourage the secondary market for securities and bonds and for the sake of equity, the rate of deduction of tax on approved securities and bonds has been reduced from 25% and 45% respectively to 20%.
- To discourage delay in filing returns, the initial penalty for non-filing is raised from Taka 500 to 10% of the last assessed income, with a minimum of Taka 2500 and thereafter, Taka 250 for each day of continued default.
- To discourage the tendency of delaying payment of tax by filing appeals to the Tribunal, before filing appeal, payment of 15% of the difference between the amount determined according to the appeal order and the admitted tax liability by the assesses has been made mandatory.

Import Duties

- Highest slab of customs duty has been reduced from 30% to 25%, and a three-slab duty structure (7.5, 15 and 25%) has been introduced in place of the previous four-slab structure (7.5, 15, 22.5 and 30%).
- Number of slabs for supplementary duties at the import stage for general imports has been reduced from seven (15, 25, 30, 40, 50, 60, and 75%) to three (15, 25 and 30%), while retaining (and enhancing in some cases) high rates on certain items on health and environmental grounds.
- To further encourage the textile industry, duty rates on textile, machinery and spares have been reduced to 0% and that for dyes and chemicals to 7.5%.
- To encourage entrepreneurs to set up quality referral hospitals, customs duties on medical and hospital equipment and accessories have been withdrawn. Taxes and duties on certain life support system used in such hospitals have also been withdrawn.

VAT

- To expand the tax base of VAT, services rendered by amusement and theme parks, picnic spots, house cleaning and maintenance agencies, lease financing institutions, express mail service providers, film distributors, commercial building and apartment builders have been brought under VAT.
- Spinning and weaving industries are transferred from excise to VAT.

Import Duty Structure

26. In continuation of the reforms undertaken during the past two years, further reforms have been introduced in the FY2005 budget in the form of reduction of the highest duty rate, reducing the number of rates, rationalizing the rate structure at the four-digit level and unifying rates for substitutes. The moderation of protection due to rate compression is expected to promote efficiency of domestic industries through generating greater competition and the rationalization of the rate structure will bring greater transparency in customs assessment by reducing discretionary powers and simplifying assessment through reducing classification disputes. Keeping assessable value of crude oil fixed at US$18.30 a barrel in the face of the significant rise in the international price of oil, leaving the retail price unchanged to avoid any pass-through to the consumers will provide only a part relief to the state owned Bangladesh Petroleum Corporation through reduced tax liabilities. The question is the sustainability of such an approach without inviting adverse budgetary consequences. Withdrawal of customs duty and VAT on capital machinery for the poultry sector will support expansion of poultry farming and the withdrawal of customs duty and VAT on machinery and spares for solar energy will encourage private investment in this sector and extend the reach of electricity to the distant and inaccessible areas of the country. The reduction of duty on mobile phones will serve to improve telecommunication in the country. The reduction in the number of supplementary duty rates will simplify assessment and bring greater transparency in administration of import taxes.

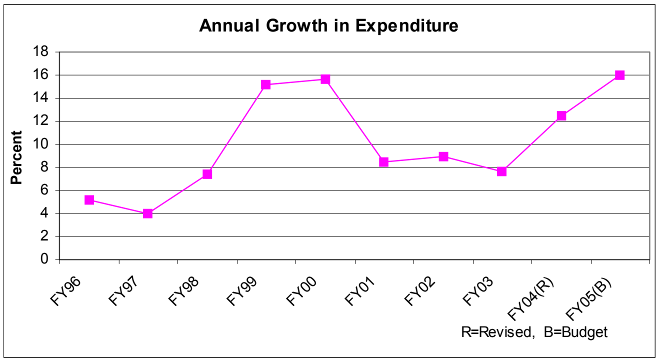
Value Added Tax

27. Measures have been taken to expand the base of VAT, through bringing certain goods and services under the VAT net although the immediate revenue implications of this measure may not be significant. The shifting of spinning and weaving from excise to VAT is a positive step that has been long overdue. Integration of the textile sector into the VAT system will auger well for the system as it will enable the credit mechanisms to work smoother by further interlinking of the chains of inputs and outputs. Withdrawal of VAT from insurance premiums, shipping bills and fees paid to C & F agents of 100% export oriented ready made garments industry will provide relief to this vital sector especially in view of the difficulties anticipated in the post–MFA period. For making the VAT administration more dynamic and for simplifying rules and procedures, legal and procedural improvements have been introduced.

28. In addition to the measures taken to expand the base of VAT, further reforms are needed to eliminate existing non-VAT specific features e.g. truncated bases, tariff values, item-specific procedures, and multiplicity of VAT rates from the VAT system in order to establish and restore into the system the central characteristics of ideal VAT. It is essential to improve the operation of the credit mechanism and establish clear credit chains and audit trails to derive full systemic benefits of VAT. Steps need to be taken to reduce reliance on VAT collection through administrative methods characteristic of the age-old excise system and a more efficient return-based collection system needs to be established. Major reforms in the operation of VAT in Bangladesh need to be undertaken to derive the full benefits of VAT as an efficient and revenue productive tax system.

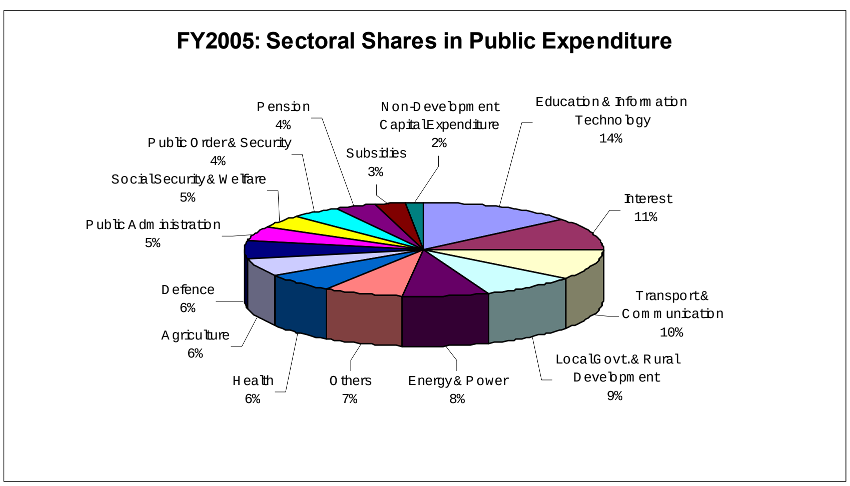
Expenditure Measures

29. The total expenditure in FY2005 is expected to increase by 15.8% over the revised estimate for FY2004, with current expenditure increasing by 13.8% and ADP expenditure by 15.8%. The ratio of total expenditure to GDP is projected to increase from 14.8% in FY2004 to 15.5% in FY2005. Further steps towards unification of the revenue and development budgets have been taken with the allocation of Taka 8.6 billion for development programs to be financed from the revenue budget. With only 11.1% growth in ADP in FY2004 as against the budgeted growth of 18.7% for the fiscal year, for achieving the projected growth of 15.8%, capacities for project processing and implementation would need to be further strengthened and upgraded. Enhanced discipline enforced on the growth of current expenditure evidenced by the actual growth of 5.9% in FY2004 over the previous year against the budgeted growth of 14.5% needs to be consolidated to ensure control of unproductive current expenditure while ensuring required resource flows to repairs and maintenance. In the FY2005 budget, priority has been attached to sectors with potential for poverty reduction and human development (details below).



Social Sectors

30. Continued high priority is maintained for the education sector, which received, as in the previous year, the highest budgetary allocation of 13.4% of the total FY2005 budget with emphasis on measures to enhance both quality and quantity of primary and secondary education. Steps to redress the shortage of teachers, ensuring supply of study materials and provision of increased financial assistance to primary level students need to be supplemented by measures to recruit well-trained teachers to ensure higher contact time between teachers and students and enhance scope for creative learning through raising the quality of instruction. Opportunities created through facilities such as the Primary Education Development Program-2, strongly supporting enhancing of quality and expansion of physical facilities need to be fully exploited to create the foundations for transforming the vast young population—a 'current liability' into a solid 'long-term asset' of an educated and skilled workforce. Sound education at the primary level, followed up by effective training at the secondary and tertiary levels will not only contribute to rapid economic



growth and faster reduction of poverty in the country itself, given the demographic transitions in developed countries resulting in a likely shortage of working age population, the country could greatly benefit from supplying educated and skilled workforce to these countries. The programs to enhance access through expansion of infrastructural facilities at the secondary and higher secondary levels and for technical education are well judged to accommodate the growing number of school and college age population over the next couple of decades. Continued emphasis on women's education, amongst others, through various financial assistance programs needs to be maintained for removing disparity against women and for facilitating women's empowerment. The Heath, Nutrition and Population Sector Program with its current thrust in the rural areas, needs to be extended to focus on the healthcare needs of the urban poor as well, through further expansion of primary healthcare services currently being financed by ADB in four city corporations of the country. The program to be undertaken to reduce maternal mortality is well advised as evidenced by the positive results for this component yielded by the ADB financed urban primary healthcare project.

Physical Infrastructure

31. In line with the allocations in the previous year, 19.2% of the development budget of FY2005 has been allocated for the energy and power sector, as high allocations to these sectors are essential for growth and poverty reduction. Higher allocations have also been made for road and railway sectors. Due emphasis has been placed on regional cooperation and development of economic and commercial relations with Bangladesh's eastern neighbors including Myanmar and Thailand through establishing road links with Myanmar. Emphasis has also been placed on developing telecommunication services, another vital infrastructure essential for developing trade and international economic relations.

Major Expenditure Measures

- Education and Technology sector has received an allocation of Taka 78.6 billion, which is 13.6% higher than the revised allocation for FY2004.
- An amount of Taka 37.3 billion has been allocated for the health sector, which is 11.6% higher than the health sector allocation under the revised FY2004 budget.
- An amount of Taka 49 billion has been allocated for local government and rural development, which is 4.6% higher than the revised FY2004 allocation.
- An amount of Taka 61.5 billion has been allocated to the transport and communication sector in FY2005, which is 7.7% higher than the revised FY2004 allocation.
- Allocations for fuel and energy have increased by 9.6% to Taka 43.6 billion.
- Allocations for agriculture, fisheries and livestock, land, environment and forest, food and water resources taken together increased by 42.1% to Taka 40.6 billion.
- Allocations for public order and safety have increased to Taka 25.8 billion, with a 8.1% increase over the revised FY2004 level.
- For social security and welfare, Taka 25.9 billion has been allocated, which is 28.4% higher over the level of the revised FY2004 budget.
- Allocations for interest payments have increased to Taka 65.3 billion with an increase of 11.8% over the revised FY2004 allocation.

Agriculture and Rural Development

32. Renewed emphasis has been attached to the agriculture sector with almost doubling of the allocation for this sector relative to the previous year, considering agriculture's critical role in reducing poverty and promoting economic growth through the vital linkages, both backward and forward, with the rest of the economy. Measures taken to reduce the interest rate on agricultural loans and waiver of interest on classified loans will provide relief to farmers. Subsidies in respect of electricity consumption and other agricultural activities have to be monitored to ensure that they reach the targeted beneficiaries. Measures taken to strengthen extension research, training, production of improved seeds and irrigation activities will need to be followed up closely for increasing food production and encouraging crop diversification keeping in view the limits of rice-centric growth. Cash incentives for export of agricultural products, fruits and vegetables will promote agro-based industries and facilitate expansion of commercial farming. The attention focused on the fisheries and livestock sector through higher allocations will support development of this sector and facilitate affordable availability of fish and animal proteins. In view of the clearer sectoral picture emerging following the formulation of the National Water Management Plan, the higher allocation to flood control and water management will support food production through increased cropping intensity, increase fish production and prevent losses to rural infrastructure and property. In continuation of the past trends, importance has been attached to rural development through higher budgetary allocations for improving rural roads and infrastructure to facilitate growth of farm and non-farm activities and creation of employment opportunities.

Social Security and Social Protection

33. A number of direct poverty alleviation activities have been undertaken in the budget such as the expansion in the rates and coverage of old-age allowances, allowances for widowed, deserted and destitute women and coverage of honorarium for insolvent freedom fighters. Allocations to special purpose funds such as for mitigating risks due to natural disasters, rehabilitation of acid burnt women and for housing of the homeless have been enhanced. Allocations to VGD, VGF, FFW, FFW (cash), TR and GR[2] have been increased. An amount of Taka 0.50 billion has also been allocated to enable voluntarily retired and retrenched workers including workers of garments industry to face economic shocks through providing facilities for retraining and creation of employment opportunities. Although apparently not adequate, the funds could be enhanced depending on the operational performance of the schemes involved. The micro-credit programs of government departments have been expanded although given the weak implementation capacity in the ministries and the poor performance of past programs, micro-credit could more efficiently be channeled through the NGOs. Expansion of micro-credit programs through PKSF including the creation of special funds for the employment generation of the hardcore poor and funds for creating micro-enterprise in the rural areas appears to be going in the right direction. Raising allocations of the Equity and Entrepreneurship Fund for computer software, food processing and assistance for agro-based industries are steps in the right direction, which, if properly availed of, could lead to employment creation and poverty alleviation.

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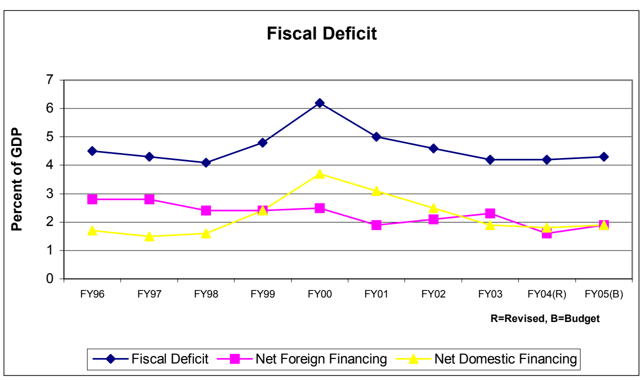
[2] VGD – vulnerable group development, VGF – vulnerable group feeding, FFW – food for work, TR – test relief, GR – gratuitous relief.

Public Administration and Law-and-Order

34. High quality of the civil service and efficient institutions in the public sector are critical factors for implementing public expenditure programs in a developing country like Bangladesh. In such countries, the civil service largely holds the key to generating required growth impetus through implementing public sector physical and social infrastructure development programs and through creating the enabling policy and institutional environment for greater private sector activities. Greater budgetary allocations to a sector would not make good sense and the Government's sectoral priorities would get distorted if the sectoral budget turns out be non-binding due to weakness in implementation capacity, as evidenced by the apparent underperformance in ADP implementation in many sectors in recent years. More attention thus needs to be focused on improving the quality of the civil service through appropriate training and providing better compensation. For ensuring quality and efficiency throughout the ranks of the civil service, greater importance to merit needs to be attached not only to promotions but also to recruitment into the civil service. Along with efficiency of civil service and public institutions, maintenance of law-and-order is crucial not only for the security of life and property of the citizens but also for allowing a proper environments for the peaceful conduct of private sector economic activities. In addition to the measures already initiated by the Government to improve law-and-order, urgent steps are needed to enhance efficiency of law enforcing agencies through providing better manpower and logistical support to them and through providing improved compensation.

Fiscal Deficit and its Financing



35. The projected fiscal deficit for FY2005 is 4.3% of GDP, marginally higher than the actual fiscal deficit of 4.2% in FY2004. The targeted fiscal deficit has been kept at a more realistic level, as the experiment with the higher targeted fiscal deficit of 4.8% of GDP in FY2004 to support expenditure expansion in a bid to broaden the productive capacity of the economy did not materialize. Containing the fiscal deficit to within the projected level seems achievable in FY2005 unless there are any dramatic slippages in revenue collection.

36. For financing the projected deficit of 4.3% of GDP for FY2005, domestic bank and non-bank borrowing will account for 1.9% of GDP and foreign loans and grants will account for 2.4% of GDP. Interest payments on domestic and foreign debts will decline from 16.5% of revenue (excluding grants) in FY2004 to 15.8% in FY2005, if the projected increase in revenue materializes.

DHAKA - CHITTAGONG ECONOMIC CORRIDOR

Introduction

37. A study has been undertaken to develop a future scenario for the Dhaka-Chittagong Economic Corridor (DCEC)[3]. The objective of the study was to consider ways to facilitate trade and development within Bangladesh, and between Bangladesh and other countries, particularly the eastern states of India, and Nepal and Bhutan. In particular, the study was to consider road, rail, port and inland water transport, energy, and Information and Communications Technology (ICT) within the influence of the corridor. The intention of the study was to combine existing, planned and new initiatives in these areas under a regional cooperation framework involving Government, ADB, other donors and financiers in a way that will complement the ongoing South Asia Subregional Economic Cooperation (SASEC) program. The emphasis of the study is on the future opportunities and requirements of the corridor. It thus takes a forward-looking approach based on the potential for export led growth in the economy over the next 15 years.

The Corridor

38. DCEC comprises the two largest cities in Bangladesh – Dhaka, the capital and Chittagong, the location of Bangladesh's main port – and the land, waterways and transport links in between. There are a number of other cities within the corridor. The corridor has a land area that comprises only 16% of the national area, but contains 30% of the population and accounts for 40% of the country's GDP.

39. The transport and energy infrastructure linking the cities of Dhaka and Chittagong is the heaviest used in the country. The estimated tonnages in the corridor are: 13 million tonnes by road, 2 million tonnes by rail and 4 million tonnes by water. About 60% of this tonnage is import/export traffic emphasizing its critical importance to Bangladesh's external trade. Altogether the corridor carries about 50% of Bangladesh's imports and exports. The main highway is heavily congested in the vicinity of numerous towns along the route. The meter gauge (MG) railway track between Dhaka and Chittagong is Bangladesh Railway (BR)'s most heavily used section in terms of traffic density. In fact, while this corridor represents only 15% of BR's route km, it produces half of BR's freight tonne kms. Oil and other bulk products move by inland waterway transport (IWT) between Chittagong and local ports in the Dhaka area. The corridor also includes power generation capacity in the Dhaka and Chittagong areas including the country's only hydro power station, major electricity transmission lines, a gas pipeline and a fiber optic communications cable.

Current Constraints

40. Deficiencies in key infrastructure (port, rail, road, energy, inland water and ICT) seriously hamper export growth and investment and limit opportunities for transport integration with Bangladesh's immediate and near neighbours. Infrastructure in the DCEC is facing serious congestion problems due to shortage of capacity and its

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[3] Based on the draft report of the study on "Dhaka-Chittagong Economic Corridor", Asian Development Bank, July 2004.

inefficient operation. This has been impeding the ability of DCEC to play what should be a crucial facilitating role in the expansion of the country's external trade and in regional transport/transhipment. Inability to deliver export cargoes to foreign destinations in a timely manner is a major problem for achieving export-led growth. In Bangladesh, the "purchase order to delivery" cycle time is one month longer than that of major competing countries. This constitutes a significant disadvantage for Bangladesh in its efforts to become a preferred location for foreign direct investment. This problem will become even more critical in the post MFA era in which manufacturers will have to compete in international markets with much smaller margins in the final delivery prices of commodities.

Port

41. Chittagong Port (CP), which handles nearly 85% of the country's sea-borne traffic, is believed to be one of the most inefficient ports in Asia. It is faced with serious problems of poor infrastructure, low labour productivity, poor management, corruption, multiplicity of trade unions and restrictive practices. CP is heavily congested and container ship turnaround time is 5-6 days vis-à-vis only 1-2 days in Singapore and Bangkok. The cost of handling and moving a container at the port is reportedly about twice that at some neighbouring ports. Although direct charges are competitive, indirect charges[4] can inflate these significantly. Most of the problems identified with the port arise because although 80% of the sea-borne cargo is containerized, the port is operating as if it were still in the conventional cargo age. There are no container cranes (it is understood that purchase of cranes has now been approved) and the recently purchased straddle carriers are idle most of the time. For most of the full container load (FCL) traffic, the containers are stripped (de-stuffed) in the port area, creating congestion and delays. There is only limited computerization at the port and little standardization of documents. As a result, simply doing the paperwork can take several days.

Rail

42. Bangladesh Railway (BR) is unable to carry containers efficiently and timely due to limited locomotive and wagon availability, lack of operational efficiency and infrastructure constraints. The poor state of rail infrastructure and rolling stock is an impediment to DCEC. Demand for rail transport exceeds supply. Because of the poor condition of rail track in the loops and sidings and on the port line, and obsolete signalling and telecommunication systems, BR is unable to increase the number of container trains. Consequently, BR currently accounts for less than 15% of container transhipment in the Dhaka-Chittagong corridor. Yet the DCEC rail network is poorly utilized by international standards. Although the railway used to be part of the pre-separation Indian railway system, major sub- regional rail links are in a bad condition and some are now missing.

Road

43. Bangladesh has an extensive road network, the result of many years of high public investment in road construction. The existing network, however, is deteriorating and requires additional funds for maintenance. It is estimated that a 50% increase in spending on maintenance is required to preserve the road network: as much again is needed over the next 10 years to clear the maintenance backlog. At the same time, funds

[4] E.g. unofficial charges to expedite delivery ("speed money").

are needed to improve the network, address the inefficiency and safety of road operations and to integrate the road network with other intermodal transport networks with particular focus on sub-regional cooperation. Road user charges appear to be lower than actual costs, especially when transport externalities are taken into account.

44. With the rapid increase in traffic, the Dhaka – Chittagong highway has become heavily congested. The average daily traffic is some 10,000 vehicles, double the average for all national roads. Although it has been the subject of ongoing improvements, much of the road remains narrow and in poor condition. Many bridges have restrictive gross vehicle mass limits that limit the carriage of containers. Traffic jams occur at towns and villages where the right of way is occupied by vendors and parked and slow moving vehicles. Road discipline is poor, with dangerous overtaking particularly prevalent. Indiscipline also reduces the effective capacity of the road. Lack of traffic enforcement leads to very high road accident and fatality rates. Because the main road cannot handle trucks carrying fully loaded containers, there is no significant transhipment using containers in the corridor. FCL containers are de-stuffed at the port and the contents are transferred to conventional two-axle trucks for transport to Dhaka.

Inland Waterways

45. There is currently no container transhipment by river between Dhaka and Chittagong. There is an extensive network of waterways throughout Bangladesh, which should make inland water transport a strong contender for some traffic. However, inland water transport suffers from siltation and lack of facilities. The variation in rainfall means that rivers are flooded in the monsoon, but are shallow in the dry season. Silt brought down by the rivers makes regular dredging imperative, while frequent changes to the navigable channels require navigation and moorings to change. As a result, navigation facilities are few, and jetties tend to have the most rudimentary of road access. Transport of containers between Chittagong and Dhaka faces the further problem that the initial part of the journey is in the Bay of Bengal, requiring sea-going capability for at least part of the year.

Energy

46. DCEC is fed from the national electricity grid and by gas pipeline from the national gas network. Most energy issues in the corridor are therefore common to Bangladesh as a whole. Bangladesh's installed electric generating capacity is currently 4.7 gigawatts (GW), of which 94% is thermal (mainly natural-gas-fired), and the remainder hydroelectric: the Kaptai plant near Chittagong. The Kaptai facility is dependent on water levels in the reservoir and can only function at full capacity for part of the year.

47. Problems in the electric power sector include high system losses (about 30%), delays in completion of new plants, low plant efficiencies, natural gas availability problems, erratic power supply, electricity theft, and blackouts, shortages of funds for needed maintenance at the country's power plants and other power infrastructure, and unwillingness of customers to pay bills. With only around 30% of the population having access to electricity, and with power demand growing rapidly, Bangladesh's Power System Master Plan (PSMP) projects a required doubling of electric generating capacity by 2010.

48. Power shortages are endemic. Load shedding (where parts of the service area are deliberately switched off in a planned rotation) is common. This is seriously affecting the productivity and reliability of industries. Many companies have back-up power plants – a practice that is costly and inefficient. Overall, it has been estimated that Bangladesh loses around $1 billion per year due to power outages and unreliable energy supplies.

49. Bangladesh has small reserves of oil and coal, but potentially very large natural gas resources. Commercial energy consumption is around 67% natural gas, with the remainder mostly oil (plus limited amounts of hydropower and coal). Non-commercial energy sources, such as wood, animal wastes and crop residues, are estimated to account for over half of the country's energy consumption. Consumption of wood for fuel has contributed to deforestation and other environmental problems.

ICT

50. Bangladesh scores badly in terms of ICT readiness, enabling environment and infrastructure development. The lack of skilled ICT workers is cited as one of the most critical factors impeding ICT development. Infrastructure development levels are relatively low compared with other newly industrialized countries. In e-commerce, Bangladesh lags behind in most factors, especially in the areas of internet payment systems, competition in the dot.com market and commercial websites. Internationally, the use of ICT to facilitate the processing of cargo documents for intermodal freight movements started in the 1980s. Its use expanded rapidly to shipping companies and other logistics providers who were able to improve the quality of service provided to their customers. The developments were often government sponsored as part of a more general concept of electronic data interchange (EDI) between purchasers and suppliers. Initially, the costs were high and uptake was generally limited to large companies. However, the introduction of the internet has allowed such systems to be developed more cheaply and their use is increasingly pervasive. Bangladesh is still at an emerging stage and lags behind the comparator countries in Asia.

Sub-regional Cooperation

51. Bangladesh has the opportunity to benefit from increased cooperation through the region. Geographically located at the centre of the South Asia Sub regional Economic Cooperation (SASEC) countries,[5] Bangladesh has borders with India and Myanmar and is in close proximity to the landlocked countries of Bhutan and Nepal. As the principal transport corridor of Bangladesh, DCEC provides potential sub regional linkages to northeastern states of India and via the Jamuna Bridge to West Bengal as well as to Bhutan and Nepal through India. Bangladesh has a high potential, particularly through the development of DCEC, to become a transport/transhipment center for the entire SASEC region.

52. Because of its location, Bangladesh can play a significant role in the sub regional transportation system by providing alternatives in terms of direct and shorter transportation links by rail, inland water transport and road. CP can be the gateway to promote trade in the region. CP has the potential to become a high revenue generating port provided it is properly overhauled and realigned. Development of CP with the requisite road and rail links would help foster export-led growth in the country and

5 Bangladesh, Bhutan, India and Nepal.

integration of the economies of Bangladesh and the northeast. Upgrading of CP is particularly important from a sub-regional cooperation perspective with the eastern Indian states, Nepal and Bhutan. The eastern states of India and also to a large extent Nepal and Bhutan currently depend on Kolkata/Haldia for export/import cargoes.

53. The 133 km Friendship Highway linking Bangladesh and Myanmar is expected to be completed by the end of 2006. This will link Dhaka to the Asian Highway through Myanmar, ultimately linking to some 40 countries. CP could serve as an alternative port for overseas trade as the transport links with Yangon port are not well developed. The concept of an Asian Industrial Corridor and a Bengal Bay Industrial Triangle proposed by JICA in 1995[6] could be revived combining SASEC with the ASEAN grouping.

54. Bangladesh (along with Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) is also a member of the South Asian Association for Regional Cooperation (SAARC), created in 1985 to help promote regional economic cooperation, plus economic and social development in general in the South Asian region. The recent successful adoption of the "Islamabad Declaration" and signing of the framework agreement on South Asia Free Trade Agreement (SAFTA) at the 12th SAARC Summit is a milestone development in fostering economic cooperation in the region.

55. With all these developments, Bangladesh could gain enormous benefits from improvements to DCEC through expansion of exports and regional trade and transhipment. Chittagong could become an attractive investment location in the region including for further expansion of the export-processing zones with wider international market.

Future Growth Scenario

56. In Bangladesh, poverty remains extensive with half of the population living below the poverty line. The average GDP per person is only slightly above $1 per day. The country has fertile land with an abundance of sunshine and water. The food gap – the difference between production and consumption that must be met from imports – has been eliminated. Yet agriculture still only employs 60% of the workforce and there is widespread underemployment. Bangladesh has a huge resource of people available to provide the goods and services necessary to raise the standard of living. Three-quarters of all exports (8% of GDP) are produced by a mere two million people working in the garments and knitwear industries. Harnessing the excess capacity in the labour market could lead to a dramatic increase in national wealth. The garment industry has come from scratch to its dominant position. Other industries could do the same.

57. Bangladesh needs increased growth to achieve the Government's poverty targets. It seems reasonable to assume that initially that growth will need to be export-led. If the development programs introduced by the Government bear fruit and opportunities are seized, it will be possible to raise the rate of economic growth to 7% from the current rate of 5-5.5%. This is the minimum rate Government believes is required to meet poverty reduction goals of MDGs[7].

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[6] Industrial Development of Chittagong Region in the People's Republic of Bangladesh. JICA 1995.
[7] According to a National Strategy for Economic Growth, Poverty Reduction and Social Development (March 2003).

58. According to this DCEC study, for 7% GDP growth, the growth in imports and exports tonnages would initially be 14%. Currently imports are 20% of GDP and exports 13%. Our tonnage forecasts assume that imports do not rise above 30% and exports 25% of GDP. Assuming that imports and exports initially grow at twice the national GDP growth rate until imports are 30% of GDP and exports are 25% of GDP, and assuming imports and exports grow at the same rate as GDP thereafter (assumed to be 7%) the average growth of traffic through the port to 2020 would be 10% – but significantly weighted to early growth.

59. Based on an estimate for FY2003/4 of 22.5 million tonnes through Chittagong including 750,000 TEU and assuming an average future growth of 10%, the traffic through the port could be expected to grow to 28 million tonnes and 1 million TEU by 2006 and be 100 million tonnes and 3 million TEU by 2020. In addition to the growth of export trade, CP could have an increased role as the gateway to promote trade in the region. Potential traffic includes imports and exports for Nepal, Bhutan, Eastern India and Myanmar.

60. In other words, if the development goals are met, and the increased trade with regional cooperation materializes, we could be looking at significant growth in the DCEC. This could involve a four-fold increase in traffic through port by 2020, 25 container ships per week (assuming increased capacity ships – 2000 TEU) and an extra 40,000 tonnes of imports and exports per day between Dhaka and Chittagong.

61. There is a body of opinion that building infrastructure for meeting present demands will inhibit future growth. While the linkage between infrastructure investment and growth is not certain, experience in countries like Republic of Korea show that building infrastructure for the future can itself be a catalyst for accelerated growth.

The Vision for DCEC in 2020

62. Even a moderate increase in growth would dramatically change the face of DCEC. By 2020, we could expect a four-fold increase in traffic through the port, and the equivalent of an extra 6,000 trucks per day between Dhaka and Chittagong. Increases in traffic of this scale will require major new infrastructure. Economic growth will also revolutionize the passenger transport market as car ownership expands from its present level of only 0.4 vehicles per 100 people.

By 2020 the sort of facilities DCEC will need include:

- New Moorings terminal and deepwater facilities at Chittagong at least for oil tankers.
- A multi-lane access-controlled tollway as well as upgrading of the existing roads.
- A new railway on a direct route between Dhaka and Chittagong.
- Feeder container ships for freight connecting Chittagong with river ports at Dhaka and elsewhere. Possibly high speed ferry services for passengers.
- A refined oil products pipeline between the Chittagong refinery and Dhaka.
- Access to Nepalese and Bhutan hydro electricity supplies.

- Sophisticated information and communications technology linking manufacturers, transport providers, port operators, shipping companies and overseas customers.

63. There are, however, a number of other preconditions for accelerated growth. These include an improvement in the general investment climate to attract local and foreign investment inflows. There is a need to remove constraints on infrastructure and service developments, improve sector governance and involve the private sector in order to reduce costs and increase customer focus. The distortions created in key industries through Government ownership and the control of prices and services must be overcome. Inter-country problems in the region with limited cooperation and restricted movement of vehicles and goods must be replaced by win-win deals involving transit agreements and energy supplies.

64. The new infrastructure and services should be maintained and operated by the private sector. Ownership of nationally important assets might be retained by the state, but service delivery should be through well-managed concessions. In particular, the proposed direct rail line should be an open access railway operated by a private company under a maintenance contract funded by users. Likely rail operators include companies establishing themselves in the New Moorings terminal at the port under a landlord port concept. As the railway will face stiff competition from road and IWT services, government control of charges should not be necessary. The latter can also be operated as toll concessions.

Concluding Remarks

65. Bangladesh is one of the world's poorest nations with half of the population living in poverty. Although the economy has been growing, and the poverty level has declined in relative terms, accelerated export-led growth is necessary to reduce the absolute number in poverty. Growth of the magnitude required is possible provided institutional and infrastructure constraints can be addressed. Initiatives for improved sub-regional cooperation will give a boost to the economy both through the stimulation of trade and the impact of transit traffic from neighbouring countries

66. The implication of accelerated growth is that the DCEC will face a potentially huge increase in activity. Efficient and effective infrastructure chosen to meet the needs of the future is required. Construction of the infrastructure could act as a catalyst to help generate more growth. Given the huge potential increase in the export and import sector, significant improvements are required at the port, the road, rail and the waterways and in the provision of energy and communications.

67. Priority needs to be given to developments at the port – without an efficient port, the other initiatives will be ineffectual. There is a case for making the railway the next priority, if it is left till after the road links have been developed, industry will adjust to the road network and attracting customers back to rail will be bit more difficult. Key assets in the corridor should be owned by the government but operated by the private sector. This could be achieved through a "toll concession" model to ensure that the infrastructure is managed efficiently and effectively and that revenue is raised so that the assets are sustainable.

68. There is a role for government, private sector, donors and other financiers to materialize the flagship initiatives of DCEC.