BANK PARIKRAMA

A Journal of Banking & Finance

Volume XLIV & XLV

Special Issue, September 2019-June 2020

Special Issue

(In Celebration of Birth Centenary of the Father of Nation Bangabandhu Sheikh Mujibur Rahman)

www.bibm.org.bd

Quarterly Journal of Bangladesh Institute of Bank Management

BANK PARIKRAMA

A Journal of Banking & Finance

Volume XLIV & XLV, Special Issue, September 2019-June 2020

Special Issue
(In Celebration of Birth Centenary of the Father of Nation Bangabandhu Sheikh Mujibur Rahman)

BANGLADESH INSTITUTE OF BANK MANAGEMENT

ISSN 1019-7044

Bangladesh Bank

Message

Bangabandhu Sheikh Mujibur Rahman, under whose glorious leadership Bangladesh achieved independence in 1971, made financial sector as the cornerstone of his national policy between 1972 and 1975. We have since been drawing our inspiration for making the financial sector as the true catalyst for development of the country from the solid legacy left behind by the father of the nation. The celebration of birth centenary of our greatest leader Bangabandhu started on March 17, 2020 and will continue till March 26, 2021.

To be part of this magnificent event, Bangladesh Institute of Bank Management (BIBM) is set to publish a special issue of its flagship journal, Bank Parikrama. This initiative gives me immense pleasure as I believe that such academic exercise would be a befitting way for an institute like BIBM to pay tribute to the greatest Bengali of all times.

The articles placed in this special issue of Bank Parikrama have been penned by renowned economists and highly experienced financial sector experts of the country living home and abroad. Taken together, these writings spell out assorted areas of Bangladesh Economy along with aspirational vision for a developed Bangladesh. This special Issue is a treasure-chest for economists, financial experts, practicing bankers, researchers and economic historians. The upcoming generation would also be greatly benefitted from this compendium while contributing to national building tasks.

A special word of appreciation is due to the Director General of BIBM and his associates for completing such an onerous job in good time even with the constraints that COVID-19 imposes in our normal life. I wish the initiative a great success.

(Fazle Kabir)
Chairman, BIBM Governing Board and
Governor, Bangladesh Bank

Bangladesh Bank

Message

Bangladesh which was virtually given up as bottomless economic basket case in 1971 has proved the doubters wrong. Largely self-sufficient in meeting its food needs of 8th largest population size (near about 170 million), the country has now emerged as one of the world's fastest-growing major economies. This development is reflected in a sharp increase in per capita income, a rapid reduction in poverty and impressive progress with human development.

The economic progression we have already achieved is the true satisfaction on the eve of celebrating the birth centenary of the architect of independent Bangladesh and the greatest Bangalee of all times of the Father of Nation Bangabandhu Sheikh Mujibur Rahman. He is remembered to us not only for his courage and leadership but also indelible contribution to Bangladesh's progress.

While Birth centenary is being celebrated with fervor in the middle of turbulent situation induced by COVID-19, it would not be comprehensive unless banking sector documents its diverse achievements since its independence with the writings of leading economists and financial experts of the country. I am pleased to learn that BIBM has shouldered this responsibility and is going to publish a special issue of the Bank Parikrama with an impressive array of essays.

I have had a glance and I believe that the banking community at large as well as researchers and academicians in the discipline of economics, finance and banking would greatly be benefitted by learning different factors of the "Bangladesh surprise" from reading out the articles. I wish every success of this publication.

(S. M. Moniruzzaman)
Chairman, BIBM Executive Committee and
Deputy Governor, Bangladesh Bank

BIBM

Message

The Government of the People's Republic of Bangladesh has proclaimed the commemoration of 2020-2021 as the 'Mujib Year (Mujib Borsho)' on the occasion of the 100^{th} birthday of Bangabandhu Sheikh Mujibur Rahman, the founding Father of the Nation and the Greatest Bengali ever. The centennial birth anniversary of Bangabandhu is being observed with due reverence and solemnity nationally and internationally.

Bangabandhu and Bangladesh are essentially the same – one could not have existed without the other. Bangabandhu dreamt of a Sonar Bangla (Golden Bengal) devoid of hunger, poverty, inequality, illiteracy, communalism and corruption, and dedicated his entire life for the people's cause. Following Bangabandhu's dream of 'Sonar Bangla' - a land of peace, progress and prosperity, Bangladesh is rapidly progressing towards becoming a middle-income country by 2021 and a developed country by 2041. Bangladesh is now considered as an emerging tiger and often mentioned as a role model for development. In contrast to the then despair of 'bottomless basket' when Bangabandhu gave his first budget of BDT 786 crore (1972-73), the current government led by his daughter honorable Prime Minister Sheikh Hasina is implementing a budget of BDT 5,68,000 crore in this fiscal year. Bangabandhu considered the financial sector as a catalyst for economic development. As such, BIBM was established in 1974 to cater to the training, education, research, and consultancy needs of the financial sector of the country.

BIBM publishes this special issue of its flagship journal - *Bank Parikrama* to pay homage to our beloved Bangabandhu on this historic occasion. We have requested the distinguished economists of the country to write for this issue, who have been actively involved with the formulation and implementation of national policies for long-time. It is worth mentioning that some of them have invaluable remembrances with the Father of the Nation due to their close professional relationship with him. This special issue certainly brings the stories of socio-economic success, prospects, and challenges of independent Bangladesh together to the readers. In this precious opportunity, I cannot stop myself but to say something about the rare contents that have been very articulately expounded by the competent authors. Dr. Mirza Azizul Islam has discussed very practically with keen analytical rigour the progress and predicaments of the financial sector development in Bangladesh. Dr. Mohammed Farashuddin has very prudently reviewed the financial sector development since the independence of Bangladesh. Dr. Atiur Rahman has very professionally shared his experiences and urged for an innovative developmental central banking to ensure the highest degree of financial inclusion and by way of doing so, to support the growth and development of the real sector including the MSMEs. Dr. Shamsul Alam has deeply elaborated the importance of effective partnership for the implementation of the eighth five-year plan in achieving SDGs. Dr. Sadiq Ahmed has assessed very rationally the imperative for banking sector reforms in Bangladesh. Dr. Mustafa K. Mujeri has very concretely reviewed the economic development of Bangladesh and identified productivity as a source of growth, and a key factor on the way to graduate from the lower-middle-income country to the upper-middle-income country taking the labour market, labour skills, ageing population, and demographic dividend into account. Dr. Sattar Mandal has provided some critical looks and reflections on the major strategic components of the first five-year plan regarding agriculture and rural development in the context of the then predominantly agrarian economy of Bangladesh that actually established the path for the radical development and success in agriculture of today. Professor Bayes has given an account of the rural credit market in Bangladesh highlighting its gradual transition from the clutches of greedy money lenders to the formal microcredit financial institutions in independent Bangladesh. Dr. Matiur Rahman has very pragmatically identified the role of banking services in building 'Sonar Bangla' with some progress, pitfalls, and prescriptions while Dr. Zahid Hussain has analysed holistically how to achieve the economic development goal by effectively managing the circular relationship of savings to deposits to investments to savings, taking interest rate as the driving force. I am personally grateful to the authors and especially, BIBM is immensely indebted to them who have whole-heartedly responded to our request. I am also grateful to Mr. Fazle Kabir, Chairman, BIBM Governing Board and Governor of Bangladesh Bank, and Mr. S. M. Moniruzzaman, Chairman, BIBM Executive Committee and Deputy Governor, Bangladesh Bank for their kind cooperation and all-out support in this endeavour. Also, my thankfulness goes to the Executive Editor, *Bank Parikrama* and his team for their dedicated efforts in publishing this special issue.

I am sure that the readers will find this collection of thoughts, experiences, opinions, and directions of the veteran scholars profoundly beneficial in understanding better how to achieve the economic emancipation – hunger and poverty-free Bangladesh, the unique vision of the Father of the Nation. This special issue will also help the policymakers, development partners and activists, international investors, researchers, bankers and others in understanding the socio-economic progress, problems and prospects of Bangladesh, and in making action plans to build the golden Bengal of Bangabandhu.

We feel proud to unveil this special issue on the occasion of the 100^{th} Birth Anniversary of the Father of the Nation Bangabandhu Sheikh Mujibur Rahman. We dedicate this special issue to our Greatest Bengali Bangabandhu and pray for the eternal peace of his departed soul.

(Dr. Md. Akhtaruzzaman)
Chairman, Editorial Board of Bank Parikrama and
Director General, BIBM

BIBM

Executive Editor's Note

Bangabandhu Sheikh Mujibur Rahman remains eternal in history as the architect and the founding Father of independent Bangladesh. His fearless, selfless, uncompromising, devoted and dynamic life-long leadership gifted the nation freedom, self-identity, pride and dignity. The country has been celebrating his centennial birthday from March, 2020 to March, 2021 till the 50th anniversary of independence with serenity amid clouding environment of COVID-19.

Immediately after the glorious victory in the Liberation War, Bangabandhu inherited a war-ravaged economy and a shattered banking sector due to exodus of massive bank deposits, capital transfers and outmigration of the then Pakistani bank owners during the War of Liberation. To revive the economy, he declared the then State Bank of Pakistan in the East wing as the Bangladesh Bank with all statutory authority and functions of a traditional central bank. All private banks, owned by erstwhile Pakistani entrepreneurs except foreign banks at that time, had to be subsequently nationalized by Bangabandhu without any waste of time. These prudent steps were timely and in the right direction to restore economic vitality in the newly independent Bangladesh.

The nation is deeply indebted to Bangabandhu. So, with endless gratitude, the Bangladesh Institute of Bank Management (BIBM) humbly dedicates this special issue of BANK PARIKRAMA under the guidance of the Governor of the Bangladesh Bank, Mr. Fazle Kabir, in memory of the Father of the Nation. This issue is amply enriched by inclusion of ten scholarly articles, contributed by eminent economists and practitioners of Bangladesh origin currently living at home and abroad. I must take my hat off to these distinguished personalities.

The readers of 'BANK PARIKRAMA' will find this special issue a treasure of knowledge. In this occasion, I could not resist myself to say something about the BIBM journal 'BANK PARIKRAMA'. This is a double-blind peer-reviewed scholarly academic journal. BIBM, aspiring for earning academic reputation, began its nascent journey to bring out 'BANK PARIKRAMA' in March, 1976 as a publication outlet for researchers on topics of current interest in banking and finance. After a long journey with continuing tireless efforts, it is now regionally if not globally acclaimed as one of the high-quality journals in the aforementioned areas. As evidence, the journal is currently listed in the Directory of Excellence in Research for Australia (ERA); Australian Business Deans Council (ABDC) Journal Quality List; Elton B. Stephens Co. (EBSCO) Database; and Europa World Year Book. To enhance reputation, the journal strives for excellence in publishing both theoretical and empirical research papers of commendable quality in the above fields by enticing submissions through its state-of-the-art global communication network.

As the Executive Editor of the journal, I would like to express my profound gratitude to honorable Governor, Bangladesh Bank and Chairman, BIBM Governing Board, Mr. Fazle Kabir; and Deputy Governor, Bangladesh Bank and Chairman, BIBM Executive Committee, Mr. S. M. Moniruzzaman, for their invaluable advice to make this special issue possible in time.

I am particularly grateful to the Director General of Bangladesh Institute of Bank Management, Dr. Md. Akhtaruzzaman, for his unfailing solid support in completing this noble undertaking.

The review team for this special issue, formed by the Governing Board of BIBM with Professor Shibli Rubayat-Ul-Islam, Chairman, Bangladesh Securities and Exchange Commission (BSEC); Dr. Syed Manzoorul Islam, Professor, Department of English, Dhaka University; and Dr. Md. Akhtaruzzaman, Director General of BIBM played a vital role in this endeavor. So, I profoundly express my heart-felt “Thank You” to these esteemed reviewers for their meticulous editing and insightful comments.

BIBM officials and staff also deserve my sincere appreciation for displaying their ‘never-say- no’ attitude toward me, while working on this project of great importance.

Finally, we remember all the martyrs in ‘Liberation War’ as the real source of our inspiration for being able to complete this special issue of BANK PARIKRAMA.

P. Banerjee

(Dr. Prashanta Kumar Banerjee)
Executive Editor, Bank Parikrama and
Professor & Director (Research, Development & Consultancy), BIBM

Contents

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp. 13-23)

Financial Sector Development: Progress and Predicaments

- Mirza Azizul Islam*

1. Introduction

There is a large body of literature that has examined the relationship between financial sector development and economic development, more specifically, growth. The conclusions, based on cross-sectional or country-specific time series analysis, are somewhat mixed. Some of these studies find that financial sector development, often used synonymously with liberalization and reforms, causes growth; according to others, there is a two-way relation meaning that financial sector is both a cause and consequence of economic growth and yet others find no or negative relationship between them. A small sample of these studies is presented in Appendix Table-1. However, as will be seen from the sample contained in Appendix Table-1, the number of studies which find causality from financial sector to growth dominates the others.

The financial institutions in Bangladesh consist of state owned commercial banks, state owned development finance institutions, private commercial banks, foreign banks, stock markets, insurance, pension and provident funds and microfinance institutions. The focus of the present paper is on the banking sector.

2. Banks and Economic Growth: Transmission Channels

There are four principal channels through which banks contribute to a country's economic growth. The first relates to intermediation. Banks serve as

---

*Dr. Mirza Azizul Islam is a visiting Professor at BRAC University Business School, Bangladesh. He worked as the Advisor to the Caretaker Government, Ministries of Finance and Planning, Government of Bangladesh; Chairman, Bangladesh Securities and Exchange Commission (BSEC); and Chairman, Board of Directors, Sonali Bank Limited. Dr. Islam did Ph.D. in Economics from the Boston University, United States of America. Views expressed in this article are the author's own.

intermediaries between savers and investors. They mobilize savings from the members of the public in the form of deposits and make these savings available to those who are willing and able to make investment in the real sectors of the economy or to engage in trade which serves as the conduit for distribution of the produced goods and services to consumers and users. The second function involves maturity transformation. The banks accept deposits, a large part of which have to be returned immediately on demand or at short notice. But they use these deposits for giving loans and advances for investments which have longer gestation periods. The third function has to do with credit allocation. In granting loans and advances, banks determine allocation of credit by sectors, regions and groups of populations. The fourth function relates to facilitating payments flows, for example, between exporters and importers as well as between buyers and sellers of goods and services that are produced and consumed domestically. It is obvious that a modern and increasingly globalized economy could not operate if there were no banks to provide these services.

In recognition of the seminal role that banks play in accelerating economic growth in an equitable manner without compromising their solvency, Bangladesh has introduced over the years a host of reforms. The major ones are listed below.

- ❖ Ceilings on disbursement of loans to a single party.
- ❖ ‘Fit and proper’ test for Chief Executives and Advisors of private banks.
- ❖ Requirement of Audit Committees in banks.
- ❖ Imposition of capital Adequacy requirement as per Basel-III.
- ❖ Promulgation of stress testing guidelines.
- ❖ Instruction to establish separate risk management unit in banks.
- ❖ Cash reserve and statutory liquidity requirement.
- ❖ Limits on banks’ investment in stock markets and the requirement to operate merchant banks by constituting separate legal authority.

- ❖ Introduction of CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risks) ratings.
- ❖ Requirement of provision against bad loans.

In Bangladesh it has been a common practice to influence allocation of credit. In most cases, efforts have been made to enhance the flow of credit to certain activities; sometimes credit to certain others has been discouraged. In the former cases, administrative pronouncements have been backed up by refinance facilities for banks at concessional interest rates. These measures are intended to promote financial inclusion in pursuance of the third function noted above. Some of the pronouncements of the central Bank in this regard are:

- ❖ Fixation of target for agricultural credit.
- ❖ A scheme titled "Solar Energy, Bio-gas and Effluent Treatment Refinance Scheme" was set up by Bangladesh Bank with a sizable revolving fund.
- ❖ A "Refinancing Scheme for Small Entrepreneurs" was instituted.
- ❖ A refinancing scheme was introduced to provide credit at the existing bank rate for adoption of Hybrid/ Hoffman Kiln equivalent technology by brick field owners.
- ❖ Group loans were introduced for women entrepreneurs and interest rate for such loans would be a maximum of 10 percent.
- ❖ Banks were directed to establish schemes for establishing solar panels in the buildings used for residential/ commercial/ industrial purposes.

3. Impact

The reforms indicated above apparently had a positive impact on the development of the financial sector. The changes over time in some key indicators lend support to this view.

There has been a decrease in M1/M2 ratio. M1 comprises currency outside banks plus demand deposits. M2 consists of M1 plus time deposits. The fall in M1/M2 ratio, therefore, suggests that an increasing proportion of deposits are being channeled through time deposits. The ratio fell from 24.6 percent in FY 2001 to 22.9 percent in FY 2018. This tends to ease the maturity transformation of banks in that they have to extend long-term loan while a significant portion of their liabilities (i.e. deposits) have to be met at no or short notice. Taking this into account and noting that there has been an impressive increase of M2/GDP ratio, it can be stated that banks have contributed significantly to financial deepening.

As regards contribution of the banks to the real sector, an important development is that credit to the private sector as proportion of GDP has seen a remarkable increase. A large part of private sector investment has been financed by bank credit (Appendix Table-2). This is not a surprising development given that the capital market in Bangladesh is small in size, suffers from high degree of instability and, following the crash of 2010, remains in a state of doldrums.

4. Financial Inclusion

Financial inclusion has been defined by some authors as the process of ensuring access to financial services and timely and adequate credit to the vulnerable and low income groups at an affordable cost. Others expressed the view that financial inclusion refers to a process that ensures ease of access, availability and usage of the formal financial system for all members of an economy. Financial inclusion means inclusion of all sections of populations which do not have much access to financial product. More broadly, it refers to a movement that envisions a society in which as many poor people as possible have permanent access to an appropriate level of high quality financial services, including savings, credit and money transfer. In other words, this would include:

- Easy and safe access to bank accounts.
- Timely and cheap credit for poor and low income households and small entrepreneurs.

There are both demand and supply side problems in enhancing inclusiveness of finance. On the supply side information asymmetry discourages financial institutions from extending credit as they are not sure of the revenue streams from the implementation of loan proposals. Among other supply side problems are high transaction cost associated with disbursement of large number of small loans, small capital base of SMEs, their low managerial capacity and perceived lack of transparency in their management. On the demand side, constraints arise from the inability to find guarantors and provide collaterals, cumbersome application forms and high interest rates charged on small loans.

A large number of initiatives are being implemented in Bangladesh with a view to enhancing financial inclusion. A year-wise lending target for SMEs was first introduced in 2010 for banks and non-bank financial institutions. In addition to this regular financing, banks and non-bank financial institutions are also providing loans to SMEs through refinance schemes of Bangladesh Bank (the central bank). At present more than ten such funds are being operated. Karmasangsthan Bank provides loans to the youths with a view to involving them in productive and income generating activities. This bank has 246 branches across the country. Palli Karma Sahayak Foundation provides financial assistance to different sectors through various partner organizations. Nearly 91 percent of the members of their partner organizations are women. Many Non-Government Organizations (NGOs) execute micro credit programs, mainly for poverty alleviation, health, education and human resource development. A particular mention should be made of BRAC which is the largest NGO of the World. Grameen Bank also administers a large micro credit program. In addition, several Ministries and Divisions of the Government operate micro credit programs. Furthermore, mobile banking has contributed to an expansion of financial inclusion.

Despite the aforementioned initiatives Bangladesh has a long way to travel to achieve the desired level of financial inclusion. For example, during the period 2016-2018 SMEs owned by women received only 3 percent of total loans received by all SMEs. An overwhelming proportion of bank loans accrues to loan sizes of more than 1 million Taka. Generally, loans of larger sizes are charged lower interest rates. Such discriminatory practice adversely affects the relatively poor. There is substantial inequality in financial access due to excessive geographical concentration of loans in Dhaka and Chattogram. Loans to rural areas fall considerably short of deposits mobilized from those areas.

5. Challenges for the Banking System

In my opinion the banking system of Bangladesh is plagued with the following problems:

- ❖ Unabated increase of non-performing loans poses a major challenge for the banking sector. Non-performing loan ratio rose from 8.8% in December 2015 to 11.99 percent in September 2019 when the absolute amount was reported to be Tk.1,16,400 crores. This official statistic grossly underestimates the real value as it excludes rescheduled loans, amounts covered by stay orders from courts and special mention accounts. According to a recent report by the International Monetary Fund, the amount of non-performing loans would be a staggering Tk. 2,40,167 crores.
- ❖ There are too many banks in Bangladesh. As many as 59 are already in operation. Permission has been accorded to one more and a few more are under consideration. The result is that the volume of business is rather small for each bank and they are not in a position to reap the benefits of economies of scale. Any business with a low volume will understandably try to charge higher unit price to reach desired revenue target. This is one explanation of why banks in Bangladesh charge high interest rates on loans.
- ❖ Governance in the banks leaves a lot to be desired. Loans are often given as a result of political influence. In many cases, loans are given to friends or relatives without paying due attention to the prospects of repayment on the basis of objective analysis of the loan proposals. In such cases, as the loan recipients fail to repay as per terms of the agreements, excessive generosity is shown in respect of recovery. The resultant high rate of default is also an important cause for high rate of interest. In the context of governance, it should also be mentioned that

the recent decision to allow four members of a family on the Board and enhance their tenure runs counter to sound governance.

- There is an inordinate delay in disposal of loan related cases. Thousands of cases have remained pending in the loan courts. A large chunk of defaulted loan cannot be recovered because of stay orders by higher courts.
- To an extent default is caused by the lack of adequate professional competence of bank staff responsible for evaluation of loan proposals. Here again the excessive number of banks aggravates the problem because banks are forced to engage in unhealthy competition to recruit professional staff from the limited pool.
- The recent decision to apply a 6 percent interest cap on deposits is fraught with the risk that growth of deposits into the banking system will decelerate substantially in view of the inflation rate of about the same level. This will erode the capacity of the banks to lend.

6. Concluding Observations

It is crucially important to deal with the above problems. In my opinion, it is not necessary to set up a Bank Commission whose diagnosis of the banking sector problems is not likely to be any different from those mentioned above. As regards solution to these problems, the first step needed is a firm political commitment to avoid political influence in either granting loans or recovering defaulted loans or sanctioning new banks. The second step needed is to resolve quickly the cases stuck up in the legal system. The third step needed is for Bangladesh Bank to effectively implement sound governance principles in banks.

Bibliography

Bangladesh Bank, (2012a), *Annual Report 2010-2011*, Bangladesh Bank, Dhaka.

______________ (2012b), *Major Economic Indicators: Monthly Update*, September, Bangladesh Bank, Dhaka.

Bashar, Omar, K. M. R. and Habibullah Khan (2009), "Liberalization and Growth in Bangladesh: An Empirical Investigation", *The Bangladesh Development Studies,* Vol. XXX, No.11(1), pp. 61-76.

Berthelemy, J.C. and Varoudakis (1996), "Financial Development Policy and Growth", Development Centre of OECD.

Demetrides, P. and K.A. Hussein (1996), "Does Financial Development Cause Economic Growth? Time-series Evidence from 16 Countries", *Journal of Development Economics,* Vol. 51, pp. 387-411.

Favara, G. (2003), "An Empirical Reassessment of the Relationship Between Finance and Growth," *IMF Working Paper No. WP/03/123*, Washington, D.C.

Fry, M. (1989), "Financial Development: Theories and Recent Experience", *Oxford Review of Economic Policy,* Vol. 6(4), pp. 13-28.

______ (1989), *Money, Interest and Banking in Economic Development*, Second Edition, The Johns Hopkins University Press, Baltimore.

GOB (2012), *Bangladesh Orthonaitik Shamikha 2012*, Finance Division, Government of Bangladesh (GOB), Dhaka.

Goldsmith, R.W. (1969), *Financial Structure and Development,* Yale University Press, New Haven, CT.

Goyal, Ashim (2012), "The Future of Financial Liberalization in South Asia," *Asia-Pacific Development Journal*, Vol. 19(1), pp. 63-96.

Graff, M. (2002), "Causal Links between Financial Activity and Economic Growth: Empirical Evidence from a Cross-country Analysis, 1970-1990," *Bulletin of Economic Research,* Vol. 54(2), pp. 119-133.

Gurley, J. and E. Shaw (1967), "Financial Structure and Economic Development", *Economic Development and Cultural Change,* Vol. 34*,* pp. 333-346.

Hellmann, T., J. Murdock and J. Stiglitz (1994), "Addressing Moral Hazard in Banking: Deposit Rate Control vs. Capital Requirements," Stanford University, Department of Economics, Stanford.

___________ (1996), "Financial Restraint: Toward a New Paradigm", M. Aoki *et al.* Eds., *The Role of Government in East Asian Economic Development: Comparative Institutional Analysis,* Oxford University Press, Oxford.

Hellmann, T. and K. Murdock (1997), "Financial Sector Development Policy: The Importance of Reputational Capital and Governance," Istran, P. Szekely and Richard Sabat, Eds. *Development Strategy and Management of the Market Economy,* Vol. 11, Clarendon Press, Oxford.

Jung, W.S. (1986), "Financial Development and Economic Growth: International Evidence," *Economic Development and Cultural Change,* Vol. 34, pp. 336-346.

Khan, M. (1995), "Fiscal and Monetary Constraints on Deregulating Commercial Banks, Financial Repression and the Need for Cautious Reform", Stanford University Department of Economics, Stanford.

Khan, M.S. and A.S. Senhadji (2000), "Financial Development and Economic Growth: An Overview," *IMF Working Paper No. WP/00/209*, Washington, D.C.

King, R. and R. Levine (1993a), "Finance, Entrepreneurship, and Growth: Theory and Evidence," *Journal of Monetary Economics,* Vol. 32(3), pp. 513-542.

_________ (1993b), "Finance and Growth: Schumpeter Might Be Right," *Quarterly Journal of Economics,* Vol. 108(3), pp. 717-738.

Levine, R. (2003), "More on Finance and Growth: More Finance, More Growth?" *The Federal Reserve Bank of St. Louis Working Paper*.

_________ (2004), "Finance and Growth: Theory and Evidence," *NBER Working Paper No. 10766*, Cambridge MA.

Luintel, K.B. and M. Khan (1999), "A Quantitative Reassessment of the Finance-Growth Nexus: Evidence from a Multivariate VAR", *Journal of Development Economics,* Vol. 60, pp. 381-405.

McKinnon, R.I. (1973), *Money and Capital in Economic Development*, Brooking Institution, Washington, D.C.

Murdock K. and J. Stiglitz (1993), *The Effect of Financial Repression in an Economy with Positive Real Interest Rates: Theory and Evidence*, Stanford University Department of Economics, Stanford.

Murinde V. and F.S.H. Eng. (1994), "Financial Development and Economic Growth in Singapore: Demand-following or Supply-lending?" *Applied Financial Economics,* Vol. 4, pp. 391-404.

Neusser, K. and M. Kugler (1998), "Manufacturing Growth and Financial Development: Evidence from OECD Countries", *Review of Economics and Statistics*, Vol. 80(4), pp. 638-646.

Pagano, M. (1993), "Financial Markets and Growth: An Overview", *European Economic Review*, Vol. 37, pp. 613-622.

Rahman, Md. Habibur (2004), "Financial Development – Economic Growth Nexus: A case Study of Bangladesh", *The Bangladesh Development Studies,* Vol. XXX (3 & 4), pp. 113-128.

Rahman, Muhammad Mustafizur (2012), "Banking Sector Reforms in Bangladesh and is Impact", Asian Institute of Technology, School of Management, Thailand.

Ram, R. (1999), "Financial Development and Economic Growth: Additional Evidence", *Journal of Development Studies,* Vol. 35, pp. 164-174.

Rioja, F. and N. Valev (2004), "Does One Size Fit All? A Reexamination of the Finance and Growth Relationship," *Journal of Development Economics,* Vol. 74, pp. 429-447.

Rousseau, P.L. and P. Watchel (1998), "Financial Intermediation and Economic Performance: Historical Evidence from Five Industrialized Countries," *Journal of Money, Credit and Banking,* Vol. 30, pp. 657-678.

Shaw, E. (1973), *Financial Deepening and Economic Development*, Oxford University Press, New York.

Trabelsi, M. (2002), "Finance and Growth, Empirical Evidence from Developing Countries: 1960-1990," Institute des Etudes Commerciales de Carthage (IHEC).

Vittas, D. (1993), *Financial Regulation: Changing Rules of the Game*, World Bank, Washington, D.C.

Appendices

Appendix Table 1: Sample of Studies on Relationship between Financial Sector Development and Economic Growth

Studies which find positive relationship, that is, financial sector development causes growth.	Mckinnon, 1973; Shaw, 1973; Fry, 1988, 1995; King and Levine, 1993a, 1993b; Pagano, 1993; Levine, 2003, 2004; Rioja and Valev, 2004; Rahman, 2004; Islam, *et al.* 2004; Murinde and Eng, 1994; Rousseau and Watchel, 1998; Neusser and Kugler, 1998; Graff, 2002.
Studies which find weak, negative or insignificant relationship.	Khan and Senhadji, 2000; Trabelsi, 2002; Favara, 2003; Ram, 1999; Bashar and Khan, 2009.
Studies which find bidirectional causality between finance and growth.	Demetrides and Hussein, 1996; Berthelemy and Varoudakis, 1996; Luintel and Khan, 1999.
Studies which find causality running from growth to financial sector development	Gurly and Shaw, 1967; Goldsmith, 1969; Jung, 1986.

Source: Compiled by the Author

Appendix Table 2: Sources of Capital (Crores of Taka)

Fiscal Year	Long-Term Industrial Finance from Banks	Amount Raised from Capital Market	Total	Amount from Capital Market as % of Total
2011-12	80,235	13,288	93,523	14.2
2012-13	90,334	12,397	1,02,731	12.1
2013-14	1,00,395	17,840	1,18,235	15.1
2014-15	1,23,142	16,971	1,40,113	12.1
2015-16	1,46,102	13,748	1,59,850	8.6
2016-17	1,70,988	22,019	1,93,007	11.4
2017-18	2,02,844	25,101	2,27,945	11.0

Source: Bonik Barta, 26 June, 2019

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp. 24-42)

Financial Sector and Its Development since Independence of Bangladesh

- Mohammed Farashuddin*

Overview

A raison d'être why the Father of the Nation Bangabandhu Sheikh Mujibur Rahman waged the long drawn out struggle for independence was to secure economic emancipation of the people of East Bengal which is now Bangladesh. Nationalization of the Banking and Insurance in 1972 was part of the strategy to make sure that concentration of economic power is prevented in a welfare state of Bangladesh. It is an appropriate time to revisit the strategy for an objective evaluation.

The Sector

The Financial Sector is a key component of an economy comprising of firms, establishments and institutions that provide financial services to commercial and retail customers. The sector is made up of a broad range of sub sectors including banks in the public and private sector, non-banking financial institutions, investment companies, insurance, capital markets and real estates.

A major function of the financial sector is generating loanable funds and investible resources. In a developing country like Bangladesh, financial intermediation is a crucially important task that the sector is required to perform. Millions of domestic household savings occur in millions of places at different times and under varying motivations. The financial (and non-financial) institutions like the scheduled banks aim at attracting those savings into pools of

---

*Professor Dr. Mohammed Farashuddin is the Chief Advisor of East West University, Bangladesh. He was also the Founder Vice Chancellor of East West University and Former Governor of Bangladesh Bank (the central bank of Bangladesh). Dr. Farashuddin did Ph.D. in Economics from the Boston University, United States of America. Views expressed in this article are the author’s own.

supply of loanable funds. Simultaneously, the entrepreneurs ('organization' in the old description of the factors of production) with ideas crystalized into feasible as well as profitable projects look for or demand loanable funds from the financial institutions. Scheduled Banks thus perform the match making role of bringing together the suppliers and demanders of the loanable funds for investment for productive purpose. The interest rate or the price of the loanable funds demanded by the entrepreneur-investors is usually higher than the price or interest rate paid to the saver-depositors. The difference is called the SPREAD which is used for (a) meeting administrative costs, (b) payment of dividends to the equity holders and (c) retained earnings for potential investment in future.

In the developed countries dominated by private sector, investible funds are usually generated in the capital market and from the insurance sub-sectors, as well as Providend Fund. Banking Institutions participate more in the form of a short-term working capital and trade financing. In Bangladesh, following (a) the dismal performance of the state owned specialized financial institutions, e.g. Bangladesh Shilpa Bank, Bangladesh Shilpa Rin Sangstha, Bangladesh Krishi Bank, (b) the absence of private sector long-term loan giving entities such as in the Philippines and Thailand and (c) on the advice of the World Bank, the government decided in 1992-93 to involve the scheduled banks in the public sector (Nationalized Commercial Banks, NCBs) alongside the Specialized Financial Institutions BSB, BSRS, BKB to meet the demand for the long term investible funds. This marked the beginning of the Non-Performing Loans (NPLs) and other ills in the financial sector because of the inherent instability caused by the short term deposit supply of loanable funds to meet the medium (two-three years) to long term deployment of the loans.

The Financial Sector at the Birth of Independent Bangladesh: The Difficult Phase: Control Regime

At birth, Bangladesh was a devastated land considered by pundits to be unfeasible as an economic entity. Most of the banks, insurance companies and other financial concerns were owned by the (West) Pakistanis who fled. The two Bangladeshis knowledgeable in central banking were stuck in the headquarters of the State Bank of Pakistan (Central Bank) in Karachi. Bangabandhu Sheikh Mujibur Rahman triumphantly returned to independent

Bangladesh from the nine and half month captivity in Pakistan on January 10, 1972 as the Father of the Nation. He immediately set to organize the financial sector. All the scheduled banks were nationalized and grouped into six state owned banks – Sonali, Agrani, Janata, Rupali, Pubali and Uttara. The central bank, Bangladesh Bank, was established with Mr. A. N. Hamidullah as the first Governor. Cash foreign exchange from Sweden and Canada initiated the foreign exchange reserve.

Bangladesh also had to grapple with the danger of inflation as defined in the Equation of Exchange, PQ=MV where P is the general price level, Q is the real output (GDP) M is the base money supply and V is the velocity of money circulation. Thus $P=\frac{MV}{Q}$ remained very susceptible to the increase in monetary aggregates which were essential for the reconstruction, rehabilitation and startup of production in the economy. Q was rock bottom and falling (Rice production in 1972-73 was 15 percent lower than that in 1969-70 and per capita rice production declined by 20 percent (*The First Five Year Plan 1973-78*). The usual gestation period of the new investment yielding output was a pain. Even the massive import of 28 lakh tons of rice could not cover the gap of food grains availability. The farm output increase was, however, expected to be fairly quick due to favorable climatic condition and the extra mileage of work enthusiasm generated by the return of the Father of the Nation to his charged up country. Recognizing the acute shortage of essential commodities, rice, edible oil and sugar as well as kerosene, the government established a public sector apparatus with the Trading Corporation of Bangladesh, TCB, for importing these commodities, and Consumers Supplies Corporation, COSCOR, for the distribution of these essential commodities as well as coarse cloth all over the country. Moreover, in those excess demand situations, statutory (compulsory) rationing was introduced in Dhaka, Narayanganj, Chittagong and Khulna. A modified rationing system was also introduced.

The First Five Year Plan and Domestic Financial Resources for Its Implementation

The Planning Commission formulated the First Five Year Plan 1973-78 with an estimated outlay of Tk. 44550 million-Tk. 39520 million in the Public Sector and Tk. 5030 million in the Private Sector. The plan declared `Poverty Reduction’ to be ‘the foremost objective of the plan’. It set a GDP growth rate target of 5.5 percent, and an annual population growth rate of 3 percent. The Plan strategy was thus to cause a 2.5 percent per capita income increase.

The domestic resource mobilization for financing the planned investment was as under:

		Taka in Million	Percentage of Total
01.	Government Revenue Surplus with 1972-73 Taxes and Tax Rates	5370	20.0
02.	New Taxes and Increased Receipts Excluding Private Sector	6250	23.1
03.	Government Domestic Capital Receipts Excluding Private Sector	3500	13.0
04.	Private Saving (excluding unmo..... saving and Time Depositions)	7200	26.7
05.	Long Term Borrowing from the Banking System	3600	13.7
06.	Financing Deficit to be Covered by Additional Measures	1060	3.9
	Total	**26980**	**100.0**

Revenue Receipts estimated for the First Five Year Plan was Tk. 23400 million.

		Tk. Million
01.	Customs Duty	7570
02.	Excise Duty	6260
03.	Sales Tax	2430
04.	Income Tax	700
05.	Land Revenue	230
06.	Other Miscellaneous Receipts (Industries Tk. 3470 million + Banks + Financial Institutions Tk. 370 million)	2370
	Total Government Revenue Receipt	Tk. 23400 million
	Total Government Expenditure	Tk. 18030 million
	Revenue Surplus	Tk. 53700 million

It is worth noting that direct tax (Income Tax + Land Revenue) constituted only about 4 percent of the total tax revenue. The preponderance of indirect taxes, the ultimate burden of which is shifted to the common people, was unacceptable then as it is today.

The Gross Private Monetized Savings which depends *inter alia*, on real interest rate was not easy to generate. When a low interest rate was a major incentive to the private sector investment, a high nominal interest was essential to enthuse the households to save. The government thus tried to deal with this dilemma by a system of credit rationing in the formal sector of the economy in which the rate of administered rate of interest was far below the rate the borrowers were prepared to pay.

It is interesting to note that the debate on `high or low' interest rate is still ongoing today. It started during the first post-independent government of Bangladesh. The Planning Commission observed, "It is unlikely that higher interest rates will have any adverse effects on the profitability of banking operation since both lending and borrowing rates will go up. But it is possible that some operations may be undesirably affected by the incidence of higher interest rate. Cottage and small industries may be so affected. If they are, a number of ways exist to ensure that they are protected from the adverse consequences." [*The First Five Year Plan 1973-78*] The need for special dispensation for the micro and small industries for generation of employment-income, reduction of poverty and denting disparity still exists.

Money Supply and Government Borrowing

Money supply during 1972-73 increased by Tk. 2103.3 million to Tk. 6960.3 million. Government and the nationalized sectors had to borrow heavily because revenue collection in a war devastated economy was grossly inadequate. The credit in the private sector declined during the period. As external grants and loans increased and exports revenue started coming in, foreign exchange reserve started building up to add to the aggregate money supply. The shortfall in revenue collection resulted in heavy government borrowing from the banking sector for financing the massive relief, rehabilitation, reconstruction and development work. According to the *Bangladesh Bank Annual Report 1973*, the movement in money supply and its components are as under:

Period	Currency	Demand Deposit	Money Supply
December 17, 1971	2066	1809	3875
June 30, 1972	1756	3101	4857
June 30, 1973	2864.3	4069	6960.3
Change during 1972-73	+1108.3	+995	+2103.3

Bank credit was Tk. 14.4 million during 17.12.71 to 30.06.72; it increased sharply to Tk. 6125.5 million during 1972-73. The increase was mainly due to an escalating demand for bank credit in the nationalized sector including jute trade, jute mills and other State-Owned Enterprises (SOEs).

The aggregate status in bank deposits as of 30.06.1973 was Tk. 3632.6 million. This showed a revival of the trust of the independent people of Bangladesh in the banking system of the country. The reduction of liquidity preference, i.e. from cash to the bank deposit phenomenon, was a great relief. The resultant bank credit increase necessitated an increase in the scheduled banks' borrowings from the central bank, Bangladesh Bank (BB), by Tk. 77.4 million. The reserve of the scheduled banks with BB declined by Tk. 373.8 million. These institutions also lost cash balance to the tune of Tk. 166.5 million.

Bank Rate and the Interest Rate

The Bank Rate was set at 5 percent the same as before the liberation. The interest rate was administratively determined as under:

	Deposit Types	Rate of Interest/ Annum %
01.	**Short Term**	
	Short Term Deposits (7 to 29 days' notice for withdrawal)	03
	Short Term Deposit (30 days or more notice for withdrawal)	3.25
02.	**Savings**	
	Saving Account with Checking Facilities	04
	Saving Account without Checking Facilities	4.50
03.	**Fixed Term Deposits**	
	03 to 06 Months Duration	4.5
	06 to 12 Months Duration	4.75
	01 Year to 02 Years	05
	02 Years to 03 Years	5.5
	Over 03k Years	06

Bangladesh Krishi Bank (BKB) and Bangladesh Shilpa Bank (BSB) could pay interest rate of 01 percent above those rates.

Credit Measures

During the period ending on 30.06.1973, the liquidity position of the scheduled banks was generally tight. These institutions had to thus get accommodation from BB for credit expansion. The equity base of BKB had been very low. But its outstanding loan stood at Tk. 372.2 million as on 17.12.1971 (overdue amount was Tk. 181.6 million). Recovery of the agricultural credit installment from the peasants in the immediate post - liberation Bangladesh was highly impossible. Thus BKB lost the refinancing facility of BB where its loan was Tk. 102.2 million of which overdue was Tk. 70.6 million. Bangladesh Bank, in terms of its objective 3: "auxiliary assistance to the socio-economic development of the country" allowed conversion of the overdue BKB loans into medium-term loan saving up the old loan accounts. BB also allowed the troubled co-operatives to finance again the defaulter members affected by circumstances beyond their control.

Credit Control Measures

Bangladesh Bank felt the time was not appropriate to invoke general credit control measures such as raising the discount rate and minimum reserve requirements. However, BB, with a view to minimizing low priority use of the bank credit funds for speculative purposes and advances against unsound securities, took special measures. Statutory Cash Reserve Requirements of the scheduled banks remained unchanged at 5 percent of their total demand and time liabilities. Liquidities Ratio remained unchanged at 25 percent of their total demand and time deposits, i.e. Advance Deposit Ratio (ADR) was 0.75. Restrictions were imposed on demand loans, overdrafts and cash credits to provide loans to individuals except against pledge of gold or gold ornaments.

Advances to provide loans to individuals for the purpose of business, construction/ repair of estates would be allowed only against security of real estate. Restriction was imposed on the use of real estates as security for 'non-productive purposes'. Prohibition was imposed on advances against stock exchange securities, shares, debentures and other security instruments issued by Pakistan/ East Pakistan Government and National Investment Trust, NIT. General prohibition was imposed on advances against commodities grant. Clean advance was not allowed except for exports advances to finance.

Thus the Financial Sector in the newly independent People's Republic of Bangladesh had a stressful roller coaster start on 17 December 1971. Mills, factories, infrastructure – roads rails, ports, culverts, bridges – needing replacement or major repairs. 2.8 million tons of imports to deal with the 3.0 million tons of food deficit, and so on. The journey of the public sector economy started with 11 sector corporations, trading corporation of Bangladesh, consumers supply corporation, and so on. Heavy public sector expenditure was made in importing food grains, and other essential commodities and in importing capital goods as well as raw materials. Revenue collection was inadequate.

The Initiation of the Recovery

A dilemma arose between higher power monetary expansions to pay for the imports as well as deficit financing versus a 67 percent inflation in unprecedented global economic difficulties. Nationalization of the banking and non-banking financial institutions, across the board administration of interest rate, credit control and exchange control had to be the order of the day. Bold and inspiring steps were initiated by the Mujib Government. Results showed that the food production in 1972-73 was better (but still lower than in 1969-71). Inflation was reduced to 40 percent. Inflationary pressure continued because of the need to import food grain, capital goods and raw materials, high global inflation and monetary expansion to cater to both public and private sector credit needs. The bank credit was taka 1859.4 million in 1972-73, which jumped to Tk. 8169.9 million in 1973-74. The debts of the scheduled banks increased from Tk. 77.4 million in 1972-73 to Tk. 478.9 million in 1973-74 despite an increase in the bank deposits from Tk. 1859.4 million to Tk. 8169.3 million in 1973-74. Financial difficulties compounded in Bangladesh due to increase in imports in 1973-74 to Tk. 6675 million in the face of reduced exports receipts of Tk. 2523 million. The deficit forced the revenue hungry government to cut the basic salary up to 10 percent and 20 percent, respectively of the specific categories (The Bangladesh Government Budget Extraordinary, Thursday, July 6, 1972).

The administered interest rate continued in 1973-74 in the same rate as in 1972-73 varying from a low short term rate of 3 percent to 3 year FDR rate of 6 percent. All the six Nationalized Commercial Banks (NCBs) experienced increase in paid up capital as follows: Sonali, Agrani and Janata from 20 to Tk.30 million (authorized level Tk. 50 million), Rupali, Uttara and Pubali from Tk. 10 million to Tk. 20 million (authorized level Tk. 50 million).

In the 1973-74 Budget, the revenue receipts were estimated to be Tk. 4113.1 million and revenue expenditure was to be Tk. 2953 million yielding a revenue surplus of Tk. 1160.1 million. The Annual Development Expenditure for 1973-74 was estimated at Tk. 5253.5 million with the highest allocation to transportation and construction in place of education which had received higher attention in 1972-73. However the drought, loss of production, severe global downturn and policy failure to manage the food imports and distribution caused a famine in October 1974. The economy started yielding positive results recording an impressive GDP growth rate of above 7 percent in 1974-75 and inflationary pressure easing considerably.

Liberalization and Reforms in the Financial Sector

The heinous and barbaric act of the meanest cowardice of the killers of the Father of the Nation Bangabandhu Sheikh Mujibur Rahman was prompted, *inter alia*, to scuttle his revolutionary steps to decentralize the administration and galvanize agricultural production through cooperatives. The godfathers of the killers made a conscious move to reverse the ideology of Bangabandhu which are aimed at establishing smile to each sad face. The deliberate step they took to open the economy to the market (private sector) was, in line with the global situation of returning to capitalism. In 1976-77 the role of the the specialized banks, Bangladesh Shilpa Bank (BSB), and Bangladesh Shilpa Rin Sangstha (BSRS) was enhanced to cater for long term credit and the bridge financing-cum-equity providing Investment Corporation of Bangladesh (ICB). This was an event of crucial significance for the financial sector.

With a 70:30 Debt-Equity Ratio, BSB and BSRS opened windows for industrial project apprisal and loan approval for the private sector entrepreneurs. There were initial natural handicaps as well as policy shortcomings. The people of East Bengal did not have much of a tradition of entrepreneurship in industrial ventures. Neither did the banking sector have any expertize in the project life cycle of identification, conceptualization for formulation, appraisal, financing, monitoring, evaluation and completion. In addition, corruption might have had already entered the system. The equity part of 30% or so comprised of land and building amongst others and some of the potential entrepreneurs, in league with the bank officials showed heavily over valued magnitudes covering most of the equity part. Secondly, in the procurement of equipment, there was a usually globally common phenomenon of kickbacks from the suppliers. Thirdly, the permit to get foreign exchange at official exchange rate for importing project machinery and intermediate raw materials could be sold at high premium (severe shortage of foreign exchange caused the exchange control) by some unscrupulous elements. Some potential borrowers thus found it more profitable to reap the benefits of all the major concessions and not to set up industrial units at all. This initiated the process of Non-Performing Loans (NPLs). Another policy failure forced the potential industrial entrepreneurs to go to an NCB to get the working capital which was not in the original sanction of BSB/ BSRS. Neither had there been a protecting shield for the exchange loss of the borrowers of foreign exchange causing ever increasing liability due to depreciation of Bangladesh Taka. Unlike in other countries, computation of interest liability during the construction period was not waived. Notwithstanding these shortcomings, the country has seen the birth of a world standard entrepreneurial class. The defaulted loans, at least a part of it can thus be seen as a social investment in creating entrepreneurs.

In the decade of 1980s, the financial sector of Bangladesh experienced action loaded events. The process of liberalization continued. The World Bank financed Banking Sector Reforms project started in a determined way. The administered interest rate regime eased to some extent and the banks were allowed to determine their own rates within a pre-set band. The export finance and agricultural credit continued to enjoy single digit fixed interest rate phenomenon.

Of critical importance, the government decided in 1983-84 to allow banking and insurance companies in the private sector. The main shortcoming of this positive move was that there was too much discretion in respect of complying with the rules and regulations. There was a provision to have paid up capital of Tk. 200 million in tax paid own money to get a banking license, several banking institutions were established with much lower paid up capital and no question was asked about the source or color of the seed money. The lack of regulations, not to speak of Prudential Regulations, for reopening the scheduled banks to the market also heralded the problem of banking sector irregularities and non-performing loans. The insurance sub-sector was born sick and has continued to be until now. The government took the laudable step of unloading high quality shares of the multinational corporate entities to the capital market through ICB. It is also in 1984 that the Grameen Bank ordinance was formulated and promulgated. It was set up as an NGO with government holding 75 percent share. As the Joint Secretary, Investment and Banking wing and the Controller of Capital Issues (there was no Banking Division nor the Bangladesh Securities Exchange Commission in those days) the author had faithfully implemented the political decision to open up banking and insurance to the private sector in trying to reinvigorate the moribund capital market. The active and erudite guidance of Janab M. Syeduzzaman first as the Principal Finance Secretary and then as the Minister of Finance helped the causes of the financial sector liberalization in the face of strong public sector preference in the bureaucracy.

The performance of the economy in the 1980s remained stable at a low level equilibrium circle. The GDP growth rate was moving between 4.5 to 5 per annum, inflation was in single digit and the current account negative balance was at a tolerable limit. Given the very low level of domestic revenue collection and a modestly ambitions desire to grow faster, there had been a major thrust in mobilizing external resources. The situation went to such a pass that the lion's share of the entire Annual Development Programme had to be funded by external resources put forward by the development partners. For instance, in the Year 1982-83, the Annual Development Programme was set at Tk. 27000 million. The external resources for the year stood at Tk. 21060 million. The Budget deficit was Tk. 25360 million (Tk. 27000 million – Revenue Surplus of Tk. 4640). Of the deficit of Tk. 25360 million, an amount of Tk. 21060 million was available from external sources, (project assistances Tk. 11200 million + counterpart fund Tk. 8800 million). Total Revenue Receipt of 1982-83 was set at Tk. 26380 million out of which tax receipts provided Tk. 21230 million. The total revenue expenditure was taka 20380 yielding a revenue surplus of Tk. 4640 million.

A very special feature of the financial sector was a healthy Debt Service Ratio (DSR) Debt Service: Exports Earning Ratio. It was 20.2 in 1985-86 and rose slightly to 23.5 in 1986-87. The decade of 1980s ended remarkably when President Hussain Mohammad Ershad was forced out of the office 'peacefully' by the united forces of democracy – the three alliances led by Awami League, BNP and the left parties in December 1990. The country returned to the path of democracy through the election of 1991. For the financial sector, an earth shaking event was the introduction of a uniform 15 percent Value Added Tax (VAT) in the Budget of 1992-93. Revenue collections improved significantly and the dependence of financing ADP from external resources dropped to a little over 50 percent. An event of devastating importance was the unilateral reduction of customs tariffs in the budget of 1992-93 on the imports coming from India without a reciprocity on the Bangladesh imports to India. The imports from India jumped from $141 million in 1989-90 to $414 million in 1993-94. Although trade imbalance is not necessarily bad, but exports expansion is a necessity as well. A third development that took place in the 1990s was the involvement of the commercial banks in long-term project lending. The reforms in the enlargement of the non-administered interest rate continued. The proportion of assets (loans and advances) and deposits (liabilities) started switching in favour of the private sector banks. Private sector credit expansion continued. Budget size increased at a slow but steady pace hovering around 15 percent or so of GDP. Tax:GDP ratio remained in single digit dimension. Remittances were at $764 million in 1990-91 and rose to two and a half billion ($2501.13 million) in 2000-01. The inflation rate kept on fluctuating as the growth in GDP also changed from year to year. The annual inflation rate which was 9.7 percent in 1983-84 rose to 11.4 percent in 1987-88. It was steadily declining since 1996-97 (3.9%) to a low of 1.7 percent in 2000-01.

The Financial Sector in the Robust Economy of the Current Period

In the current year (17.03.2020 to 17.03.2021), of the centenary celebration of the Father of the Nation Bangabandhu Sheikh Mujibur Rahman the economy is very lively thanks to the gutsy, innovative and humane leadership of the Head of the Government Janabandhu Sheikh Hasina. Poverty reduction has been spectacular from 80 percent or more in 1972 to 20 percent or so in 2020. The table below shows the Bangladesh Development Progress since Independence:

Indications		1974	1980	2000	2018
01.	GNI per capita	111	140	383	1909
02.	People under Poverty Line %	77	58.5	52.3	21.8
03.	Life Expectancy at Birth	46.2	54.8	63.6	72.3
04.	Infant Mortality %	138.8	111.5	58.0	22.0
05.	Adult Literacy	25.8	29.2	52.8	73.9
06.	Population Growth Rate	2.5	2.35	1.41	1.2

Source: Bangladesh Bureau of Statistics

Towards the completion of the yet unfinished dream of establishing Sonar Bangla, there are imperatives before the government and the people. The laudable targets for the Perspective Plan 2021-2041 (PP2041) are ambitious but achievable when measured against the potential and capabilities of the country. The PP 2041 seeks to eliminate extreme poverty, limit moderate poverty to a low single digit level, secure Upper Middle Income country status by 2031 and reach a developed prosperous country by 2041. In the meantime, the graduation from the status of a Least Developed Country (LDC) to a Developing Country (DC) – the hurdles of which were theoretically crossed in March 2018,has to be perfected by 2024. Bangladesh is fortunate to be endowed with an enterprising people, a fertile land that produces three crops a year, plenty of water, open access to sea, homogeneous people sharing a common language (with exception which will need careful nurturing) history, culture and tradition as well as a strong sense of national pride. The victory at ITLOS opens up an unprecedented opportunity to develop the 'Blue Economy' potential to double up growth and prosperity. A paramount necessity is, however, to transform the 50m people between the age of 15 to 30 years into human resources through vocational and technology oriented education.

Ever since independence, the unraveling of the financial sector has been consistent with the development in countries with similar circumstances. The GDP of $9 billion in 1972 is now $307 billion in 2019. The exports have jumped to $40 billion in 2018-19 but 85 percent of which is RMG alone a narrow base indeed. The annual budget of Tk. 7860 million in 1973-74 is now at Tk. 5,23,1900 million for the current 2019-20 fiscal year. But at 18.1 percent of GDP, it is still lower than the optimal size of one fifth (20%) of GDP. The structure of GDP has undergone a spectacular change; with the primary sector contributing 13.6 percent of GDP, the secondary sector contributing 35.14 and the service sector contributing 51.26 percent. But the loss of the primary sector's share at 53 percent in 1972 to less than 14 percent now has not been captured by the secondary sector to bolster the employment generating secondary sector to 45 percent or so. The inflation rate is still moderate at around 5.5 percent. The unsatisfactory mobilization of domestic resources with 10 percent or so Tax:GDP ratio one of the lowest in the world needs to have priority attention.

The banking sector of the country has demonstrated spectacular structural reversal from the public sector dominance to a private sector preponderance. With 49 percent of the branches, the privately owned banks have 70 percent of the deposits and 72 percent of the assets. This scenario is an about turn of the NCB dominance of the 1970s and even 1980s. In 2018 the distribution of banking service between the urban and the rural gave rise to several intriguing questions. With 51.7 percent of the total branches of banks (10114), the urban segment collects 79.34 percent of the total deposits of taka 1.04 trillion and advances 90 percent of the total loans. This situation of very low intensity of banking in the rural Bangladesh has to change. The major thrust in the forthcoming industrialization for job creation including self-employment, establishment of the Special Economic Zones outside the urban areas and priority in the micro and small industries towards a backward linkage-cum-self-employment in the rural areas will depend, to a large extent, in strengthening the rural economy. Historically, Bangladesh is strong when its rural areas are productively engaged. Thus the banking services in the rural areas have to gear up.

A misconception even amongst the leading economists is that there are too many banks in the country. The number of banks is irrelevant for comparison purposes because there are banks with 05 branches operating and there are banks with 1000+ branch activities. In Bangladesh as of 2018, each of the

10114 branches of scheduled banks served 1680 persons on an average; the comparable figures in India and Pakistan are considerably lower. Not only this, the Janabandhu Sheikh Hasina Strategy of 'Amar Gram Amar Shohor' will necessitate rural Bangladesh to have all modern urban amenities including banking services and therefore, escalation of socio-economic development activities will have to be blown up in the villages.

Challenges before the Financial Sector

The most serious impediment in the smooth functioning of the financial sector is its fragmentation. For instance, the loanable fund market cannot function competitively because of the roadblock or rigidity created amongst others by a cartel of the owners of the private banks. The cartel has successfully increased the total profit of their banks from Tk. 54980 million in 2009 to Tk. 120772 million in 2019. In the 1990s total bank profit hardly exceeded Tk. 100 million. Yet the cartel does not allow any reduction in lending interest rate which is at the range of 13-15 percent. But the government desire to bring down the interest rates to 6 percent (deposit) and 9 percent (lending) could better be effectively implemented through the market mechanism. The critical bottleneck is the market rigidity which the government and the central bank need to remove for ensuring competitive conditions in the loanable funds market.

Interest Rates

There is yet another imperative in promoting development of private institutions for dealing with terms loans for industrialization. This would shift the burden of the short term deposit collections scheduled banks to private long term industrial credits. The scheduled banks will be continuing to cater to the trade credits, working capital loans and the durable goods. An institutional arrangement to funnel the insurance subsectors surplus to the industrial credit arena is also desirable. Appropriate policy measures can also help in bringing the provident fund and other such resources into the loanable funds market. It is also time to think of encouraging the inward remittance resources to get into equity formation perhaps through a profit making but autonomous Bangladesh Bridge Authority. A point to always ponder about is that there is no absolute truth about the higher interest rate being necessarily bad. The Republic of

Korea's financial reforms in 1963 catapulted deposit interest rate from 8 percent to more than 20 percent resulting in a sensational rise in domestic savings. Also the higher lending rate eliminated irresponsible borrowing because the entrepreneurs took loans only for the most productive projects. That's why there is practically no defaulted loans in that country. This is not to discourage a lower lending rate which may reduce the cost of production. On an average, interest rate costs are estimated to constitute 12-15% of the total project costs. Many industrial loan borrowers also complain about the inadequate quality of services e.g. delays, and speed money rather than the high interest rates problem.

The continuous accumulation of defaulted loans creates a bad economic culture. It causes upward trends in higher lending interest rates. If, in addition, the defaulted borrowers are given special concessions as in recent times, the law abiding 'good' borrowers feel frustrated. Some of them may even get to deliberate defaults. According to the 'Global Economic Prospectus' of the World Bank, the defaulted loan situation in South Asia is as under:

Country	% of Default Loan
Bangladesh	11.4
Bhutan	10.9
Afghanistan	10.8
India	8.9
Maldives	8.3
Pakistan	8.2
Srilanka	3.6
Nepal	1.7

The international standard of default is 2 percent or less. The government of Bangladesh data however, show a default of 11.2 percent in September 2019. In dropped to 9.8 percent in December 2019 through an incredibly high reschedulement of Tk. 500 billion in three months – October to December 2019. Collective thoughts and innovative soul searching endeavors may be commissioned to help alleviate the default loan problem without having to be harsh with anyone. Acquisitions and mergers are an option. Floating an Asset Management Company is another. Time is perhaps opportune to review the banking sector provision that allows four members of the same family in the Board for nine years in a row which is certainly helping concentration of economic power.

The Capital Market in Bangladesh never made any headway. There is simply a lack of confidence in the two bourses, the Dhaka Stock Exchange and the Chittagong Stock Exchange. The collapse of the stock market in 1996 soon after the return of Awami League to power after 21 years of military or pseudo military rule had given lessons from which nobody learnt. Professor Amirul Islam Chowdhury, a former Vice Chancellor of Jahangirnagar University conducted an enquiry after the crash of 1996 and most appropriately pictured how the “greed for getting rich overnight” in an environment of “complete darkness about the fundamentals of companies” led to people duped into investing in non-existing company shares and losing their assets to the manipulators. The report had excellent recommendations as to how to close the loopholes for a healthy development of the capital market. But the government bypassed the report and the manipulators were encouraged to prosper and the people continued to lose confidence in the capital market. The 2011 disaster of the capital market was mostly due to the failure of the central bank to enforce the ADR of 0.85 percent Bank operators who in league with the capital market manipulators corrupted the Book Building Method, ‘Placement’, Revaluation of assets, ‘Premium’ based IPOs as well as the Demutualization. Credits meant for SMEs and women entrepreneurs were used to transact secondary shares until the manipulators made their windfalls, withdrew their funds and laundered these abroad. It is imperative for the government to set up an objective mechanism to rectify the defects as mentioned, allow the CEOs and CFOs to function independently, objectively select a group of independent directors and instal an effective surveillance system. The rule of Bangladesh Securities and Exchange Commission (BSEC) that prohibits the less than 02 (two) percent equity shareholders to be eligible to get elected as company directors or to unload their shares deserve immediate review. This is a grossly anti-investment rule. A functioning capital market should see the birth of a bond market and reduction of the burden of the banking system in the loanable funds territory.

The low Tax:GDP ratio is perhaps the most serious challenge facing the financial market. It may even slow down growth rates through inadequate Investment. On the face of an estimated 12.5 million Bangladeshi having per capita income of $5000 or so (Boston Consulting Group, 2015), every constructive and innovative effort should be commissioned to broaden the present base of 2.1 million tax payers to at least 10 million by 2025. High income people need to be identified (not by a very badly drafted letter from the DCT) by higher ups meeting and presenting arguments as to why it is good to pay taxes for themselves and the country. Improvement in the investment climate (private sector credit is in a continuous declining path) through attractive policy packages should prevent money laundering of $6 billion or so every year (Financial Integrity Institute of Washington, IMF and UNCTAD) and invest these within. Let there be a most hospitable climate in place of an unfriendly bureaucratic apparatus in attracting capital for investment from within and outside. It is worthwhile to mention that there is difference between the ‘black money’ whose owners earn illegally, cheat on taxes, send money abroad taking advantages of an appreciated currency as well as the system loopholes and ‘tax not paid’ money where owners are forced by the government policy to officially receive lower amounts from the land transactions and the real estates. Due to a possible negative elasticity between the tax rates and the taxation revenue, the author feels that a recalculation of the tax slabs and rates may yield higher tax revenue. The recommendations are as under:

a) Tax Exemption Threshold

Status	Existing (in BDT)	Proposed (in BDT)
General tax payers	2,50,000/-	Unchanged
Women and Senior citizens of 65+ years	3,00,000/-	
Persons with Disability	4,00,000/-	
Gazetted war-wounded freedom fighters	4,25,000/-	

b) General Tax Rate

Taxable Income (Tk.)	Existing Tax Rate	Taxable Income (Tk.)	Proposed Tax Rate
first 2,50,000/-	0%	2,50,000	%
next 4,00,000/-	10%	next 5,00,000	5%
next 5,00,000/-	15%	next 15,00,000	10%
next 6,00,000/-	20%	next 3000000	15%
next 30,00,000/-	25%	next 50,00,000	20%
balance of total taxable income	30%	Remaining Taxable Income	25%

c) Special Rate

	Existing Tax Rate	Proposed Tax Rate
Cigarette, Bidi, Zarda, Chewing Tobacco, Gul, any other tobacco manufacturer	45%	unchanged
Income of Non-Resident	30%	25%
Income of Co-operative Society	15%	unchanged
Income of which NOT TAX PAID DUE TO GOVERNMENT POLICY	10%	unchanged
Income which is NOT TAX PAID BLACK MONEY	30%	proviso

Provided that the government (not the NBR) will give a guarantee that in future, no authority in the government will ask any question on this whitening of the money.

Provided further that unless the holders of such black money whiten these amounts by payment of the taxes at 30 percent by 30.06.2021, the entire amount shall be confiscated by the government; this confiscation cannot be justiciable.

The Rate Structure in the Corporate Sector

Corporate taxation may also be rationalized. Banking is a very serious and sensitive matter. There may be a positive correlation between the conservativeness and the safety and soundness of the banking operations. Non-banking activities such as mobile fund transfer and transaction through agents should not be recognized as banking by BB because these are (a) not licensed by the central bank as deposit taking scheduled banks and (b) cannot issue cheque books. The above (a) and (b) are the essential properties without which an entity cannot be called a banking institution.

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp. 43-68)

Innovations in Monetary Policy: The Bangladesh Experience

- Atiur Rahman*

1. Introduction

During the last financial crisis most central banks of the developed countries came forward to pump directionless liquidity to the financial institutions which came to be known as Quantitative Easing (QE). Although most developed countries benefitted from this unprecedented monetary expansion and regained some kind of growth momentum, the process yielded very little optimism on the sustainability front. The fiscal stimulus plans benefited mostly corporations and big businesses without actually touching the ground where most of the bottom of the social pyramid struggle to survive. As a result aggregate demand at the lower end did not improve much and the world missed the bus of a robust inclusive growth recovery. Instead, the global growth rate started falling and the on-going corona crisis will certainly accelerate the process of deceleration of the economy. The breadth and depth of this meltdown will, of course, depend on the length of the health hazard. If it is prolonged the job-loss and social chaos could be much deeper than what was initially anticipated. Probably, this time the stimulus plan of greater scale will be in place to recover the economy. In fact, most countries have already started rolling out stimulus packages of unprecedented amount. Most central banks have come forward to take the hit and expand their balance sheets to cope with desired recovery plans. One commentator foresees a much larger stimulus plan as high as USD ten trillion (Riaz, 2020). In reality this could be even larger. My only fear is that this may end up in'big pockets' as well like last time. If this happens, there is likelihood of further accentuating of the income inequality and

*Dr. Atiur Rahman is the Bangabandhu Chair Professor, University of Dhaka and Chairperson, Unnayan Shamannay, Bangladesh. He was the former Governor of Bangladesh Bank (the central bank of Bangladesh). Dr. Rahman obtained Ph.D. in Economics from the University of London, United Kingdom. Views expressed in this article are the author's own.

social instability. In fact, in addition to this heightened deceleration and instability risks, the global economy has already been facing the growing climate change threats. Moody's January 2020 update titled 'Approach to Assessing Climate Change Risk for Sovereign Issues' identifies nearly a dozen countries including Bangladesh as the most susceptible to climate change which may face downgrade in rating due to rising sea-level and subsequent disruptions in the economy and society.

It is in this wider context, this paper tries to argue that we need to go back to basics of the financial sector for which it was created i.e. to touch the real sector in a manner so that it can serve many and not only a few. The drive for sustainable development, in fact, reframes this historic relationship between finance and the real economy leading to the shared prosperity, poverty reduction and respect for planetary boundaries. In fact, the COVID-19 knows no bounds and has almost flattened the world making the undesired hunger for endless amassing of wealth nearly meaningless and providing an opportunity to the nature to regain its space which was usurped by humans for their sky-rocketing greed. This, indeed, demands on financial sector to embrace a new set of transmission channels that call for large-scale mobilization, as well as mainstreaming of Economic, Social and Governance (ESG) factors. "Actions in financial sector are in turn also expected to shape ESG outcomes in the real economy, through a set of desired response channels, including market leadership along with policy and regulatory measures and international cooperation"(Rahman, 2020, p. 3). These response measures should ensure that the financial sector is as effective, efficient and resilient as possible to deliver the desired transition to sustainable development (UNEP, 2015). Given this expectation from the financial sector to help reshape the real economy, there is an imperative for the Monetary Policy to become more innovative to give strong signal to the stakeholders to achieve the following goals:

a. Effectiveness of the market in embedding new drivers of value creation and risk management to meet the needs of the intended beneficiaries of financial services.
b. Efficiency of the system in terms of underlying costs in delivering these services. Resilience of the system to shocks flowing from unsustainable

development as well as from potential volatilities as part of the transition process.

The financial industry has to reorient itself to become more responsible so that it can serve people and the economy at large as desired in the above goals. Once the financial sector becomes compatible with the original purpose of the market which must serve many and not a few it can be "safer, more sustainable, and ethically sound" (Lagarde, 2019). The key to achieve this goal, "is to reshape the finance into something that is more aligned with societal values and more connected to interests of the stakeholders: from customers, to workers, to shareholders, to local communities and future generations" (ibid). This goal can only be achieved if the finance becomes more innovative, regulated and ethical. For that matter, the financial sector must focus on more long-term inclusive and sustainable growth process. The sector can certainly benefit from the evolving digital technology to accelerate the inclusion revolution which is already in motion to help flourish individuals and small businesses, so that market serves many as was proposed by the classical economists, primarily Adam Smith (Rahman, 2020).

Unfortunately, this socially responsible inclusive financing is still in the sideline and the mainstream financial flows continue to cater to the needs of the corporates and the big businesses. I only hope, the on-going corona crisis reminds the regulators about the fall-outs of the last global financial crisis and reorient their policy paradigm which is more inclusive and ethical. More funds should now flow to SMEs including digital start-ups and as well as green entrepreneurs shunning unproductive speculative outlays in asset and commodity markets. Bangladesh did pretty well in addressing the challenges of last global financial crisis by innovating monetary policy which helped sustain the growth by pushing the financial flows to the bottom of the pyramid in addition to providing needed incentives to the export sectors. The SMEs and agriculture were prioritized along with modernizing the payment system to allow the money to transmit faster to the smaller units and individuals who helped the economy to move on with bolstered domestic consumption and demand. In fact, Bangladesh Bank emerged as an innovative developmental central bank during this process. I am sure, if Bangladesh Bank can further strengthen its innovative monetary policy to support the real sector focusing particularly on the lower-segments of the economy without forgetting its conventional role of a regulator for all along with containment of inflation, Bangladesh will again emerge successfully as a fast moving economy with some adjustment in its growth rate despite the huge global challenges foreshadowing all prospects at the moment. The small and medium enterprises need focused attention as these are facing greater challenges in accessing funding at a time when the growth of private sector credit has declined to only about 9 percent lately.

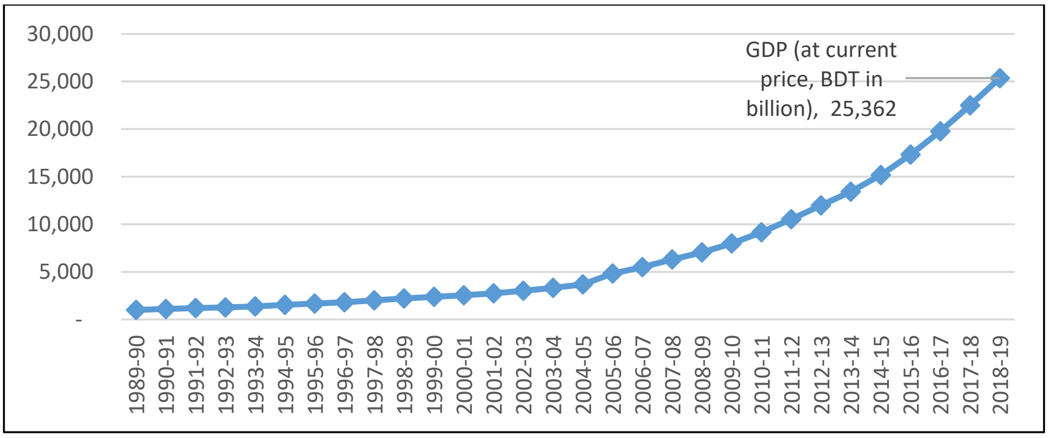
2. The Developmental Role of the Central Bank

The persistent global financial crisis has created an opportunity for a central bank to be developmental with a wider participation of stakeholders including those who are at the bottom of the rudder and have mostly been either unserved or underserved by the financial institutions. Bangladesh Bank emerged as a non-conventional central bank during the last global financial crisis which started catalyzing innovation and efficiency in bank-based financial products and services catering to the needs of the excluded. It ventured to play a coordinating role with private and public sector agencies to push for financial inclusion meaning providing affordable financial services of their choices to those who did not have access to this and as well as deepening the same for those who were underserved (Rajan, 2019; Rahman, 2020). This developmental central bank started serving as an incubator for good ideas by setting examples of public sector innovation and institutional reforms. The impact of its demonstration effect on the financial and related sectors has been simply astounding. The following sections will focus on the role of a developmental central bank in the context of Bangladesh which has been going through multi-speed transitions and how it has been catalyzing innovation and efficiency in bank-based financial systems. It will also try to find out how a central bank has been serving as an incubator for good ideas and is setting examples for others through the demonstration effect and as well as playing a coordinating role with private and public sector agencies.

3. The Bangladesh Context

Bangladesh has come a long way from a low agrarian economy at its birth in 1971 to a lower middle income country of 165 million people by now. Until very recently, the growth performance of the economy, particularly during the last decade has been simply stunning. The economy could defy the brake of the last global financial crisis and remained vibrant throughout the decade. Indeed, the inclusive development strategy of the country complemented by financial inclusion campaign by the central bank helped maintain this momentum of the economy. GDP of Bangladesh increased from just over BDT 1 trillion in FY1989-90 to over BDT 25 trillion in FY 2018-19 (Figure-1). While the size of the GDP has increased by over 25 times in three decades, the curve became much steeper since the final years of the first decade of the new century. Over the last decade, the GDP has increased more than 3.5 times. This is a testament to the success of the prudent policy moves undertaken by the current regime.

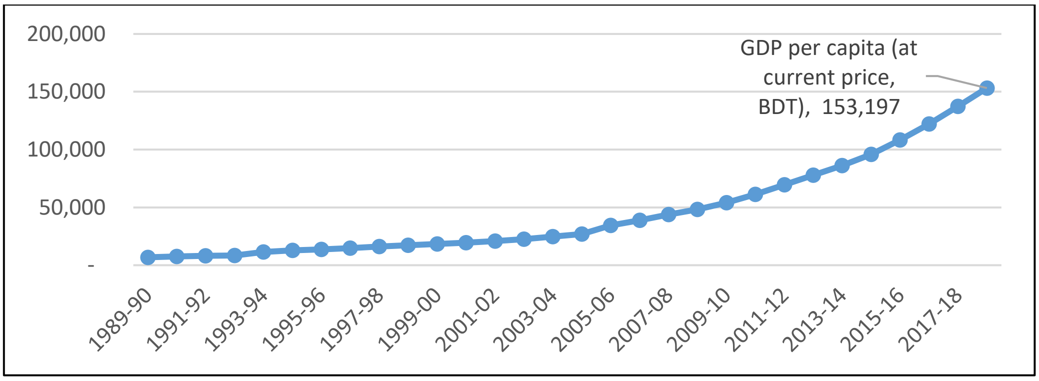
Figure 1: Bangladesh GDP (at current price in billion BDT) between FY1989-90 and FY 2018-19



Source: *Bangladesh Economic Review 2019,* Ministry of Finance, Government of Bangladesh.

Review of the per capita income of Bangladesh during the same period also reveals a similar picture. Over the last three decades per capita income has increased by over 21 times. It was almost BDT 7 thousand in FY1989-90 and reached over BDT 153 thousand in Fiscal Year (FY) 2018-19 (Figure-2). Here again, a quantum jump is visible from FY 2008-09. The per capita income has more than tripled since then.

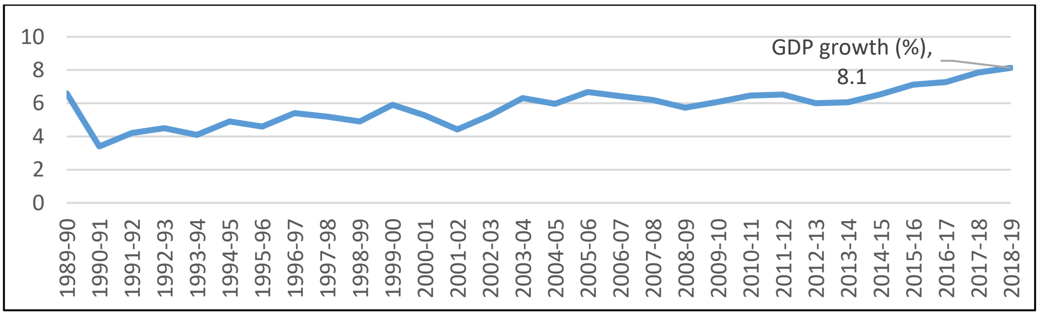
Figure 2: GDP Per Capita (at Current Price, BDT) of Bangladesh between FY1989-90 and FY2018-19



Source: *Bangladesh Economic Review 2019,* Ministry Finance, Government of Bangladesh

The GDP growth rate has generally shown an increasing trend since Bangladesh entered the democratic era in early 1990s. But this increase in the growth rate became more consistent since the late 2000s (Figure **3**-3). By the end of FY 2018-19 the GDP growth rate exceeded the 8 percent mark. Many experts opined that the country will experience double digit growth rate within another few years. The corona virus fallout may, however, dampen this optimism if this crisis is prolonged. Bangladesh can certainly rise up if it is a short-term scenario. Even if the pandemic is prolonged the overall growth performance of Bangladesh economy will still be better than most of its peers mainly because of its early investment in inclusive growth process in alignment with robust digital financial inclusion strategy of the central bank.

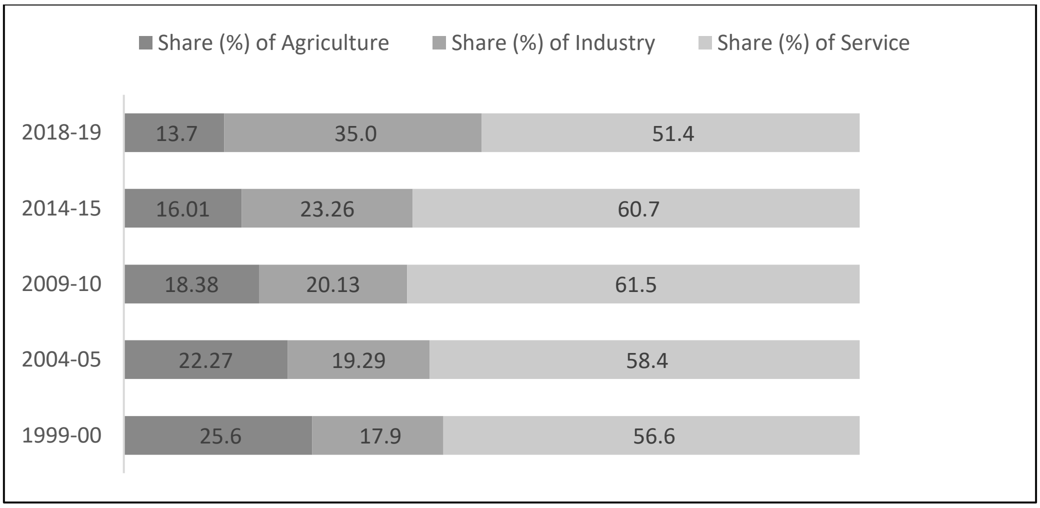
Figure 3: Bangladesh GDP Growth Rate (%) from FY1989-90 to FY2018-19



Source: *Bangladesh Economic Review 2019,* Ministry of Finance, Government of Bangladesh

The GDP growth related figures alone does not speak adequately about the amazing macroeconomic transformation that Bangladesh has experienced especially during the last decade or so. The structure of the economy has also changed for the better, and that too to a significant extent. Even in the late 1990s the agriculture sector of the country contributed over one-fourth of the GDP of the country. By the end of FY2018-19, the share of agriculture decreased to below 14 percent of the GDP. The space left by agriculture, has been primarily occupied by the modern industrial sector. Share of industrial sector has increased from below 18 percent in FY1999-00, to 35 percent in FY2018-19 (Figure-4).

Figure 4: Share of Major Economic Sectors in GDP of Bangladesh over the Years

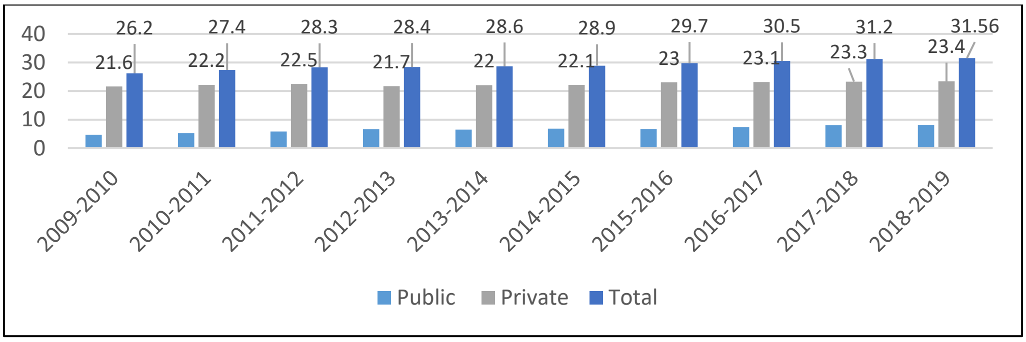


Source: *Bangladesh Economic Review 2019,* Ministry of Finance, Government of Bangladesh.

Over the last decade, consistent growth of investment has also helped macroeconomic transformation. Figure-5 shows the investment to GDP ratio for Bangladesh between FY 2009-10 and FY 2018-19. It shows that total investment to GDP ratio has increased from just over 26 percent to almost 32 percent during this period (an almost 6 percentage point increase). Private investment to GDP ratio has increased by only 1.8 percentage points (from 21.6 percent in FY 2009-10 to 23.4 percent in FY 2018-19). However, public investment to GDP ratio has increased by 3.5 percentage points. This implies that growth in the investment to GDP ratio for Bangladesh has been mainly driven by the public sector. Again, one should not undermine the complementary role which the Micro, Small and Medium Enterprises (MSMEs) have been playing in taking the growth trajectory upward.

Besides policy support given by a developmental central bank, most of the borrowers of tiny loans from MFIs have by now transformed into MSMEs for which the growth story of Bangladesh looks so robust and thriving, of course until very recently. However, it is encouraging to note that Bangladesh Government with the refinancing support of the central bank has come out with a number of stimulus packages focusing on agriculture, SMEs and informal unorganized sector to keep these small and medium entrepreneurs on the move. If well implemented these packages can certainly help the economy at the bottom of the pyramid not only afloat but as well as vibrant at the end of the day.

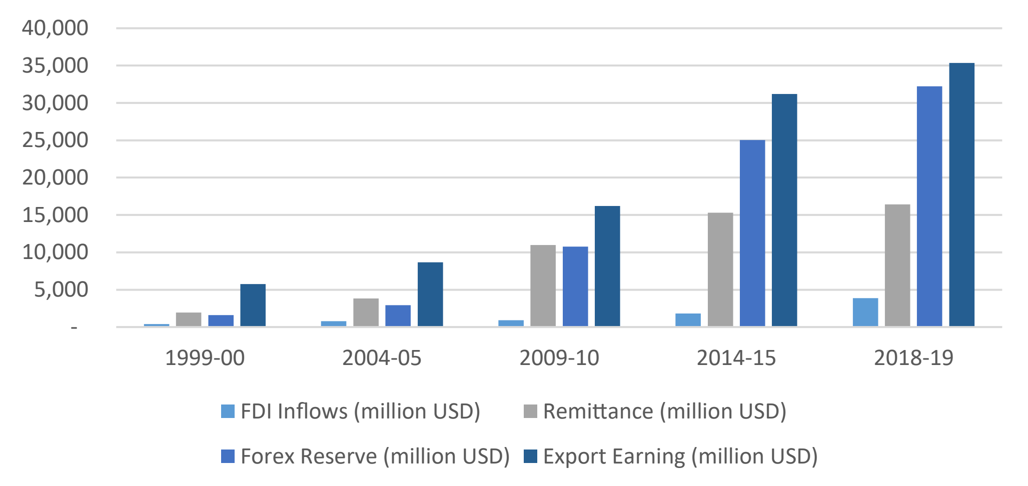
Figure 5: Investment to GDP Ratio (%) for Bangladesh (Public, Private and Total)



Source: *Bangladesh Economic Review 2019,* Ministry of Finance, Government of Bangladesh.

Over the last decade or so, the Government of Bangladesh has not only ensured bolstering of the growth process, but also emphasized on ensuring macroeconomic resilience. Review of performance in the external sector reveals that Bangladesh has been doing especially well in terms of FDI inflows, remittance flow, and stabilizing foreign exchange reserve and export earnings (Figure-6).

Figure 6: External Sector Performance of Bangladesh Economy between FY1999-00 and FY2018-19



Source: Bangladesh Bank

The figure above reveals that FDI inflows to Bangladesh was just USD 383 million in FY1999-00 which increased to almost USD 4 billion in FY2018-19. FDI inflows got a significant boost between FY2009-10 and FY20181-9. During this period FDI inflows more than quadrupled.

Remittance has been a pillar of Bangladesh economy over the last three decades. Between FY1999-00 and FY2018-19, remittance inflows increased from below USD 2 billion to over USD 16 billion. Over the last decade (between FY2009-10 and FY2018-19), remittance inflows increased by almost 1.5 times (Figure-6)

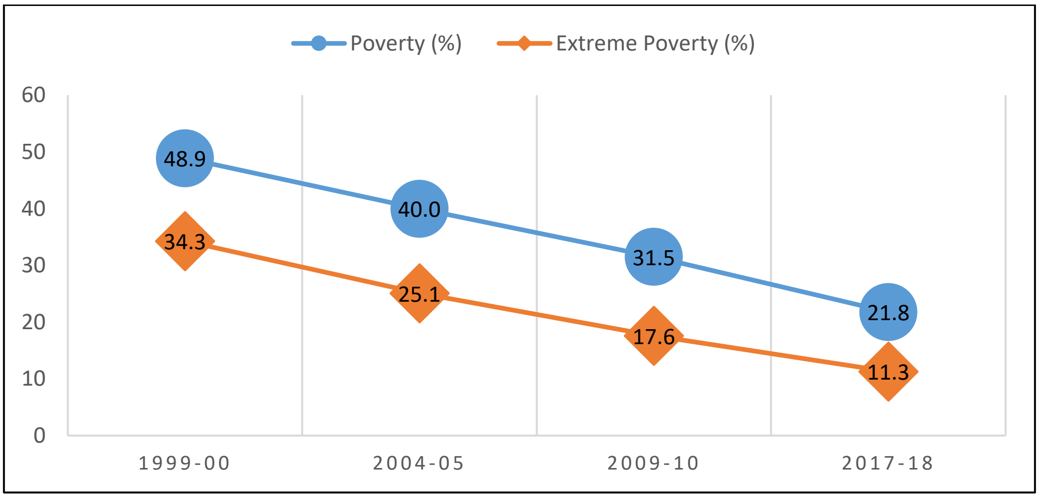
Recent Governments of Bangladesh have all emphasized on maintaining a healthy (and hence safe) foreign exchange reserve. Consequently, foreign exchange reserve has grown from just over USD 6 billion in 2008 to a staggering USD 32.2 billion in 2019. The prudent policy moves by Bangladesh Bank (central bank of Bangladesh) during the last decade helped bolster the foreign exchange reserve position of Bangladesh. As a result, the size of the reserve has almost quadrupled (Figure-6). However, huge current account imbalance during the last few years restrained the growth of the reserve as it was in the early years of the decade. Many experts called for speedy devaluation of local currency to remove this imbalance.

Finally, export earnings have also increased significantly over the last decade. The country earned over USD 5.8 billion through exports in FY1999-00. This increased by 181 percent and exceeded USD 16 billion in 2009-10. Due to increased emphasize from the part of the Government to export skilled and semi-skilled human resources abroad, this further increased and more than doubled by FY2018-19 (in that year the export earnings for Bangladesh stood at USD 35.3 billion). This stunning performance of the export sector in Bangladesh is likely to face a big blow due to recession in European and the US economies which constitute the bulk of the sources of its external demand. The Government of Bangladesh is aware of this challenge and has rightly extended its hand with robust stimulus package for the apparel industries.

While it has to be acknowledged that performance of Bangladesh economy in terms of bringing in more Foreign Direct Investment (FDI) could have been better, it must also be noted that the country has done remarkably well regarding enhancing export earnings and remittance inflows. And these have been reflected in the growth of foreign exchange reserve. It is based on this reserve the government has managed to take up gigantic development projects including the Padma Bridge. Despite some pressure originating from the recent imbalance of the balance of payment, this positive performance in external sector has certainly contributed towards enhancing resilience of the economy as well. This extraordinary strength of the external sector along with consistent on time debt repayment to all the financing partners has put Bangladesh in a much better position to access a significant amount of low-cost emergency and medium term funding support from the same sources in coping with the shortfall in resources needed for maintaining its healthy growth process.

While on the one hand, Bangladesh has gone through a process of robust growth, the prudent policies and programs of the Government have ensured inclusiveness of the growth process on the other. That is, the policy regime has focused on channeling the benefits of the growth especially towards the poor and marginalized to a large extent notwithstanding sharp growth in income inequality due to faster growth of 'super riches'. The consumption inequality remained stable during the last decade. Consequently, extreme poverty and poverty rates have declined dramatically over the years. Figure-7 shows that both extreme poverty and poverty rates in Bangladesh have decreased consistently over the recent decades. Bangladesh has managed to reduce extreme poverty from 34.3 percent in FY1999-00 to 11.3 percent in FY2017-18. Similarly, during the same period the share of people in poverty (i.e. those living below the upper poverty line) has also decreased from 48.9 percent to 21.8 percent. The figures have further gone down to 20.5 percent to 10.5 percent respectively in 2018-19, according to Bangladesh Bureau of Statistics.

Figure 7: Declining Poverty and Extreme Poverty Rates in Bangladesh



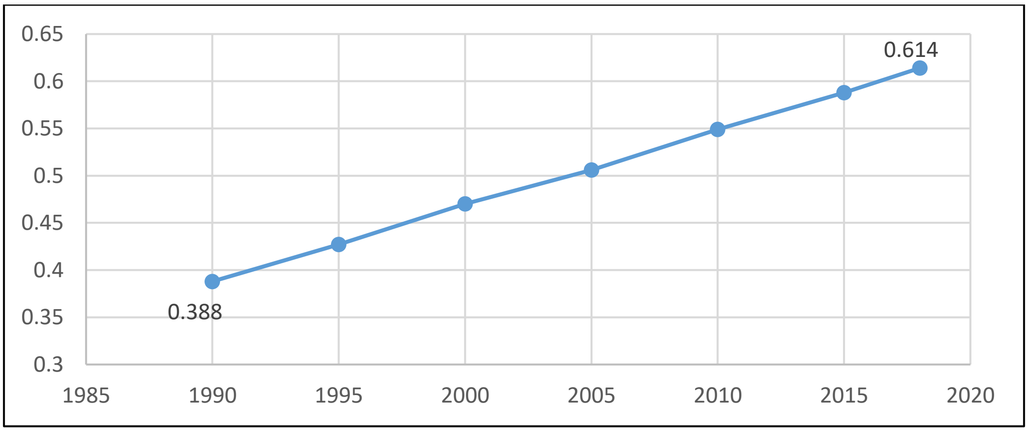
Source: *House hold Income and Expenditure Survey (HIES) 2016,* Bangladesh Bureau of Statistics (BBS).

Not only in terms of poverty reduction, has also Bangladesh surpassed many non-LDCs in terms of human development and gender indices. Bangladesh has indeed set a positive example for LDCs to emulate. Bangladesh, a medium Human Development country ranks 139 out of 188 countries (non-LDC countries like Kenya, Pakistan, Nigeria, Zimbabwe have much lower Human Development index). In terms of Social Progress index, Bangladesh ranks 101 out of 133 countries (Rahman, 2020).

However, much of these eye-catching gains in poverty reduction and human development may be washed away if the on-going pandemic is prolonged. In fact, the early signs of increase in new poor originating from the informal and services sectors are already visible in Bangladesh. The Government and NGOs are, of course, doing their best in terms of enhancement of various social protection supports, both cash and food, to tide over this unprecedented crisis. It is, however, quite premature to tell what will be the final picture as the pandemic is still raging in full force in Bangladesh, at least at the time of this report preparation.

Performance of Bangladesh in terms of human development is well reflected in the Human Development Index (HDI). The *Human Development Report 2019* by the United Nations Development Program (UNDP) shows that Bangladesh climbed up a spot to 135 among 189 countries (Molla, 2019). The report attributes the steady progress of Bangladesh to reduction in poverty along with gains in life expectancy, education and access to healthcare (UNDP, 2019). In fact, due to steady progress in terms of the said indicators HDI score of Bangladesh has been steadily increasing over the last three decades. Figure **8**-8 shows that HDI value for Bangladesh has increased from 0.388 in 1990 to 0.614 in 2020, a 58 percent increase in less than thirty years. During the said period, life expectancy at birth increased by 14.1 years (now 72.3 years) and expected years of schooling increased by 5.6 years (now 11.2 years).

Figure 8: Steady Increase of HDI Value for Bangladesh over the Last Three Decades



Source: UNDP Data, Retrieved from http://hdr.undp.org/en/countries/profiles/BGD

It is evident that the inclusive development strategy pursued by the Government of Bangladesh during the last decade has ensured a fair share of the benefits of growth for people from all walks of life. The process of development has been robust and humane at the same time.

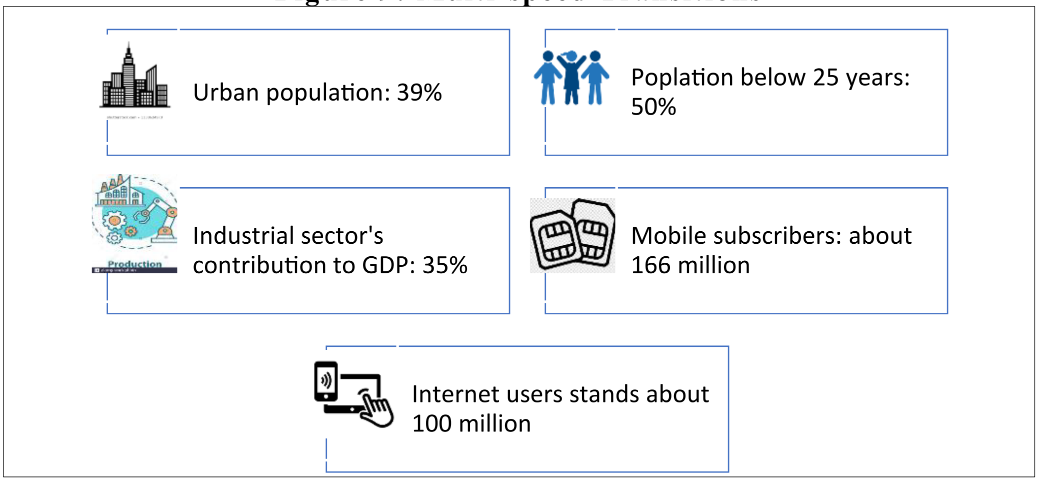
It must also be noted that despite these significant achievements in terms of economic and social development indicators, as already indicated income inequality in Bangladesh has slightly increased. Macroeconomic data from the Finance Division of the Government of Bangladesh reveals that income inequality coefficient has increased from 0.458 in 2010 to 0.483 in 2016. Yet, this slight increase in income inequality is not at all unnatural in a fast-growing economy. In fact, Bangladesh has set an example of moderating inequality while maintaining a very high growth rate. This is why Nobel Laureate economist and former Chief Economist of the World Bank, Paul Romer (2016) in his speech at the End Poverty Day event at Dhaka in October said- *"We know from the recent experience in Bangladesh that it is possible to have more growth and more equality. I am also convinced that it is possible to sustain a pattern of growth via equality as it evolves into a middle income country …"*

Indeed, despite some minor hiccups, and some geopolitical challenges including the influx of more than a million of displaced Rohingyas from neighboring country Myanmar, Bangladesh has managed to maintain a good pace of the positive macroeconomic transformation. And due to its sheer pace of growth and inclusiveness of the development process, Bangladesh today is globally being acknowledged as a role model of sustainable and inclusive development.

Despite such a spectacular performance in its growth and inclusivity outcomes, it remains to be seen what could be the possible scenarios in both short and long terms following Covid-19 crisis which has been ravaging the global economy and society. Surely, the COVID-19 macroeconomic landscape of the world including that of Bangladesh will be so different that we may not even imagine at this moment of time. If the pandemic is prolonged the Great Recession which this will initiate may be far deeper than the last global financial crisis and as well as the Great Depression of 1930s. The sectors like aviation, tourism and lifestyle industries may have to reboot their survival strategies in the ‘new normal’ world. The future of the globalized trade and industries based on deeply inter-connected supply and demand chains may have to think differently and re-strategize their ways forward. And all these will have significant impact on the contents of the monetary and fiscal policies which may have to further innovate to adjust to the ‘new normal’ world economy and society.

Apart from the impact of the global pandemic, there are a number of structural challenges originating from the multi-speed transitions which have been going on in Bangladesh, perhaps in many other developing countries as well, for quite some years and will continue to impact our economy and society. Among many we can focus on only four major transitions which have been taking place in Bangladesh.

Figure 9: Multi-speed Transitions



Source: Bangladesh Bureau of Statistics (BBS)

The above figure demonstrates how urbanization, industrialization, demographics and technology are interacting and synergizing our growth process despite many fallouts of these transitions. One of the biggest fallouts could be the immiserization of the urban poor most of whom are climate refugees and eke out their livings in many challenging and innovative ways. Devoid of well-organized social security system as is normally available in rural setting, these urban poor deserve better support from both public and private organizations for their sustainable livelihoods as they contribute hugely to the urban economy and society. In fact, financial inclusion, particularly mobile financial services and agent banking, is already playing an important role as one of the strategic tools to ensure smooth coordination of these transitions. And as we have already noted, the country has been witnessing stunning performance in terms of various macro-economic indicators. Let us now present some innovative measures taken in the financial sector for strengthening the process of financial inclusion.

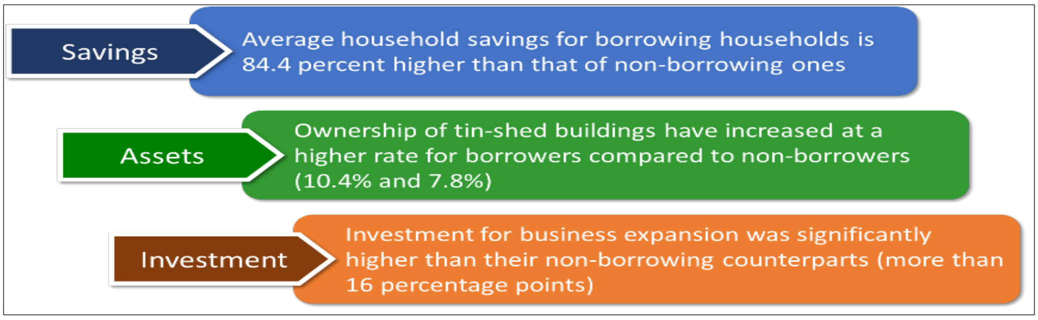
4. The Innovative Financial Inclusion Initiatives in Bangladesh

The central bank funding for refinance has been kept within reserve money growth permitted in Bangladesh Bank's (BB's) price stability focused monetary programs. Banks have been partnering with locally active Non-governmental Organizations (NGOs) and Microfinance Institutions (MFls) in reaching out to their new inclusion clientele bases. Until recently one particular BB project was using BRAC, a leading NGO-MFI, in extending agricultural financing to the sharecroppers. The beneficiaries were mostly women and the landless or marginal farmers with significant impact on human development including better education and health facilities to their children (Hamid *et al.,* 2017).

4.1 Contribution of MFIs in Promoting Entrepreneurship at the Bottom of the Pyramid

Microfinance has been contributing significantly in promoting financial inclusion in Bangladesh as it was the pioneer in reaching the unbanked and unserved while NGOs were making a transition from relief to developmental activities, first informally and then formally under the regulatory eyes of Micro-Credit Regulatory Authority with closer support of the central bank (Rashid, 2019). The central bank further bolstered injections of funds to the rural economy, in particular to develop agricultural sector, by encouraging banks to go for Bank-MFI linkage programs. At present, nearly a third of the total agricultural loans are given through such linkage programs. Disbursement of loans to MFI members by types of activities for the fiscal year 2017-18 clearly demonstrate the following outcomes (Figure-10):

Figure 10: Impact of MFIs on Savings, Asset Building Investment

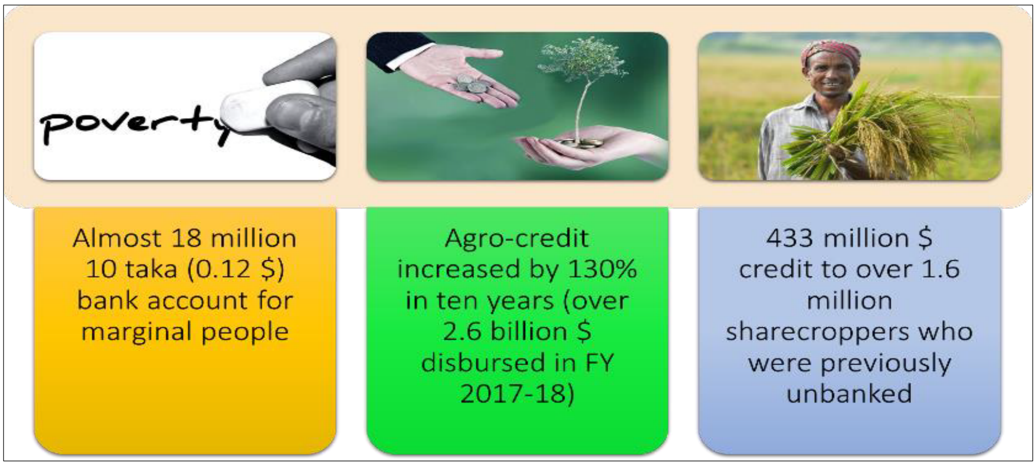


Source: Rahman and Kabir, 2018

4.2 Financing Real Economy: Reaching the Bottom of the Pyramid

Figure **11**-11 demonstrates how the central bank helped open more than 18 million Ten Taka accounts for the marginal people and provided credit to the farmers including the share-croppers.

Figure 11: Financing Real Economy: Reaching the Bottom of the Pyramid

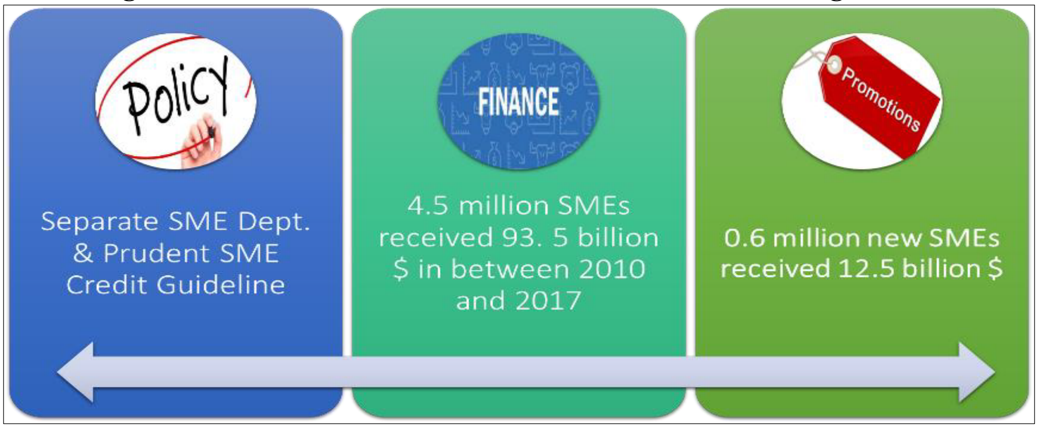


Source: Bangladesh Bank Website

4.3 Promoting SMEs

Bangladesh Bank created ample opportunities to finance alternative Income Generative Activities to promote SMEs (Figure-12):

Figure 12: Finance for Alternative IGAs: Promoting SMEs

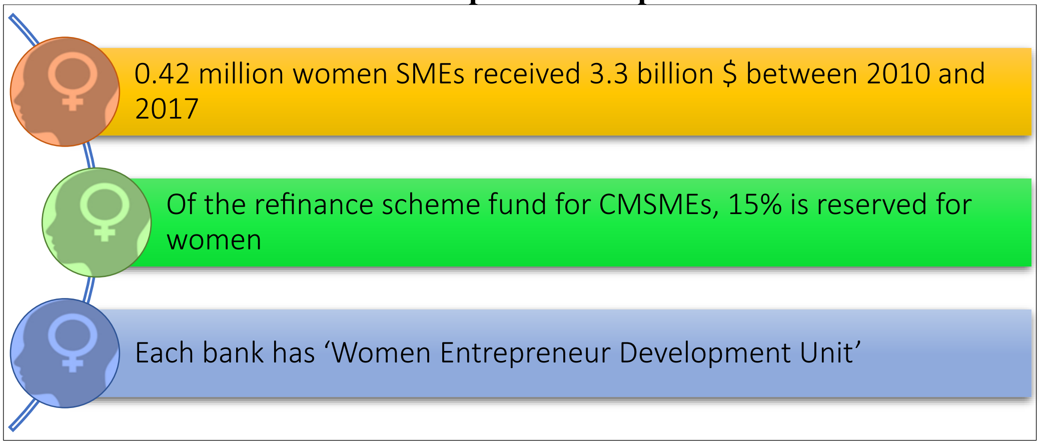


Source: Bangladesh Bank Website

4.4 Promoting Women Entrepreneurship

In order to ensure gender equality, Bangladesh Bank has been taking pro-active inclusive initiatives to promote women entrepreneurs who have been generally unbanked and unserved (Figure-13).

Figure 13: Ensuring Gender Equality: Promoting Women Entrepreneurship



Source: Bangladesh Bank Website

4.5 Digitizing Finance

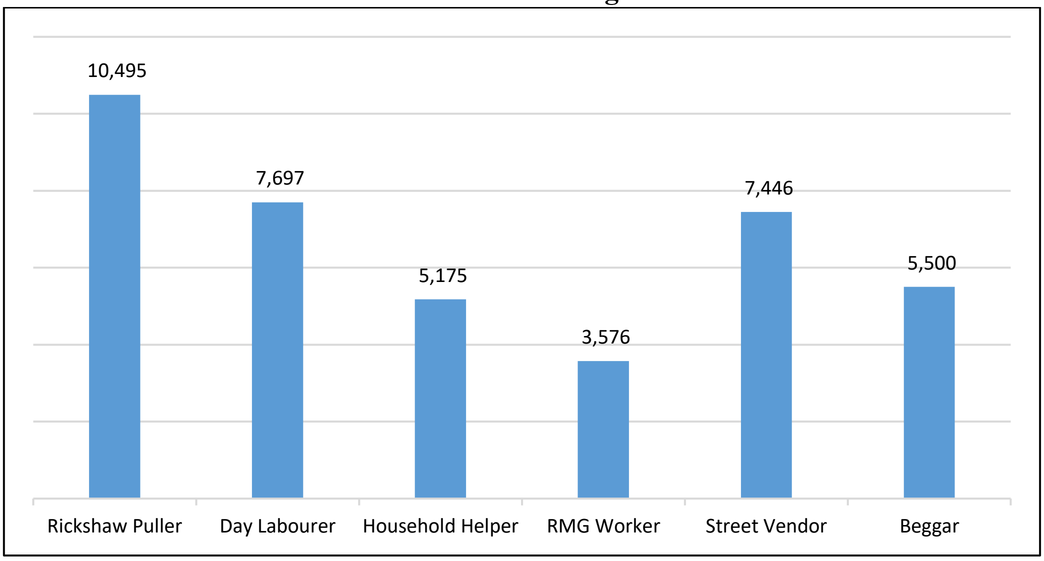
Bangladesh Bank has been promoting Mobile Financial Services and Agent Banking and has revolutionized financial inclusion by using ICT to serve the unserved and underserved (Figure-14).

Figure 14: Digitizing Finance: ICT for Serving the Unserved/Underserved

Source: Bangladesh Bank Website

A recent survey (on 200 respondents) conducted by the author to assess utilization of digital financial service by low income group households in Dhaka city has revealed (Figure-15).

Figure 15: Average Amount (BDT/month) Sent by Survey Respondents to Home/Village



Source: Survey by the author

A rickshaw-puller using mobile financial services sends, on an average, BDT 10,495 per month to his native village. Day-laborers and street vendors of

Dhaka city send over BDT 7, 000 per month. Even many of the beggars have been found to be sending BDT 5,500 per month to their families back home.

Of the same respondents, 48 percent found MFS to be the fastest transmission channel currently available to them. Twenty percent of the respondents reported they are now able to send money home more frequently (e.g. a rickshaw-puller sends money five times in a month).

Over 80 percent of the respondents reported they used to either carry the money home themselves or send it through a friend/relative travelling home, before Mobile Financial Service (MFS) was available/ accessible.

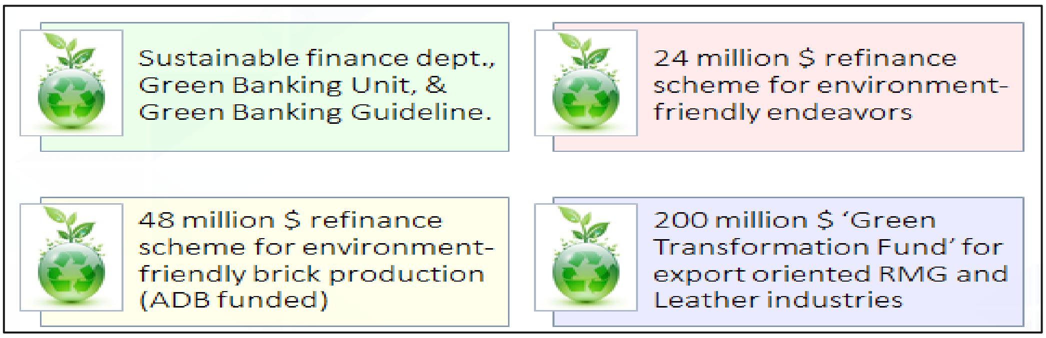
However, there is not adequate awareness about other facilities of MFS among the current users. For example, only 8 percent are aware of the payment (shopping, bill payment, etc.) facilities of MFS.

The point to be noted here is that these are very low-end customers who go to smaller shops without MFS facilities. In addition, the MFS have been very handy in providing leakage free salary to more than four million RMG workers and cash support to half a million vulnerable people to cope with the pandemic challenges. Other organizations as well as individuals have been transferring cash to the vulnerable segments of the population through this payment system. This has, indeed, been a smart response to the pandemic challenges.

4.6 Green Finance

Bangladesh Bank has pioneered green finance in the banking sector by greening the regulations and as well as providing refinance for sustainable production (Figure-16).

Figure 16: Green Finance: Environmentally Sustainable Production

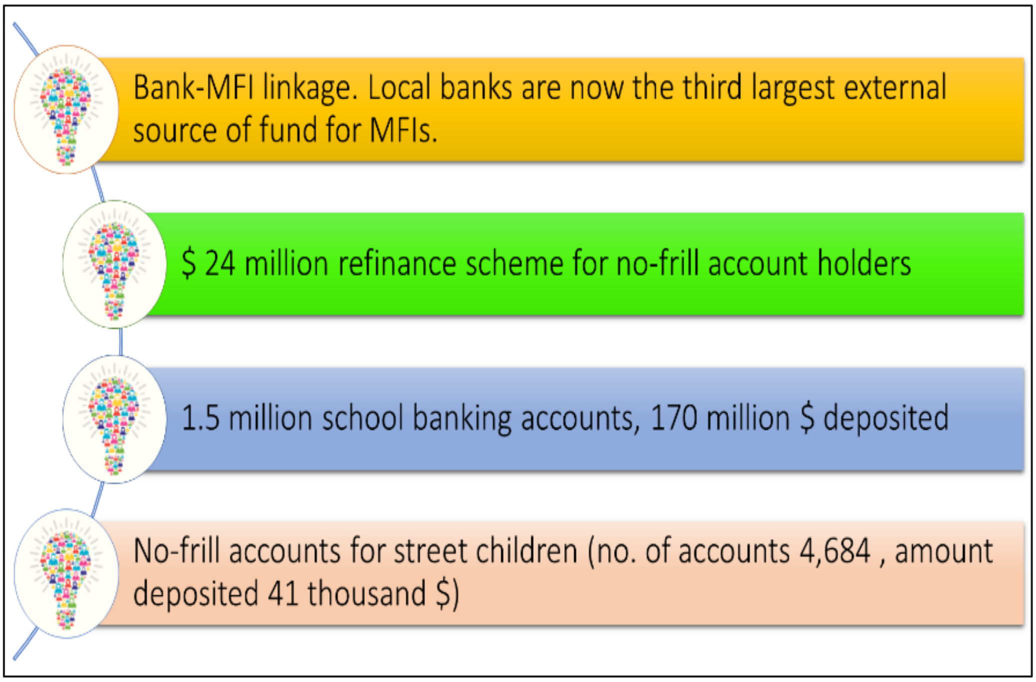


Source: Bangladesh Bank Website

4.7 Other Financial Inclusion Innovations

In addition, a number of innovative financial inclusion initiatives have been undertaken by Bangladesh Bank to reach the most disadvantaged segments of society (Figure-17).

Figure 17: Other Financial Inclusion Innovations



Source: Bangladesh Bank Website

Apparently a silent revolution has already taken place in Bangladesh through this drive of financial inclusion. The rising number of bank branches, particularly in the rural areas, ATM outlets, mobile agent outlets, mobile money accounts and mobile money transactions. Add to this the thriving Agent banking and sub-branching activities is making monetary transmission on one of the fastest in the recent history of Bangladesh. There has been 7 percent growth in bank branches per one-hundred thousand adults, 68 percent increase in the number of ATM outlets in addition to significant increase in green and SME finances including access to finance for the farmers. Even the share-croppers have been included in the process. Thanks to these financial inclusion initiatives of the central bank and the inclusive development strategy undertaken by the government Bangladesh has witnessed unprecedented output growth and price stability during the past decade. I am not sure if this stability can still be sustained following the corona crisis which has literally brought the global and local economy to a standstill. But the silver lining for Bangladesh remains due to the early gains of these financial inclusion and we may witness a faster recovery if we continue to push money into these initiatives which have always been touching the ground or for that matter real economy. Yet, one must not underestimate the huge challenges arising from the likely deceleration of the economy due to corona crisis in addition to the rising income inequality and overwhelming climate change. Given these perspectives including gains and challenges of the Bangladesh macroeconomic and microeconomic transformations let us now look at the mandate of Monetary Policy of Bangladesh Bank and how effective has been its journey towards developmental central banking in the recent path.

5. The Monetary Policy and Evolution of its Developmental Philosophy and Initiatives

Like many other central banks the core mandate of Bangladesh has been price stability while supporting growth of output and employment. However, it instituted a new emphasis on the quality of monetary implementation. As already indicated the monetary policy (along with the fiscal policy) prioritized inclusive, environmentally sustainable growth, thereby fostering medium-to long-term macro-financial stability and widening economic base. In fact, in response to the last global financial crisis Bangladesh Bank focused on experimentation and implementation, while being mindful of what monetary policy can and cannot do.

Reflecting local context and following the Global Financial Crisis in 2008, Bangladesh Bank (BB) embarked on ingraining a socially and environmentally responsible financing ethos, combing short-term business cycle fluctuation management with long-term sustainability agenda. As a part of this agenda BB focused on upgrading:

I. Technology and Market Infrastructure
II. Regulatory Framework
III. Refinancing Initiatives.

The goals were to i) improve monetary transmission channels; ii) to promote macro-financial stability risks through inclusion, regulation, and supervision; and iii) to induce directional bias towards more productive and sustainable activities.

5.1 Evolution of Monetary Policy Framework

BB conducted monetary policy during 1970s-'80s with direct control of interest rate, exchange rate and credit flows. The financial sector was primarily dominated by the public sector banks during this period except the entry of only a few of the private banks. The 1990s saw gradual liberalization of interest rates. 2000s witnessed market-based interest and exchange rates. Monetary Policy Statements (MPS) began to make inroad into the financial landscape to anchor inflation expectations. BB made a special move to introduce financial inclusion in MPS to support real economy including agriculture, SMEs and other productive activities. Broad-based stakeholder consultations were introduced before formulating MPS to make monetary policy more participatory.

5.2 Market Infrastructure Upgrade

In order to enhance the speed of monetary transmission, Bangladesh Bank prioritized laying the foundation of a digital infrastructure for connectivity, efficiency, and stability. The measures undertaken to upgrade the market infrastructure included:

i. Online Credit Information and Supervisory Reporting.
ii. Payment Systems including introduction of RTGS.
iii. Bangladesh Automated Clearing House (BACH).
iv. National Payment System (NPS).
v. Electronic Fund Transfer (EFT).
vi. Electronic Platform for the Bond Market.
vii. Mobile Financial Services (MFS).
viii. Agent Banking

5.3 Regulatory Upgrade

Bangladesh Bank began to nudge the domestic and foreign banks to serve the agriculture and agro-processing industries, women, youth, MSMEs through targeting regulatory support. It started declaring the agricultural credit policy for the banks with specific targets and providing incentives for better implementation of the same. It also promoted linkage programs creating a closer link between the banking industry and MFIs. As a special case, an exceptional refinance program was initiated to support the share-croppers or the tenant farmers directly from the central bank. BB also started supporting green enterprises and motivating banks to adhere to Economic, Social and Governance guidelines to make finance sustainable. Another special foreign exchange based program called 'Green Transformation Fund' was introduced to promote green factories, housing and other small and medium entrepreneurs. In addition, an inter-agency coordination committee chaired by the Governor of Bangladesh was created to address shadow-banking and other regulatory problems. The members of the committee included Bangladesh Bank, Bangladesh Securities and Exchange Commission, Microcredit Regulatory Authority, Ministry of Law and others.

5.4. Refinancing and Other Policy Support

A number of 'out of box' refinance windows were created to support agricultural, SME lending and green financing. This now has become a regular policy agenda of BB. In fact, this has been the major window of Bangladesh Bank in providing low-cost liquidity support to Banks, MFIs and other financial institutions to keep the economy moving forward during the Covid-19 crisis .The lending targets are intended to attain and uphold adequacy of lending in the supported sectors, not to create any credit surge in any sector. Macro prudential policy support for green financing include:

Good performance in sustainable financing earn better BB supervisory (CAMELS) rating.

Differential equity margin requirements.

Differential loan pricing and equity margin according to environmental risk grading.

No-frill accounts for farmers and the disadvantaged having access to specially designed refinance.

Market development agenda to support medium – to long-term financing, with assistance from the World Bank.

5.5 Motivation and Awareness Campaigns for Financial Inclusion

Effective communication for forward guidance by the central banks has been gaining ground all around the world. Bangladesh Bank made an early start and began to make monetary policy truly participatory. It really believes that monetary policy implementation encompasses more than just announcing targets. Frequent consultations with banks, financial institutions and other stakeholders' help regulators remain vigilant about what is happening in the market and change course in the middle of journey if warranted. Guidance circulars are now regularly issued on modalities and operations of the monetary policy. BB has been promoting financial literacy and consumer education programs to ensure necessary protection of customer interests. The campaigns contributed to:

- Sensitizing entire financial sector to serve the unserved and the underserved.
- Mainstreaming socially responsible financing ethos in the financial system.

5.6 Outcome

Besides the positive stability outcome in the real sector, the financial sector also remained stable until recently, well supported by inclusive financing. The depositor's base has been significantly diversified in terms of its base and geographical location. The digitization has reduced market segmentation and contributed significantly in increasing efficiency in the financial sector. The hope has been to conduct monetary policy not through 'helicoptering money" but more through "bullock-cart money" that touches and transform the ground. It may not be unwise to continue to promote this inclusive monetary policy even in this challenging time of deeper recession further accentuated by the global pandemic. However, one should not underestimate the challenges ahead as we move on to implement various elements of the innovative monetary policy.

6. The Challenges Ahead

As the bottom-up initiatives mature and bear fruit, we need to shift from the current money-stock-based targeting towards a market- interest- rate based targeting. Promoting inclusive, environmentally sustainable financing needs to complement, not substitute, the core price stabilization objective of the monetary policy. Continuous attention is needed to reduce Non-Performing Loans (NPLs) that hinder monetary transmission channels. Digitization needs to be strategically leveraged and managed to increase efficiency, market gaps, and price discovery. Central bank autonomy remains key for monetary policy credibility. Unfortunately, the autonomy gained by the central banks throughout the world have come under attack from the fiscal end creating huge credibility gave of the monetary policy. This is even more disheartening at a time when the whole world economy is going through the biggest challenge of the century originating from the invisible enemy called Covid-19 with huge implications for the economy and society.

7. Conclusion

Bangladesh has so far been doing exceptionally well in terms of sustaining continuous growth for more than a decade. It is now a new member of the 7 percent plus growth club. However, the global recession which has already been looming large and accentuated by corona crisis is bound to create hurdles against its vibrant growth trajectory. So, Bangladesh needs to complement its export-led growth model with bolstering domestic demand strategy. In fact, Bangladesh weathered pretty well the last global financial crisis by adopting this strategy. This time too, monetary policy innovations will have to play an important role in navigating shocks in a more integrated economy.

References

Bangladesh Bank (2019), All Publications, Retrieved from https://bb.org.bd/pub/puball.php.

BBS (2016), *Household Income and Expenditure Survey (HIES) 2016*, Bangladesh Bureau of Statistics (BBS), Dhaka.

Hamid, Abdul *et al.* (2017), “Impact Assessment of Credit Program for sharecropping in FY16 Implemented by BRAC under Refinancing Scheme of Bangladesh Bank,” *Special Research Work,* Research Division, Bangladesh.

Lagarde, Christine (2019), “The Financial Sector: Redefining a Broader Sense of Purpose”, *32nd World Traders’ Tacitus Lecture,* London, UK.

MoF (2019), *Bangladesh Economic Review 2019,* Ministry of Finance (Mof), Government of Bangladesh (GoB).

Rahman, A (2020), "Ethics in Banking: Interfacing Financial Inclusion for Socially Responsible Development, Nineteenth Nurul Matin Memorial Lecture on Ethics in Banking (2020)". Bangladesh Institute of Bank Management (BIBM), Dhaka, Bangladesh.

Rahman, A. and Kabir, M. (2019) "Impact Assessment of Financial Inclusion through MFIs in Bangladesh." Shamunnay and CDF, Dhaka, Bangladesh

Rashid, Lila (2019), *Institutionalizing Microfinance in Bangladesh Players, Games & Outcomes,* University Press Limited, Dhaka.

Rajan, Raghuram G. (2019), *The Third Pillar: How: How Markets and the State Level the Community Behind*, Harper Collins Publishers India.

Romer, P. (2016). "To End Poverty, Give Everyone the Chance to Learn". Speech on the Occasion of End Poverty Day Event at Dhaka, October, Bangladesh. Retrieved from: https://www.worldbank.org/en/news/speech/2016/10/17/to-end-poverty-give-everyone-the-chance-to-learn

Riaz, Ali (2020), “Covid-19; The Era of Perpetual Emergency and the Emerging New Normal?” The Daily Star, March 25.

UNEP (2015), “Inquiry: Design of a Sustainable Financial System-The Financial System We Need: Aligning the Financial System with Sustainable Development”, *The UNEP Inquiry Report.*

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp. 69-85)

Effective Partnership for Implementation of 8th Five Year Plan towards Achieving SDGs

- Shamsul Alam*

In a fractured and divided world, building partnership within and across nations is becoming increasingly more vital. Achieving Sustainable Development Goals (SDGs) requires effective partnership between the governments, private sectors, development partners, Non-Government Organizations (NGOs), academics and professional bodies. SDG 17, which is to "strengthen the means of implementation and revitalize the global partnership for sustainable development," articulates the need for multi stakeholder partnership for mobilizing resources, transferring technology and sharing knowledge to fully materialize the agenda 2030. Initially, implementation of SDGs depends on how effectively it is integrated into national policy cycle (Okitasari *et al.,* 2018). Bangladesh well integrated Agenda 2030 into the national development plan at the early stage firstly because the 7th five year plan period (2016-2020) coincided with the initial period of SDGs (2015-2030); secondly political leaders were passionate about SDGs, underpinned by the success in regards to MDGs. The implementation period of 7th plan is about to end in June 2020 and the new 8th plan will start from July 2020. The 8th plan will take the second Perspective Plan 2021-2041 and the election manifesto of the ruling Awami League as the guiding principles while the SDGs will remain an integral part.

Given the backdrop, the Perspective Plan 2021-2041 has come at a time when Bangladesh has made significant strides in economic and social development. Over the last decade, Bangladesh has been one of the fastest growing economies with an average growth rate of 6.75 percent, reflecting the prospect of Bangladesh being an upper middle income economy by 2030. One

---

*Dr. Shamsul Alam has been serving the Bangladesh Planning Commission as a Member (Senior Secretary), General Economics Division since 2009. He obtained his Ph.D. in Economics from Newcastle University, United Kingdom. Views expressed in this article are the author's own.

of the core objectives of the first perspective plan 2021 was for the country to become a middle income economy by 2021, which was achieved in 2015. Another milestone that has been attained with much celebration across the country is the eligibility of its graduation from Least Developed Country (LDC) status to a developing country. With these achievements, Bangladesh now aspires to be an upper middle income country by 2031 and prosperous country by 2041. The other strategic goals that are of critical importance include eradicating extreme poverty, cutting moderate poverty down to single digit by 2030, industrialization with export oriented manufacturing, efficient energy and infrastructure to support rapid and sustained growth, and building a resilient nation. The challenges ahead seem to be daunting and the country has to undergo a massive transformation through institutional reforms, by improving productivity business competitiveness over the next two decades. It is understood that the transformation will not be easy. To overcome the challenges, the first and foremost requisite is political commitment and macroeconomic stability.

The present government with the visionary leadership of Prime Minister Sheikh Hasina has been successfully running the country for three consecutive terms and has laid the foundation for future prosperity. During this period, the poverty rate came down to 20.5 percent in 2019 from 31.5 percent in 2010 and extreme poverty to 10.5 percent from 17.6 in 2010. The improvement in social sector, particularly in reducing maternal mortality, under-five mortality, child mortality, stunting and wasting and increasing life expectancy at birth, adult literacy rate, access to water and sanitation, gender parity index, empowering women has been remarkable. Along with continued and scaled up investment in social sector, the government is now set to drive the economy up to a new level by investing heavily in mega infrastructures and establishing economic zones for foreign direct investment. Mega projects that are under implementation include the construction of the Padma Bridge, Dhaka Mass Transit, Payra Deep Sea Port, Rooppur Nuclear Power Plant and Matarbari power plant, Chattogram-Cox's Bazar Rail Link which, once completed will transform the economy, boosting it by at least two percent.

With these initiatives given the highest importance, Bangladesh now looks into moving forward beyond SDGs. In 2041, the country will celebrate its platinum jubilee of independence. In that year, Bangladesh expects to join the developed countries' club. Vision 2041, which spells out the modalities of reaching the milestone, will be achieved in phases. The first phase of implementation will be accomplished through the 8th five-year plan. The plan will broadly take into account two things – firstly, graduation from LDC status by 2024 and secondly, achieving Agenda 2030. The following is the projection of moderate and extreme poverty based on the growth elasticity during the 8th Five Year Plan Period.

Table 1: Poverty Projections over the 8th Plan Period

	FY21	**FY22**	**FY23**	**FY24**	**FY25**
Moderate Poverty (Ratio)	17.27	15.84	14.52	13.31	12.17
Extreme Poverty (Ratio)	8.37	7.46	6.65	5.91	5.28

Source: *8th Five Year Plan Projection,* General Economic Division (GED)

The core theme of the eighth plan is "Promoting Prosperity Fostering Inclusiveness". After all, the ultimate objective of the Father of Nation Bangabandhu Sheikh Mujibur Rahman was to transform Bangladesh into a happy and prosperous nation which will be built as a welfare state where everyone can have a decent standard of living and enjoy the social, economic, political, cultural and human rights. The major vision and objectives of the eight plan include building infrastructure similar to those built by upper middle income economies, reducing moderate poverty to 12.17 percent and extreme poverty to 5.28 percent, graduating from LDC to a developing country by 2024 and achieving the major targets of SDGs – particularly those that entail leaving no one behind. To achieve the development vision by the 8th five-year plan period, the government must resort to collective action where the private sector will take the leading role. A large part of the underlying partnership will come through in the form of investment and trade through North-South, South-South, regional and international cooperation. Such investment is expected to have spillover effect in the areas of science, technology and innovation. There are two parts of implementing the plan – one is the hard part, that is investment in infrastructure, education, health, poverty reduction – those that generally entail a sizable cost – while the other is the soft part – which basically involves the capacity of institutions, reforms in the functionality of administrative, legal, judicial, social, economic and political institutions that requires a relatively small cost but can make huge impact on development.

Rapid Rural Transformation: One of the major themes of the ruling party's election manifesto for the 2019 Election was 'My Village-My Town' – which envisages extending modern civic amenities to every village – in other words, rapid rural transformation. The next decade will be marked by rapid and massive transformation in rural Bangladesh in terms of information, communication and technology, transport facilities, modernization of agriculture, health care and education facilities, infrastructure, financial inclusion, entrepreneurship, domestic consumption, training and capacity building.

To bring about a radical transformation in rural areas, measures will be taken in promoting modern agriculture practices as a base of commercial agriculture providing rural electrification; improving education and health services; and encouraging development of micro, small and medium enterprises and other industries. The plan will highlight the efforts to provide every village with facilities of modern town, including developed infrastructure, safe and improved drinking water and sanitation, electricity supply, establishing growth centers with modern amenities, agricultural products storage facilities, access to loans and the training to rural youths. Partnership will be needed between the government and private sector in entrepreneurship development, between the government, NGOs, and Development Partners in investing in human capital – health, education, sanitation, women empowerment, poverty reduction, microfinance, and even between different government agencies – in synergizing impact of government intervention.

The next issue is the "young generation: power of youth, prosperity of Bangladesh" – implying the utilization of youth in transforming the country to upper middle-income status by 2031. From the perspective of governance, the government has adopted the policy of "zero tolerance" against corruption. The 8th plan is expected to be drafted by February for which background papers and inputs from Ministries are being compiled. The following are the proposed strategies for the 8th plan, stated in the concept note.

Boosting Saving Investment: While public investment surpassed the target in consecutive years, private investment fell behind, which downsized overall investment compared to GDP. The target of double-digit growth is largely dependent on the amount of private investment. The country has considerable scope in improving ease of doing business, creating an enabling environment for investment and enhancing business competitiveness. The targeted sustained higher growth demands effective partnership between Governments to Government, and Government and Business in scaling up investment, technology transfer, capacity building and facilitating trade. Estimates say overall investment of 77,418 billion BDT will be required during the plan period, of which the private sector will contribute 75 percent and the rest will be done by the government.

Table 2: Projection of Investment in the 8th Plan Period

Fiscal Year	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**
	(As % of GDP)					
Gross National Savings	30.8	31.8	32.9	33.9	35.0	36.2
Gross Investment	32.8	33.6	34.5	35.3	36.2	37.2
Public Investment	8.2	8.4	8.5	8.7	8.9	9.0
Private Investment	24.5	25.2	25.9	26.6	27.3	28.2
Foreign Direct Investment (FDI)	1.0	1.2	1.4	1.6	1.8	2.0
Domestic Investment	23.5	24.0	24.5	25.0	25.5	26.2
Investment (in Billion Taka)	9580	11171	13038	15134	17581	20494
Public	2401	2786	3227	3732	4308	4968
Private	7178	8385	9811	11402	13272	15526

Source: *Macroeconomic Framework*, 8th Five Year Plan Projection

Harnessing the Potentials of the Young Generation: The prosperity of Bangladesh will rely heavily on how effectively the youth can deliver their leadership and action to the nation. They must be well equipped with quality education, skill and employment, and good physical and mental health. A large portion of youth is not registered in education, employment or training. One of the major challenges of the coming years will be to create employment opportunities for them, to provide training and skills that match the market demand and, most importantly, build entrepreneurship which will have multiple impacts on poverty, employment and growth. The projection for employment over the plan period is as follows:

Table 3: Projection for Employment in the 8th Plan Period

	FY21	FY22	FY23	FY24	FY25
Labor Force (Total in Million)	67.1	68.8	70.5	72.3	74.1
Labor Force Growth (%)	2.3	2.3	2.3	2.3	2.3
Overseas Employment	0.6	0.6	0.6	0.6	0.6
Employment Growth Rate (%)	2.3	2.3	2.3	2.3	2.3
Job Creation (Domestic)	1.4	1.5	1.5	1.5	1.6
Job Creation (Overall)	2.0	2.1	2.1	2.1	2.2
Unemployment Rate (%)	3.1	3.1	3.1	3.1	3.1
GDP Growth Rate (%)	8.23	8.29	8.32	8.37	8.51

Source: *Macroeconomic Framework*, 8th Five Year Plan Projection

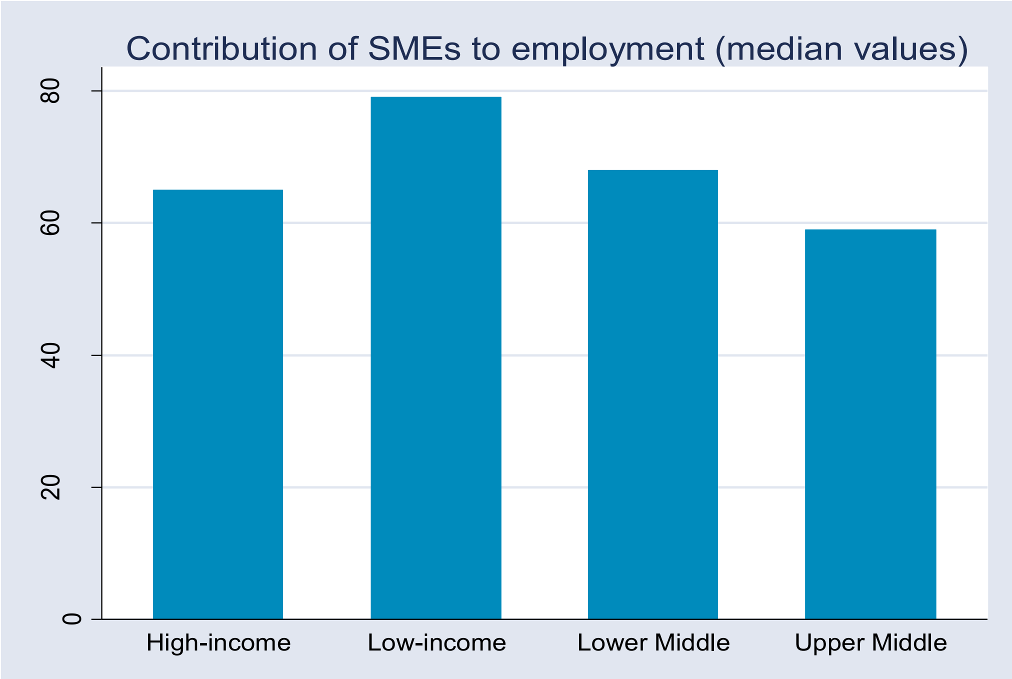
Cooperation will be needed between the government and the private sector and it should be such that the government creates a conducive environment that will provide incentives to the private sector in generating large scale employment. Foreign Direct Investment through G2G and B2B mainly from G-77, coupled with large scale investment in mega infrastructure through Public Private Partnership (PPP) is also expected to contribute to overall employment.

***Consolidating Effort for Revenue Mobilization*:** A 40 percent investment GDP ratio will substantially require a massive drive to enhance the revenue base which can eventually be used for public investment. In the seventh plan period, despite reform measures, the progress has been below satisfactory level. More generally, investment in health, education and social protection largely unmet which actually constrained by the size of the government revenue. The Eighth plan will put more emphasis on reform measures to address the gap between the target and the actual result. The role of the government will be crucial in this part as it involves massive changes across institutions engaging in revenue collection and law enforcement. Most importantly the mindset of the mass people which will have to be transformed as well which can be done through an awareness raising campaign.

Big Push for Rapid Implementation of Mega Infrastructures: As the government is pledged to a fast implementation of mega projects, the undertaking will be accelerated during the eighth plan period. These are supposed to speed up economic activities and economic zones will be instrumental in attracting foreign investment. The country still needs a sizable level of investment in infrastructure which similar to that made in middle-income economies. PPP can play a critical role in financing large infrastructure projects apart from arranging soft loan from multilateral organizations.

Supporting SME Development: Recognizing the fact that Bangladesh is one of the labour surplus countries, and it has no highly productive capital-intensive sector that can absorb labor, however the relatively low productive sector can nevertheless employs a large number of labor force. Therefore, SMEs have greater scope in terms of employment and growth. According to a World Bank Survey, in emerging markets solely, formal SME contributes up to 45 percent of total employment and up to 33 percent of Gross Domestic Product (GDP). The contribution of SME to employment in lower middle income economy is estimated to be around 68 percent (Edinburgh Group, 2012).

Figure 1: Contribution of SMEs to Employment (Median Values)



Source: *Growing the Global Economy through SMEs, 2012*

High labor intensity of SMEs also means low capital cost for employment than large firms. The Eighth Plan will seek to drive SME sector through supportive environment and policy incentive to private sector and through effective partnership with it.

Eradicating Poverty and Reducing Regional Disparity: Bangladesh has achieved tremendous success in reducing poverty. Now it is time to look more at micro level – that is, the poverty pocket from disaggregated data. As per its commitment to SDGs, the government intends to focus on a multidimensional poverty measure which has become a trend across developing countries. The objective is clear and it is to help enable more targeted programmes and policies to ensure that the most vulnerable and the most disadvantaged are not left behind. The 8th five-year plan will continue the renewed emphasis on minimizing regional disparity through not just social safety-net but scaling up investment in health, education, physical infrastructure, and establishing economic zones in regions lagging behind.

Promoting Modern and Sustainable Agriculture for Nutrition for All: Agriculture still comprises 40 percent of total employment despite its diminishing contribution to GDP. Bangladesh has achieved self-sufficiency in rice production. The challenges in the coming years will be to ensure food security, food safety, nutrition and the sustainability of agricultural production in the midst of climatic risks. The Plan will address the gap in issues related to nutrition, food security, production sustainability and the impact of climate change on agriculture. This will need cooperation from development partners, NGOs, the private sector and government agencies – particularly the Ministry of Agriculture, Ministry of Food, and Ministry of Water Resources.

Focusing on Quality Education: Achieving SDGs requires more focus on quality rather than quantity. In the education sector, our achievement is literally limited to gender parity in primary and secondary education and adult literacy rate in the 7th plan period. A number of measures and reforms will be explored to enhance quality education apart from the continuing strategy undertaken in the 7th plan. Quality education is something that the government has big responsibility for but needs utmost support from academia, development partners and NGOs. There is still scope for improvement in completion of higher secondary school, increasing participation in tertiary education, and technical and vocational education particularly for girls, which will eventually reduce early marriage and improve reproductive health of women.

Ensuring Power and Energy Security: Energy will be the driving force for future Bangladesh. The government has undertaken major steps in ensuring uninterrupted supply of power to the households and for use in agriculture and industry. These measures include increased installed generation capacity, expanded transmission and distribution network, reduced system loss, increased coverage of electricity and renewable energy share, and initiation of cross border trade among Bangladesh-India-Nepal (BIN) network. The 8th plan will take further steps to ensure energy security through construction of transmission lines, exploration of oil and gas from the Bay of Bengal, establishment of energy hubs in Maheshkhali and Payra, distribution of LNG gas, constitution of cross border pipeline and prudent use of coal resource among others, that will also need cooperation with neighboring countries. The Ministry of Foreign Affairs (MoFA) has the biggest role to play in exploring potential agreements with neighbors, which can serve low cost energy.

Ensuring Quality Health Care: The government has pledged to ensure basic health care and sufficient nutrition services to all for better quality life. Although, life expectancy has reached 72.3 years, other health indicators – such as maternal and neonatal mortality and skilled attendant assisted birth have been of concern in recent times. Despite continued increase in health expenditure in national budget, per capita health expenditure and out of the pocket expenditure are comparatively high. The 8^{th} plan will seek to strengthen the effort of the government in making health and nutrition services for all and health services free of cost for person below one year and above 65, introducing of modern technology, increasing the number of doctors, improving the quality of health services, and ensuring availability of medical persons in the rural areas. Partnership between the government and NGOs will be enhanced in the area of primary health care services, raising awareness, vaccination, and preventing both communicable and non-communicable diseases.

***Empowering Ethnic Minorities, the Marginalized and the Disabilities*:** The impulse of SDGs – "leave no one behind" becomes reality if the government can empower the most disadvantaged. With regard to children from small ethnic communities, dalits and the disabilities, quota and facilities in education and job should be maintained in the coming years. Development partners, NGOs and multilateral organizations should come forward for raising their living standard through investment in health, education, skill learning, training and capacity building.

Encouraging Women Empowerment: Bangladesh has gained global acclaim for advancing women empowerment, particularly ensuring female representatives in National Parliament and creating opportunities for female participation in education. However, women are still subject to sexual violence inside and outside homes. The government will follow a zero-tolerance policy against rape, sexual harassment, abuse, and human trafficking. Creating suitable environment for women at work place and encouraging female labour participation will be promoted so that more women can enter in the economic activities (Women's participation in labour force is 36.3%). Women empowerment is a long and continuous process that will require intervention in every aspect of development. No single approach is enough and thus it needs a concerted effort from all. If women's participation in labour force could be increased to 45 percent, this alone could add 2 percentage points more to GDP growth.

Managing Urban Transformation: The strategy for urbanization in the 8th plan will focus on polycentric decentralized development; better utilization of land resources; mitigating increased demand for housing and urban services; protecting, preserving and improving the urban environment, particularly the water bodies; involving public and private agencies and strengthening coordination among urban service providers. Execution of these strategies must be made through coordination and cooperation of respective government agencies and the private sector.

Tackling Climate Change, Managing Disaster and Protecting Environment: Climate Change is already taking a toll on millions of people in Bangladesh by affecting their livelihood, agriculture, and infrastructure. In the eighth plan, in compliance to Bangladesh Delta Plan 2100, fund will be mobilized to undertake more programs in climate change adaptation and mitigation. The area of productive forest will be increased to 20% while adoption of clean air law, zero emissions of industrial waste, recovery and protection of water bodies, marshy lands, and expansion of green coastal belt will be undertaken. While the government must provide regulatory framework, the private sector will be forced to comply with the regulations. Financing for climate change will be sourced from global multilateral organizations and entities that work bilaterally.

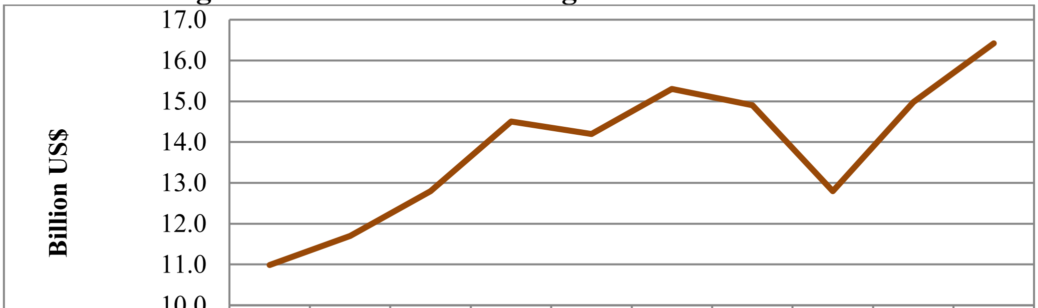
Eradicating Corruption, Making Accountable Administration, and Ensuring Good Governance: The government has adopted a zero tolerance policy against corruption. Besides political, social and institutional improvement, collaboration will be developed on both the supply side (government agencies) and demand side (citizens). The vision of a developed country will be realized when citizen gets whatever services they need in an easy, efficient and timely manner. Essentially, ICT will be instrumental to ensure transparency and accountability in the delivery of service of public servants and law enforcing agencies.

***Empowering Local Government and Decentralization*:** The 8th plan will underscore the process of decentralization with the theme of "My village-My Town", in which the role of the local government will be pivotal in transforming the lives of rural people. The Union Parishad, Upazila Parishad, Zilla Parishad, Municipalities and City Corporation will further be strengthened. Local governments will need additional fund for local infrastructure development and maintenance which can be supported by development partners and multilateral organizations.

Recent Progress in Partnerships for the Goals

Since the adoption of the SDGs, the government has been escalating its efforts, reviewing progress and engaging stakeholders including the private sector, development partners and NGOs to accelerate the action. The government estimates that almost 928 billion US$ additional resources will be required to implement the SDGs in our country by 2030, an amount which cannot be sourced domestically in its (GED, 2017). In our country context, remittance plays a considerable role in increasing domestic consumption, supporting entrepreneurship and accelerating poverty reduction. Bangladesh entirely has continued to receive higher remittances during the last decade despite slowdown in fiscal year 2016 and 2017. The agenda 2030 identifies five main areas of partnership, of which the following are of concern – finance (ODA, FDI), technology and capacity building. With respect to domestic financing, Value Added Tax and Supplementary Duty Act, 2012 is in effect from July 2019. The government intends to collect 50 percent of the total NBR tax revenue from income tax by FY2021-22 and raise Tax-GDP ratio to 15 percent by 2021 from 11.42 percent in FY2018-19. The idea of the government is to increase tax revenue by broadening the tax base without raising tax rate. Electronic Fiscal Devices will be set up in every business organization and income tax department will be expanded up to Upazila level.

Figure 2: Remittance Earning over the Last Decade

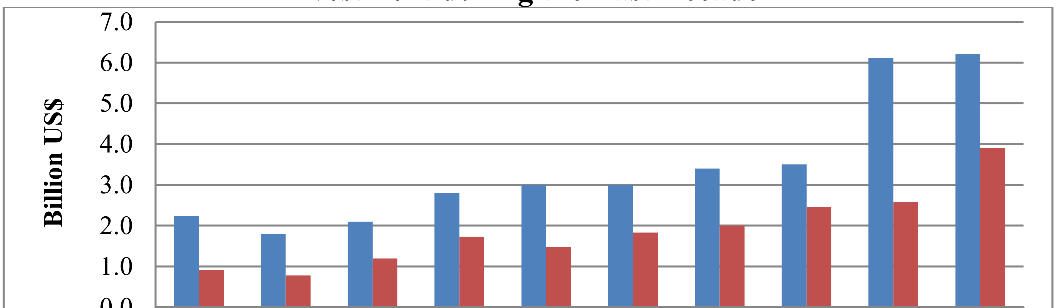


	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Remittance	11.0	11.7	12.8	14.5	14.2	15.3	14.9	12.8	14.98	16.42

Source: Ministry of Finance, Government of Bangladesh.

One of the targets of the SDG 17 is to provide 0.7 per cent of ODA/GNI to developing countries and 0.15 to 0.20 per cent of ODA/GNI to the least developed countries. ODA gained momentum in the last two fiscal years largely due to influx of Rohinga refugees, which is expected to decline gradually after Bangladeshi's graduation from LDC status. In recent times, private investment has not gone the way as it was expected. To boost private investment, the government plans and to facilitate single digit interest rate for all loans from April 2020. Not only this, the government now also aims to attract a large chunk of FDI through improving competitiveness, and establishing one stop services for business, tax incentives and special economic zones.

Figure 3: Official Development Assistance (ODA) and Foreign Direct Investment during the Last Decade



	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
ODA	2.2	1.8	2.1	2.8	3	3	3.4	3.5	6.1	6.2
FDI	0.9	0.8	1.2	1.7	1.5	1.8	2.0	2.5	2.6	3.9

Source: Ministry of Finance, Government of Bangladesh

Both ODA and FDI surged in the last couple of years, which is expected to continue if macroeconomic stability prevails.

The major responsibility of the government will be to consolidate revenue generation to carry out the programs to be outlined in the plan as well as continue raising public investment. Tax efforts may lead to a further 2 or 3 percent increase of GDP through invoking appropriate reforms including the policy of progressive taxation. The next thing the government will focus on is improving governance by driving out corruption, eliminating rent seeking and enforcing a zero tolerance policy.

To achieve double digit growth, FDI will be used as a tool for which the government is on the way to establish 100 economic zones to attract investment from both developed and developing countries. The government will continue to improve business competitiveness and ease of doing business while scaling up investment in mega infrastructure, poverty reduction and health and education with a primary focus on technical and vocational education.

The government will ensure transparency, accountability and efficiency of the development expenditure, besides implementing a national social security strategy to ensure that no one is left behind.

Table 4: Fiscal Operation of the Government, FY2020-2025

Fiscal Year	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**
Fiscal Sector Indicators	**Projections**					
Revenue and Grants	**10.75**	**11.85**	**13.06**	**14.19**	**15.26**	**16.35**
Total Revenue	**10.60**	**11.70**	**12.92**	**14.05**	**15.12**	**16.21**
Tax Revenue	9.30	10.20	11.20	12.20	13.20	14.20
NBR Tax Revenue	8.90	9.80	10.80	11.80	12.80	13.80
Non-NBR Tax Revenue	0.40	0.40	0.40	0.40	0.40	0.40
Non-Tax Revenue	1.30	1.5	1.72	1.85	1.92	2.01
Grants	**0.15**	**0.145**	**0.14**	**0.138**	**0.136**	**0.135**
Total Expenditure	**15.57**	**16.75**	**18.06**	**19.30**	**20.40**	**21.52**
Non-Development Expenditure including Net Lending	**9.42**	**10.02**	**11.18**	**12.30**	**13.35**	**14.42**
Non-Development Expenditure	**9.22**	**9.82**	**10.98**	**12.10**	**13.15**	**14.22**
Revenue Expenditure	8.50	9.12	10.30	11.44	12.51	13.60
Capital Expenditure	0.72	0.70	0.68	0.66	0.64	0.62
Net Lending	**0.20**	**0.20**	**0.20**	**0.20**	**0.20**	**0.20**
Development Expenditure	**6.15**	**6.73**	**6.88**	**7.00**	**7.05**	**7.10**

Fiscal Year	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**
Fiscal Sector Indicators	**Projections**					
ADP Expenditure	6.00	6.58	6.74	6.86	6.92	6.97
Non-ADP Development Spending	0.15	0.15	0.14	0.14	0.13	0.13

Source: 8th Five Year Plan Projection, GED

Role of Private Sector

The private sector is considered in Bangladesh as the engine of growth, which comprises almost 77 percent of total plan investment. Investment and growth in the Plan period will mostly be driven by the private sector. But, as far as sustainability is concerned, globally, the emergence of 'smart business' has become a phenomenon. Smart business involves making business for societal and environmental benefit while keeping the profit motif intact. Global Partnership for Effective Development Co-operation (2019) identified five principles to promote ownership of private sector engagement (PSE): (1) inclusive country ownership, (2) results and targeted impact, (3) inclusive partnership, (4) transparency and accountability, and (5) leave no one behind. The last one is about recognizing, sharing and mitigating risks for all partners, implying that the private sector has to go beyond the traditional approach. Private investment must be at least 25 percent of GDP over the next five years while it contribute to revenue mobilization by paying tax.

Table 5: Private Investment, FY2020 -2025

Fiscal Year	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**
Fiscal Sector Indicators	**Projections (As % of GDP)**					
	FY20	FY21	FY22	FY23	FY24	FY25
Private Investment	24.5	25.2	25.9	26.6	27.3	28.2
Foreign Direct Investment (FDI)	1.0	1.2	1.4	1.6	1.8	2.0

Source: 8th Five Year Plan Projection, GED

Role of Development Partners (DPs)

Although the role of DPs in the development process has been shrinking over time, they are still considered a major player as far as socio economic development is concerned. Foreign aid and investment can play a supporting role with the following actions.

Continue and upgrade support to policy reforms and implementation;

Strengthen the role of DPs for localization of SDGs realigning their country strategies with enhanced fund provisions;

Scale up investment in health and education sector (Supply side intervention);

Reinforce the action for building resilience against climate change and disaster and helping implement BDP 2100;

Enhance support to capacity building and sustainability;

Promote actions that have lasting impact on the societal progress – particularly human development;

Support to duty free quota free market access to developed countries and developing countries as well on a continuing basis;

Facilitate foreign direct investment to contribute to employment, growth and poverty reduction.

Revisiting the Role of NGOs

NGOs can play a significant role in implementing the 8th plan and SDGs at the grass root levels by operating in the remote areas and helping people to combat the adverse effects of climate change. In addition to micro-finance services, NGOs can be largely concentrated in the following sectors relating to human development: (1) Health, Nutrition and Population; (2) Education; (3) Water, Sanitation and Hygiene; (4) Skill Development; (5) Disaster, Environment and Climate Change; (6) Rural Development; (7) Urban Development; (8) Agriculture and Food Security; (9) Gender Justice and Women Empowerment; (10) Poverty Eradication; and (11) Uplifting the Marginalized and the Most Disadvantaged.

Bibliography

Edinburgh Group (2012), *Growing the Global Economy through SMEs,* Edinburgh Group.

GED (2019), *Concept Note of Eighth Five Year Plan.* Dhaka: General Economics Division (GED), Bangladesh Planning Commission.

GED (2017), *SDGs Financing Strategy: Bangladesh Perspective,* Dhaka: General Economics Division (GED), Bangladesh Planning Commission.

GPEDC (2019), *Kampala Principles on Effective Private Sector Engagement in Development Co-Operation,* Global Partnership for Effective Development Cooperation.

Okitasari, M., B. Dahiya and K. Takemoto (2018), *Building Successful Multi-Stakeholder Partnerships to Implement the 2030 Agenda in the Asia-Pacific Region,* In K. Chakrabarti, B. Dahiya, C. Gual and T. Jørgensen, *Approaches to SDG 17 the Sustainable Development Goals (SDGs),* Barcelona: Global University Network for Innovation (GUNi).

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp. 86-113)

The Imperative for Banking Reforms in Bangladesh

- Sadiq Ahmed*

1. Overview

The Father of the Nation Bangabandhu Sheikh Mujibur Rahman dreamt of a Bangladesh that was prosperous, was free of poverty, where social justice prevailed, where there were equal opportunities for all, and where no rent-seeking behavior or corrupt practices prevailed. Considerable progress has been made since independence in many areas of relevance to this dream of Bangabandhu. Progress has been especially good over the past 10 years under the dynamic leadership of his daughter and the current Prime Minister Honorable Sheikh Hasina (Table-1). Yet, her government recognizes that there is still an unfinished agenda that needs to be addressed and resolved in order to fulfill Bangabandhu's dream. A part of this unfinished agenda is incorporated in the government's upcoming 2041 Perspective Plan (Government of Bangladesh, 2019) that seeks to eliminate extreme poverty, limit moderate poverty to a low level, secure Upper Middle-Income Country (UMIC) status by FY2031 and attain High-Income Country (HIC) status by FY2041.

Table 1: Bangladesh Development Progress since Independence

Indicators	1974	1980	2000	2018
GNI Per Capita ($)	111	140	383	1909[1]
Poverty (UPL) (%)	77[2]	58.5[3]	52.3	21.8
Life Expectancy (years)	46.2	54.8	63.6	72.3
Infant Mortality (%)	138.8	111.5	58.0	22.0
Adult Literacy (%)	25.8	29.2	52.8	73.9
Population Growth Rate (%)	2.5	2.35	1.41	1.2

Source: Bangladesh Bureau of Statistics (BBS)

*Dr. Sadiq Ahmed is the Vice Chairman, Policy Research Institute of Bangladesh (PRI). Dr. Ahmed began his career as a Lecturer in the Department of Economics at the University of Dhaka in 1974 and later worked at the Bangladesh Institute of Development Studies (BIDS) as a Research Fellow. He joined the Young Professional program of the World Bank in 1981 and held several key positions in the World Bank before taking early retirement in July 2009. He did his Ph.D. from the Boston University, United States of America. Views expressed in this article are the author's own.

[1] Refers to FY2019
[2] Refers to 1977. See Sen (2000)
[3] Refers to 1983

The laudable targets for the 2041 Perspective Plan (PP2041) are ambitious but achievable when measured against the true potential and capabilities of Bangladesh. The track record of development progress summarized in Table-1 speaks of this. Bangladesh is richly endowed with a highly motivated and hard-working people, a fertile land that can produce three crops a year, plenty of water, open access to sea, broadly homogenous people who share a common language, history, culture and traditions, and a strong sense of national pride and a drive to move forward. In this development-friendly environment, it is not surprising that the economic actors respond to incentives and opportunities, and equally well they rise to meet the challenges when they emerge. So, while the development agenda put forward in the PP2041 will challenge the country, with good policies and institutional reforms, Bangladesh should be able to secure or at least come close to these admittedly stretch development targets.

The reform agenda underlying PP2041 is massive, encompassing many areas including fiscal, monetary and exchange rate policies; tax reforms; public expenditure management; reforms for improving the investment climate for private domestic and foreign investors; banking and financial sector reforms; trade and industrial policy reforms; agricultural sector and water management reforms; energy, power and transport sector reforms; health and education sector reforms; social inclusion, female empowerment and social protection reforms; environment protection reforms, and public administration and governance reforms. In each of these areas, reforms entail the formulation of right policies and institutions and their sound implementation.

A review of past progress shows that while a wide range of policy reforms have been initiated and implemented, institutional reforms have lagged behind (Ahmed *et al.,* 2016; 2017). This is a major gap that needs to be addressed much more forcefully than in the past. The rationale for this is easy to see. If Bangladesh aspires to reach UMIC by FY2031 and HIC by FY2041, it cannot do so by keeping its institutions unchanged to the current LMIC level. On the economic front, there are a few over-arching institutions that need urgent strengthening. These include: the taxation system; the banking sector; land management; urban institutions; institutions for water management; the legal system, and public administration. Each of these institutions have far-reaching effects on economic and social outcomes and if they don't work well, they could constrain the ability to achieve the targets for FY2041.

The main objective of this paper is to focus on one of the key institutions of development – the banking sector. Financial sector performance is well recognized as a major determinant of the growth of the private sector in any modern economy. International evidence shows that over the longer-term economic development and the maturity of the financial sector are strongly correlated (Loyaza and Ranciere, 2004; DFID, 2004; Calderon and Liu, 2003; Khan, 2002; Khan and Senhadji, 2000; Levine, 1997)[4]. In today's world of global markets and competition, the cost and efficiency of financial services can often make the difference between a competitive and non-competitive firm. In low-income developing economies the financial sector typically tends to be dominated by banking enterprises. The non-bank financial institutions normally tend to be at an evolutionary stage. This is primarily because the regulatory and institutional capabilities required for managing a sound capital market typically do not exist in most low-income countries[5]. So, much of the financing for private enterprises is typically provided by the banking sector. This situation is also representative of Bangladesh, even though the country has moved ahead into LMIC status. In particular, the capital market as an institution is not well developed yet, although as development proceeds Bangladesh will need to pay attention to this important financial institution as well. The immediate priority, however, is to ensure the establishment of a strong, competitive and stable banking sector.

---

[4]The literature on this subject is vast. DFID (2004); Khan and Senhadji (2000); and Levine (1997) provide useful summary of the literature and underlying issues. Since financial sector mismanagement including unduly rapid credit expansion can also cause short-term disturbances that reduce growth, the literature now makes a distinction between short-term and long-term effects of financial intermediation. See, Loayza and Ranciere (2004) on this point.

[5]See, IFC (2017) for a useful summary of the challenges in developing capital markets.

2. Evolution and Structure of the Banking Sector

Following independence, the banking sector was nationalized. The dominance of these nationalized banks continued well until the late 1990s, even though gradually private banks were allowed entry into the banking business. It is only since 2000 that the private banking has taken deeper roots. Currently, the banking sector comprises 6 State-Owned Commercial Banks (SCBs), 2 government-owned Development Finance Institutions (DFIs), 40 Private Commercial Banks (PCBs) and 9 Foreign Commercial Banks (FCBs). The structure of the banking sector as of June, 2018 is shown in Table-2.

Table 2: Structure of Banking in Bangladesh, June 2018

Bank Types	Number of Banks	Number of Branches	Total Assets (Taka Billion)	Percent Distribution	Deposits (Taka Billion)	Percent Distribution
SCBs	6	3721	3380	26	2701	27
DFIs	2	1407	318	2	273	3
PCBs	40	4758	8758	67	6508	66
FCBs	9	69	604	5	393	4
Total	**57**	**9955**	**13059**	**100**	**9875**	**100**

Source: Bangladesh Bank, *Annual Report 2017-18*

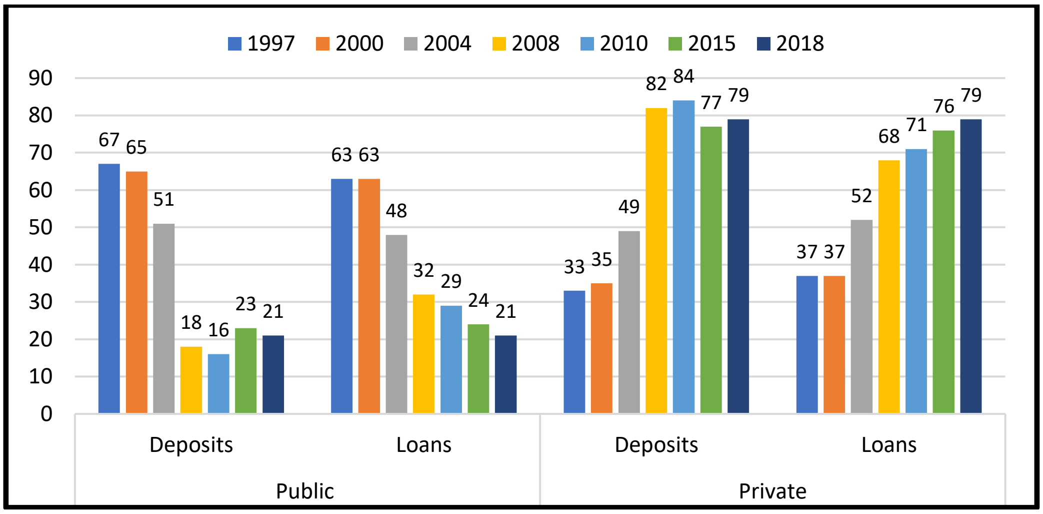
The structure of banking sector has changed substantially over the last 20 years or so following the initiation of a major banking sector deregulation policy. The policy opened up the banking sector to private competition. The response was substantial. The resultant structural transformation of the Bangladesh banking sector is shown in Table-3 and Figure-1. Thus, even as late as 2000, public banks (SCBs+ DFIs) accounted for some 65 percent of the deposits and 63 percent of the loans. By 2018, these shares had fallen to 21 percent each. The fact that the private sector banks now account for 79 percent of loans and deposits compared with only around a third in 2000 has radically transformed the banking sector from a public-led activity to a private-led activity.

Table 3: Structural Change in Banking in Bangladesh

Year	Deposits (Taka Billion)		Deposits (Percent Share)		Loans (Taka Billion)		Loans (Percent Share)	
	Public	Private	Public	Private	Public	Private	Public	Private
1997	342	168	67	33	231	137	63	37
2000	400	213	65	35	282	166	63	37
2004	544	515	51	49	387	420	48	52
2008	414	1902	18	82	573	1243	32	68
2010	599	2768	16	84	737	1837	29	71
2015	1757	5967	23	77	1291	4070	24	76
2018	2238	8203	21	79	1802	6668	21	79

Source: Bangladesh Bank, *Annual Report 2017-18* and *Scheduled Bank Statistics*

Figure 1: Share of Public and Private Deposits and Loans



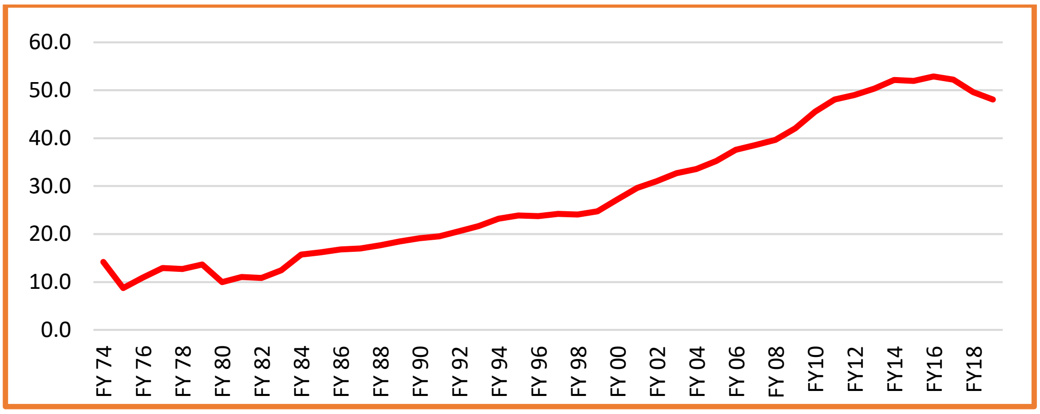
Source: Table-3

3. Economic Impact of the Banking Sector Transformation

The impact of the rapid transformation of the banking sector on economic activities can be gleaned from three related banking sector outcomes.

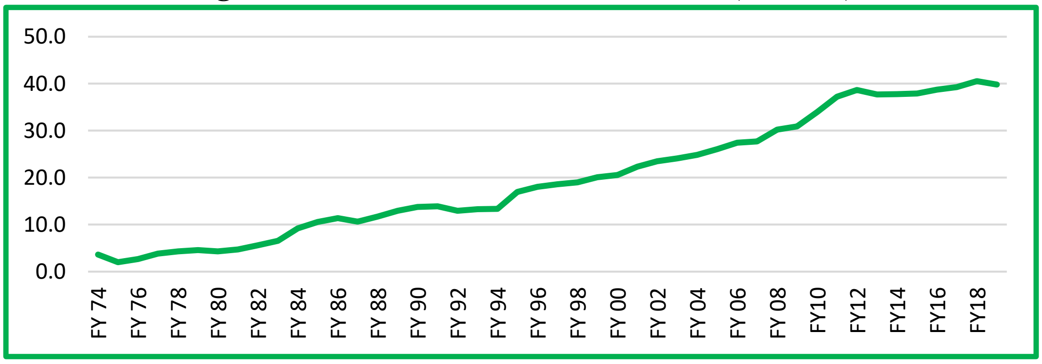
Financial Deepening: First, there was a remarkable growth in deposits that led to a huge increase in broad money (M2) as a share of GDP (Figure-2). Market competition fueled a massive drive for deposit mobilization through a range of products. The growth in M2/GDP is one indicator of the deepening of the financial intermediation in Bangladesh. The other important indicator is the growth of private credit as a share of GDP. The deposit mobilization contributed to a huge expansion of private credit that spurred the growth of private investment, exports and GDP (Figure-3). In the absence of a well-functioning capital market, the banking sector financing was the main source of private business financing for investment, trade credit and working capital needs.

Figure 2: Trend in M2/GDP Ratio (Percent)



Source: Bangladesh Bank

Figure 3: Trend in Private Credit/GDP (Percent)



Source: Bangladesh Bank

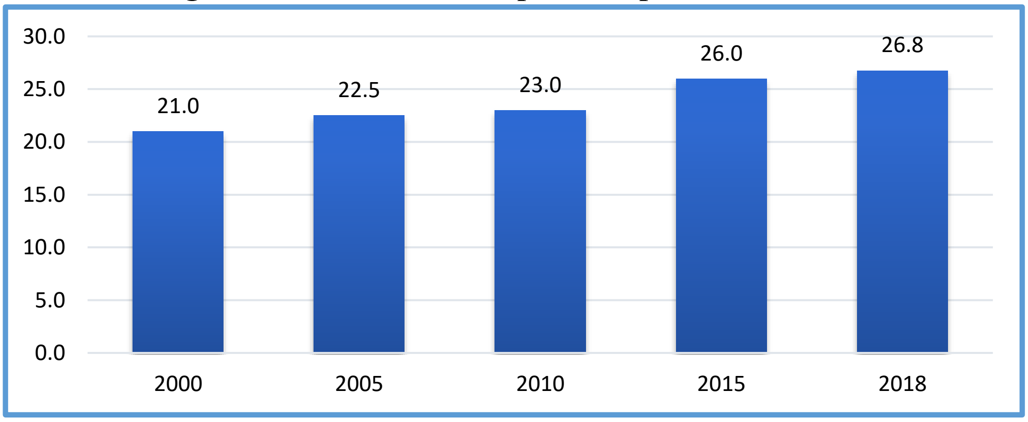
Financial Inclusion: A second important way that the banking sector transformation contributed to economic development was improved financial inclusion. Not only that the number of banks increased, bank branches also multiplied rapidly serving an increasingly larger share of population (Table-4 and Figure-4). Private Banks which are motivated primarily by profits normally tend to serve the urban markets in the urban growth centers, typically the capital city Dhaka and the port city of Chattogram. Through policy, Bangladesh Bank (BB) was able to spread banking outside these two natural banking centers to other urban and rural areas (Table-4). To strengthen financial inclusion, the BB adopted other policies including establishment of the special Small and Medium Enterprise (SME) window within BB, setting targets for bank lending to SMEs, introducing SME refinancing schemes, enhancing agricultural credit schemes, establishing the Microcredit Regulatory Authority, and introducing the Mobile Financial Services.

Table 4: Spread of Bank Services in Bangladesh

Year	Number of Branches			Deposits (Taka Billion)			Loans (Taka Billion)		
	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total
2000	3659	2460	6119	161	549	710	100	494	594
2005	3764	2638	6402	218	1198	1416	118	1000	1118
2010	4393	3265	7685	437	2942	3379	207	2367	2574
2015	5334	4063	9397	1575	6365	7940	571	5227	5798
2018	4890	5224	10114	2143	8224	10366	863	7607	8470

Source: Bangladesh Bank, *Annual Report 2017-18*

Figure 4: Thousands of Population per Bank Branch



Source: Bangladesh Bank, *Annual Report 2017-18*

Customer Service: Before deregulation, much of the banking services was provided by the SCBs. Due to an absence of competition, service quality was low in terms of the range of banking products offered, both on the deposit and lending sides, as well as the basic client services. The transaction costs in terms of time spent on making deposits or withdrawing money were high. Lending was often discretionary based on contacts with government or elected officials. The deregulation policy changed all this substantially. As the number of banks grew, customer service related to deposit mobilization improved dramatically in private banks. Competition for bank deposits led to the development of a variety of bank products, and banking service quality increased substantially. Banks invested heavily in customer facilities and customer service development. The ease and convenience of banking further improved as bank branches expanded that sharply lowered the time spent on commuting to the bank branch office and the wait time at the counter. The lending products and access to bank loans also improved, subject mainly to the usual credit-worthiness assessments. Progress, however, was mostly concentrated in private banks. Public banks have remained mostly dependent on government operations and lending to high-profile and politically well-connected enterprises and entities.

4. Banking Sector Policies

What factors have contributed to this positive structural change of the banking sector and related improved quantity and quality of banking services in Bangladesh? Historically, the banking sector in Bangladesh has been plagued by the problem of Non-Performing Loans (NPLs). Public banks with seriously infected portfolio dominated the banking sector. Even in the private banks, the portfolio infection was pretty high. A 1998 World Bank study of the banking sector noted that "The three institutional pillars of banking – a strong regulatory system, well-managed banks, and an effective court system – have crumbled to such a point that the banking institutions cannot be relied upon to ensure the safety of deposits and efficiently allocate credit, their two most important functions. In a more difficult economic environment, the banking system could become Bangladesh's Achilles Heel" (World Bank, 1998).

Due to weak management, constant political interference, corruption and directed lending, even as late as 2000, the four SCBs, holding 63 percent of the industry's net assets, were technically insolvent, with the ratio of their gross NPLs to total loans estimated at 46 percent. The court system could not be relied upon to protect creditor rights, which further vitiated lender incentives and contributed to misallocation of credit. While the issue of NPLs in public banks is fundamentally a problem of political economy, there were many associated management problems in Bangladesh relating to the inadequacy of the legal framework for banking control, weak banking supervision, inefficient management and overstaffing in public banks, and poor service standards in many banks, particularly in public banks (World Bank, 1998).

Faced with this rather alarming situation, reform efforts since 2000 have sought to improve the regulatory and legal environment for the banking sector aimed at facilitating more competition and improving the soundness of the banking sector.

Banking Sector Deregulation

The most fundamental reform that happened is the progressive deregulation of the banking sector that allowed a large number of private banks and Non-Bank Financial Institutions (NBFIs) to grow. As a result, the total number of private commercial banks grew from 15 in 2000 to 42 in 2019. This was a fundamental policy change that signaled the government's intention to move away from an inefficient public-dominated banking to a more competitive and efficient private banking sector.

Strengthening of Prudential Regulations

The government recognized that prudential regulations are key to developing an efficient and healthy banking system, especially in light of the prevailing weak governance in the banking sector. A number of steps were taken to improve prudential regulations. These focused on increasing the capital adequacy of banks, tightening guidelines for rescheduling various types of loans, improving accounting standards to align to international standards, moving towards tighter provision requirements for non-performing loans, imposing limits on individual loans and strengthening disclosure requirements. In a series of steps starting in 2003, the BB gradually tightened its supervision norms by adopting the Basel guidelines. According to BB, it has already implemented Basel Accords-I and II, and Basel Accord-III.

To ensure that these measures are properly implemented, efforts have been made to strengthen the regulatory capacity of the BB. Supervision capacity has been strengthened. The BB has issued new risk management guidelines for all banks, aiming to control the NPLs and the increasing risks in the banking sector. The new guidelines require each bank to prepare a Comprehensive Risk Management Guideline (CRMG) to be approved by the respective bank's Board and submitted to BB. Banks are required to appoint Chief Risk Officer as the head of the risk management department and reconstruct the risk management organogram. The BB also asked lenders to increase the use of electronic payment channels, such as the 'Real-Time Gross Settlement' and 'Bangladesh Electronic Fund Transfer Network,' to promote transparency and efficiency. The BB has asked banks to maintain an 'Internal Credit Risk Rating' to help them manage and control credit risks.

The BB has introduced a new policy for offshore banking operations. Banks, which are engaging or intend to engage in offshore banking, must invest at least 75 percent of total outstanding offshore operations' funds inside the country and comply with the Cash Reserve Requirement (CRR) and the Statutory Liquidity Ratio (SLR). Any bank wishing to operate offshore banking must obtain approval from BB. Moreover, banks must follow Asset Liability Management (ALM) guidelines for their offshore banking operations. In addition, closure of a bank's offshore banking operations, as well as shifting and merging of any offshore banking unit, requires prior permission from BB. Loans under offshore banking operations are required to be reported to the Credit Information Bureau (CIB) of the BB.

5. Emerging Banking Sector Risks and Challenges

The deregulation of the banking sector led to the major transformation of the banking sector noted in Section-3. However, the performance record in terms of improved health of the banking sector is mixed. There has been progress in improving capital adequacy on aggregate for the banking sector, but major concerns remain about the capital adequacy of the SCBs. Regarding the incidence of NPLs, they did come down substantially for the banking sector as a whole from the high-level of the 1990s, but the menace of NPLs has re-emerged as a major concern over the past several years, especially for the public banks. At the heart of the banking sector health concerns is the policy towards the SCBs. While banking sector deregulation has substantially reduced the operations of SCBs in Bangladesh, their poor performance continues to threaten the stability of the banking sector. Two additional issues that need to be watched and require policy actions are the observed sharp slowdown of growth in deposits and the re-introduction of interest controls.

Reform of SCBs

While the implementation of prudential regulations and greater competition in banking are welcome steps, progress in reforming the SCBs has been much more limited and hesitant. Between 2002-2008, some half-hearted attempts were made to reform SCBs with support from the World Bank. The reform sought to privatize three of the four SCBs through a two-step process. The first step involved efforts to strengthen SCB performance through better management based on corporatization; and then move to the second step to prepare them for transferring to private ownership. The reform effort proved short lived and was reversed once a new government took over in December 2008. At the heart of the SCB reform is the ownership issue and the associated political constraints. The government is yet to reconcile to the idea that public ownership of banks is not a sound banking concept (Ahmed *et al.*, 2003). Without change of ownership and relying on market forces, regulations are not likely to have the full desired impact especially in an environment of weak governance.

Capital Adequacy

A major reform implemented by the BB is to gradually adopt the main recommendations of the Basel prudential norms for bank supervision (Box-1). In addition to strengthening bank supervision and developing an early warning system for risk mitigation, the main focus of the Basel Accords is to lower banking sector risks by requiring the holding of high-quality capital in relation to risk-weighted assets that could be easily converted into cash to address any unforeseen drawdown of bank deposits.

Box 1: The Basel Accords for Strengthening Bank Supervision

The Basel Committee for Bank Supervision (BCBS) was established in 1974 in city of Basel, Switzerland as an international forum where members could discuss various bank supervision issues. The main objective of BCBS is to strengthen the stability of the banking system by minimizing systemic risks through Accords. These Accords seek to provide guidelines for improving banking supervision. The Basel Accords are not legally binding and member countries are expected to be responsible for their own banking system and its supervision. However, banks that are engaged in international transactions are expected to comply with these Accords to maintain international credit-worthiness. Countries where their banking system does not comply with the Basel accords can expect to be downgraded as high-risk countries with adverse implications for attracting international capital flows and engaging in international transactions.

Basel has so far announced three Accords: Basel-I, Basel-II and Basel-III. The first Basel Accord, known as Basel I, was issued in 1988. It focused mainly on credit risk by establishing a bank asset classification system and suggesting a minimum capital requirement based on the ratio of capital to risk weighted assets. Basel I fixed this ratio at 8% to be accomplished by 1992. The risk weights for calculating risk-weighted assets were defined under 5 categories with risks of 0%, 10%, 20%, 50% and 100%. Cash, central bank debt and government debt were considered very safe assets and assigned a risk weight of 0% while all private sector debt is considered extremely risky with a 100% risk weight.

Basel-II was issued in 2004 with a view to further tightening the supervision criteria for bank risks. It is based on three main pillars: minimal capital requirements, regulatory supervision, and market discipline. The minimum regulatory capital requirement was further tightened by defining the eligible regulatory capital of a bank into three tiers. The higher the tier, the less subordinated securities a bank is allowed to include in it. Each tier must be of a certain minimum percentage of the total regulatory capital. Basel II also tightened the definition of risk-weighted assets into a 2-step process. In the first step the eligible asset base is determined by using the Basel definition of risk weighted assets. In the second step, the asset base is recalculated by assigning higher risk weights to higher risk assets. This way, holding of bad assets is punished by not only reducing its eligibility for determining regulatory capital but also by reducing the bank's value in measuring the risk weighted asset base.

The second pillar of Basel-II provides the framework for national regulatory bodies to deal with various types of risks, including systemic risk, liquidity risk, and legal risks. The market discipline pillar provides various disclosure requirements for banks' risk exposures, risk assessment processes, and capital adequacy, which are helpful for users of financial statements.

Basel-III was introduced in 2009 as a set of reforms designed to improve the regulation, supervision and risk management within the banking sector. Definitions of eligible capital and eligible assets were further refined to foster greater resilience of individual bank in reducing the risk of system-wide shocks.

The performance of the different types of banks by the capital adequacy requirement indicator is shown in Table-5. Several results stand out.

First, when the performance of public banks against this criterion is considered, it is rather dismal. Capital adequacy improved over the 2000-2011 period but has been deteriorating since then. It has now reached a stage where they can be considered as virtually bankrupt and under prudential norms should not be allowed to lend any more. This has happened despite frequent episodes of equity injections by the treasury, amounting to an estimated Tk. 175 billion over FY2010-FY2019.

Second, the private commercial banks have been maintaining the required capital adequacy ratio on the aggregate. However, there is considerable dispersion in performance. There are a number of PCBs who are unable to meet the capital adequacy ratio and their performance is under observation by the BB.

Third, not surprisingly, private foreign banks have played it most safe in maintaining very generous capital adequacy ratio. These are the safest banks in the industry and as a result are able to attract a considerable deposit base with lower than average deposit rates.

Table 5: Progress in Capital Adequacy (Percent)

Bank Type	**1997**	**2000**	**2005**	**2010**	**2011**	**2015**	**2017**	**2018**
SCBs	6.6	4.4	5.2	8.9	11.7	6.4	5.0	2.0
DFIs	6.0	3.2	6.0	-7.3	-4.5	-32	-35.5	-31.9
PCBs	8.3	10.9	9.2	10.1	11.5	12.4	12.5	12.2
FCBs	16.7	18.4	17.1	15.6	20.6	25.6	24.9	23.0
Total	**7.5**	**6.7**	**7.3**	**9.3**	**11.4**	**10.8**	**10.5**	**10.0**

Source: Bangladesh Bank *Annual Reports 2003* and *2017-18*

Asset Quality: The Menace of Non-Performing Loans

The trend in NPL is shown in Table 6. The asset quality challenge facing the banking sector in Bangladesh can be grouped under three phases: A historical pre-reform phase lasting up to 1999, a reform phase running from

2000-2011 and a drifting phase since 2012 and ongoing that is characterized by mixed performance with some reforms but many challenges.

Table 6: Trend in Non-Performing Loan as Percent of Total Loans during 1997-2011

Bank type	1997	1998	1999	2000	2002	2008	2011
SCBs	37	40	46	39	34	25	11
DFIs	66	67	65	63	56	26	25
PCBs	31	33	27	22	16	4	3
FCBs[6]	4	4	4	3	3	2	3
Total	**37**	**41**	**41**	**35**	**28**	**11**	**6**

Source: Bangladesh Bank, *Annual Report 2003, 2005, 2015*

Pre-reform Phase (Up to 1999): In the historical pre-reform phase, the portfolio quality issue was a major problem. Generally, the public banks have always been saddled with a large infected portfolio and this infection got sharply severe between 1997 and 1999, raising the share of NPL to 46 percent for the SCBs and 65 percent for the DFIs. The reasons are well known and international experience shows that Bangladesh was not alone in this regard, although the severity of the problem was more intensive. Much of the problem is a manifestation of corruption linked with the politics of public ownership, but this also reflects poor banking decisions due to weak management, poor staffing quality and lack of accountability. The private commercial banks also had a fairly large share of bad loans, reflecting inadequate regulations and weak supervision by the BB. The only good-performing banks were the foreign commercial banks.

Reform Phase (2000-2011): In the reform phase starting in 2000, the portfolio quality registered significant improvements. Initially much of the portfolio performance improvement happened in private commercial banks; thus, NPLs fell sharply from 27% in 1999 to 16% in 2002. This performance gathered momentum subsequently as prudential norms and supervision effort of

[6]The observed deterioration of NPLs in foreign banks reflects the effects of two poorly performing banks: the Islamic Commercial Bank owned by the Malaysians and the National Bank of Pakistan. Their share of the deposit base is negligible and do not pose a major stability threat.

BB gained strength. NPLs fell dramatically to 6% in 2011. The portfolio quality also improved in public banks, initially very slowly but gaining speed during 2010-2011 periods. By 2011, the NPL ratio of SCBs had fallen to only 11%, down from 46% in 1999. Even the DFIs registered improvement with the share of NPL falling from its peak of 67% in 1998 to 25% in 2011. This improvement in the banking portfolio was a very welcome development and shows that good reforms lead to good results.

Banking Policy Drift Phase (2012-ongoing): The improvements secured over the banking sector reform phase have come under pressure in the third and the currently ongoing phase of banking policy drift. The portfolio quality improvement has been reversed and the menace of NPLs is creeping up again (Table-7). While the main problem is with the public banks which, as noted above, are getting bankrupt owing to the growing menace of NPLs and are unable to maintain the required prudential regulatory capital base, the infection is also spreading to private commercial banks. As noted, the performance of private commercial banks is uneven and the aggregate NPL hides the portfolio difficulties faced by several weakly-performing private commercial banks. In general, the increase in NPL incidence in private banking, despite improved supervision efforts by the BB reflected in the progress with implementation of Basel Accords, and the continued slide in the performance of SCBs is a reflection of the growing political interference in the working of the banking system that must be stopped and reversed.

Table 7: Trend in Non-Performing Loan as Percent of Total Loan during 1997-2019

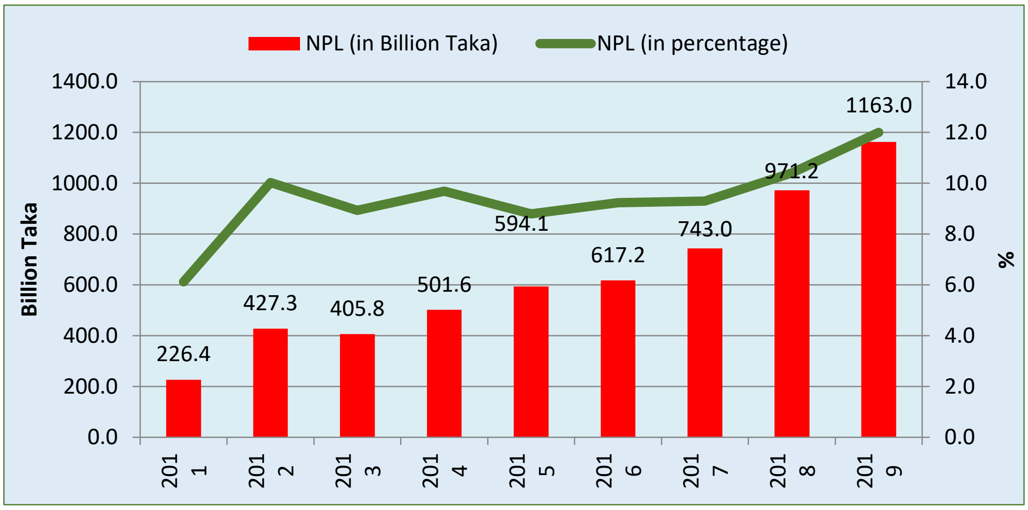
Bank type	2011	2012	2013	2014	2015	2016	2017	2018	2019
SCBs	11	24	20	22	22	25	27	28	32
DFIs	25	27	27	33	23	26	23	22	18
PCBs	3	5	5	5	5	5	5	6	7
FCBs	3	4	6	7	8	10	7	7	6
Total	**6**	**10**	**9**	**10**	**9**	**9**	**9**	**10**	**12**

Source: Bangladesh Bank, *Annual Report 2017-18* and Bangladesh Bank Website

Non-Performing Loans and Fiscal Risks

The rapid transformation of the banking sector from public-dominated banking to private-led banking has reduced the overall risk of the banking sector by sharply lowering the share of the loan portfolio of the public banks. This is a positive development that has helped lower the overall NPL ratio for the banking sector as a whole. Yet, in absolute taka terms, the total value of NPLs is a huge source of concern. This is shown in Figure-5. The total value of NPL for the banking sector as a whole has grown from Tk. 226 billion in 2011 to Tk. 1242 billion in 2019, which is a 450% increase in 8 years. As a share of GDP, gross NPL surged from 2.4% of GDP in 2011 to 4.9% in 2019.

Figure 5: Gross Non-Performing Loans of the Banking Sector



Source: Bangladesh Bank

The large amount of NPL raises two important policy questions: first, who will bear this loss in the event that little or nothing of the outstanding NPL amount is recovered? And second, what are the implications for the sustainability of the banking sector? Some of the NPL value is accumulated interest income. While this will not directly affect the liability of the banks in the short term, it will reduce the profitability of the banking sector and thereby adversely affect the ability to keep provisions for bad loans while also lowering the capacity to mobilize and service the deposit base.

But a significant part of the NPLs is the principal amount owed. As far as private commercial banks are concerned, they are partly protected by the build-up of provisioning and the remaining exposed position will have to come from future earnings. As noted, this provisioning can only be sustained if the stock of NPLs does not grow. So, a growing NPL over a prolonged period will drive the concerned private banks towards bankruptcy and could severely jeopardize the ability to service the deposits.

Regarding the SCBs, large NPLs pose a major fiscal challenge to the government for three reasons. First, the SCBs have much larger share of the NPL value even though their lending base has shrunk because of the large incidence of the NPL ratio. Thus, their share of NPL for 2019 is estimated at Taka 596 billion. After allowing for interest suspense and provisioning, net NPL amounts to an estimated Taka 231 billion that becomes contingent fiscal liability. The Finance Ministry is already facing a severe fiscal crunch owing to a very low and falling tax/GDP ratio (presently less than 9% of GDP) (Ahmed 2019). In this environment, the large contingent fiscal liability of the SCB operations could challenge fiscal sustainability and or ability to protect the interest of the depositors.

6. Loan Recovery and Banking Courts

This is another area where progress is slow. Generally, getting decisions from the court system on outstanding loans is a long-drawn process, discouraging financial institutions from seeking this remedy. To obviate this problem, the Artha Rin Adalat Ain 2003 Act (Money Loan Court Act, 2003) was enacted in March 2003 with a view to streamlining the process of realization of overdue loans and advances by banks and financial institutions. Provisions have been made in this Act for realizing of the banks dues by selling properties held as security, without prior orders of the court. This is an encouraging step; its effectiveness remains to be proven due to the tremendous implementation challenges including logistical arrangements.

Interest Rate Management

The role of interest rate management for development has been studied extensively. The most cited work is that of McKinnon (1973) and Shaw (1973), who define financial liberalization to mean the establishment of higher interest rates that equate the demand and supply of savings. The authors argue that higher interest rates will lead to increased savings, higher financial intermediation and improvements in the efficiency of use of financial resources. Increases in savings along with more efficient use will add to economic growth.

Balassa (1989) summarizes available empirical evidence that suggests that higher real interest rates increase the extent of financial intermediation while increased financial intermediation raises the rate of economic growth in developing countries. Furthermore, he also found evidence that moderately high real interest rates have a positive effect on investment efficiency and on economic growth. The paper notes, however, that excessively high interest rates will have unfavorable economic effects. Such a situation can be avoided if the liberalization of the banking system takes place under appropriate conditions, including monetary stability and the appropriate supervision of the banks. This would further the goal of establishing equilibrium interest rates.

The World Bank's seminal study on the factors that contributed to the performance of the High-Performing East Asian Economies (HPAEs) concluded that a major determinant was the sound management of the financial sector (World Bank, 1993). Financial sector policies in HPAEs were geared to increasing financial savings and channeling them into activities with high social returns. On the policy front two major policies were to keep real interest rates positive to help mobilize financial savings and establish a stable and secure banking system based on protection and prudential regulations.

While there is controversy about implementation of financial liberalization for developing countries, especially in its broadest neo-classical definition of lifting all restrictions on domestic and foreign financial flows and letting domestic and international interest rates equilibrate (adjusting for exchange rate movements), there is much more consensus that the domestic interest policy should avoid severe financial repression that keeps domestic interest rates negative in real terms for depositors and very low for borrowers such that these lending rates are substantially below the marginal productivity of capital leading to excessive demand for credit. Such financial repression could stifle the growth of financial savings, reduce the scope for financial intermediation and lead to capital rationing to avoid excess demand for credit. Credit rationing in turn would seriously misallocate capital to inefficient uses. Severe financial repression could also contribute to instability of the financial system (Xu and Gui, 2019).

So, regarding interest rate management, the most important policy message for Bangladesh is to keep real deposit rates moderately positive (2-3%) while keeping the real lending rates in line with the marginal productivity of capital (the 6-7% range) would seem reasonable.

As against these theoretical arguments and empirical findings, what has been the experience in Bangladesh? Table-8 shows the trend in nominal and real 5-year average deposits and lending rates. The yearly rates are weighted average rates for different banks. Bangladesh Bank has persistently followed a controlled interest rate policy that was periodically adjusted. There is no clear policy pattern that emerges from Table-8. However, overall, it would appear that Bangladesh has generally shied away from financial liberalization and followed a policy of mild financial repression with the objective of keeping the cost of borrowing to a low level (Mickinon, 1973 and Shaw, 1973).

In the early years after independence (1976-1985), nominal deposit and lending rates were kept low despite high inflation, causing real deposit rates to be substantially negative while keeping real lending rates low. Interest rate management improved over the 1986-2005 period supported by better macroeconomic management that sharply lowered the average inflation rate. The real deposit rates were positive but the average real lending interest rates were on the high side owing to the large spread between average lending and deposit rates caused by the growing incidence of NPLs. Real deposit and lending interest rates have fallen sharply during 2006-2019 through a combination of inflation control and interest rate control policies.

Table 8: Average Nominal and Real Interest Rates

Period Average	Nominal Deposit Rate	Real Deposit Rate	Nominal Lending Rate	Real Lending Rate
1976-1980	6.7	-1.63	11.1	5.19
1981-1985	7.6	-4.29	13.7	1.82
1986-1990	8.8	1.48	14.7	7.44
1991-1995	6.8	1.24	13.9	8.35
1996-2000	6.9	1.04	13.8	8.00
2001-2005	6.3	2.39	12.3	8.55
2006-2010	6.7	-0.95	12.1	4.41
2011-2015	7.7	0.12	12.9	5.33
2016-2019	5.3	-0.30	9.9	4.25

Source: Bangladesh Bank

What have been the effects of these interest rate management on financial intermediation and investment rates? The results are summarized in Table-9. Negative real deposit rates, low GDP real growth, low real per capita income and lack of banking competition all militated against financial intermediation keeping the M2/GDP ratio at a very low level well up to the mid-1980s. The private investment rate also remained depressed despite low real lending rates owing to weak investment climate and slow growing economy. Interest rate management became more supportive of deposit mobilization over 1986-2005 when real deposit rates became positive. Along with high real GDP growth rates, rising per capita real incomes and banking competition the M2/GDP ratio surged, reaching an average of 32.4% during 2001-2005. Real deposit rates fell in the negative zone during 2006-2019. But the adverse substitution effects were offset by the income effects of high GDP growth and the rising real per capita income. Therefore, the M2/GDP ratio continued to grow over 2006-2015. However, a prolonged period of negative real deposit rates has started to take a toll and the M2/GDP ratio has been stagnant during FY2016-19. So, on the whole it would appear reasonable to conclude that positive real deposit rates are an important determinant of deposit growth in Bangladesh and are necessary to support further financial deepening as concluded by the McKinnon-Shaw hypothesis.

Table 9: Real Interest Rates, Financial Intermediation and Private Investment

Period Average	Real Deposit Rate	Real Lending Rate	Real GDP Growth Rate	M2/GDP	Average Private Investment Rate
1976-1980	-1.63	5.19	4.2	12.0	6.1
1981-1985	-4.29	1.82	3.8	13.2	7.7
1986-1990	1.48	7.44	3.6	17.8	7.2
1991-1995	1.24	8.35	4.4	21.8	11.3
1996-2000	1.04	8.00	5.2	24.8	15.1
2001-2005	2.39	8.55	5.4	32.4	15.9
2006-2010	-0.95	4.41	6.0	40.7	19.6
2011-2015	-0.29	4.92	6.9	50.3	22.1
2016-2019	-0.30	4.25	7.6	50.7	23.0

Source: Bangladesh Bank

The behavior of private investment rate is interesting. It remained depressed despite low real lending rates during 1976-1985. But it jumped from an average of 7.2% of GDP during 1981-86 to 15.9% in 2001-2005 even though real lending rates reached historical high levels of 8 percent plus. Real lending rate fell dramatically between 2006-2015 and private investment rate surged to 22.1%. Real lending rates fell further during FY2016-19 but private investment rate barely increased. The main conclusion that appears plausible is that the real lending rates are not well correlated with private investment and there are other variables including real GDP growth on the demand side and investment climate on the supply side that influence investment behavior. Indeed, the fact that the private investment rate has remained stagnant at around 22-23% of GDP over the past 10 years (FY2010-FY2019) despite falling real lending rates and rising GDP growth rate leads to the inevitable conclusion that the investment climate facing Bangladesh needs an overhaul to boost private investment (Ahmed, 2020). Forcing real interest rates to fall further to push private investment is not going to work.

It would appear from the above experience that continued financial repression even in its present mild form that drives down real lending rates to the negative zone as a means to promote private investment and GDP growth is not a sound policy. This approach tends to hurt deposit mobilization and financial intermediation, which can adversely affect long-term growth by lowering financial savings. There is already evidence that mild financial repression is hurting the growth of deposits and M2/GDP. Thus, the M2/GDP ratio is on a declining trend since FY2016, falling from the peak of 52.9% to 48.5% in FY2019. This trend should be reversed as soon as possible. Regarding the relationship between investment rate and real intertest rate, the evidence suggests that real intertest rate is only one variable that influences investment. Other determinants include the rate of growth of GDP and the cost of doing business. Evidence shows that the cost of doing business in Bangladesh is very high (Ahmed, 2020). This must be addressed forcefully while keeping real interest rates in line with the marginal productivity of capital. Single-minded pursuit of driving real interest rates to very low levels without regards to the marginal productivity of capital and the investment climate will not boost private investment rate or GDP growth rate on a sustained basis.

7. The Way Forward

The banking sector deregulation in Bangladesh since 2000 has served the country well by establishing a competitive private-sector led banking sector that has substantially boosted financial intermediation, enhanced access to banking services and improved service quality. This progress needs to be consolidated with further improvements in the quality and efficiency of banking services. The reforms will have to be real that go to the root causes of the emerging banking sector weaknesses described in Section E and seek to address them comprehensively and in a sustained manner. Frequent loan restructuring and efforts to delay the implementation of the Basel Accords or to change accounting practices to hide the NPLs and regulatory capital deficiencies will be futile and further hurt the health of the banking sector. This can compromise the government's ability to achieve the PP2041 targets, which are key elements of Prime Minister Sheikh Hasina's strategy to realize the dream of Bangabandhu.

The bank reforms of 2000-2011 have successfully limited the role of the poor-performing public banks. But, with a large infected portfolio and continuous need for financial support from the Finance Ministry to stay in business, these banks cannot function as they are doing presently. They already present a huge contingent fiscal liability to the government in an environment of low tax revenues. Political interventions in private banks are also a source of concern that is creating financial difficulties in a number of private banks. This must be forcefully addressed to avoid creating major headaches for the health of the banking sector. Furthermore, the government needs to adopt a sound management of the interest rate policy to ensure that deposit rates are positive in real terms to avoid the risk of a financial disintermediation at a time when the M2/GDP ratio and private credit to GDP ratio need to grow further to facilitate private investment and growth as envisaged under PP2041.

Ensure the Autonomy of the Bangladesh Bank

At the very top of the reform list is the need for autonomy of the BB. In the absence of adequate autonomy, political interventions have compromised the ability of BB to fully implement its supervision role, especially in the case of the public banks. The government should carefully review the issue of the independence of the BB and the amount of autonomy it wants to convey to the regulator. There is clear evidence from international experience that an independent Central Bank is necessary to move to UMIC and HIC status. This is an essential institutional reform for achieving the targets of the Perspective Plan 2041 (PP2041). A fully autonomous regulator that can hire quality staff it needs, procure the technology it requires to strengthen its effectiveness, and implement prudential norms without the fear of political influence is essential to prevent inefficiencies and corruption in the banking sector. An autonomous Central Bank is also necessary to conduct sound monetary policy management and to exercise utmost prudence in such matters as the licensing of new banks.

Improve Supervision of the Banking Sector

The positive experience with better supervision of banks leading to adoption of Basel-I, II and III is a reflection of the importance of continuously improving high-quality supervision. The deterioration in the portfolio quality of PCBs suggests that the supervision effectiveness of the BB may have been selectively compromised owing to political interventions in support of the politically-connected owners of poor-performing PCBs. The government must not interfere or compromise the BBs implementation of the full supervision norms of PCBs. The government should also rethink the strategy for the supervision of public banks. The weakly performing public banks with a huge amount of infected portfolio is a serious threat to the soundness of the banking sector. In addition to efforts to improve their performance, these banks must be brought under the full regulatory supervision of the BB and must be required to comply with all prudential norms, including certification of the bank boards and senior management as per the approved fit and proper criteria. The government must understand that it cannot both be a producer of banking services (as owner) and also a regulator of these services. This is a serious conflict of interest that must be corrected.

Reforming the Public Banks

Over the longer term, the government should reassess whether it really needs to be in the business of providing banking services. There is plenty of international evidence that publicly-owned banks do not perform well in an environment of weak governance. The quality of portfolio inevitably gets tainted owing to political interventions that are inconsistent with sound banking decisions. The first best option is to privatize the state-owned banks. The government should plan to retain the Sonali bank to conduct treasury operations. The other three SCBs should be privatized. This is not simply a matter of listing them on the stock market and selling some shares to raise capital, but a full-fledged operation leading to privatization of ownership and management as private commercial banks. Even Sonali bank that is retained as an SCB, must be reformed to be financially viable and required to be fully compliant with all prudential norms under the supervision of the BB.

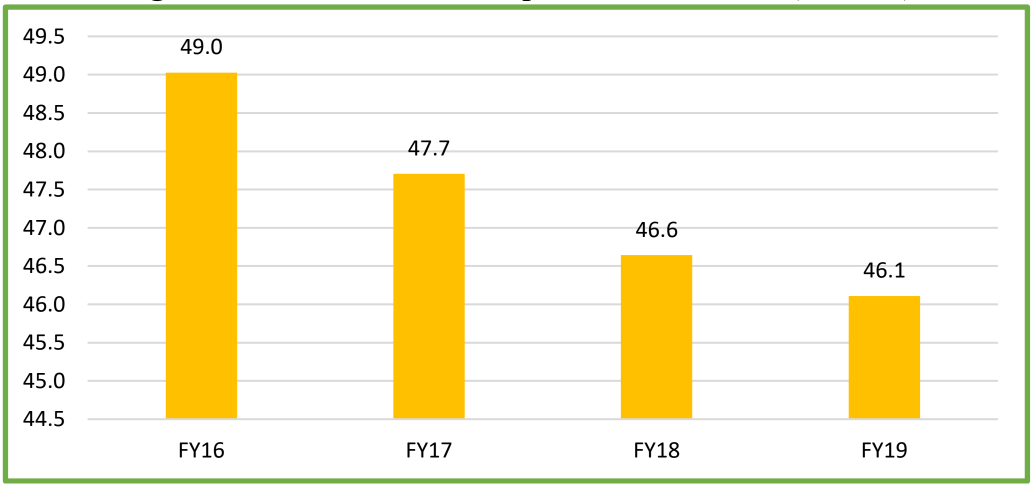
In a political environment where privatization is not imminent, there is a second-best approach that might work. This option is to take away the lending role of public banks. If such banks are allowed to only hold government paper, their deposit growth would be indirectly limited and sounder banks would intermediate more flows. Such lending restrictions are akin to a “dual banking system” with “narrow banks” that are likely to remain state-owned (and only allowed to gather deposits to invest in government paper) and conventional private sector banks. No new laws are required because the government as owners of the public banks could take this decision.

The idea of narrow bank is not a new one and merits serious attention (Ahmed *et. al.,* 2003). At the least the government might ask the Bangladesh Bank to review this option carefully and provide a technical proposal. The government must understand that it faces a very tight fiscal situation and it cannot absorb a fiscal shock from a potential liquidity crisis in public banks emerging from an overload of infected portfolio.

Proper Management of the Interest Rate Policy

Bangladesh should seriously rethink its approach to interest rate policy. As noted in Section-E, interest rate management has been unstable with periods of relaxation followed by tight control. As a result, the real deposit rate has often been negative. This is presently the case where the real deposit rate has been negative for the past several years and the rate of growth of bank deposits has been falling significantly (Figure-6). A slow-growing deposit base in the face of rising NPLs could create serious liquidity and profitability problems for banks that could lead to financial disintermediation and hurt growth. It could also hurt the stability of the banking sector that must be avoided.

Figure 6: Recent Trend in Deposit to GDP Ratio (Percent)



Source: Bangladesh Bank

In the short term, BB must ensure that the real deposit rates are positive and real lending rates are aligned to the marginal productivity of capital. As noted earlier, a rough rule of thumb could be to target real average deposit rates at 2-3 percent and real average lending rates in the range of 6-7 percent. Interest rates offered on specific products should be market determined based on supply and demand for such loans and associated risks. Fixing a single interest rate ceiling for all products without regards to supply, demand and risk profile would create serious inefficiences in credit allocation and also lead to credit rationing. This type of financial repression must be avoided.

Over the longer term, since Bangladesh is aspiring to move to UMIC and HIC in the next 20 years or so, it is appropriate that instead of pursuing a control-oriented and administratively determined interest rate policy, Bangladesh should adopt a proper market-driven interest rate policy. As in other UMIC, Bangladesh can infuence interest rate level through a proper use of monetary policy instruments. Presently, the link between monetary policy instruments (reserve requirements, BB discount rate and open market operations involving sale and purchase of Treasury bills) is weakened by the absence of a well-developed bond market. The government can spur the development of the bond market by opening up the market for Treasury bills (T-bills) for private trading. This will then set a benchmark for other interest rates. The BB can then influence interest rates more forcefully through the supply of T-bills as a key monetary policy instrument. This would modernize interest rate management and offer savers a major secured financial asset. It would also facilitate deposit mobilization as banks compete with each other through attractive financial products as substitutes for T-bills.

References

Ahmed, Sadiq (2020), "Strengthening the Investment Climate to Promote Domestic and Foreign Private Investment", (Draft) *Background Paper* prepared for the 8th Five Year Plan, General Economics Division, Planning Commission, Government of Bangladesh, Dhaka.

Ahmed, Sadiq (2019), "Fiscal Policy for an Upper Middle-Income Bangladesh," *Paper* prepared for the 4th Bangladesh Economists Forum (BEF) Conference, Westin Hotel, Dhaka, November 04.

Ahmed, Sadiq, Mohiuddin Alamgir and Mustafa K. Mujeri (Ed.) (2017), *Institutions for Development: Urbanization and Land Issues in Bangladesh,* Bangladesh Economists Forum (BEF), Dhaka.

Ahmed, Sadiq, Mohiuddin Alamgir and Mustafa K. Mujeri (2016), *Strengthening Institutions to Accelerate Growth and Lower Poverty,* Bangladesh Economist's Forum (BEF), Dhaka.

Ahmed Sadiq, Marilou Uy and S. Ramachandran (2003), "South Asian Banking and Finance: Growth with Festering Problems", *South Asia Internal Discussions Paper,* No. IDP-186, World Bank, Washington, D.C.

Balassa, Bela (1989), "Financial Liberalization in Developing Countries," *Policy Planning and Research Working Paper Series No. 55,* World Bank, Washington, D.C.

Bangladesh Bank (2018), *Annual Report 2017-2018*, Bangladesh Bank, Dhaka.

Calderon, Cesar and Lin Liu (2003), "The Direction of Causality between Financial Development and Economic Growth", *Journal of Development Economics*, Vol. 72(1).

Department for International Development (DFID) (2004), "The Importance of Financial Sector Development for Growth and Poverty Reduction", *Policy Division Working Paper,* London.

Galindo, Arturo and Alejandro Micco (2003), "Do State-Owned Banks Promote Growth? Cross-Country Evidence for Manufacturing Industries", *Working Paper Number 483*, Inter-American Development Bank, Washington, D.C.

Government of Bangladesh (2019), *Perspective Plan of Bangladesh 2041 (Final Draft),* General Economics Division, Planning Commission, Ministry of Planning, Dhaka.

International Finance Corporation (IFC) (2017), "The Importance of Local Capital Markets for Financing Development", Available at: www.ifc.org

International Monetary Fund (2003), *International Financial Statistics,* June, Washington, D.C.

McKinnon, Ronald, I. (1973), *Money & Capital in Economic Development*, Washington, D.C., The Brookings Institution.

Khan, Mohsin, S. (2002), "Inflation, Financial Deepening, and Economic Growth," *Paper* prepared for the Banco de Mexico Conference on *Macroeconomic Stability, Financial Markets and Economic Development*, Mexico City, November 12-13.

Khan, Mohsin S. and Abdelhak Senhadji (2000), "Financial Development and Economic Growth", *IMF Working Paper WP/00/209*, Washington, D.C.

Levine, Ross (1997), "Financial Development and Economic Growth: Views and Agenda", *Journal of Economic Literature,* Vol. 35, No. 2.

Loayza, Norman and Romain Ranciere (2004), "Financial Development, Financial Fragility, and Growth", *Draft Working Paper*, World Bank, Washington, D.C.

Sen, Binayak (2000), *Bangladesh Poverty Analysis: Trends, Policies and Institutions,* Mimeo, Bangladesh Institute for Development Studies (BIDS), Dhaka.

Shaw, Edward S. (1973), *Financial Deepening in Economic Development,* New York, Oxford University Press.

World Bank (1998), "Strategy for Establishing a Sound and Competitive Banking Sector," Draft *Report*, Finance and Private Sector Unit, South Asia Region, Washington, D.C.

Xu, Guangdong and Binwei Gui (2019), "From Financial Repression to Financial Crisis? The Case of China," *Asian Pacific Economic Literature*, Vol. 33, Issue 1, pp. 48-63.

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp. 114-161)

Financial Sector-Real Sector Nexus in Bangladesh: Challenges and Opportunities

- Mustafa K. Mujeri*

1. Introduction

Bangladesh has made remarkable progress in raising economic growth and reducing poverty since its independence in 1971. Based on the international poverty line of $1.90 per person per day, Bangladesh reduced the poverty incidence from 44.2 per cent in 1991 to 14.8 per cent in 2016. Along with this, life expectancy, literacy rates, per capita food production, and other social indicators have risen significantly. The progress was underpinned by rapid economic growth - GDP growth reached 8.13 per cent in 2018-19 (MOF, 2019).

After independence, Bangladesh was one of the poorest countries in the world with a war-ravaged economy. Its economic prospects were regarded so unpromising that it was considered as a 'test case for development'. It was argued: 'If development could be made successful in Bangladesh, there can be little doubt that it could be made to succeed anywhere else. It is, in this sense, that Bangladesh is the test case for development' (Faaland and Parkinson, 1976).

However, within a mere 45 years, the country achieved a per capita Gross National Income (GNI) of $1,909 in 2018 which was $120 in 1972. Bangladesh's recent development and the rapid progress in many economic indicators achieved within a short span of time are widely treated as a unique model of success on many counts (Mujeri and Sen, 2006). In particular, the progress in social sectors has been noteworthy with several indicators showing some of the fastest improvements in the history of development.

---

*Dr. Mustafa K. Mujeri is the Executive Director of Institute for Inclusive Finance and Development (InM), Bangladesh. He was the Director General of Bangladesh Institute of Development Studies (BIDS) and the Chief Economist of Bangladesh Bank (the central bank of Bangladesh). Dr. Mujeri obtained Ph.D. in Economics from McMaster University, Canada. Views expressed in this article are the author's own.

Sustained rapid growth has enabled Bangladesh to reach the Lower Middle-Income Country (LMIC) status in 2015. No doubt, the upgradation of Bangladesh's development status to a LMIC is a remarkable milestone in the country's economic achievement.[1] In 2018, Bangladesh also fulfilled all three eligibility criteria for graduation from the UN's Least Developed Countries (LDC) list for the first time and is on track for graduation in 2024.[2] To achieve its growth aspiration of becoming an Upper-Middle Income Country (UMIC) by 2030 and a High Income Country (HIC) by 2041, Bangladesh has adopted the 'Vision 2041' along with longer term development plans.

As a LMIC, Bangladesh is likely to face increased vulnerability to economic and financial openness in the coming years. Middle-income countries which expose themselves to global flows of goods and capital without proper safeguards run the risk of being affected more by global crises. The challenge of financial vulnerability is likely to be more severe for the countries which have liberalised their financial markets in order to gain easier access to capital. Capital mobility allows countries with limited savings to attract financing for productive investment. To address complex development challenges, many countries expedite reforms to modernise their financial sector and increase integration to the global financial markets, as well as adopt a more open and liberal capital account regime (Anglingkusumo, 2013).

---

[1] The World Bank divides the world's economies into four income groups: high, upper-middle, lower-middle, and low. The income classification is based on a measure of national income per person, or GNI per capita. For the 2020 fiscal year, low-income economies are defined as those with a GNI per capita, calculated using the World Bank Atlas method, of $1,025 or less in 2018; lower middle-income economies are those with a GNI per capita between $1,026 and $3,995; upper middle-income economies are those with a GNI per capita between $3,996 and $12,375; high-income economies are those with a GNI per capita of $12,376 or more.

[2] The graduation from UN's LDC status depends on three criteria: Gross National Income (GNI) per capita, Human Assets Index (HAI) and Economic Vulnerability Index (EVI). Bangladesh fulfilled the eligibility criteria for graduation for the first time in 2018. If Bangladesh meets the graduation criteria again in 2021, it will be recommended for graduation from the LDC category in 2024.

For avoiding financial vulnerability, Bangladesh needs reforms including the implementation of a strong and coordinated medium-term macroeconomic framework so as to reduce the risks to financial and macroeconomic stability (World Bank, 2010; Van Doorn *et al*., 2010). The important issues are: a lack of flexibility in the exchange rate, high debt-equity ratio, a lack of regional cooperation for volatility control, and weak institutional frameworks to deepen local currency markets (Gill and Kharas, 2007; UN General Assembly, 2011; Foxley, 2009).

In addition, vulnerability may also emanate from the very economic integration which contributes to increased competitiveness. Rapid integration of the Bangladesh economy to the global market can have adverse effects when domestic industries are not sufficiently competitive and when there is an unplanned transfer from agricultural to industrial production. In the former case, domestic industries unable to keep up with global production fall behind, exposing the economy to volatile global commodity markets. In the latter case, a slow transfer of labour into industrial production increases unemployment and results in low wages of labour.

On the other hand, recovery in the face of a global financial crisis is facilitated by the capacity to attract large capital inflows, which allows reviving growth before undertaking restrictive monetary and fiscal policies. Furthermore, financial deregulation needs to be a long and gradual process, especially in the context of large external account surpluses. There should also be monetary and fiscal policies to overcome weak economic fundamentals and the self-fulfilling nature of the crisis. The financial sector reforms should focus on quickly normalising the financial system through restructuring, and rebuilding a financial safety net to prevent future crises.

Further, Bangladesh needs to ensure that all banks (and also, non-bank financial institutions) are strong and healthy. It also needs to manage the pace of further liberalisation of the financial markets and to balance it against the risk of the interconnectivity of domestic financial markets with global financial flows. The country also needs to implement a consistent macroeconomic policy framework with multiple instruments, including the traditional market-based interest rate instrument and administrative measures such as statutory reserves requirement, for absorbing the excess liquidity generated by capital inflows (Anglingkusumo, 2013).

This paper is organised in four sections. After this introductory section, Section-2 discusses in brief Bangladesh's growth experience over the past decades and examines economic vulnerability and structural transformation issues and strategies and policies needed by Bangladesh for moving beyond the 'middle-income trap'. Section-3 analyses financial sector issues with an emphasis on banking and capital market development for upper-middle-income Bangladesh. Finally, Section-4 provides conclusions and major policy implications.

2. Bangladesh's Development and Financial Sector Implications

For discussing the financial-real sector nexus for an Upper Middle Income (UMI) Bangladesh, a review of the country's development experience of the past decades is useful, as it serves as the reference point for identifying future challenges and the policy choices.

The long term average growth rate has accelerated slowly in Bangladesh, and despite significant variation around the long term average, the growth rate has never reversed for a prolonged period (Table-1). The rate of GDP growth increased from 3.77 per cent during 1961-1970 (pre-independence period) to 3.99 per cent during 1976-1980 and decreased to 3.62 per cent during 1986-1990; but the next three decades saw average GDP growth rate rising by about one percentage point in each decade. The annual per capita GDP growth rate, which was only around one per cent till the 1990s, accelerated in the later years and reached 5.54 per cent during 2014-2018. Bangladesh's GDP per capita increased by nearly three-fold in absolute terms from BDT 18,293 to

BDT 54,485 (at constant 2006 prices) since the second half of the 1970s (Table-1).

Table 1: Bangladesh's GDP Growth at Constant Prices

Period	Average Yearly Growth Rate, % (Constant 2006 Prices)	Annual Per Capita GDP Growth Rate, Constant 2006 Prices, %	GDP Per Capita, Constant 2006 BDT	GDP Per Capita Index, 2006 Prices (2006=100)
1961-1970 (Pre-independence period)	3.77	1.01	22,700	68.41
1976-1980	3.99	1.40	18,293	55.13
1986-1990	3.62	1.07	20,490	61.75
1996-2000	4.61	2.62	25,346	76.39
2006-2010	5.52	4.60	36,637	110.42
2014-2018	6.63	5.54	54,485	164.21

Source: World Bank, *WDI, 2018*

The Table-1 shows that Bangladesh's long-term economic growth has steadily accelerated over the last several decades, without any major reversals. The acceleration of growth is evident not just for aggregate GDP, but even more strongly for per capita GDP. This steady and rapid acceleration of both aggregate and per capita GDP growth within such a short span of time stands out as something unique to Bangladesh.

Bangladesh's rate of growth has also become more stable. This is due to two major developments in the sectoral composition of growth. First, growth within all major sectors (agriculture, industry and services) has become more stable over time; and second, there has been a transition of the economy towards the services sector, where growth is usually more stable. This has been true especially since the 1990s. During the 1970s and 1980s, growth volatility was more pronounced, and annual growth rates were characterised by large and unsustainable annual variations. After liberalisation, growth has not only accelerated since the 1990s, but has also become more stable.

Over the years, Bangladesh's economic growth has also become more diversified. The fastest acceleration has taken place in the services sector, followed by industry, and agriculture. Over the long run, growth has been driven by large consumption expenditures, and rising investments and exports. There have also been productivity gains-both labour productivity and Total Factor Productivity (TFP), although the size of the gains is small.

Moreover, growth has broadly been resilient to shocks, both domestic and external. The resilience of Bangladesh's growth can be attributed to the country's spatially diversified economy, as well as to its diversified production structure. It can also be attributed to the country's progressively diversifying trade basket (mostly comprising essential commodities) and broad range of trading partners, mostly in the developed world.

The resilience of Bangladesh's growth process was on display in recent years when the country quickly tackled the impacts of two major global shocks – the global financial crisis of 2007-08; and the high indebtedness that has become a critical feature of the global economy since the 2010s. In the last decade, debt levels have risen visibly across countries and sectors, fuelled by ultra-loose monetary policies in major economies. Public and private debt has reached historical highs in many countries. According to the United Nations Conference on Trade and Development (UNCTAD), the global debt stock is nearly one-third higher than in 2008 and more than three times the global GDP.

Yet, despite the growth rate recovering, attaining a double-digit growth by Bangladesh on a sustained basis would depend on an effective structural reform agenda. Over the last five decades, there have been seven episodes of high growth exceeding 7 per cent, one each in the 1970s and 1980s, and the rest five in the 2000s of which four are consecutive during 2016-2019. The earlier episodes lasted for only one year, and corrected sharply in the year thereafter. In some of these cases, high growth was due to a low base impact of slow growth in the previous year followed by unusually good agricultural output. The only durable episode of growth sustaining at levels above 7 per cent for four consecutive years is the one that lasted from 2016 to 2019. This episode benefited from the combined effect of important reforms undertaken in the 2000s, and from a favourable global economy, leading to high sustained growth across sectors and all components of GDP.

In future, sustaining a growth rate higher than the trend growth rate of 7.0 to 7.5 per cent, and reaching a growth rate of 9 percent or higher, will require contributions from all domestic sectors as well as support from the global economy. Achieving this would require a concerted reform effort that maintains the reform momentum and widens its scope, and succeeds in reversing the slowdown in investment, credit supply and exports. Maintaining the hard-won macroeconomic stability, arriving at a definite and durable solution to banking sector issues, realising the expected growth and fiscal dividend from the tax reforms, and regaining the momentum on the unfinished structural reform agenda are other key components of attaining high growth.

It must also be acknowledged that Bangladesh has been more penetrated by social actors than many East and Southeast Asian countries since the beginning. As is well-known, state-driven nationalisation or state-driven globalisation processes demand a state having adequate command over powerful social and interest groups in society. However, in the case of Bangladesh, successful reforms need to evolve in a gradual manner along with building a social consensus on the reforms. The country's development model is a partnership between the state and society, where the power of the state, even in its commanding moments, can be moderated by social actors.

Furthermore, economic policy reforms need to build upon the historical path of gradual changes in ideas and policies, punctuated by economic crises. Such dynamics explain the success of the politics of the green revolution and understanding of liberalisation after the 1990s. It is also important to realise that the trade, investment and infrastructure reforms of the 1990s, although they constituted a break from the past, were largely path-dependent. Without the experience of the 1970s and the 1980s, the conviction required to break the deadlock in favour of the status quo bias would not have arisen. It is a story of getting to higher rates of growth in a gradual manner after building a policy consensus among diverse stakeholders. No doubt, economic crises aid the arrival of a new policy consensus in Bangladesh.

2.1 Financial-Real Sector Nexus: Theoretical Underpinnings

Current development policy pays increasing attention to the importance of the financial sector in economic and social development, and creating economically sound and stable financial institutions. A developed financial system mobilises productive savings, allocates resources efficiently, improves risk management, and reduces information asymmetry, all of which facilitate innovation and entrepreneurship. The models which focus on the growth-enhancing effects of the financial system derive their insights regarding the importance of the financial system and financial institutions for growth from the theory of finance and through transplanting these insights into models of growth (see, for example, Bencivenga and Smith, 1991; Greenwood and Jovanovic, 1990; King and Levine, 1993). The positive correlation between economic growth and the development of the financial system essentially results from higher marginal productivity of the invested capital. Moreover, higher economic growth from increased levels of financial asset formation occurs in countries where there is a low or medium per capita income, as in Bangladesh.

The relationships between the financial and the real sectors may be classified in terms of causality working through five possible hypotheses: (i) no causal relation; (ii) demand-following relation; (iii) supply-leading relation; (iv) negative causal link from finance to growth; and (v) interdependence. In addition, a number of syntheses can be possible using the five hypotheses, basically with respect to evolutionary sequencing or different needs on the part of industries or types of enterprises.

The view of no significant relationship between financial sector development and real growth is expressed most prominently by Lucas (1988). The assertion is consistent with a neoclassical world of zero transaction costs and perfect information. In such a world, the Modigliani-Miller theorem holds and institutions, in particular financial institutions, do not matter (Modigliani and Miller, 1958). This ‘irrelevance hypothesis’ has been widely criticised on several counts: (i) economists increasingly deny the existence of frictionless markets, primarily based on informational and related arguments (such as agency problems, transaction costs etc.); (ii) the importance of institutions is now widely recognised; and (iii) a large number of empirical studies show strong evidence for the relevance of finance for real growth. Robinson (1952) argues that 'finance follows where enterprise leads' showing a causal relation from the real to the financial sector (demand-following finance). This hypothesis regards financial development as endogenously determined by the real economy or its needs. This view is consistent with the Coase theorem (Coase, 1960) and the New Institutional Economics which argues that institutions adjust to market imperfections in a way that maximises individual utilities. The 'demand-following approach', on the other hand, is based on empirical evidence and regarded as a temporary situation that may persist only under special circumstances, such as transition to a market economy.

The recent supply-leading finance arguments begin with McKinnon (1973) and Shaw (1973), who consider finance as largely supply-leading, i.e. finance positively influences the real economy. There also exists a hypothesis that finance has a detrimental effect to the real development of an economy which refers to the danger of financial crises, often in relation with speculative bubbles (Bhatt, 1995) or, more generally, hiding of the fundamentals of the real economy, particularly through capital market speculation.

Empirical evidence, in general, suggests that both arguments in favour of supply-leading and demand-following finance are of relevance, i.e. the causal link between finance and real growth runs in both directions. The influence may be exerted at the same time, implying that financial depth (i.e. large financial markets) drives real growth, while the growing economy's demand for finance is met by the advancing financial sector. Alternatively, it may depend on an economy's general development stage whether its financial sector is supply-leading or demand-following. The most prominent hypothesis of such a sequential pattern of causation is put forward by Patrick (1966). Patrick argues that developing countries can gain significantly in real terms from developing their financial sectors (supply-leading finance), whereas, in the developed economies, finance becomes increasingly demand-following.

Recognising the importance of financial sector in development and financial policies in developing countries including Bangladesh have put increased emphasis on the market mechanism and liberalisation which is partly a response to the developments in the financial markets themselves. In developing countries, the main impulse behind liberalisation is the belief, based on the notion that interventionist financial policies are one of the main causes of financial crisis, that liberalisation would help to restore growth and stability by raising savings and improving overall economic efficiency. However, these expectations have not generally been realised. In many developing countries, instead of lifting the level of domestic savings and investment, financial liberalisation has increased financial instability. Financial activity has increased and financial deepening occurred, but without much benefit to the real sector.

On the other hand, the policies have succeeded in making finance serve the industry and trade, but not the other way round. In most cases, these policies necessitated considerable intervention and control over the financial activities. These have included persistent misalignment of prices of financial assets, resulting in inefficiencies in the allocation of resources; sharply increased short-term volatility of asset prices, resulting in greater uncertainty, shorter maturities and higher interest rates; excessive borrowing to finance speculative asset purchases and consumption, resulting in unsustainable stocks of debt, increased financial fragility and reduced household savings; and loss of autonomy in pursuing interest rate and exchange rate policies in accordance with the needs of trade and industry. The government intervention in finance has often been misguided as well, giving rise to inefficiency and waste. The main challenge is to determine where and how the government should intervene and to ensure that the intervention achieves its aims.

2.2 Moving beyond 'Middle-Income Trap'

One major challenge to growth and competitiveness for an UMI Bangladesh is industrialising while gaining in productivity. The Bangladesh economy is in transition to industrial production and experiencing a sharp fall in the share of agriculture (or primary production) without experiencing a commensurate rise in secondary sector productivity. This is central to falling into the 'middle-income trap' (Ohno, 2011).

A major concern relates to Bangladesh's chance of developing beyond the so-called 'middle-income trap'.[3] This relates to a situation, in which middle-income countries fail to progress further to high-income economies, since they fail to shift their growth model towards more specialisation in production and employment, greater reliance on innovation, and more emphasis on the ability to shape new products and processes (Gill *et al*., 2007). The Asian Development Bank (ADB) uses the term to refer to 'countries stagnating and not growing to advanced country levels' and attributes the cause of the phenomenon to the failure to 'make a timely transition from resource-driven growth, with low-cost labour and capital, to productivity-driven growth' (ADB, 2011).

Development economics literature offers several plausible explanations for a middle-income trap or slowdown. The first is the rising labour costs after the economy reaches the Lewis turning point (Wang and Weaver, 2013). The second is the exhaustion of the catch-up effect. After an economy reaches middle-income status, marginal returns to capital accumulation diminish rapidly so that further labour productivity growth has to rely more on technological progress. However, with industrialisation progressing to the technological frontier, most of the 'low-hanging fruits' get picked up; and fewer technologies remain to be adopted.

[3] The term 'middle-income trap' contrasts the concept of 'poverty trap' (or 'low-income trap'), which is well-studied in the literature of development economics. For many years, development economics has paid much attention to 'poverty trap', i.e. '[a] bad equilibrium for a family, community, or nation, involving a vicious circle in which poverty and underdevelopment lead to more poverty and underdevelopment, often from one generation to the next'. See, Todaro and Smith, 2012: 175. According to World Bank and DRC (2012), in past half a century, many countries have developed rapidly into middle-income status, but far fewer have gone on to high-income status. Of the 101 middle-income economies in 1960, only 13 managed to upgrade themselves to high-income status by 2008. Between 1995 and 2005, the increase of per capita wealth in the upper-middle income group was only 11%, considerably slower than that of high-income OECD group (25%), lower-middle income group (48%), and low-income group (17%) (World Bank, 2011).

Since low-cost labour and easy technology adoption are the main drivers that propel the growth of developing economies such as Bangladesh, the disappearance of these drivers may cause significant slowdown if new engines of growth are not identified, especially in technological innovation and creative business models. The loss of these drivers is further aggravated through international links, which prevail in the globalised world. Even if there are no trade barriers or frictions, the Balassa–Samuelson effect may operate such that the fast-growing country’s real exchange rate rises, either via faster domestic inflation or nominal exchange rate appreciation or both (Samuelson, 1994). This reduces the middle-income country’s export competitiveness to slow down export-led growth.

There are also social and environmental factors that may contribute to the middle-income country slowdown. The inverted-U Kuznets curve suggests that in the early stage of industrialisation, the distribution of income tends to worsen before it eventually improves at a later stage (Kuznets, 1955). Although empirical evidence on Kuznets curve exists in some historical cases but remains elusive in others, the hypothesis fits well with Lewis model’s implication on changes of income distribution before and after the economy reaches the Lewis turning point. The plausible scenario of rising social inequality through the early stage of industrialisation may pave the way to a period of social unrest, political instability, and economic slowdown.

The environmental Kuznets curve presents an inverted-U relationship between the level of per capita income and the level of environmental pollution. Although, there exist some exceptions in cases like green-house emissions, most environmental pollutants, such as suspended particulate matter, sulfur dioxide, sewage, etc. have followed the projection of the curve. The logic behind the curve suggests that the opportunity costs of pollution abatement are too high to be affordable when industrialisation starts. When income reaches a certain level, ‘people become rich enough to care about pollution and take steps to reduce it.’ (Weil, 2013) When resources are diverted to clean up the pollutants, GDP-measured growth often has to slow down.

In the case of Bangladesh, many of the plausible causes of middle-income slowdown may be compounded by reality. For instance, the impact of Lewis turning point is likely to be intensified by the country's rapid demographic transition. The arrival of a fast-aging society bodes badly for the future of the country's social security burden and productivity growth. In addition, income inequality is rising; the Gini coefficient has increased from around 0.40 in the early 1990s to over 0.48 in 2016.

Several policy issues are important for Bangladesh in the context of moving beyond the middle-income trap. First, the fiscal capacity of the government is a key condition for ushering a successful transition. Ultimately, fiscal capabilities are the ultimate determinants that define the quality and level of public goods that the government could provide to sustain the country's catching-up progress in future.

Secondly, the trends and problems of the country's financial market show that the prominance of the state-owned financial enterprises distorts these markets and these distortions contribute significantly to the risks of stumbling on a middle-income trap. The markets needs more freedom to act without these distortions so that a Schumpeterian process of 'creative destruction' can be set in motion and private entrepreneurship can play a greater role to promote productivity growth.

Thirdly, as Bangladesh moves from LMI to UMI status, the demand for urban housing is likely to surge in the backdrop of massive urbanisation. How this housing market boom affects household savings may have important implications on national savings, the loanable fund market, and consequently the economy's growth trends.

The process of industrial upgrading that Bangladesh needs to undergo as it enters the UMI stage, should shift the economy from labour-intensive to technology-intensive production, driving up wages and driving down competitiveness (World Bank, 2012). In the process, Bangladesh faces two constraints in properly mobilising technical skills to increase productivity. The first is that the growth in industrial production is spurred, in most cases, by an influx of small and medium enterprises which decrease overall productivity

(Cervantes-Godoy and Brooks, 2011). These firms are not sufficient to drive growth in technical skills (Ohno, 2009). Unless this is properly resolved, Bangladesh may experience productivity-reducing structural change, where labour moves to activities with lower productivity.

The second reason is that a newly industrialising UMI Bangladesh could be outpaced by regional powerhouses such as China and India. Both China and India, for example, absorb a large portion of cheap labour-intensive industry, creating a barrier to entry by its low wages and scale (Chandra *et al.,* 2012), even though, in some cases, regional powerhouses may pull up other neighbouring countries.

Bangladesh, as a newly graduating UMIC, may initially benefit from factor accumulation in the secondary sector, which drives growth as it did in South Korea, Nigeria, and Egypt in the 1960s and 1970s. However, growth in industry is not sustainable without gains in total factor productivity (Satoru, 1997). For example, South Korea's attention to productivity growth through its policies and institutions enabled it to sustain productivity growth.[4] South Korea's productivity-specific institutions and policy focus provide useful policy lessons for Bangladesh which is starting to experience rapidly increasing industrial production and rising wages.

For Bangladesh, one important challenge to competitiveness is in establishing suitable institutions for industrial policy. In the past, at lower levels of industrialisation, gains in economic growth could be experienced by liberalising trade and safeguarding macroeconomic balances (Altenburg, 2011). Institutions did not require high importance. Growth in Bangladesh at early stages of industrialisation has therefore taken place in the absence of properly-functioning institutions.

---

[4] South Korea established the Korean Productivity Centre in the late 1950s with the sole aim of increasing productivity. This institution was allowed to play a central role in economic policy planning, enabling productivity growth policy to be incorporated in long-term economic planning (KDI, 2011; Hak, 2005).

However, institutions for industrial policy are important for a UMI Bangladesh for three important reasons: (i) adjusting production across various sectors to learn what is profitable and feasible, which requires support from the government; (ii) managing investment and growth in the economy with expanding secondary sector production and lacking policy coordination among stakeholders; and (iii) ensuring an efficient and equitable distribution of public inputs in the form of infrastructure, legislation, and research and development (Altenburg, 2011).

Middle-income countries that have seen great successes in industrial policy are also seen to have established effective institutions at the same time as they have carried out economic liberalisation (Cheng *et al.,* 1998). This suggests the importance of institutional alignment in tandem with economic liberalisation for MICs (Altenburg, 2011).

The ability of the state to effectively participate in coordinating economic activity presents another important challenge to UMI Bangladesh. Middle-income economies are especially susceptible to both falling into low equilibriums in sector productivity and inability to mobilise investment and entrepreneurial enterprises (Rodriguez-Clare, 2005). This is because MICs with a rising skilled labour force but insufficient capital endowments are not able to properly invest in and profit from modern sector production.

The state may thus have to play a central role in encouraging economic growth, especially in negotiating market and coordination failures (World Bank, 1993; Jomo, 2001; Rodrik, 2008). However, the policies for the productive sector aimed primarily at correcting market failures should not be piece-meal, non-transparent and not well coordinated. More importantly, they should focus sufficiently on accumulation of technological capabilities, which allows for broad-based structural change towards higher value-added activities and is therefore the driving force behind sustained productivity growth. It is seen that successful state attempts at coordinating economic activity have mobilised capital and investments efficiently (World Bank, 1993).

Bangladesh's transition to the UMI status also faces the challenges in integrating economic activities since Bangladesh needs to establish economies of scale for its export industries and develop a wide variety of industries having scale and competitiveness. Firstly, there has to be vertical integration—to have control over supply chains and intermediary goods to reduce production costs and ensure the supply of parts (Gill and Kharas, 2007). Secondly, there is a need for spatial integration to benefit from economies of agglomeration (World Bank, 2009). Finally, regional integration may be necessary to fully benefit from technical assistance and access to capital markets in the region (Fallon *et al.*, 2001; UN General Assembly, 2011). Further, a key advantage of such integration for Bangladesh will be to facilitate the dynamic specialisation of trade and 'trade fragmentation' for developing niche local advantages to attract specific types of production in intermediary goods and allow the country's Small and Medium Enterprises (SMEs) to get involved in regional production networks and upgrade their value-added in production (Kimura and Obashi, 2011).

Bangladesh's success in moving up the global production chains also requires facilitating domestic policies, such as spatial integration. One way to achieve this is through industrial park planning and development. For the purpose, the government needs to take the responsibility of construction, location and functioning of the parks.[5] This will help streamline foreign and domestic investments, and technology transfers can be made easier and the needs of industries adjusting to rapid urbanisation could be taken into account.[6] Thus, proper integration of economic activity is a useful tool when implemented in tandem with new industrial growth policies of the middle-income transition.

Another important challenge for UMI transition of Bangladesh is increasing innovation. Although wage increases may not harm productivity if accompanied by increases in labour efficiency or overall efficiency of production, limited

---

[5] For example, South Korea's industrial parks were developed in the early 1960s, nearly 20 years before its entry into the middle-income status. As a result, South Korea benefitted from an easier adjustment to challenges faced as it became a middle-income country.

[6] An example of urbanisation adjustment could be to develop an industrial park near the capital city of Dhaka specifically to accommodate small and medium enterprises relocating from the city centre.

innovation, technical change and technological adoption may rapidly exhaust productivity gains from factor accumulation. In order to sustainably increase productivity and competitiveness, gains in innovation are required (Gill and Kharas, 2007).

For a successful UMIC, three features are important: (i) ability of a significant share of local firms to adopt technological knowledge from more advanced countries to the enterprise and country-specific contexts; (ii) Transition of Transnational Corporation (TNC) emerges from the assembly of labour intensive, low-tech products towards production in medium and high-tech products; and (iii) emergence of skills training programmes and growing/high enrolments at the secondary school level for building key social capabilities (Paus, 2013).

There are two major obstacles for achieving more innovation in Bangladesh. The first is the very limited spending on research and development (R&D). Higher innovation is correlated with higher growth (World Bank, 2011). Low public spending on R&D and a low share of R&D spending by the private sector adversely affect innovation (ADB, 2011). The second is the lack of institutional capacity to absorb the existing technology and human capital that contributes to higher innovation. This includes the inability to guarantee a job market to accept a higher educated population, quality institutions for research and higher education, and collaboration between public and private sectors (Gill and Kharas, 2007).

In the above context, the South Korean experience during its middle-income period provides several valuable insights. The first is in its use of economic and financial mechanisms to boost investment and direct production. The state initially offered credit subsidies and tax incentives to the private sector, directing public investment into enterprises focusing on modern sector production and exports (Rodrik, 1995). The state also subsidised specialised education, technology and innovation initiatives tailored to private sector needs (World Bank, 2006).

Currently, Bangladesh is struggling to properly mobilise innovations. According to the Global Innovation Index 2018, published annually by Cornell

University and the World Intellectual Property Organisation (WIPO), Bangladesh is ranked 116th, the lowest in South Asia. Bangladesh's R&D expenditure is the lowest in the region and the majority of the amount is spent by the government. Bangladesh's science and technology policies are not integrated with its education policies, and have very limited interaction between its institutions of higher learning and enterprises. The Bangladesh example highlights both the potential for economic gains via primary sector innovation and the constraints imposed by a lack of private sector involvement in R&D.

3. Policies for UMI Transition

The above analysis brings out a number of basic challenges that deserve well-articulated policies for ensuring a relatively smooth transition of Bangladesh to the UMI status.

One major challenge relates to economic and financial stability. In addition to domestic determinants, these are related to global and regional financial flows and the rising openness of the country's markets and trade regimes. Bangladesh needs to design specific macroeconomic mechanisms and tools to avoid crises, and recover from crises during its UMI journey. There are also challenges to economic growth, in which the planning and implementing roles of both the public and private sectors are important. Bangladesh needs to successfully navigate the relationship between the public and private sectors in overcoming the challenges to growth.

Also, challenges to social equity have particular dimensions in Bangladesh, and the country's approach to the problems of poverty and income inequality and access to social services needs to shape an effective social welfare regime. Environmental challenges are also keys to understanding and managing sustainable future growth for Bangladesh. Both environmental and social inclusiveness need appropriate financing along with innovative strategies. These challenges should comprehend the crucial role of demography and urbanisation.

Further, adopting policies for Bangladesh's UMI journey is not a simple two-step matter of identifying the 'correct' policies and adapting these to Bangladesh context. More consideration needs to be given to the policy formulation process (the 'how') and to the fuller understanding of the direction that the country is taking for development (the 'why').

The policy agenda also needs to highlight the interconnectedness of the above issues and the importance of sequencing in tackling them. The traditional sequencing is to provide overriding priority to industrial growth, followed sequentially by efforts to rescue and prevent crises, promote equality and welfare, and finally alleviate climate change and environmental degradation. Also, the preference for addressing inequity is not by radical redistribution policies, but mainly by social protection measures. The real challenge for Bangladesh is to find a model that can tackle all the above issues within a short period of time without incurring serious adverse effects that fit with the country's multiple goals.

For an UMI Bangladesh, one critical strategy for reducing inequalities is that of ensuring universal access to good quality basic goods and services. This can be seen as part of a 'social protection floor' - an integrated set of social policies designed to guarantee income security and access to essential social services for all, paying particular attention to the vulnerable groups and protecting and empowering people across the life cycle.

In the above context, it is important to recognise that the growth of social assistance has important implications for the working of the labour market and evolution of welfare institutions. Labour supply responses to social assistance transfers are broadly positive. Human development-focused programmes targeting children's schooling mostly reduce child labour, while social pensions reduce the labour supply of elders. Social assistance programmes can facilitate welfare improving re-allocation of household productive resources. A guaranteed minimum income can facilitate job search, labour migration, and improve labour earnings; but the effects are highly dependent on household conditions. The growth of social assistance will also shape in important ways the evolution of welfare institutions. Social assistance growth is effective in supporting the inclusion of informal and low-income groups within social protection systems.

3.1 Financial Sector Policies

For the financial sector, an important priority is to ensure that all banks (and also, non-bank financial institutions) are strong and healthy. It is well recognised that an economic crisis that includes a banking crisis usually have a more severe and prolonged impact on the real sector of the economy. An unhealthy banking industry also tends to weaken the determination of policy makers to implement a consistent macroeconomic policy when these policies are most needed. As a result, an unhealthy banking industry tends to exacerbate macroeconomic imbalances and solidify the foundations for a larger financial crisis.

Accordingly, the government needs to develop stronger regulatory and supervisory frameworks for the banking industry and continuously enhance the frameworks so as to make them in line with the international best practices. Another important financial policy is to implement a counter-cyclical capital buffer. This would reduce the pro-cyclicality of credit growth over the business cycles, hence promoting moderation of economic cycles.

It is also necessary to ensure that the government's medium to long-term fiscal posture is solid. A weak fiscal posture projects inconsistency of macroeconomic policy and creates a credibility gap which severely lowers the government's ability to consolidate private supports for reform.

In addition, it is important to manage the pace of liberalisation of the financial markets. While introducing more financial innovations into the financial markets will add to the vibrancy of trading activities and improve liquidity, it would also increase the interconnectivity of domestic financial markets with the global financial markets, particularly with markets in mature economies, and attract more speculative traders.

As such, macro-financial policy makers need to carefully weigh in on the balance between advantages and disadvantages of such policy direction. Moreover, policy makers need to complement the implementation of stability-oriented monetary policy with steps to further strengthen the regulatory, supervisory, and monitoring frameworks of the financial system. The overriding aim should be to prevent excessive leveraging (ris- taking behaviour) that may compromise the state of financial stability. The promotion of market discipline and injection of a reasonable dose of conservatism through strong regulations are key factors in ensuring that financial markets do not develop into a shock amplifying factor for the real side of the economy and hence a nullifying factor on the pace of poverty reduction.

Bangladesh's priority would be to implement a consistent macroeconomic policy framework with multiple instruments, including the traditional market-based interest rate instrument and administrative measures, such as statutory reserves requirement, for absorbing the excess liquidity generated by the capital inflows. This is particularly important at the initial stage of Bangladesh's financial development. Towards this end, the need is to accelerate the development of domestic capital markets, with particular attention to the market for government bonds, by promoting a more liquid market for local currency government bonds and a well-functioning money market. These would help increase the effectiveness of the implementation of a market based monetary policy.

This may be followed by the use of fully sterilised foreign exchange market interventions, to limit the impact of real exchange rate appreciation on economic growth during episodes of large capital inflows. In other words, as Bangladesh wants to accumulate foreign exchange reserves, it needs to fortify itself with self-insurance against the adverse impact of volatile capital flows. But if this measure is taken, in addition to full sterilisation, Bangladesh also needs to expedite real sector reform, for real competitiveness an outcome of value-added and not of prices. In this context, Bangladesh needs to implement measures to strengthen the capacity of public institutions in planning, implementing and monitoring structural reforms. This would help remove a large portion of impediments to a more balanced and higher long-run economic growth.

3.2 Issues of Middle-Income Trap

The concept of the middle-income trap is based on a well-known stylised fact. Low-income countries can grow rapidly and graduate to middle income but then find it difficult to sustain rapid growth after they reach the middle-income status. A justification for this belief is the assumption that economic growth intrinsically slows down when a country graduates from low to middle income. An alternative view is that growth slowdowns in countries reaching middle-income status may sometimes be due to poor policies rather than something intrinsic or inherent to the process of economic growth.

Nevertheless, there are intuitive reasons for thinking that growth may slow down as countries reach middle-income status. The easy gains from shifting workers from low-productivity agriculture to higher-productivity manufacturing and/or services end once the pool of underemployed rural labour is drained. Marginal returns to capital may decline as the economy accumulates a larger capital stock. As countries approach the global technology frontier, they must move up the technology ladder and develop new technology on their own rather than relying on advanced technology imported from abroad.

Further, measures towards strengthening innovative capacity are important for successfully navigating the transition to high-income status. But growth based on productivity improvement poses new and different challenges—challenges sometimes seen as inherently more difficult—than growth based simply on additional inputs. As the share of manufacturing in employment and output peaks and gives way to employment and output of services, it may become more difficult to boost productivity, given that capital and technology have traditionally been difficult to apply to the production of services.

3.3 Strengthening the Financial Sector

Like most developing countries, Bangladesh's financial sector is relatively weak. The modern theory of finance shows that with asymmetric information among potential borrowers and lenders, it is rather difficult to organise interpersonal and intertemporal resource transfers due to the incentive and information problems inherent in any financial transaction. Accordingly, the institutions which organise the bulk of this resource transfer and therefore constitute the core of any financial system - the commercial banks have to implement mechanisms to overcome these problems.

The hypothesis is therefore strong in a country like Bangladesh that the underdevelopment of the financial sector is due to the fact that the financial institutions are unable and/or unwilling to overcome the incentive-related problems associated with external financing and there exist poor risk diversification, inadequate loan evaluation, and corruption and fraud. A key element in any strategy for development for UMI Bangladesh is therefore to extend the 'frontier of finance'.

The major institutional challenges for financial sector management, however, emerge from striking the right balance to achieve the triple aims of financial stability, growth, and equity (Griffith-Jones *et al.,* 2010; IMF, 2012; Haldane and Madouros, 2012). These relate to the links between the financial sector and inclusive and sustainable development. This may include issues such as the desirable size and structure of the financial sector and regulatory challenges to maximise the likelihood of achieving financial stability, while safeguarding inclusive and more sustainable growth.

3.3.1 Finance-led Growth and Growth-led Finance

Theoretical underpinnings of the link between financial development and growth stem from the insights of endogenous growth models, in which growth is self-sustaining without exogenous technical progress. Financial institutions have also been included in the analysis of endogenous growth models (see, Greenwood and Jovanovic, 1990). Well-developed financial markets promote investment and growth by channeling financial resources to the most productive uses.

The finance-led growth hypothesis is based on the notion that finance causes economic development through the transfer of scarce resources from savers to investors (Levine, 1997). The supply-leading finance transfer from traditional (non-growth) sectors to modern high-growth sectors stimulates entrepreneurial response in the modern productive sectors. The hypothesis assumes a causal relationship from financial sector development to economic growth, meaning that the establishment of financial institutions and markets increases the supply of financial services leading to economic growth.

The growth-led finance (demand-following), on the other hand, stipulates that economic growth creates demand for financial instruments and enterprises lead and finance follows, so the relationship starts from growth to finance, hence the demand following hypothesis. The theory posits that financial development and innovative products are engineered in a passive response to the demands of a growing economy. As the economy grows, demand for financial services grows and the demand forces the financial system to respond by providing new products and services specifically meant for new needs. The feedback hypothesis is based on the view that there is a bi-directional causal relationship between financial growth and economic performance.

In practice, both hypotheses may work in Bangladesh. Over the years, Bangladesh's financial system, particularly banking and microfinance, has grown and developed. The banks' total assets and private credit ratios to GDP have increased; and bank deposits, as a percentage of GDP, are comparable to other South Asian countries. Private domestic banks now hold a majority of bank assets; the shares of State-Owned Commercial Banks (SCBs) and Specialised Banks (SBs) have declined correspondingly. Bank branches, access to banking, and microfinance services have expanded substantially.

Nonbanking financial institutions have also grown but remain small; banks still account for over 90 per cent of financial institutions' assets. Equity market listings and capitalisation have grown substantially; market capitalisation in recent years is around 15 per cent of GDP. A government bond market is developing. Further sound financial development in the various parts of the financial sector, and increased access, will benefit from improvement in fundamentals: better credit information and improved legal and judicial enforcement of creditors' rights and collateral execution (World Bank, 2010).

3.3.2 Size and Structure of Financial Sector

Financial intermediaries perform an important function in the development process, particularly through their role in allocating resources to productive uses. The increased availability of financial instruments reduces transaction and information costs while larger and more efficient financial markets help economic agents hedge, trade and pool risk, thereby raising investment and economic growth (Goodhart, 2004).

In a country like Bangladesh, the causality between finance and growth can have important differences due to institutional factors and the quality of finance, which are, in turn, determined by the quality of financial regulation and the rule of law. For example, an increase in financial deepening, as captured by standard indicators of financial development, may not result in increased growth because of corruption in the banking system or political interference, which may divert credit to unproductive or even wasteful activities or to feed speculative bubbles. Similarly, where it is used for consumption purposes as opposed to productive investment, the effect of financial depth on economic growth is limited (Beck *et al.,* 2012).

After independence in 1971, Bangladesh's financial sector was controlled under the directives of the government and the Bangladesh Bank - the central bank of Bangladesh. In the 1990s, a financial sector reform programme was undertaken for gradual liberalisation of the financial markets. The reforms included flexible interest rate, convertibility of BDT, introduction of 91-day bill, recapitalisation of banks, and new procedures for loan classification system, introduction of REPO in the money market, and strengthening of money and capital markets.

It may be mentioned that the financial sector of Bangladesh is relatively small and less developed. This sector mostly consists of a banking segment and an emerging but still nascent capital/ equity market segment. The banking segment is relatively more developed than the equity market segment, even though both are less developed in international comparison.

3.3.3 The Monetary Policy

Although maintaining price stability is a predominant objective of Bangladesh's macroeconomic policy, the country refrains from the conservative stance of 'inflation targeting' (Hammond, 2012), which has been widely adopted in many countries. The Monetary Policy Statement (MPS) of the Bangladesh Bank usually aligns with the overall macroeconomic objectives of the economy, and adopts '*monetary policy stance and monetary program…. with dual objectives of maintaining price stability and supporting inclusive, equitable and environmentally sustainable job rich economic growth in tune with the government's strategies and goals for sustainable growth and development'* (Bangladesh Bank, *Monetary Policy Statement*, Fiscal Year 2019-20).

For an UMI Bangladesh, the price stability challenge is complex and requires a careful review of what should be realistic short-run inflation, how low it should be, and how it is calibrated through potential inflation-growth trade-off. It is also important to trace the multiple causes of inflation, and the policy instruments that are traditionally applied to contain inflation. There are only few empirical studies on inflation-growth trade-offs in Bangladesh and monitoring of such trade-offs.

In Bangladesh, available evidence shows that the volatility in inflation comes from factors affecting both non-food inflation and food inflation. There are various factors behind food price fluctuations e.g. supply disruptions due to floods and other natural disasters, price distortions by market intermediaries, and rise in food import prices, among others. Clearly, controlling inflation in Bangladesh requires other interventions to complement the monetary instruments. Long-term public investments and other measures would be needed to address structural factors and food price volatility. It may be noted that, over the last two decades, the rate of inflation in Bangladesh has fluctuated, and the level of fluctuation was much higher in the 1990s than in the 2000s. Thus, the volatility of inflation has not been a major concern during the past two decades in Bangladesh.

Furthermore, monetary policy seems to have a limited power to control inflation in Bangladesh. The instruments at the disposal of Bangladesh Bank are often not effective to respond to inflationary tendencies. The Bank rate (the policy rate) has been held constant almost since FY2003-04 (Bangladesh Bank uses the repo rate as a proxy policy rate); instead, it addresses price stability largely through the credit/deposit channel, often by maintaining a closely monitored relationship between broad money (M2) and reserve money (RM).[7] The use of control over money aggregates (credit channel) provides a pseudo control over the credit flow to the private sector. The credit channel, however, has its limitations, and may miss the inflation target. On the other hand, the policy rate channel cannot be made effective since the 'transmission mechanisms' are very weak, and financial infrastructure is underdeveloped.

In a UMI Bangladesh, reforms for greater market competition in the financial sector will have to be broadened and deepened. This will place an increasing responsibility on the Bangladesh Bank's 'policy rate', the effectiveness of which will depend on, among others, greater financial deepening, strengthening of credit and debit markets and interbank transactions and integration—all within an efficient regulatory and accountability framework.

A major concern is to increase the efficiency of the existing monetary and financial system, along with its ability to control inflation and exchange rate stability in the near future, when the economy will be poised towards a higher growth pathway which may require greater external interaction. There are other potential threats to price stability that can trigger inflation uncertainties, such as fiscal dominance. Bangladesh's projected growth for transition to UMI status would require much higher public expenditure to meet infrastructural and social needs. Increased borrowing, especially from the banking sector, in case there is revenue shortfall will then likely to cause price instability.

Another potential source is the exchange rate volatility. Although in principle, Bangladesh maintains a market-based, free-floating exchange rate regime, Bangladesh Bank periodically intervenes to buy/ sell foreign currency to reduce volatility and support international competitiveness of Bangladesh exports. In the growing Bangladesh economy, growth of export capacity to meet

---

[7] This reflects a calibration of inflation rate tracking and potential output growth, weighted by a money demand multiplier; usually taken as a sum up of projected inflation, GDP growth, plus a multiplier factor.

future import surge and sustained growth in remittance flows are important determinants of external stability.

In short, the working of the monetary policy at present remains constrained by serious shortcomings of several factors as reflected in the persistently unacceptable level of Non-Performing Loans (NPLs) and Capital Adequacy Ratios (CARs), high interest rate spreads and the huge proportion of classified loans, especially in the State-Owned Commercial Banks (SCBs).

3.3.4 The Banking System

In the post-reform period, the structure of the banking system has changed significantly. As part of the reform programme, some Nationalised Commercial Banks (NCBs) were privatised, foreign ownership of banks was opened up, and additional new commercial banks were allowed to start and operate in the private sector. At present, six State-Owned Commercial Banks (SCBs), two Specialised Banks (SBs), 40 Private Commercial Banks (PCBs), and nine Foreign Commercial Banks (FCBs) operate in the country. Besides, the Investment Corporation Bank (ICB) also plays a vital role as an investment bank.

Despite the reforms and expansion of different types of institutions, a strong, competitive and efficient banking system has not as yet emerged. The banking system is mired in corruption, mismanagement, and direct interference from the government. The banks do not follow the practice of determining the interest rate under competitive conditions. Both lending and deposit rates are set under oligopolistic conditions, possibly following collusive or cartel type behaviours.

It may be noted that the banking sector is still the dominant financial intermediary in Bangladesh's financial system due to the underdeveloped money and capital markets, limited availability of financial instruments, and lack of confidence in the financial system as a whole. Bangladesh Bank faces significant limitations in following an independent monetary policy consistent with its objectives. The government still plays an important role in the financial sector as a major borrower from the banking system.

There is very limited scope for individuals to invest in the capital market and the lack of alternative opportunities for investment compel many to invest mainly in bank deposits, post office savings certificates and government savings bonds. Banks operate with old and outdated banking procedures, and a lack of coordination between proper manpower planning and bank schemes, a lack of market research for customer analysis, scarcity of financial derivatives, inefficient banking services, and a lack of long-term planning create bottlenecks preventing banks from adopting modern banking practices.

Further, overall stability and performance of the banking sector are not satisfactory due to high Non-Performing Loans (NPLs), lack of good governance, and other factors. As Table-2 shows there exists a huge variation in CARs and the NPLs amongst various groups of commercial banks. The better performance in these indicators by the foreign banks allows them to maintain a higher interest rate spread. The interest rate spread is still relatively high, and is often attributed to loan defaults (and scams), but also to alleged 'collusive, oligopolistic fixing' of lending rates. Some of these factors are linked to political and vested interest groups. There also persist serious governance deficits, which constrain any move to bring the financial institutions to the best-practice standards. The current turmoil in the banking and financial sector could increase rapid exposures to investment risks.

Table 2: Banking Sector Indicators in Bangladesh

	2005			2018		
	CAR	**Gross NPL Ratio**	**Interest Rate Spread**	**CAR**	**Gross NPL Ratio**	**Interest Rate Spread**
SCBs	-0.84	24.37	5.14	2.0	28.24	3.57
SBs	9.20	34.90	5.13	-31.86	21.68	3.24
PCBs	9.45	7.76	5.25	12.24	6.01	4.33
FCBs	24.62	1.54	7.93	22.97	6.66	7.07
All banks	7.08	15.79	5.31	10.00	10.41	4.45

Source: Bangladesh Bank, *Annual Report*, Different Years

Further, proper assessment of risks and costs of alternative sources of funds are often acute in decision making by financial administrators. Lack of ethics in the banking sector is a part of a wider and persistent socioeconomic and political culture in the country (see, Mujeri and Islam, 2008). Unhealthy competition among different banks displays lack of ethics in doing banking business.

In Bangladesh, where financial inclusion has taken the centre stage, the role of banks cannot be over emphasised. The question remains whether the collective efforts around banking sector development translate to economic growth. A developed banking sector plays a pivotal role in ensuring access to basic financial services such as savings, payments and credit which contribute positively towards improving poor people's lives.

A strong and stable banking system is the backbone of an effective economy. While the financial sector comprises the financial markets, financial institutions, banks, bond markets, insurance sector, securities sector, stock exchanges and microfinance sector all of which play a secondary role in providing access to finance, they do not optimally contribute to the resource mobilisation for economic development. Many countries largely rely on the banking sector which serves as a bridge between savers and borrowers, among other functions.

A strong financial system and an appropriate financial infrastructure are essential to sustain price stability, encourage savings and investment, and foster growth and employment generation. More specifically, the financial sector should cater to the needs of the country's growing economy, such as through mobilisation of savings and credit growth to the private sector. Table-3 shows a growing trend of the key indicators of financial sector deepening in Bangladesh, but the pace has to be stepped up for financial resource mobilisation and credit utilisation by the private sector. Financial structure development also needs to be geared towards greater inclusion and participation through broadening the lending base, and diversification of credit allocation.

Table 3: Deepening of Financial Sector in Bangladesh

	Annual Growth Rate in Per cent					
	2005	**2008**	**2010**	**2012**	**2015**	**2017**
M2	16.7	17.6	22.4	17.4	12.4	10.9
Private Sector Credit	16.8	24.9	24.2	19.7	13.2	15.7
Domestic Credit	17.4	21.0	17.8	19.5	10.0	11.2

Source: Bangladesh Bank, *Annual Report*, Different Years

Further, the rapid introduction of digital technology in the banking system, such as mobile banking, e-banking, modernisation of payment systems, regulations, guidelines and supervision are likely to bring about greater transparency and accountability, and a reduction in the costs of delivery of financial services. The challenge for the government would be to develop appropriate institutional and regulatory frameworks to provide new intermediation initiatives between bank profitability and financial inclusion within a broader monetary policy framework.

3.3.5 Capital and Equity Market

For stimulating economic growth and development, Bangladesh requires long-term funding, far longer than the duration for which most savers are willing to commit their funds. In this regard, the capital market provides an avenue for mobilisation and utilisation of long-term funds for development and hence it is referred to as the long-term end of the financial system. An upsurge in capital market activity as a tool for fast-tracking economic progress is therefore extremely important for UMI Bangladesh.

Bangladesh is still at a nascent stage of capital market development although a well-functioning capital market is of great significance for the country for channeling domestic saving to productive investments, attracting foreign investors to the market, and allocating the national savings most efficiently, among others. However, the Bangladesh equity market is small, thin and non-transparent, and inefficient as well.

Bangladesh has two major exchanges, the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE). The DSE is the larger of the two stock exchanges in the country. Formal trading on the DSE began in 1956 while the CSE was established in 1995. In 1993, the Securities and Exchange Commission (SEC) was established under the Securities and Exchange Act 1993. The functions of the YSEC include regulation of equity trading, protection of investors, ensure legislative and regulatory compliances, and promote a fair, transparent and efficient security market.

The underdeveloped and non-transparent nature of the capital market in Bangladesh provides ample opportunities for unethical and even illegal manipulations resulting in several market crashes in recent decades. Such unwarranted crashes usually cause severe financial damages to investors, particularly the small investors, and erode confidence in the market.

Over the past few decades, there has been an upsurge in capital market activity, which suggests the growing recognition of the capital market as a tool for fast-tracking economic progress in Bangladesh. In principle, the capital market is expected to accelerate economic growth by providing a boost to domestic savings and increasing the quantity and the quality of investment, provide individuals with additional financial instruments that may better meet their risk preferences and liquidity needs (Levine and Zervos, 1998).

Further, the emphasis on capital market results from the operation of several interrelated factors: (i) progressive deregulation of financial markets; (ii) internationalisation of these markets; (iii) in troduction of financial products allowing riskier and bigger financial investments; and (iv) emergence and increasing role of new actors in the financial markets particularly, institutional investors.

It also provides an avenue for the marketing of shares and other securities in order to raise fresh funds for expansion of operations leading to increased in production. It creates a means of allocating real and financial resources between various industries. Through capital formation and allocation mechanism, the capital market ensures an efficient and effective distribution of the scarce resources for optimal benefit to the economy. Further, it reduces the over-reliance of the corporate sector on short term financing for long-term projects and also provides opportunities for the government to finance projects aimed at providing essential amenities for socioeconomic development.

One should, however, be aware that the capital market may face serious challenges in countries like Bangladesh and may not perform efficiently since capital market development requires huge costs and strong financial structures.

These problems are magnified by weak regulatory institutions and macroeconomic volatility. High price volatility in stock markets reduces the efficiency of the price signals in allocating investment resources.

The role of capital markets in stimulating economic progress is less debatable as there are well-established theoretical frameworks for *a priori* expectation to be in the affirmative. However, there are considerable challenges in developing the capital market in Bangladesh:

Macroeconomic Stability

A stable macroeconomic environment is crucial for the development of the capital market. Macroeconomic volatility worsens the problem of informational asymmetries and becomes a source of vulnerability to the financial system. Low and predictable rates of inflation are more likely to contribute to stock market development and economic growth. Both domestic and foreign investors will be unwilling to invest in the stock market where there are expectations of high inflation. Garcia and Lin (1999) argue that sound macroeconomic environments and high income levels, domestic savings, and domestic investments are important determinants of stock market development.

Development of the Banking Sector

The development of the banking sector is important for stock market development. At the early stages, the capital market is a complement rather than a substitute for the banking sector. Developing the financial intermediary sector can promote the development of the capital market. The conduct of macroeconomic policies not only affects but may also be affected by the condition of the financial system.

Support services from the banking system contribute significantly to the development of the stock market. Consequently, liquid inter-bank markets, largely supported by an efficient banking system, are important for the development of the stock market. Conversely, a weak-banking system can constrain the development of the stock market.

Institutional Quality

Institutional quality is important for stock market development because efficient and accountable institutions tend to broaden appeal and confidence in equity investment. The development of good quality institutions can affect the attractiveness of equity investment and lead to stock market development. Good quality institutions such as law and order, democratic accountability, and bureaucratic quality are important determinants of stock market development as they reduce political risk and enhance the viability of external finance (Yartey and Adjasi, 2007).

Shareholder Protection

Another key determinant of capital market development is the level of shareholder protection in publicly traded companies. Capital market development is more likely to take place in countries with strong shareholder protection because investors do not fear expropriation. In addition, ownership in such a market can be relatively dispersed, which provides liquidity to the market.

No doubt, the stock market in Bangladesh is a complex institution imbued with an inherent mechanism through which long-term funds of the major sectors of the economy comprising households, firms, and government can be mobilised, harnessed and made available to various sectors of the economy. The development of the capital market, and the stock market, provides opportunities for greater fund mobilisation and improved efficiency in resource allocation.

At present, Bangladesh's capital market does not have varied instruments/products in both equities and debt markets. The former are instruments or products that confer ownership rights on the investor, while the latter are interest-bearing obligations with fixed or floating interest rates.

Moreover, the country's capital market problems are both endogenous and exogenous. The exogenous problems are those outside the direct control of the market but which are regulation-induced. The endogenous problems are those that are internal to the market but which are amenable to changes with improved operational procedures including the adoption of information technology. Some of these problems cover the small size of the market, problem of illiquidity of the market, slow growth of the securities market, double taxation, lack of effective underwriting, and macroeconomic instability.

3.3.6 Functioning of the Stock Market

According to orthodox theory, a stock market can contribute to development through a variety of channels: it could raise savings and investment by making it possible for individuals and households to purchase a fraction of an enterprise, thereby spreading the risk, without which investment may not occur. Similarly, the monitoring function is performed automatically by the stock market and, from the perspective of an entrepreneur, this helps raise investment. A well-functioning stock market allocates resources more efficiently through its normal pricing process, which would accord, other things being equal, higher share prices to efficient firms and lower prices to inefficient ones.

Further, the take-over mechanism ensures that not just the new investment resources but also the existing capital stock is efficiently utilised. Inefficient use of existing resources is penalised by the market for corporate control through disciplinary takeovers. In practice, how effectively the stock market can perform the above tasks depends on the efficiency of two critical market mechanisms, namely (i) the pricing mechanism; and (ii) the take-over mechanism.

In the case of share prices, it is suggested that, in the face of highly uncertain future, share prices are likely to be influenced by the so-called 'noise traders', and by whims, fads and contagion. In developing countries, apart from the normal mis-pricing, which is particularly likely to be severe as the firms are not likely to have a long track record, share prices are more volatile than in advanced countries. Share price volatility is a negative feature of stock markets for several reasons. First, it reduces the efficiency of the price signals in allocating investment resources. Secondly, it increases the riskiness of investments and may discourage risk-averse enterprises from financing their growth by equity issues, and indeed from seeking a stock market listing at all.

Thirdly, at the macroeconomic level, a highly volatile stock market may lead to financial fragility for the whole economy (Singh, 1999; 2002).

Bangladesh's stock markets are characterised by large volatility with recurrent periods of boom and bust that represent a destabilising force for the economy. For example, following a bull run during 2010, the Dhaka index fell by about a half from its December 2010 all-time high, corresponding to a loss of about 22 per cent of GDP by October 2012. The market correction wiped out $27 billion in market capitalisation and, with it, bankruptcies, savings, and jobs, triggering a wave of social discontent (Shah, 2016). The ensuing liquidity crunch led to heightened solvency risks. Given the interconnectedness between banks and equity markets, such incidents can result in a negative feedback loop from the financial sector to the real economy.

The market for corporate control is often considered as the evolutionary endpoint of stock market development. An active market for corporate control presents a credible threat that inefficient managers will be replaced to maximise shareholder value and thereby raise corporate performance. This consideration is particularly important for developing countries like Bangladesh where there are large, potentially predatory, conglomerate groups. These could take over smaller, more efficient firms and thereby reduce potential competition to the detriment of the real economy.

At present, Bangladesh, like most other developing countries, does not have well-functioning stock markets. Not only is there inadequate government regulation, efficient private information gathering and disseminating firms are also absent. The markets suffer from significant regulatory and informational deficits: the markets remain 'immature' (i.e., riddled with insider trading and lack of transparency) and relatively illiquid. Most trading takes place in a few blue-chip shares. The regulator also finds it difficult to regulate the stock markets, as is indicated by frequent scams in the stock markets.

Volatility in the stock market may further accentuate if external portfolio capital inflows are allowed. This greatly increases the vulnerability of the economy not only to international shocks, but also to domestic shocks, substantially magnifying their effects. The main reason for this is that capital inflows lead to an interaction between two inherently unstable markets – the stock market and the currency market. In the event of a large shock (domestic or external), these interactions generate a negative feedback that may lead to, or greatly worsen, a financial crisis.

Therefore, along with developing the banking sector, Bangladesh needs to take appropriate measures and regulations to ensure that the stock markets do not become a source of instability or short-termism in the economy. For this reason, Bangladesh also needs to discourage the emergence of a market for corporate control. Bangladesh should find other institutional ways of replacing inefficient managements which are reliable and cheap compared to the takeover device on the stock markets.

For a middle-income Bangladesh, regulation of the financial sector needs to be counter-cyclical to prevent boom-bust cycles which can lead to developmentally costly crises-and comprehensive, to include all institutions that provide credit. Capital flows should also be prudently managed, and where appropriate, capital account regulations should complement domestic financial regulation. Furthermore, since borrowing on the international bond markets could lead to future problems; and it needs careful monitoring.

The fact that Bangladesh's financial system is still relatively small in relation to the size of its economy allows more space for the policy-makers and regulators to try to shape the financial systems to serve well the needs of inclusive and sustainable growth (e.g. much needed lending to MSMEs), as well as desirable structural change. Furthermore, since the financial sector is smaller as a proportion of GDP, it may imply it is less powerful politically, thus, potentially giving more autonomy to the regulators to shape the financial sector to serve the real economy.

However, a key issue is not just the size, but also the structure of the financial sector. Because the financial sector is riddled with market imperfections and market gaps, it is important to have government intervention to correct these market imperfections (e.g. the pro-cyclical nature of private lending) and institutional arrangements to fill market gaps (e.g. sufficient long-term finance for helping finance private sector investment). In addition, it is useful for the government to have institutions and mechanisms to help finance development of particular sectors to implement the vision and strategy of development.

In this context, it is important to design instruments and institutions that can perform such functions. Public development banks have worked well in several countries (e.g. Japan, South Korea, and others) with appropriate regulations. Often it is argued that smaller, more decentralised banks may be more appropriate in developing countries, especially to lend to MSMEs, partly because they know their customers better, reducing both asymmetries of information and transaction and default costs.

Overall, a more diversified banking system, with large and small banks, as well as private and public development banks seems to offer benefits of diversification; and thus less systemic risk, complementarities in serving different sectors and functions, as well as providing competition for providing cheaper and appropriate financial services to the real economy.

3.3.7 Capital Market for Financing Development

It is well known that a growing economy in need of new forms of financial intermediation to finance investments that are either too long-term or too risky for commercial banks, is one of the most important drivers of capital market growth.

The development of local capital market can increase access to local currency financing and thereby help manage foreign exchange risk and inflation better. For investors and savers, capital market offers more attractive investment opportunities-with better returns than bank deposits, depending on risk profile, liquidity needs, and other factors. Further, with a wider range of securities and instruments offered, the capital market can help investors diversify their portfolios and manage risk.

Through the use of derivatives, a well-developed capital market provides risk management tools not only to the market participants, but also to end users. Well-developed capital markets also provide benefits at the macroeconomic level by supporting monetary policy transmission, which is facilitated through liquid securities market. Further, they can serve as a 'spare tire' for the financial sector, enhancing financial stability and reducing vulnerabilities to exchange rate shocks and sudden interruptions of capital flows.

An essential condition for a well-functioning financial system-with both banks and capital markets is the existence of sound macroeconomic and relevant policy frameworks. The institutional framework is also critical, as markets depend on investor confidence and strong institutions provide the basis for investor and creditor protection.

However, capital markets are not without risks. In a country like Bangladesh, these may include the potential for asymmetric information between savers and users, non-transparency and lack of adequate regulation and monitoring of issuers, lack of adequate and efficient market infrastructure for issuing, trading, clearing and settlement, and the potential for increased volatility due to liquidity, interest rate and rollover risks. To reliably extract the benefits of well-functioning markets, adequate regulation for issuers, investors, and intermediaries in addition to robust supervisory arrangements to protect investors, promote deep and liquid markets, and manage systemic risk are critical. Such a framework in turn needs to be anchored in a good investment climate that includes a sound taxation and accounting framework, reliable and quality accountancy, creditor rights, property rights, and bankruptcy and competition law.

Finally, markets need an infrastructure – exchanges and trading platforms, clearing houses, and custodians. Typically, capital market offerings of debt securities start with the highest credit quality issuer which is typically the government, and government bond markets – beginning with short-term money market instruments and extending to longer tenor bonds – form a basis for further market development by establishing price points along a yield curve and providing instruments for liquidity management. They also provide a critical mass of securities to support market infrastructure development.

Banks are often the next issuers able to come to the market. While banks may benefit from including capital market instruments in the funding mix to better match liabilities to assets, they tend to have a ready source of liquidity from deposits available to service their obligations. Utilities, which typically have long-term capital investment needs but steady and predictable cash flows, may follow and then come other corporates.

In parallel, it is critical that efforts be focused on developing the investor base. The most reliable and stable investor base is local. Nurturing domestic investible asset pools via pensions, insurance, and savings vehicles for individuals to deploy into the capital market is critical for local sustainable capital market development. Pension reform, development of the local insurance industry, and an increase in household savings are often part of a comprehensive capital market development programme.

Experience shows that the development of the local capital market and making greater use of it to fund private investment and strategic economic needs tends to happen in stages in a developing country like Bangladesh. Therefore, some sequencing of policies is essential. This is particularly true for debt markets, which require well-functioning money markets to create government bond markets. These in turn are essential for corporate bond markets. Understanding the linkages between different segments of the market and their building blocks is critical to ensuring a proper sequencing of policy and regulatory reforms. Capital market development is a gradual process requiring strong leadership from the government as well as a significant commitment of time and resources. If done correctly, the payoffs can be substantial and long-term. The imperative, however, is to develop strategies that fit the particular circumstances of Bangladesh.

4. Concluding Remarks

Both theoretical reasoning and empirical evidence suggest that a well-developed financial system plays a positive growth-inducing role in development. For transiting to a UMI Bangladesh, a developmental approach to financial sector growth is necessary, while at the same time attending to prudent regulations. The country's progressive financial system must ensure a sound financial structure with varieties of financial products and services, including an electronic trading system to trade derivatives in stock exchanges, a carefully outlined series of regulations that govern the market judiciously and allows market participants to contain systemic risks.

The key to financial sector development in Bangladesh is the reduction of fragmentation in financial markets, so that they gradually set more accurate (and therefore consistent) prices that reflect resource scarcity. Often the establishment of positive real interest rates is considered as the first step in this direction, providing a base from which the financial system can be developed to produce more refined prices. However, real returns may still experience significant dispersion unless issues such as information asymmetry and high transaction costs-a symptom of poor physical, technical, tax, and regulatory infrastructure – are addressed.

The range of price dispersion decreases as the financial system develops. Development of mechanisms (like effective company and securities industry laws and regulations) to eliminate information asymmetry, creation of new institutions (like credit-rating agencies) for producing higher quality information, use of technology to improve the processing and dissemination of information (including prices), adoption of efficient business practices, and market organisation in the financial sector, together with deregulation, will facilitate further development over time. Markets for complex financial instruments, like derivatives, that require a sophisticated infrastructure base will emerge as the development process progresses.

Banks are the fulcrum of Bangladesh's financial system, but over time the relative importance of financial markets for instruments like bonds, equity, and commercial bills, will rise. Financial sector deregulation is an integral part of a wider set of economic reforms. Elimination of centralised controls over prices, resource distribution, and trade flows and the freeing of nominal interest rates and exchange rates fundamentally alter the economic and financial risk exposures of financial institutions and companies, generating demand for effective risk management products that cover liquidity and price risk. Only advanced financial systems have the infrastructure to provide them. These risk management products also reduce price dispersion by linking markets across space and time.

The development of the country's capital and equity markets will occur only as a part of a comprehensive endeavour that addresses all the factors that affect the profitability and attractiveness of private enterprises. The challenge is to ensure a delicate balance between a system that assures adequate protection of the investors and one that does not deter market growth.

However, for a successful journey, Bangladesh should not wait for the market to bring development. For example, since market outcomes of human capital are likely to be sub-optimal; a strong justification exists for state intervention. The need is to have ‘smart’ interventions. Instead of the top-down approach, the ‘developmental state’ approach is needed which uses ‘market-following’ policies, such as supporting the availability of skilled labour to attract enterprises towards greater productivity and value addition.

The developmental state paradigm holds that as an economy develops and its factor endowment becomes increasingly capital and skilled labour intensive, development demands a ‘comparative advantage following’ strategy of government support for structural transformation (Lin, 2012). An economy’s specific factor endowment determines its optimal industrial structure, and each industrial structure demands a particular level of tangible and intangible infrastructure, from transport to human capital.

Bangladesh needs to bring rapid structural transformation by emphasising human capital-focused strategies, skill development, and progressively higher value-added activities. The focus should be on upgrading the skills of the workforce and incentivising enterprises to invest in their workers. A pre-condition for the above is to ensure strong public institutions so that the government can address ‘government failure’ before it can fix ‘market failures’.

In the development process, one key issue for Bangladesh would be to introduce ‘tripartism’—institutionalised cooperation of business, labour, and the government on economic issues — to help policymakers acquire the inputs for informed decision making and help build consensus. The strategy would be to advance in a planned way from labour-intensive industry to capital-intensive industry and finally to a knowledge-intensive economy that includes research, services, and high-end manufacturing.

In the Bangladesh context, investments in human capital can drive development for which the need is to ensure a combination of public investment, incentives for private investment, and close coordination with business and labour. This can rapidly upgrade skills and productivity; and ultimately the standard of living of the people.

Bangladesh, having successfully completed the journey from low income to an LMI country, now faces the more perilous journey to UMI status and then to a high-income country. While the first leg of the journey provides grounds for optimism, Bangladesh must become more innovative and productive in order to successfully complete the second and the third stages, a journey in which the financial sector needs to play a more supportive role to bring higher levels of prosperity.

References

ADB (2011), *Asia 2050: Realizing the Asian Century*, Asian Development Bank (ADB), Singapore.

Altenburg, T. (2011), *Industrial Policy in Developing Countries: Overview and Lessons from Seven Country Cases,* German Development Institute. Bonn.

Anglingkusumo, R. (2013), "Addressing the Complexity of Macroeconomic Management in Middle Income Countries," *Paper* presented during the Experts Meeting on the Common Challenges of Middle-Income Countries in Seoul, 13-15 May.

Bangladesh Bank, *Annual Report,* Different Years.

Bangladesh Bank, *Monetary Policy Statement,* Fiscal Year 2019-20, p. 10.

Beck, T, B. Buyukkarabacak, F. Rioja and N. Valev (2012), "Who Gets the Credit? And Does it Matter? Household vs. Firm Lending across Countries," *BE Journal of Macroeconomics,* Vol. 12.

Bhatt, V. V. (1995), *Financial Systems, Innovation, and Development,* Sage, Delhi.

Cervantes-Godoy, D. and J. Brooks (2011), "Smallholder Adjustment in Middle-Income Countries," *OECD Food, Agriculture and Fisheries Working Papers No. 12*, Organisation for Economic Cooperation and Development (OECD), Paris.

Chandra, V, J. Lin and Y. Wang (2012), "Leading Dragons Phenomenon: New Opportunities for Catch-up in Low-Income Countries," *Policy Research Working Paper 6000*, The World Bank, Washington, D.C.

Cheng, T, S. Haggard and D. Kang (1998), "Institutions and Growth in Korea and Taiwan: The Bureaucracy," *Journal of Development Studies*, Vol. 34, No. 6.

Coase, R. (1960), "The Problem of Social Cost," *The Journal of Law and Economics*, Vol. 3, pp. 1-44.

Faaland, J. and J.R. Parkinson (1976), *Bangladesh: The Test Case for Development,* C. Hurst and Company, London.

Fallon, P. *et al.* (2001), *Middle Income Countries: Development Challenges and Growing Global Role,* The World Bank, Washington, D.C.

Foxley, A. (2009), *Recovery: The Global Financial Crisis and Middle Income Countries*, Carnegie Endowment for International Peace, Washington, D.C.

Garcia, F. V. and L. Lin (1999), "Macroeconomic Determinants of Stock Market Development," *Journal of Applied Economics,* Vol. 2(1), pp. 29-59.

Gill, I, H. Kharas, D. Bhattasali, M. Brahmbhatt, G. Datt, M. Haddad, E. Mountfield, R. Tatucu and E. Vostroknutova (2007), *An East Asian Renaissance – Ideas For Economic Growth*, The World Bank, Washington, D.C.

Gill, I. and H. Kharas (2007), *An East Asian Renaissance: Ideas for Economic Growth,* The World Bank, Washington, D.C.

Goodhart, C. (Ed.) (2004), *Financial Development and Economic Growth: Explaining the Links,* Palgrave Macmillan, London.

Greenwood, J. and B. Jovanovic (1990), "Financial Development, Growth, and the Distribution of Income", *Journal of Political Economy,* Vol. 98 (5, Part-1), pp. 1076-1107.

Griffith-Jones, S, J. A. Ocampo and J. Stiglitz (2010), *Time for a Visible Hand: Lessons from the 2008 World Financial Crisis,* Oxford University Press, New York.

Hak, K. P. (2005), *Productivity Performance in Developing Countries: Country Case Studies- Republic of Korea,* United Nations Industrial Development Organisation, Vienna.

Haldane, A.G. and V. Madouros (2012), "The Dog and the Frisbee," *Speech* at the Federal Reserve Bank of Kansas City's 366th Economic Policy Symposium, "The Changing Policy Landscape", Jackson Hole, Wyoming, 31 August.

Hammond, G. (2012), *State of the Art of Inflation Targeting*, Handbook, Centre for Central Banking Studies, Bank of England, London.

IMF (2012), "Walking Hand in Hand: Fiscal Policy and Growth in Advanced Economies," *Discussion Paper*, International Monetary Fund (IMF), Washington, D.C.

Jomo, K. S. (2001), *Rethinking the Role of Government Policy in Southeast Asia*, in J. Stiglitz and S. Yusuf, (eds.), *Rethinking the East Asia Miracle,* Oxford University Press, New York.

King, Robert G. and Ross Levine (1193), "Finance and Growth: Schumpeter Might Be Right," *The Quarterly Journal of Economics*, Vol. 108(3), August, pp. 717-737.

KDI (2011), *Modularization of Korea's Development Experience: Productivity Improvement*, Korea Development Institute, Seoul.

Kimura, F. and A. Obashi (2011), "Production Networks in East Asia: What We Know So Far," *Working Paper*, Asian Development Bank Institute, Tokyo.

Kuznets, S. (1955), "Economic Growth and Income Inequality", *American Economic Review*, Vol. 45, pp. 1-28.

Levine, R. (1997), "Financial Development and Economic Growth: Views and Agenda," *Journal of Economic Literature*, Vol. 35, pp. 688-726.

Levine, Ross and Sara Zervos (1998), "Stock Markets, Banks, and Economic Growth," *American Economic Review*, Vol. 88(3), February, pp. 537-558.

Lin, J. Y. (2012), *New Structural Economics: A Framework for Rethinking Development and Policy,* The World Bank, Washington, D.C.

Lucas, Robert Jr. (1988), "On the Mechanics of Economic Development," *Journal of Monetary Economics,* Vol. 22(1), pp. 3-42.

McKinnon, R. I. (1973), *Money and Capital in Economic Development*, The Brooking Institution, Washington, D.C.

Modigliani, F. and M. H. Miller (1958), "The Cost of Capital, Corporation Finance and the Theory of Investment", *American Economic Review*, Vol. 48 (3), pp. 261-297.

MOF (2019), *Bangladesh Economic Review 2019,* Finance Division, Ministry of Finance, Government of the People's Republic of Bangladesh, Dhaka.

Mujeri, M. K. and M.E. Islam (2008), "Rationalizing Interest Rate Spread in the Banking Sector: Some Policy Suggestions," *Policy Paper No. 0804*, Policy Analysis Unit, Bangladesh Bank, Dhaka.

Mujeri, M.K. and B. Sen (2006), *Economic Growth in Bangladesh, 1970-2000*, in K.S. Parikh (ed) *Explaining Growth in South Asia,* Oxford University Press, New Delhi.

Ohno, K. (2009), "Avoiding the Middle-Income Trap: Renovating Industrial Policy Formulation in Vietnam," *Asean Economic Bulletin*, Vol. 26(1), pp. 25-43.

Ohno, K. (2011), *What is the Middle Income Trap?* Asian Development Bank, Seminar, Available at: http://www.grips.ac.jp/forum-e/pdf_e11/ADB/middleincome_adb3.pdf.

Patrick, H.T. (1966), "Financial Development and Economic Growth in Underdeveloped Countries," *Economic Development and Cultural Change*, Vol. 14, pp. 174-189.

Paus, E. (2013), "Globalization and the Middle-Income Trap: A Capabilities-Based Approach with a Focus on Latin America," *Paper* presented during the Experts Meeting on the Common Challenges of Middle-Income Countries in Seoul, 13-15 May.

Robinson, J. (1952), *The Rate of Interest and Other Essays,* MacMillan, London.

Rodriguez-Clare, A. (2005), "Coordination Failures, Clusters and Microeconomic Interventions," *Working Paper No. 544*, Inter-American Development Bank, Washington, D.C.

Rodrik, D. (2008), "Industrial Policy: Don't Ask Why, Ask How," *Middle East Development Journal,* Vol. 1.

Rodrik, D. (1995), "Political Economy of Trade Policy," *Handbook of International Economics,* Chapter 28, Vol. 3, pp. 1457-1494.

Samuelson, P. A. (1994), "Facets of Balassa-Samuelson Thirty Years Later", *Review of International Economics,* Vol. 2 (3), pp. 201–226.

Satoru, O. (1997), "Industrialization Policies of Korea and Taiwan and Their Effects on Manufacturing Productivity," *The Developing Economies*, Vol. 35, No. 4.

Shah, S.A.M.H. (2016), "Capital Market Development in Bangladesh: A Sector Reform Perspective," *ADB South Asia Working Paper Series No. 48*, Asian Development Bank (ADB), Manila.

Shaw, E. S. (1973), *Financial Deepening in Economic Development,* Oxford University Press, New York.

Singh, A. (1999), "Should Africa Promote Stock Market Capitalism?" *Journal of International Development,* pp. 343-365.

Singh, A. (2002), *Asian Capitalism and Financial Crisis*, in J. Eatwell and L. Taylor (Eds.), *International Capital Markets: Systems in Transition,* Oxford University Press, Oxford.

Todaro, M.P. and S. C. Smith (2012), *Economic Development,* 12th Edition, Pearson, Boston.

UN General Assembly (2011), *Development Cooperation with Middle Income Countries,* United Nations General Assembly, 66th Session. Report of the Secretary General, New York.

Van Doorn, R. *et al.* (2010), "Can Middle Income Countries Deal with the Global Financial Crisis?" The World Bank, Washington, D.C.

Wang, X. and N. Weaver (2013), "Surplus Labor and Lewis Turning Points in China," *Journal of Chinese Economic and Business Studies*, Vol. 11 (1), pp. 1-12.

Weil, D. N. (2013)*, Economic Growth*, 3rd Ed., Pearson, Boston, MA.

World Bank, *World Development Indicator 2018.*

World Bank (2012), *China 2030: Building a Modern, Harmonious and Creative High-Income Society,* The World Bank, Washington, D.C.

World Bank (2012), *Inclusive Green Growth: The Pathway to Sustainable Development,* The World Bank, Washington, D.C.

World Bank (2011), *East Asia and Pacific Economic Update*, The World Bank, Washington, D.C.

World Bank (2011), *The Changing Wealth of Nations: Measuring Sustainable Development in the New Millennium,* The World Bank, Washington, D.C.

World Bank (2010), *Financial Sector Assessment: Bangladesh*, The World Bank, Washington, D.C. Available at: https://openknowledge.worldbank.org/handle/10986/15917

World Bank (2010), *Robust Recovery, Rising Risks, World Bank East Asia and Pacific Economic Update*, Vol. 2, The World Bank, Washington, D.C.

World Bank (2009), *WDR 2009: Reshaping Economic Geography – Looking Back, Seeing Ahead,* The World Bank, Washington, D.C.

World Bank (2007), *Development Results in Middle Income Countries: An Evaluation of the World Bank's Support*, The World Bank, Washington, D.C.

World Bank (2006), *Korea as a Knowledge Economy: Evolutionary Process and Lessons Learned*, The World Bank, Washington, D.C.

World Bank (1993), *The East Asian Miracle: Economic Growth and Public Policy*, The World Bank, Washington, D.C.

World Bank and DRC (2012), "China 2030: Building a Modern, Harmonious, and Creative High-Income Society," Joint *Research Report* of the World Bank, Washington, D.C. and the Development Research Center (DRC) of China's State Council, Beijing.

Yartey, C.A. and C. K. Adjasi (2007), "Stock Market Development in Sub-Saharan Africa: Critical Issues and Challenges," *IMF Working Paper WP/07/209*, International Monetary Fund (IMF), Washington, D.C.

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp. 162-172)

Reflections on Planned Development of Agriculture and Rural Economy in the First Five Year Plan of Bangladesh

- M. A. Sattar Mandal*

1. Introduction

The formal introduction to planned economy in Bangladesh began with the launching of her First Five Year Plan (FFYP), 1973-78 from July 1973. It was actually a broad road map toward economic development following a socialistic path in line with the fundamental principles laid down in the constitution of the newly independent country. The need for a planned economy was underscored by the Father of the Nation Bangabandhu Sheikh Mujibur Rahman in his pronouncements for the emancipation of people from poverty, hunger and injustices. He had mobilized a group of dedicated professional economists of high international repute to form the first Planning Commission immediately after he took over as the Prime Minister of the country. It is a historical record that the FFYP was prepared in an unusually short period of one and a half years time in a situation that there was little or no reliable data required for planning. However, the elevated authority that was given to the Planning Commission gradually eroded and it completely lost its authority to shape the economic policies in the light of the plan by 1974 as a result of tensions, controversies, rivalries, political and economic crisis (Islam, 2003).

Theoretically speaking, as Lewis (1972) puts forward in his seminal book on development planning, a development plan can address any or all of the

---

*Professor Dr. M. A. Sattar Mandal is Emeritus Professor of Agricultural Economics and former Vice-Chancellor of Bangladesh Agricultural University, Mymensingh, Bangladesh. He was a member of the General Economics Division (GED) and Agriculture Division of Bangladesh Planning Commission during 2000-2002 and 2011-2013, respectively. Dr. Mandal did Ph.D. from the University of London, United Kingdom. The author is grateful to Mr. M. Syeduzzaman, former Finance Secretary and Technocrat Finance Minister, Government of the People's Republic of Bangladesh for his valuable comments on an earlier draft of this paper. Views expressed in this article are the author's own.

elements such as a survey of economic conditions, list of public expenditures, private sector development, macroeconomic projections and review of government policies. He also classifies a plan as indicative or controlling, the latter being the documents of authorization in communist countries. An indicative plan sets in broad terms the current priorities of a country taking into consideration the socioeconomic and political realities, likely availability of resources, institutional capabilities and above all political commitments. It is in this perspective that the FFYP was well taken as an indicative plan which outlined eradication of hunger and poverty as the major objectives of planning and justifiably kept flexibilities for regular adjustments in the face of changing conditions of resource mobilization and actual rate of achievements of planned goals and objectives. Such a position was also duly admitted by the then Deputy Chairman of the Planning Commission that the detailed formulation of projects, programmes and policies would be reviewed and updated from year to year based on the availability of new data (Islam, 1977).

There is however an array of diverse opinions about the Plan. Asaduzzaman (1995) in a detailed critique of all the five year plans until mid-nineties asserts that the planning in Bangladesh is in practice just approval of projects by the Planning Commission. He concludes that the FFYP document was mostly concerned with rehabilitation of the war ravaged economy and that it did not form any long-term perspective plan. One would not necessarily agree with this conclusion about the absence of any long-term perspective in the FFYP if one looks at the Plan's emphasis on some critically strategic issues e.g. underscoring mobilization of labour for development as a separate chapter in the plan document or projecting transformation of agriculture and rural economy for sustainable economic growth. Also, the plan repeatedly stressed on the need for generating empirical data required for long-term planning. The government immediately involved academic institutions such as Bangladesh Agricultural University (BAU) at Mymensingh, Rajshahi University and Chittagong University to conduct special purpose surveys and village level studies on various aspects of rural development in early seventies (for a detailed exposition on this point, see Mandal *et al.*, 2017). There are also opinions about typology of plans in Bangladesh. Syeduzzaman (1995) argues that the Five

Years Plans including the FFYP of this country were actually for a mixed economy, evolving from one of central planning to a market economy model. I think, many of the independent observers would agree with his view that public sector under any government has always a strong presence in Bangladesh and that 'the economy essentially worked on the basis of market forces distorted by or influenced by state interventions (call it state dirigisme), political aspirations, political and bureaucratic patronage, and the nature and quantum of foreign aid available at the time.' (Syeduzzaman, 1995).

The aim of this article is not to offer a critique of the FFYP nor is it intended to chart out successes or failures of the plan, which is needed but extremely difficult given the unexpected disruptions taking place within the plan period due to change of political regime in 1975, changes in socioeconomic priorities and availability of global assistance. The modest purpose here is to provide some informed reflections on the major features of planned programmes and policies for agriculture and rural development as envisaged in the plan and highlight their implications for future growth and development at large.

2. Putting Labour Force into the Centre

In the predominantly labour surplus economy of Bangladesh, employment was put high on the FFYP agenda. The projection was that even if the programmes outlined in the plan would be implemented fully, these would at best create new employment for only 54 lakh man-year of labour force. There would still be huge number of unemployed or underemployed people who would not be able to get gainful employment due to lack of complementary inputs and capital goods. The plan quotes, 'a lot of work needed to be done and a lot of people going around without work' (Planning Commission, 1973). Lack of opportunities and sufficient motivations were made responsible for this. It implies that identification of productive activities, their nature and distribution over different locations of the country were of utmost importance for proper planning. Largely, on an ad-hoc basis in absence of any dependable information or labour survey, the plan opted for mobilization of labour including rural youths, farm and non-farm labour in physical work such as construction of rural roads, small dams, irrigation and drainage, health, and sanitation, education, etc. The FFYP projects were to incorporate such labour mobilization programmes keeping provisions of material inputs required for such work. Educated persons in their leisure time and adult students in their vacations were also called upon to participate in these activities in the vicinity of their residence, academic compounds and work places. A system of commutation for labour donation was also envisaged. The expected benefits of using students and educated elites were more succinctly described in the following lines: 'One of the by-products of the use of students for productive work would be to establish the dignity of labour and to demonstrate that preference for white-collar work is not socially desirable or covetable. It will bring the urban elite in touch with the rural poor and may arrest the process of alienation between the rural and urban areas as well as between those who work with their hands and those who work in offices.' (Planning Commission, 1973).

The purport of planned mobilization of labour otherwise unemployed or underemployed in that time can be clearly visualized in two relevant expressions from Bangabandhu. The first is his keen impression and observation during his visit to China in 1952 about people's voluntary participation in nation building work like building 100 miles road in response to the call of the new communist government of China under Chairman Mao, especially at a time when the government did not have enough financial resources to undertake building such a huge infrastructure (Rahman, 2020). The second resemblance is Bangabandhu's historic speech at the Bangladesh Agriculture University on 13 February 1973, in which he made a clarion call to the students to put off coat pants for a while and go to villages to participate in practical farming work together with farmers to realize agricultural revolution for our planned development (BAU, 2013). In my view, this congruence of cherished views from the top political leadership with the planned programmes makes the FFYP a big difference from the successive plan documents.

3. Food Self-sufficiency as a Means to Eradicating Hunger

FFYP kept the highest sectoral allocation for agriculture and water resources, which constituted 24 percent of total financial development outlay of

Taka 4455 crores for the plan (Planning Commission, 1973). Two broad strategies were pursued in the plan- increasing yields and multiple cropping, for accelerating food grain production including rice and wheat from the benchmark of 11.33 million tons to 15.3 million tons in 1977-78, the terminal year of the plan (Planning Commission, 1973). While no significant increase in rice yields was expected overnight due to inadequate supplies of complementary inputs, major emphasis was given on the increase of High Yield Variety (HYV) rice areas in pump irrigated and rain fed areas. The plan envisaged rapid expansion of acreages under irrigation e.g. 562 percent increase in area for HYV Aman, 1367 percent increase for HYV Aus and 91 percent increase for HYV Boro rice over the plan period. Expansion of HYV rice varieties for Aus, Aman and Boro rice production was also planned for rain fed areas, which was quite justified due to the fact that required levels of irrigation, fertilizers and other inputs were still to be provided.

Annual plan for inputs of fertilizers, pesticides and seeds was prepared, which shows that the use of chemical fertilizers would have increased from 0.23 million tons to 0.93 million tons during the plan period. Most notable intervention suggested in the plan was for farm power through improvement of mechanization of irrigation and tillage implements, the latter being so crucial because of the colossal loss of draft animals due to 1970 cyclones in the southern regions and then by huge killings of animals by the Pakistan occupation forces during the liberation war. Notwithstanding the resource constrains, the plan made an allocation of Taka 3 crores (3 percent of total outlay for agriculture) for promoting mechanization including provisions of loans/ grants to farmers, subsidy to adopters of implements and research into farm machines.

Similar programmes were also outlined for non-rice crops as well as non-crop agriculture constituting fisheries and livestock sub-sectors. These sub-sectors were duly emphasized in the plan keeping in view the dire need of increasing supply of nutritious food as well as creating productive employment opportunities for rural people including women.

One would appreciate the concerns of the plan for two strategic interventions flood control and irrigation, the latter to be expanded mostly through increasing number of Deep Tube Wells (DTW), Shallow Tube Wells (STW) and Low-lift Pumps (LLP). One may however not appreciate the planned regulation of spacing between tube wells, something born out of typical engineering wisdom those days. Two other organizational steps for stimulating agricultural support services were the proposed reorganization of agencies under the ministry of Agriculture and decentralizing Bangladesh Water Development Board (BWDB) at the local level. Another remarkable event during the plan period was the signing of the Ganges water sharing treaty with India in February 1975, which was a big step forward for development of water sector of Bangladesh (an account of this diplomatic success by Bangabandhu's government is given in Mandal, 2019). The plan also proposed appropriate fiscal measures to gradually withdraw subsidies on irrigation i.e. 68-82 percent for LLPs, STWs and DTWs and 5-46 percent for large scale canal irrigation in order to reduce budgetary pressure as well as to increase efficiency. Later on, while these were implemented for groundwater tube well irrigation as a part of large scale privatization since late eighties, substantial subsidies continued for BWDB large scale irrigation projects.

In a bid to ensuring fair prices of products for farmers, framing of a pricing policy was suggested in the plan. For this purpose, FFYP proposed formation of an independent Agricultural Prices Commission which would be provided with required data to be collected by the Department of Agricultural Marketing. Later on, this proposal was also adopted in the National Agriculture Policy 1999. It is surprising that although the size of agriculture and volume of production from its diverse sub-sectors have increased manifolds and that the 'getting prices right' for agricultural commodities have remained a major constraint, the long expected agricultural prices commission has not yet seen the light.

Before we leave this section, it is worth looking at the performance of food grain production during the FFYP period. It looks like a nature-induced puzzle that despite reasonable implementation of programmes total production of food grains including rice, wheat and other minor cereals could hardly rise from the base level of 12 million tons in the first year to 13.3 to 13.83 million tons according to various sources, meaning a huge short fall from 15.4 million tons set as target by the end of the plan period. This could be explained with valid reasons. Apart from technological reasons, partly affected by the political upheaval in August 1975, severe onslaught of natural calamities like drought and early rains in 1972-73, and then catastrophic floods in 1974-75, all of which caused severe damage to rice crops in the early years of the plan. This did not only contribute to production shortfall but also warranted repeated revisions of targets for annual production and food grain import (see Islam, 1977).

4. Integrated Rural Development through Cooperatives

The position taken by the FFYP for a transformation of agriculture and rural economy was very brave and consistent with a socialistic approach as it meant that 'the means and processes of production and distribution be socially controlled and regulated'. Major vehicle for facilitating such transformation was proposed to be through village based cooperatives. During the plan period 250 thanas (now upazilas) would be included for forming village cooperatives integrated into thana level federation. This has remained a major weakness that the cooperatives in general do not have much of a success story, rather it has been criticized for dominance of 'kulak', 'cooperative capitalism', or 'elite capture' of benefits and it usually exists as long as subsidized credit, inputs or lumpy capital like deep tube wells are provided (Dumont, 1973 and Khan, 1979).

The plan outlined three categories of members eligible for membership of cooperatives e.g. landless households, farmers owning and cultivating their own land, and farmers owning land but cultivating with the help of hired labour. The plan excluded the landlords and those who do not participate in farming directly were not entitled to membership of cooperatives as planned. In fact, there were potential flaws in categorizing cooperative members. For example, how much land one would be allowed to cultivate with hired labour or to rent out in excess of land one cultivates was not spelled out. There is prevalence of huge part-tenancy, which means a farmer can cultivate some of his own land and rent out other parts for the sake of better management of farming or disadvantageous location of plots, and for the same reasons, one can rent out as well as rent in land to optimize farming operations. Apart from such definitional inconsistencies, cooperatives as outlined by the plan raised more complications that included organization of the cooperatives based on class conflicts in rural communities, lack of clarity about how the landless members would benefit from cooperatives or enactment of 33 acres land ownership ceiling that created 'open clash' between land ownership and formation of cooperatives (Chowdhury, 1975). Besides, most cooperatives fail to resolve the collective action problems confronted by members with diversity of occupations and income sources. This caused problems of implementing cooperatives as envisaged in the Plan.

The problem of credit distribution to tenants, small and marginal farmers, and landless labourers was recognized and their inclusion in the cooperatives was proposed in the plan. Also, a set of steps was proposed to be followed by the banks for improvement of credit delivery to farmers. However, the extent of credit delivery to farmers did not improve even during 1973-1977 of the plan period; only 9-11 percent of bank credit went to agriculture (Jansen, 1986). This means that the importance of agricultural credit was not recognized fully. Any informed observer of today will admit that the problems remain more or less the same, be it cooperatives, Agriculture banks or other banks. Major constraints include procedural complexities with loan application by marginal and small farmers, and pure tenant farmers without any legal records of land to be mortgaged as collateral, and many farmers do not have bank account either, let alone the question of time consuming monitoring of loan processing by farmers.

5. Concluding Remarks

i. FFYP has been a big learning document in planning exercise for its commendable efforts to articulate development priorities and choices of a war-torn country inhabited by a dense population inflicted by food crisis, endemic poverty and hunger. It has demonstrated that high professionalism with deep commitment can overcome the shortage of data by allowing flexibilities to adjust programmes and policies in changing conditions. Emphasis on census option and data collection was very important in that more reliable data sets were available for input-output table to be used in successive planning exercises.

ii. The plan created opportunities for academic discourses with respect to village studies, data generation and informed debates about what worked and what did not work. What made the FFYP unique that it encouraged Bangladeshi academia to generate new knowledge about local level development initiatives, which paved the way for incorporating empirical understanding of challenges and constraints of planned development (an account of academic discourses on rural economic development in the post-liberation period is given in Mandal, *et al.* 2017).

iii. As experience was gathered with time, a set of pragmatic policy changes were adopted in the direction of a mixed economy during the FFYP period. Some of these include raising private sector investment limit, disinvestment of abandoned small industries nationalized by the government, use of traditional monetary measures for inflation control, exchange rate adjustment, and reduction of subsidy (Syeduzzaman, 1995, p. 265).

iv. The emphasis on food self-sufficiency/ food security, poverty reduction and hence agricultural development that started with the FFYP has remained common in all the plan documents. This is reflected in large public sector expenditure in the form of subsidies, tax rebates and duty exemptions on imported inputs and machinery for agricultural sector. These measures have, however, encouraged the participation of private sector in agricultural business.

v. As the dominance of public sector was evident in the FFYP, issues like agricultural commercialization through private sector investment were virtually missing. These together with other issues i.e. agribusiness, rural non-farm development, climate change, etc. have gradually taken place in the successive five year plans.

vi. FFYP emphasized the expansion agricultural education and research to back up the efforts to accelerate production of food and it also proposed the existing Bangladesh Agricultural University and agricultural colleges at Dhaka to enroll larger number of students to cater to the needs of agricultural development. As a result, number of agricultural universities increased gradually from only one (BAU) at Mymensingh that time to as many as seven more universities that provide solely or predominantly agricultural education. Today's National Agricultural Research System (NARS) constituting a large number of commodity specific research institutes have been established or upgraded in line with the suggestions laid down in the FFYP. As a result of these initiatives a growing number of graduates are produced from broad disciplines of agriculture, which in turn helps strengthening agricultural research and extension services, and accelerating agricultural development of the country.

References

Asaduzzaman, M. (1995) "The Fall and 'Rise' of Plan and Planning in Bangladesh," *Bangladesh Journal of Political Economy,* Vol. XIII, No. 2. pp. 245-262.

BAU (2013), "*Gourober Ponchash Bochor (Glorius 50 years)*" Historic Speech by Bangabandhu at the Bangladesh Agricultural University (BAU) campus, Souvenir published on the occasion of Golden Jubilee and Alumni Reunion 2012 held at the BAU, Mymensingh campus, 3-4 January.

Chowdhury, Malik K. (1975), "First Five Year Plan, Economic Development, of Policy Instruments and Institutions in Bangladesh," *Center Discussion Paper, No. 241*, Yale University, Economic Growth Center, New Haven, CT.

Dumont, Rene (1973), "Problems and Prospects for Rural Development in Bangladesh," *Working Paper* submitted to The Ford Foundation, Dhaka, 30 November.

Islam, Nurul (1977), *Development Planning in Bangladesh- A Study in Political Economy*, C. Hurst & Company Ltd. London.

Islam, Nurul (2003). *Making of a Nation: Bangladesh- An Economist's Tale*. University Press Ltd, Dhaka.

Jansen, Eirik G.(1986), *Rural Bangladesh: Competition for Scarce Resources*. Norwegian University Press, Universitetsforlaget AS, Oslo.

Khan, A.R. (1979), "Comilla Model and the Integrated Rural Development Programme of Bangladesh: An Experiment in "Cooperative Capitalism", *World Development,* Vol. 4 &5, April-May, pp.397-422.

Lewis, W. Arthur (1972), *Development Planning: The Essentials of Economic Policies*, George Allen and Unwin Ltd., Fifth Impression. London.

Mandal, M. A. Sattar, Stephen D. Biggs, and Scott E. Justice, (2017), Bangladesh: "A Special Case of Rural Mechanization and Rural Development" In: Mandal, M. A. Sattar, Stephen D. Biggs, and Scott E. Justice, (2017), (ed.) *Rural Mechanization- A Driver in Agricultural Change and Rural Development*, *pp.1-22*, Institute for Inclusive Finance and Development (InM).

Mandal, M. A. Sattar (2019), "Bangabandhur Sarker: Swolpotomo Somoy-Dirghotomo Kormokando," In: Mandal, M. A. Sattar (2019), *Unnoyoner Golpo: Krishi Khadyo Gramonnoyon*, *pp.69-76*, Grontho Kutir, Dhaka.

Planning Commission (1973), *The First Five Year Plan: 1973-78*, Government of the People's Republic of Bangladesh, November.

Rahman, Sheikh Mujibur (2020), *AMAR DEKHA NAYACHIN (New China as I saw)*, Bangla Academy, Dhaka.

Syeduzzaman, M. (1995), "The Evolving Planning Format in Bangladesh," *Bangladesh Journal of Political Economy,* Vol. XIII, No. 2. pp. 263-272.

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp.173-185)

Rural Credit Market in Bangladesh

- Abdul Bayes*

1. Introduction

Bangabandhu Sheikh Mujibur Rahman, the Father of the Nation, had the dream to build a 'Sonar Bangla' which would be free from socio-economic and political exploitations. A priori reasoning would suggest that agricultural sector would constitute the linchpin of that Sonar Bangla. The initiatives his government took were in line with these reasonings. Prominent among these initiatives were: rebuilding the war-ravaged agricultural infrastructure, ensuring supply of agricultural equipment on an emergency basis free of cost or at concessional rates, ensuring adequate supply of seed, cancelling 1 million certificate cases for loan default against farmers filed during the Pakistan period, fixing minimum fair prices for agro-products, introducing ration facilities for the poor and marginal farmers, etc. An ardent admirer of Rabindranath Tagore, Bangabandhu might have also been influenced by the poem 'Dui bigha Jomi' in introducing these measures which helped the poor and marginalized farmers. In the poem, poor Upens borrows money from a landlord at an exorbitant rate of interest, which kept piling up, eventually forcing him to surrender the parcel of land he owned which was his only possession.

Immediately after independence, Bangabandhu's government asked all the banks to provide credit to agriculturalists at reasonable interest rates. Bangladesh Krishi Bank, the largest specialized bank of the country, was established under the Presidential Order No. 27 of 1973 to finance the climate-dependent uncertain and risky agriculture sector.

---

*Professor Abdul Bayes is an Adjunct Faculty, East West University, Bangladesh. Earlier, he was the Vice Chancellor and Professor, Department of Economics, Jahangirnagar University, Bangladesh and Chairman of Bangladesh NGO Foundation. Views expressed in this article are the author's own.

Bangladesh has achieved remarkable progress since its birth in 1971. Once termed a "test case of development", it has apparently emerged as a "development puzzle" in the discourse on socioeconomic development. Economic growth has accelerated from 4 percent in the 1980s to over 6 percent during the last decade. After falling into the trapped in 6.5 percent for a pretty long time, the country could cross the much-waited 7 percent growth rate in the recent few years. The target of growth rate for the current financial year (2019-2020) is estimated at 8.2 per cent. On the social front, Bangladesh has made remarkable progress in the reduction of fertility rates (from 6 percent in the 1980s to 2.2 percent in 2011) and in infant and under-five mortality rates. The school participation rate at the primary level is now almost universal, and the gender disparity in school participation at the secondary level has almost disappeared. Organization of women in village associations in tandem with access to micro-credit has contributed substantially to women's empowerment, and their participation in economic activities has gone up over time. The per capita income stands at USD 2,064 in 2020 compared to USD 100-150 in the 1970s (World Bank Data). Although income disparity has grown over time, the poverty rate has declined from over 70 percent in the 1970s to 32 percent in 2010 and 24 per cent in 2016 (Ministry of Finance, 2019).

More importantly, the agricultural and the rural sector witnessed remarkable resilience and progress. The traditional technology and subsistence-based farming was giving way to, a modern agricultural sector, steered by the government of Bangabandhu Sheikh Mujibur Rahman in the 1970s. The sector is now dominated mostly by small and marginal farmers (Hossain and Bayes, 2009). Over four-fifths of the rice land is now covered by high-yielding varieties developed in the National Agricultural Research System. Agricultural mechanization has swept across the country. Crop diversification and commercialization are seemingly on the rise. Agro processing, contract farming and production of high value crops such as potatoes and vegetables are gradually gaining ground. With impressive growth in agricultural productivity, the country is now on the brink of achieving self-sufficiency in staple food production (rice), despite a reduction in cultivated land by 0.6 percent per year. Infrastructural development such as access to electricity, irrigation and paved roads has contributed to the rapid expansion of non-farm activities that has contributed to a scarcity of agricultural labor and rapid increase in real wages. A census of households in 62 villages carried out in 2013 shows that roughly two-thirds of the rural income is derived from rural non-farm activities compared to 40 percent two decades ago (Hossain and Bayes, 2009).

2. Objectives, Methodology and Data Sources

The purpose of this article is to provide an account of the rural credit market in Bangladesh. The paper draws on primary sources of data, secondary official statistics and published documents. The primary data was obtained from a census of households in 62 randomly selected villages carried out in 2013 by BRAC – covering about 12,000 households. However, to provide a comparative picture, the analysis would also use information from the repeat sample survey of households in the 62 villages carried out in 1988, 2000 and 2014. It may be mentioned here that some of the information was already analyzed by the authors (Hossain and Bayes, 2009). A multistage random sampling technique and structured questionnaires were used in the selection of villages and households.[1]

3. Financial Inclusion

Historically, rural credit market has been dominated by the informal sources like landlord, mohajons, traders, relatives and friends, etc. Table-1 shows that, in 1982 for example, about 62 per cent of rural households received credit from informal sources and only 14 percent accessed credit from institutional sources. More important to note, about 92 percent of the functionally landless borrowers borrowed from informal sources.

[1] The details of research methodology and data source have been shown in various documents (Hossain and Bayes, 2018).

Table 1: Access to Rural Credit, by Landownership Group, 1982

Land Owned (Acre)	Households Receiving Loans (%)		Amount of Loans Per Household (Taka Per Year)		Share (%) of Total Loans Obtained from Institutions
	Institutional Sources	Informal Sources	Institutional Sources	Informal Sources	
Up to 0.49	6.8	91.6	81	936	8.0
0.5 to 1.99	15.0	55.9	226	841	21.2
2.0 to 4.99	20.0	46.9	504	936	34.4
5.00 or more	21.0	29.0	929	1493	38.4
All households	14.3	61.7	323	964	25.0

Source: Compiled from a survey of 640 randomly selected households in 16 villages that was jointly conducted by the International Food Policy Research Institute (IFPRI) and the Bangladesh Institute of Development Studies (BIDS)

Table-2 shows that the proportion of rural households taking loans, from both formal and informal sources, increased from 37 to 55 percent over 25 years. In fact, the initial period of the survey closely approximates the advent of NGO MFIs as suppliers of rural credit. The financial inclusion has increased faster for the land-poor households (primary target for NGO MFIs), compared to the landowning households. In 2013, for example, 60 percent of land-poor households accessed credit – as against about 38 percent of them in 1988 – and 48 percent for households which owned land in sizes over 0.5 acres. It may be noted that the access to credit was almost the same for both groups in 1988 (Table-2).

Table 2: Expansion of the Rural Credit Market (% of Households Taken Loans), 1988 to 2013

Year of Survey	Landless Households	Landowning Households	All Households
1988	37.5	36.5	37.0
2000	41.5	31.0	36.3
2004	44.6	34.7	40.0
2008	50.7	37.8	44.8
2013	60.0	47.7	55.1

Source: Own estimate from unpublished data from a longitudinal sample household survey that covered 57 randomly selected villages from 57 districts (for methodology of the survey, see Hossain and Bayes, 2018)

3.1 Sources of Credit and Market Share

The information on the importance of different sources of credit and its change over 1988-2013 can be noted from Table-3. The numbers indicate that most of the expansion in the credit market and the loan from formal sources is due to increased access to credit from NGO MFIs. The households accessing credit from NGO MFIs increased from about 4 to 34 percent from 1988 to 2013; the NGOs share of total credit increased substantially from a mere 7 percent to about 60 percent. Very few rural households accessed credit from commercial banks, but for those who had access, the average size of credit increased almost five times – from USD 136 to USD 539, and for NGOs, from USD 102 to USD 250.

Table 3: Sources of Credit Market in Rural Bangladesh and Their Share of the Market, 1988-2008

Sources of Loan	Households Borrowing from the Source (%)		Average Size of Loan (US$)		Share of the Source in Total Loan (%)	
	1988	2008	1988	2008	1988	2008
Commercial Banks	9.0	4.8	136	735	20.7	21.0
NGO MFIs	3.8	34.1	102	184	6.7	37.0
Moneylenders	11.6	4.6	155	537	39.0	14.8
Friends and Relatives	12.6	4.9	115	920	33.6	26.8
All Sources	37.0	44.8	131	374	100.0	100.0

Source: Hossain and Bayes (2018)

The counterfactual, perhaps, carries more analytical weight. About one-fourth of the rural households in 1988 accessed credit from informal sources (moneylenders, friends and relatives) that declined to only 10 percent in 2013, while the average size of loan increased almost six times. During the same period, the share of informal sources to total loans in rural areas declined from 72 to 42 percent. Thus, the expansion of credit from NGO MFIs led to the reduced dependence of rural households on the usurious informal markets. But disconcertingly, the share of the informal market still remains large.

One of the factors behind the continued dependence of rural households on loans from the informal market despite a rapid expansion of NGO credit is the small size of loans provided by NGO MFIs. The average size of loans from the MFIs increased from US$102 in 1988 to US$250 in 2013. To finance large size expenses, taken to improve housing, for example, marriages or to hold or finance overseas migration, households still depend on high cost informal sources. It could also be that informal loans are more easily accessible than NGO loans. Finally, especially ultra- poor groups lean on informal loans through inter-linked transactions, especially of labor.

The 2013 data for financial inclusion and the coverage of NGO credit obtained can be seen from Table-4. The Table-4 also provides information on the coverage of big NGOs in the credit market. The data reveals that of the 55 percent of rural households accessing credit in 2013, 44 percent borrowed from institutional sources like commercial banks and NGOs. Two observations are noteworthy from Table-4. First, the financial exclusion still remained high despite rapid expansion of the NGO MFIs as high as half of rural households, by force or by choice, remained outside the reach . Second, only 2 percent of rural households received credit from the commercial banks, compared to about 42 percent covered by NGOs. However, the average size of loan provided by banks is almost five times higher than the amount provided by the NGOs. It may indicate that commercial banks continue to serve the better-off sections in rural areas who access credit in large amounts. Third, informal sources of credit covered about 12 percent of households and constituted 30 percent of total credit supplied in rural areas. Fourth, among the NGO MFIs, Grameen Bank alone provided loans to 12 percent of rural households, followed by ASA which covered another 10 percent of households. BRAC was the third MFI that covered about 6 percent of rural households. A large number of local NGOs also participated in the credit market. These NGOs were funded by the government sponsored Palli-Karma Sahayak Foundation that provides subsidized loan funds. They have become an important player in the rural credit market.

Table 4: The Role of NGO MFIS in the Credit Market in 2013: Findings from A Census of Households from 62 Randomly Selected Villages

Sources	Households Receiving Loans (%)	Average Loan (US$)	Share of Total Loan (%)
Institutional Sources	**43.6**	**352**	**70.0**
Commercial Banks	2.0	1,156	12.6
NGOs MFIs	41.6	257	57.4
Grameen Bank	12.3	235	15.9
ASA	9.5	240	12.6
BRAC	6.3	309	10.7
Other NGOs	13.5	244	18.2
Informal Sources	**11.5**	**452**	**30.0**
Friends/Relatives with Interest	4.8	527	13.9
Friends and Relatives without Interest	2.9	448	8.2
oneylenders/Traders/Landowner	3.8	381	7.9
All Households	**55.1**	**411**	**100**

Source: Census of All Households from 62 Villages to Draw the Sample Frame for A Repeat of the Sample Survey in 2013

3.2 Rural Indebtedness and NGO MFIs

Does the MFI credit contribute to deepening indebtedness in rural areas? The critiques tend to argue that easy access to credit led many households to take loans without knowing of the loans could be productively used and whether the investment would give a return higher than the rate of interest charged on the loan. The interest charged on the loans from NGO MFIs is large (27 percent on declining balance) due to high cost of servicing the loan and the risk of bad debt. It is possibly more so because recently the MFIs have been borrowing loan funds from the commercial banks to expand their credit operation. The cost of the loan fund is usually 10 to 13 percent per year. So the cost of servicing the loans comes to about 25 percent. If the borrower fails to utilize the loan in productive ventures, and rate of return is lower than the rate of interest, the loan would be difficult to repay and the misery of the household would increase further. This apprehension is demonstrated by: (a) media reports that the MFIs take recourse to coercive methods for collecting overdue loans, and (b) multiple borrowings of the households from a number of NGO MFIs. It is argued that about 40 percent of borrowing households borrow from one MFI to repay the overdue loan obtained earlier from another MFI.

Empirical evidences however do not seem to support the hypothesis. In the 2013 survey conducted by BRAC Research and Evaluation Division, sample households were asked to report on the overdue loans from the non-payment of instalments in due time and the overdue loans after the expiry of the tenure of the loans contracted earlier. The findings are reported in Table-5. It may be noted that only 15 percent of rural households reported that they had either defaulted on the current loans (loan from NGOs are collected in weekly or monthly repayments) or has accumulated debt due to failure to repay the previous loans. Amount of debt per indebted household was US$652.

Interestingly, however, the major sources of overdue loans were from commercial banks and moneylenders or friends and relatives. Only one to three percent of the households reported indebtedness due to loans obtained from NGO MFIs. The highest amount of debt was from loans from the informal markets or from commercial banks. The NGOs share of the debt was only 2.3 percent.

Table 5: Incidence of Debt from Different Sources of Loan, 2013

Sources	Households Reporting Indebtedness (Percent)	Average Size of Debt (US $) from the Source	Share of Total Debt (Percent)
Commercial bank	43.5	539	36.1
Grameen Bank	2.6	282	1.1
ASA	0.8	188	0.2
BRAC	1.0	443	0.6
Other NGOs	1.0	257	0.4
Friends/Relatives with Interest	14.1	673	14.6
Friends/Relatives without Interest	26.2	777	31.2
Moneylenders	14.1	701	15.2
All Sources	**14.8**	**652**	**100.0**

Source: Unpublished data from census of all households in 62 villages, BRAC

The moot question is: which households are more indebted than others? To answer this question, we analyzed the incidence of indebtedness across different socioeconomic groups such as landownership, education of the household head, and the poverty status. The information is presented in Table-6. It may be noted that the economically better off households are more indebted than households with less land and less education. For instance, only 12 percent of the functionally landless households reported indebtedness compared to 24 percent of households owning more than 2.5 acres. About 21 percent of household heads who had passed secondary schools reported indebtedness compared to 11 percent who were illiterate or had less than four years of schooling. The difference is mainly due to accumulation of debt from non-repayments of previous loans. It thus appears that the richer sections willfully defaulted because they had the capacity to repay overdue loans if they were forced to do so. In this context, mention may be made of the examples of exemption pertaining to principal and accumulated interest by the government. Occasionally, the government makes such a "generous gesture" to gain popularity at the time of elections. In hindsight of course, this provides a distorted incentive for willful default of loans from commercial banks.

Table 6: Households (Percent) Reporting Debt by Socioeconomic Status

Socioeconomic Groups	Households Reporting Debt	Households Reporting Overdue of Current Loan	Households Reporting Overdue of Past Loans
Land Owned (Acre) by the Household			
Up to 0.50	12.4	7.3	5.1
0.50 to 1.00	17.2	7.7	9.5
1.00 to 2.50	19.8	8.6	11.3
2.50 and Over	23.9	8.3	15.6
Education of the Head of Households			
Up to 4 Years of Schooling[2]	13.6	7.6	6.0
Primary Passed and Secondary Dropout	15.8	7.8	8.0
Secondary Passed	20.8	7.2	11.6
Poverty Status of the Household			
Rich	13.5	4.8	8.7
Self-sufficient	15.5	6.8	8.7
Moderate Poor	14.6	9.1	5.5

[2]It includes households that do not have formal education.

3.3 Utilization of Credit

Microfinance organizations in Bangladesh have long been accused of bypassing the agricultural sector and the chronic poor. The critics mention that these organizations targeted only functionally landless households (having 50 decimals of land), and funded mostly non-farm activities. Over time, however, things have changed. Of late, the chronic poor have been brought under the net of micro-credit by some NGOs (especially, BRAC), and credit has also been extended to pursue agricultural activities. As shown by Table-7, 40 percent of the loans from microfinance organizations were used for agricultural investment in 2013 compared to only 26 percent in 2000. However, the opposite holds in the case of bank loans. The use of bank-financed loans for non-agricultural investment declined from 51 to 44 percent from 2000 to 2013. It appears that with a view to meeting the requirement of working capital of the poor farmers, microfinance organizations have increasingly targeted agricultural activities.

Table 7: The Pattern of Utilization of Credit (% of Loan Money), 2000 and 2013

Sources	Commercial Banks		NGO MFIs		Informal Sources	
	2000	2013	2000	2013	2000	2013
Agricultural Investment	51.4	43.6	25.5[3]	39.8	19.3	27.0
Non-agricultural Investment	25.3	21.3	31.8	29.2	24.1	25.2
Medical Care	3.5	3.5	5.0	3.8	6.1	4.8
Education Expenses	0.0	0.7	2.7	1.3	2.3	2.8
Housing Improvement	7.7	7.4	9.7	9.4	5.6	7.9
Repayment of Overdue Loans	2.8	8.4	8.4	8.0	6.0	3.7
Food Expenses	5.6	4.0	16.5	8.1	29.3	16.8
Financing Overseas Migration	9.7	11.1	0.4	0.4	7.3	11.8

Source: Longitudinal household surveys of 62 randomly selected village from 57 districts.

Three other important observations may be noted from Table-7. First, the utilization of loan money for food expense declined over time in general and for NGO MFIs supplied loans in particular. About 16.5 percent of the NGO

[3]Mudahar and Ahmed (2010) show that loan disbursement by NGO-MFIs to fisheries, livestock, and agricultural high value crops from December 1997 to December 1999 averaged 33 percent. If food processing is counted, then the share reaches 40 percent.

supplied loans were used for food consumption in 2000; the number come down to 8.1 percent in 2013. The change might have resulted from the rapid progress made in Bangladesh in achieving of food security.[4] Bangladesh has long been a major rice importing country, but it did not have to import any rice in 2010 and started exporting rice from 2014. Second, about 10 percent of the NGO loans were used for housing improvement. The share almost remained at the same level during the 2000-2013 period. The utilization of loans for meeting food expenses by NGOs or informal loans went down over time. Third, critics argue that a large proportion of NGO loans are taken for repayment of overdue loans contracted earlier. Table-7 shows that only 8 percent of the NGO loans accessed in 2000 were used for this purpose. The number remained almost at the same level in 2013 despite rapid expansion of the NGO loans during 2000-2013.

4. Concluding Remarks

Given the role of NGOs and informal sources of credit in rural Bangladesh, the critics condemn government's involvement in extending agricultural credit to rural households as a history of frustrations and wasteful endeavor; sadly, a history of hype against hope. The recovery rate against outstanding loans by government banks, especially averaged 22 per cent from 1998 to 2010. A World Bank study reported that the importance of banks and cooperatives in rural lending had declined over time, while the importance of MFIs increased (Mudahar and Ahmed, 2010).

By and large, microfinance is a mature industry in Bangladesh providing financial services to at least half of the rural households. Noticeably, the average size of the loan provided by commercial banks has increased many times but their coverage of rural households has reduced substantially. Most of the credit expansion from the formal sector has come from NGO MFIs who started their journey in the credit market in the late 1980s. The NGOs, however, give loans in small sizes that often fail to satisfy the demand from successful borrowers. Now, almost 40 percent of the borrowers from NGO MFIs access

---

[4] The production of rice, the staple food in Bangladesh has increased three fold since 1971.

loans from multiple NGOs. The culture may have crippled credit discipline which was an exemplary characteristic of NGO loans in the early days.

Contrary to the hypothesis that a large part of the loan provided by NGOs to poor households is used to meet consumption needs, and repayment of old loans wasn't found to be valid. In 2000, nearly 56 percent of NGO loans were used to finance agricultural and non-agricultural investment. The share increased to 68 percent in 2013. Agriculture's share of NGO loans increased from 25 to 39 percent within this period.

But the dream of Bangabandhu Sheikh Mujibur Rahman demands that a more active role should have been played by the government banks in the service of the rural people especially in meeting their agricultural credit needs. It has long been alleged that the loans extended by the Krishi Bank mostly go to the large and middle farmers with sufficient collateral and connection with power structure. As opposed to this, the poor and marginal farmers are left in the hands of the most exploitative informal sources and relatively less exploitative NGOs.

This is a pity.

References

Hossain, M. and Abdul Bayes (2018*), Rural Transformation: Insights from Bangladesh*., Dhaka: The University Press Limited.

Hossain, M. and Abdul Bayes (2009), *Rural Economy and Livelihoods: Insights from Bangladesh,* A. H. Development Publishing House, Dhaka, Bangladesh,

Ministry of Finance (2019), *Bangladesh Economic Review, 2019,* Ministry of Finance (MoF), Government of Bangladesh.

Mudahar, M.S. and Raisuddin Ahmed (2010), *Government and Rural Transformation Role of Public Spending and Policies in Bangladesh,* Dhaka: The University Press Limited.

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (186-203)

Role of Banking Services in Building "Sonar Bangla": Some Progress, Pitfalls and Prescriptions

- Matiur Rahman*

Executive Summary

The Father of the Nation's 'Sonar Bangla' vision, in this author`s view, embodies rights, liberties and justice for all with peaceful co-existence. Each component has economic, political and social dimensions for inclusive symmetric accesses to economic opportunities and prosperity. Since independence, the banking sector has been enormously contributing toward the fulfilment of the 'Sonar Bangla" vision through credit flows in agriculture, manufacturing, services, infrastructures, healthcare and education, as Bangabandhu envisioned in the First Five-Year Plan for the newly independent Bangladesh. The recent decade has been the decade of remarkable progress on the above fronts under the dynamic, bold and dedicated leadership of his daughter, Honorable Prime Minister Sheikh Hasina, but a lot more is yet to be done to realize this vision.

The key role of the Bangladesh Bank, as the country's central bank, is to ensure safety and soundness of the banking sector for a healthy economy. Despite discernible progress, the banking sector is seemingly infected with double-digit percentage of non-performing loans out of the total outstanding amount. The trajectory of year-to-year non-performing loans as ratios of total outstanding amounts reveals upswings and downswings due to adverse external and internal shocks. Early detection of problems for loans going into possible defaults and requiring timely corrective actions by the Bangladesh Bank are an exigency of the hour, to say the least.

Despite remarkable economic and social progress, rising income inequality, widening wealth-gap and widespread corruption in all sectors of the economy

---

* Professor Dr. Matiur Rahman is the JP Morgan-Chase Endowed Professor of Finance, McNeese State University, United States of America. Dr. Rahman did Ph.D. from the Southern Methodist University, United States of America. Views expressed in this article are the author's own.

are serious national concerns. They call for immediate bold policy actions and their proper and timely implementation to fulfill the "Sonar Bangla" vision of the Father of the Nation.

Notably, the currently launched war against corruption, though belated, is a gigantic step in the right direction to restore public confidence in governance. However, as the saying goes, "better late than never." In this war, failure will not be an option, any more.

Keywords: Sonar Bangla, Father of the Nation, Banking Services, Progress, Pitfalls, Prescriptions.

1. Brief Review of History

In this author`s view, the Father of the Nation`s "Sonar Bangla" is a vision, not just a dream. Succinctly, this is about "rights, liberty and justice for all with peaceful co-existence." Each component of his great vision has economic, political and social dimensions. However, the primary focus of this analytical paper is on the economic dimension of each. To say the very least, the Father of the Nation Bangabandhu Sheikh Mujibur Rahman deeply felt the economic pains of the people of Bangladesh that strongly motivated him to dedicate his life for finding a permanent cure. He firmly stood against the Pakistani rulers of that time to ensure economic rights, economic liberty and economic justice for all. To achieve this goal, he introduced the historic Six-Points Program in 1966, against all political odds. To be specific, the glaring economic disparity between the two wings of former Pakistan was very much against the economic interest of the East Pakistan resulting in huge resources and wealth transfers to West Pakistan. Although the seed of independence was planted during the Language Movement of 1952, it began to germinate with the Six- Points Program. Due to hostile and uncompromising stands of the Pakistani ruling class against his demands on 7th March, 1971, Bangabandhu gave a historic speech in the Suhrawardy Udyan (the former Race Course). Undoubtedly, this famous speech was virtual declaration of independence for Bangladesh. None can muddy this fact because fact speak for itself. History was distorted for some time since the darkest hours of 15th August of 1975, but eventually it followed its own course. After twenty years of his brutal assassination, history of Bangladesh has proved the obvious truth. Bangabandhu was restored in history in a unique position with full glory beyond any doubts and disputes. Truth prevailed and truth matters. If he were alive now, he would be 100 years old on 17 March, 2020. The nation will remember him with the deepest gratitude while celebrating the 50th anniversary of independent Bangladesh a year letter. To add further, after a nine-month bloody liberation war against the ruthless Pakistani military, Bangladesh emerged as an independent country on 16 December, 1971. In this liberation war, at least three million innocent men, women and children gave up their precious lives. Their noble sacrifices never must go in vain in achieving the everlasting vision of the Father of the Nation. Bangabandhu's mission in life was to see his people live happy and prosperous lives. During his entire political life, he spent thirteen years or so of the prime time of his life in the Pakistani prisons rejecting all lucrative deals offered by the Pakistani rulers. His journey toward independent Bangladesh was very uneven. Sometimes, he fought alone keeping four of his most trusted compatriots (late Tajuddin Ahmed, Syed Nazrul Islam, Captain Mansur Ali and Kamruzzaman) on his side. These four national leaders never deviated from his vision for Bangladesh. In this arduous journey, his very own family members went through untold sufferings making tremendous sacrifices. So, it is now our turn to give something back to the nation in fulfilment of his "Sonar Bangla" or "Golden Bengal" Vision. Bangladesh was saddled with an economy in ruins, infrastructures in shambles and communication in a crisis. But under Bangabandhu's dynamic leadership, things began to improve at a great pace. His daughter, honorable prime minister Sheikh Hasina picked up his unfinished agenda and gave at a momentum. Here is a brief history of the progress made by her government in the economic sector particulars in the last decade.

2. Brief on Economic Progress

In 1972, per capita real GDP was barely \$94.0 while total population was 75 million. In a continuum of economic trajectory, it rose to \$413 in 2002 and then to \$883 in 2012. Since 2011, the number steadily and speedily spiked at \$2064.0 in 2020 depicting a robust annual economic growth hovering around 6.5 percent to 7.0 percent or even exceeding 8 percent in the most recent years with a total population of over 163.7 million on official record. This is a decade of spectacular economic success under the current political regime (let it be called the decade of economic prosperity). Bangladesh has now graduated from a least developed economy to a low-middle income economy aspiring to be a middle-income country in the very near future. Bangladesh has been on a sustainable growth path amid global economic uncertainties and potentially long-running US-China trade war. Such remarkable success has proved those who ridiculed Bangladesh as a "bottomless basket" in the early years of independence wrong. Bangladesh and Pakistan are now two countries and two very different tales. To limit the scope of discussion on economic progress of both, Bangladesh is a story of tremendous economic success and Pakistan is a story of dismal failure. In short, Pakistan has become a failed state over the years. The contributors to Bangladesh economic miracle are the government as a facilitator; inclusive banking for farming; large enterprises, SMEs and micro-businesses. Trade in goods and manpower, new technology adoption and emerging entrepreneurship that are fueled by banking services play a vital role in the economy. A healthy financial system is a prerequisite for sustaining the growth momentum. The task of the Bangladesh Bank is to ensure that the financial system remains safe and sound. Any central bank acting under undue outside pressures will weakly perform in this regard. At the initial stage of economic progress, worsening of economic income inequality is a likelihood, but it must not go unchecked forever. The proper time has come to mitigate it through equitable redistribution of income to ensure that every stakeholder gets a due slice of the prosperity-pie. Otherwise, it will go against the very core of Bangabandhu's "Sonar Bangla" Vision. We must remember that the Father of the Nation relentlessly fought against the Pakistani rulers to ensure economic fairness for by narrowing the widening economic disparity. Concomitantly, higher economic growth has drastically reduced the overall headcount and extreme poverty rates. Both are higher in rural areas than in urban centers. Primarily, economic activities are urban-centric. For example, poverty rate was 35.2 percent in rural areas, as compared to 21.3 percent in urban areas in 2010. According to 2016 Household Income and Expenditure Survey by the Bangladesh Bureau of Statistics, both rates significantly came down to 26.4 percent and 18.9 percent, respectively. In addition, extreme poverty rate fell from 17.6 percent in 2010 to 12.9 percent in 2016. In subsequent years, more progress has been made on both fronts. But still higher poverty rate persists in rural areas over that of urban areas. To alleviate rural poverty further, economic and business activities need to be diffused further throughout rural Bangladesh through decentralization and creating both "Opportunity Zones" for the low-income and appropriate "Economic Zones" for promoting nascent rural entrepreneurs. To this effect, agro-based small and micro-businesses should be given higher priority. Farmers should receive fair prices for their produces above per unit production costs. Enhancement of storage capacity in rural areas and farmers' holding period of produces would successfully reduce poverty rates from the current levels. The Government should design appropriate policies and implement them in time to move forward.

3. Progressive Journey of the Banking Sector

During the pre-independence period from 1947 to 1971, the commercial banking sector was mostly under Pakistani private ownership which dominated the banking market in Bangladesh. The banks under their ownership mobilized our local deposits and heavily concentrated on lending to Pakistani industrial conglomerates in both wings of Pakistan. Conjecturally, this resulted in significant deposit outflows from the East wing to the West wing. The local businesses had inadequate formal access to bank credit. This greatly impeded local business growth and development of local entrepreneurship. After independence, the owners of those banks either left or stopped operations in Bangladesh. As a result, they were taken over by the Government of Bangabandhu immediately after independence and the State Bank of East Pakistan was renamed the Bangladesh Bank with all central banking operations. The banking sector began its journey with six nationalized banks, two specialized banks and three private foreign banks. There were no locally owned private banks in operation at that time. The measure of nationalization laid foundations for subsequent development and future competitive expansion of the private banking sector in Bangladesh since 1982. Currently, there are 48 private banks in operation. Among them 39 are locally owned and 9 are under foreign ownership. As stated above, six banks were kept in the public sector instead of lumping them into a single state-owned bank, as a such move would create a natural monopoly. Bangabandhu's vision was to create a competitive fringe within the public sector to serve the economy better. In fifty years after independence, total number of bank branches swelled to 10,114 as of June, 2020 from 6,886 in June. 2008 revealing nearly 47 percent spectacular growth during the current regime (Bangladesh Bank, 2020). In terms of numerical strength, the Bangladesh banking sector made visible progress, though there is a larger concentration in urban areas. In general, private banks prefer urban locations of branches for higher profitability. Loan-to-deposit ratio is 0.40 in rural areas. Surprisingly, this is 1.03. in urban areas. This shows that a large part of mobilized rural deposits is transferred to urban areas to make additional loans for higher profit. Provided the above available data are correct, the rural-urban bank lending growths out of specific local deposits are lopsided. They do not properly align with the "Sonar Bangla" vision of the Father of the Nation. Moreover, regional distributions of bank loans are uneven, based on active-age population distributions. The bank branches are thinly distributed in rural areas per 100,000 of population in the age group of 15 years and above. Introduction of inclusive banking through agent banking, mobile banking services and enabling farmers to open a bank account with a minimum amount of Tk. 10 deposit are remarkable feats. They likely have salutary impacts on efforts to attain sustainable growth and to dent poverty further. In addition, micro finance institutions play an important role in financial inclusion. They could contribute more, if there were no allegations against them for profiting on poverty, while enjoying the benefits of non-profit entities. But much more needs to be done for the rural Bangladesh, as the above statistics reveal. Moreover, data can be tampered by the interpreters to support what they seek to say. There are certain things the private banks might not like to do in the rural areas because of profit motive. So, state-owned banks have to play a much greater role in rural financial inclusion. The public sector banks have some social business roles as well. This is consistent with Bangabandhu's pro-rural and pro-poor growth strategies. On that ground, state-owned banks' overall performance should be evaluated somewhat differently because they are presumed to advance socio-economic goals as well. In recent years, state-owned banks` average loan-to-deposit ratio has been 0.60, as compared to that of private banks at 0.80. It shows that state-owned banks have become relatively more risk averse in light of being plagued with bad loans given to selected large enterprises. However, they should be more engaged in prudent future lending. Private banks` profit-maximizing behaviors are likely to be different from those of public banks to certain extent. But they also have to perform Corporate Social Responsibility (CSR) to return something back to the society out of their profits. Though they are expected to behave somewhat differently, their corrupt practices as well as perpetual operational and managerial inefficiencies resulting in deadweight losses to the society are not acceptable by any reasoning.

4. Economic Role of the Banking Sector

Bank-based financial services are essential to long-term economic growth. In modern days, commercial banks perform multiple functions. Among them, financial intermediation, payments mediation and credit function are crucial to Bangladesh. In particular, bank credit is the lifeblood of the economy. Steady, timely and adequate flows of credit to the vital sectors of the economy, as identified in the First Five-Year Plan of the Father of the Nation, are of great importance for inclusive and sustainable long-term economic growth and hence job creation. The sectors, as identified in the Plan, included agriculture, industry, healthcare and education. These four sectors interact with one another and need to grow together to ensure sustainable economic progress benefiting all stakeholders. This is what Bangabandhu envisioned.

Bangladesh has now achieved self-sufficiency in foods. This has been possible due to enhanced credit to agriculture, irrigation, rural electrification, technology adoption, fertilizers and seed subsidies concomitant with other government support services through agricultural research and advising extension centers. None of these would matter if rural farmers were not working much harder. Bank credit contributed a lot to this agricultural miracle in Bangladesh.

During the pre-independence quarter century, there were not enough local entrepreneurs. The industrial sector was vastly dominated by the West Pakistani owners of mills and factories. In the post-independence era, local entrepreneurs evolved. They have been contributing hugely to various segments of the industrial sector. Now, Bangladesh has a vibrant industrial sector employing tens of millions of workers and professionals. This sector also leads to the growing services sector. The services sector continues to evolve as the largest engine of job creation. These could not have been accomplished in 50 years without independence. Larger access to bank credit by evolving local entrepreneurs played a vital role in industrial success.

Some discernible progress has been made in the last decade as well in healthcare and education fronts, but they appear to be highly inadequate and somewhat faulty. To be specific, the availability of healthcare services in rural Bangladesh is extremely inadequate and poor in quality. Still there remains a lot to be done in this sector in fulfilling Bangabandhu's "Sonar Bangla" vision. Proper access to creative education is the key to the formation and development of human capital. This is the exit door for getting out of poverty through gainful employment. Access to better educational opportunities is highly skewed in favor of urban areas. Producing a large number of graduates lowering educational standards is a faulty strategy. It will do more harm than good in the long run. The resulting net negative outcome is a continual rise in unemployment among the inappropriately educated youths. This is equivalent to planting a time bomb to explode in the future.

A good overall infrastructural development needs massive financing in which bank credit plays an important role. The overall infrastructure includes physical facilities for capacity-building, such as, roads, highways and ports for transportation; communication and information technologies healthcare and education. Proper integration of the above and close performance monitoring for timely completion would help gain national competitiveness in the age of increasingly globalized world. Otherwise, the road ahead would be bumpy. This, in turn, would decelerate the pace toward fulfillment of Bangabandhu's vision of "Sonar Bangla".

The bold, dynamic and dedicated leadership of the Prime Minister Sheikh Hasina has taken the above very close to her heart. Adequate financing of the projects for completion is not an end in itself. To bring these all to fruition, her daunting challenge is to clean up the mushrooming corruption in all sectors of the economy. She has realized the severity of this infectious and chronic social disease and launched a war against it. For her, failure must not be an option in this war. Bangabandhu clearly understood this problem. But his tenure at the helm of the government was very short. In other words, he didn't get enough time to fight it out, while alive. Now, it has become a moral duty of his daughter to mitigate corruption from the society to build "Sonar Bangla".

5. Some Pitfalls and Prescriptions

All successes have some failures that need to be identified in time. Failures have remedies too, but all remedies may not always be perfect. There are pitfalls either in conceptualization or in implementation. It is a great virtue to acknowledge shortfalls and solicit advice to rectify.

The pre-requisite for an economy to be healthy is a robust financial system. To ensure a robust financial system for this great cause, the Bangladesh Bank has a daunting task. True, banks have a central role in the economy, as they provide credit, accept deposits, mediate payments and help customers manage risk. But non-performing loans (generally, in default and arrears) primarily resulting from poor asset quality, lack of close monitoring and supervision, adverse macro-economic and business conditions, and moral hazard have an adverse impact on economic development and financial stability. To state in brief, non-performing loans organically arise when the borrowers no longer pay in accordance with the terms of the loan. This has a negative impact on bank's profitability leading to loan losses and, at worst, default. Simply put, large volumes of bad loans risk are reducing bank equity thereby making it more difficult to issue new loans. Effective management of bad loans involves banks identifying such loans at an early stage and writing down their value equal to the expected loan losses. For unprofitable banks, this causes a reduction in their equity. In turn, this leads to major uncertainty regarding banks' viability. In general, loans to SMEs and households have higher chance going into default. But in Bangladesh, several big businesses, on record, are perennial loan defaulters. Currently, the non-performing loans out of total bank loan portfolio is 11.9 percent whereas by a standard norm it should be no higher than

5 percent. The trajectory of non-performing loan ratios is uncharted rarely falling below a double-digit in any particular year since independence.

If several inter-affiliated banks are affected simultaneously by large volumes of bad loans, this systemic risk would have deleterious impacts on the entire economy emanating from reductions in access to bank loans, lower investment, fewer jobs and lower economic growth. A high share of bad loans also affects the conditions for monetary policy. Central banks may in different ways influence the bank's funding costs. But these costs are subsequently passed on to households and corporations in good standing by lowering deposit rates and raising loan rates. By increasing or reducing banks' borrowing costs, central banks can accelerate or slow down economic growth. Large volumes of bad loans limit banks` lending capacity. Consequently, they also reduce the ability of the central bank to influence the economy through monetary policy actions.

Usually, the share of bad loans increases in consonance with severe economic downturns. Large volumes of bad loans are normally preceded by sharp credit growth, resulting in higher loan-to-value ratios among corporations and households. During such periods, competition in the loan market has often escalated. In such cases, banks become more lenient in their lending in violation of normal credit standards. They get tempted to engage in subprime lending. Greater leverage, lower credit quality and other vulnerabilities built up during periods of economic boom subsequently push the economy downward. This leads to the growth in larger volumes of bad loans.

As a rule, banks with large volumes of bad loans need to consolidate their balance sheets to enable them to issue new loans and hence regain their profitability. There are different ways for banks to do it. The first step is to hold dialogues with the borrower with a view to exploring the conditions for paying back the loans. If repayment is still considered possible, the particular bank and the particular borrower can renegotiate the terms of the loan agreement, for instance, by extending the term of the loan or adjusting the interest rate. This possibly has been abused in certain cases through what is known as 'ever greening'. This is a situation when banks recurrently renegotiate and renew loans, solely with the aim of avoiding write-downs, instead of classifying them as bad loans.

Following renegotiation, if the borrower is still not able to pay, the bank can initiate legal proceedings to take over any underlying collateral. The bank can subsequently sell the collateral to get its money back. Another alternative for the bank may be to sell the bad loan at some reasonable discount with or without recourse to a newly created external party. This process is called factoring. This has been in place in Europe for many decades. However, such sales have been made more difficult by the fact that the book value of the bad loans has often been higher than the value that external buyers have been willing to pay. The main reason is that banks, in many cases, have been reluctant to write down the value of their bad loans to a sufficient degree. Many banks with insufficient equity thus risk becoming insolvent without proper write-downs. As a special note, no central banks should relax the definition of bad loans and allow banks to set their own loan standards. They consequently lead to organic growths of moral hazard and adverse selections of borrowers. All branches of the same bank must follow the same normal standards. Otherwise, the borrower will hop from one branch to another to qualify for loans.

Corporate culture, risk appetite and internal processes are bank-specific factors that determine the quality of lending and how well a bank can manage new flows of bad loans. The life-cycle of a loan can, in simplified terms, be divided into three stages. How banks manage each stage determines how large is the risk associated with the volumes of bad loans, and the effect it exerts on the bank's profitability and long-term ability to survive. The first stage is the banks' credit assessment, which determines whether a loan is to be granted or not. Among the factors analyzed is the borrower's ability to repay the loan. The second stage is a continual loan monitoring, whereby the bank will continually ensure that the borrower doesn't breach, or risks being in breach of, the terms of the loan. The third and final stage is managing a loan after it has been classified as non-performing.

Banks are themselves ultimately responsible for having internal processes to ensure sound lending, efficient loan monitoring and correct management of bad loans once that they have originated. Ensuring the above requires effective bank supervision. Supervisory authorities shall continually monitor banks' risks and regulatory compliance, for instance by ensuring that they have made correct loss provisions. Other determinants that affect the bank's ability to manage bad loans are structural factors, such as the design of insolvency rules and bankruptcy legislation.

The earlier a bank detects problems in its lending and starts implementing measures, the better are its chances of being able to counteract high levels of bad loans. Banks should, therefore, periodically stress-test their credit portfolios. Loan monitoring also includes managing underlying collateral. It is important that the collateral is correctly valued and that banks allow for proper economic conditions or fallings prices that cause the value of the collateral to diminish.

There are many structural factors that affect how bad loans are managed. The effectiveness of the legal system can, for instance, determine how quickly it is possible to realize the value of the collateral linked to bad loans. An ineffective system could make it difficult to value a loan.

In Bangladesh, outstanding high percentage of bad loans amounting to over Tk. 40,000 crores is an ominous sign for a viable future of the banking sector. Out of this outstanding amount, more than 25 percent is with the Sonali Bank alone. There exists a growing list of identified perpetual loan defaulters. They happen to be large industrial conglomerates with heavy concentration of borrowed funds from selected state-owned banks. Things started going wrong from the stage of assessing their credit worthiness, which should be done carefully based on the net worth (total assets-total liabilities). The net worth in itself is highly questionable in Bangladesh due to deficiencies in relevance, reliability, timeliness and completeness of given information. Some bank branch managers purposefully act on such flimsy information to grant loans for side payments. Moreover, the big borrowers use personal connections with bank officials, influence and external pressures to obtain loans. In many instances, their defaulting on loans is intentional. Later on, they manage to get bad ones rescheduled seeking refuge in the loopholes in the regulatory framework and selected overly accommodative judicial courts. The fraudulent, corrupt and cunning corporate borrowing culture, as developed over decades, jeopardizes the health of the banking sector to the detriment of the realization of the "Sonar Bangla" vision of the Father of the Nation. This problem is so deep-rooted and chronic that it cannot be solved so easily. However, the severity of problem in the banking sector can be mitigated by early detection of bank vulnerability to external shocks (macro-systemic risk) and internal shocks (micro-systemic risk), followed by pragmatic actions (Appendix-I). To remedy the problem of unduly high bad loans, timely corrective actions are needed, as prescribed in Appendix-II. At the same time, the Central Bank has to be more assertive in implementing the corrective measures, as called for.

6. Closing Remarks

In closing it can be said that the "Sonar Bangla" vision of the Father of the Nation can be achieved if we all as stakeholders and as a nation diligently and duly perform our own patriotic responsibilities. Instead of seeking just our individual self-interest, we should rather ask ourselves what we can do in our individual capacity to build "Sonar Bangla". Together, we can move forward, leaving political differences aside, to achieve this vision since it ought to be our collective vision too.

Suggested Readings

Accornero, M., A. Pierogiorgio, L. Carpinelli and A. Sorrentino (2017), "Non-Performing Loans and the Supply of Bank Credit: Evidence from Italy", *Bank of Italy Occasional Paper 374*.

Aiyar, S., W. Bergthaler, J. Garrido, A. Ilyina, A. Jobst, K. Kang, D. Kovtun, Y. Liu, D. Monaghan and M. Moretti (2015), "A Strategy for Resolving Europe's Problem Loans", *IMF Staff Discussion Note No 15/19*, International Monetary Fund (IMF), Washington, D.C.

Barr, R., L. Seiford, and T. Siems (1994), "Forecasting Bank Failure: A Non-Parametric Frontier Estimation Approach", *Louvain Economic Review*, Vol. 60, pp. 417-429.

Barth, J., G. Caprio and R. Levine (2004), "Bank Regulation and Supervision: What Works Best?" *Journal of Financial Intermediation*, Vol. 13, pp. 205-248.

Beatty, A. and S. Liao (2011), "Do Delays in Expected Loss Recognition Affect Banks' Willingness to Lend?" *Journal of Accounting and Economics*, Vol. 52, pp. 1-20.

Beck, T., Jakubik and A. Piloiu (2013), "Non-performing Loans: What Matters in Addition to the Economic Cycle?" *European Central Bank Working Paper 1515*.

Bergthaler, W., K. Kang, Y. Liu and D. Monaghan (2015), "Tackling Small and Medium Sized Enterprise Problem Loans in Europe", *IMF Staff Discussion Note 15/04*.

Bruno, V., I. Shim and H.S. Shin (2017), "Comparative Assessment of Macro-Prudential Policies", *Journal of Financial Stability*, Vol. 28, pp. 183-202.

Caballero, R., T. Hoshi and A. Kashyap (2008), "Zombie Lending and Depressed Restructuring in Japan", *American Economic Review*, Vol. 98, pp. 1943-1977.

Chiak, M., Demirguc-Kunt, Martinez Peria and A. Mohseni-Cheraghlou (2012), "Bank Regulation and Supervision around the World: A Crisis Update", *World Bank Policy Research Working Paper 6286*.

Cucinelli, D. (2015), "The Impact of Non-Performing Loans on Bank Lending Behavior: Evidence from the Italian Banking Sector", *Eurasian Journal of Business and Economics*, Vol. 8, pp. 59-71.

ECB (2017), "Stocktake of National Supervisory Practices and Legal Frameworks Related to NPLs", *Banking Supervision Paper*.

Espinoza, R. and A. Prasad (2010), "Non-Performing Loans in the GCC Banking System and Their Macroeconomic Effects", *IMF Working Paper 10/224*.

Gonzales-Hermosillo, B., C. Pazarbasioglu and R. Billings (1997), "Determinants of Banking System Fragility: A Case Study of Mexico", *IMF Staff Papers*, Vol. 44, pp. 295-314.

Hou Y. and D. Dickinson (2017), "The Non-Performing Loans: Some Bank Level Evidence", Research Conference on Safety and Efficiency of the Financial System, EU-Asia Link Programme.

Jonung, Lars (2009), "The Swedish Model for Resolving the Banking Crisis of 1991-93, Seven Reasons Why It Was Successful", *European Economy – Economic Paper 360*.

Jorda, 0., M. Schularick and A. Taylor (2013), "When Credit Bites Back", *Journal of Money, Credit and Banking*, Vol. 45, pp. 3-28.

Klein, N. (2013), "Non-Performing Loans in CESEE: Determinants and Macroeconomic Performance", *IMF Working Paper 13/72*.

Kwan, S. and R. Eisenbeis (1995) "An Analysis of Inefficiencies in Banking", *Journal of Banking and Finance*, Vol. 19, pp. 733-734.

Leon, H. and M. Tracey (2011), "The Impact of Non-Performing Loans on Loan Growth", *IMF Working Paper*.

Louzis, D., A Vouldis and V. L. Metaxas (2012), "Macroeconomic and Bank-Specific Determinants of Non-Performing Loans in Greece: A Comparative Study of Mortgage, Business and Consumer Loan Portfolios'', *Journal of Banking & Finance*, Vol. 36, pp. 1012-1027.

Maggi, B. and M. Guida (2009), "Modelling Non-Performing Loans Probability in the Commercial Banking System: Efficiency and Effectiveness Related to Credit Risk in Italy", *University of Rome La Sapienza Working Paper*.

Nkusu, M. (2011), "Non-Performing Loans and Macro-Financial Vulnerabilities in Advanced Economies", *IMF Working Paper 11/161*.

Plekhanov, A. and M. Skrazypinska (2017), "Are Government Policies to Reduce Non-Performing Loans Effective? Bank-Level Evidence", *University of Bristol Working Paper*, Forthcoming.

Quagliariello, M. (2009), "Macroeconomic Uncertainty and Banks' Lending Decisions: The Case of Italy", *Applied Economics*, Vol. 41(3), pp. 323-336.

Appendices

Appendix I: Assessment Indicators of Vulnerability of Commercial Banks

External Vulnerability:

1) A significant erosion in international liquidity position.
2) Much faster growth rate of external debt than growth rate in export earnings.
3) Accelerating inflation rate in home country.
4) Deterioration in export performance.
5) Adverse internal political conditions.
6) Overdependence on short-term foreign capital.
7) Maturity mismatch between short-term foreign borrowings and their uses to make longer-term domestic loans.

Internal Vulnerability:	**Correlating Factors**	**(Relationship)**
1) Return on average asset (ROA)	↑	(-)
2) Commercial and industrial loans as % of total asset	↑	(+)
3) Net Worth = (Total asset – Total liabilities)	↑	(-)
4) Loans past due as % of total asset	↑	(+)
5) Nonaccrual loans as % total asset	↑	(+)
6) Asset quality	↑	(-)
7) Capital protection	↑	(-)
8) Management competence	↑	(-)
9) Earnings strength	↑	(-)
10) Liquidity risk	↑	(+)
11) Market risk	↑	(+)

Composite rating based on the above factors:

Rating	**Implications**
1	Financial institutions are sound in every respect
2	Fundamentally sound
3	Exhibit some degree of supervisory concern
4	Have serious financial or managerial deficiencies resulting in unsatisfactory performance
5	Extremely unsafe and unsound

Action Plan to Mitigate Potential Vulnerability:

1) Undertake frequent portfolio analyses to assess future debt service prospects and problems and propose action that should be taken to overcome them;
2) Prepare debt sustainability analyses to assess the long-term sustainability of projected borrowing levels;
3) Assess external vulnerability using debt and reserve adequacy indicators;
4) Formulate policies for the issue of government guarantees and on-lending borrowed funds;
5) Assess and manage market, rollover, liquidity, credit, settlement and operational risks in the loan portfolio;
6) Adopt specific targets, benchmarks or guidelines for various debt variables such as the currency mix, share of floating debt, share of foreign debt, maturity profiles and share of short-term debt in total debt outstanding;
7) Formulate a borrowing policy and an annual borrowing plan for the government/public sector. It could involve the adoption of ceilings for total debt outstanding broken down into foreign and domestic debts and targets for various stock and flow debt indicators;
8) Prepare a borrowing strategy for implementing the annual borrowing plan involving choices between domestic and foreign borrowings, foreign markets to be accessed, currency of borrowing, and interest rate and maturity structures;
9) Formulate guidelines for unguaranteed borrowings of state enterprises and the private sector; and
10) Prepare or provide inputs on public debt to periodic economic and financial reports and data for presentation.

Appendix II: Action Plan for Managing Non-Performing Loans (NPLs)

1. Interpretation of existing supervisory powers and legislation regarding NPL provisioning.	8. Improving loan- type information required from banks.
2. Addressing potential under provisioning via automatic and time-bound provisioning.	9. Strengthening data infrastructure from NPLs, including potential transaction platforms.
3. Extending single Supervisory Mechanism NPL guidelines to small banks.	10. Developing a Blueprint for Asset Management Companies.
4. Adopting management guidelines for non-performing exposures.	11. Developing Secondary Markets for NPLs.
5. New guidelines on banks' loan origination, monitoring and internal governance.	12. Benchmarking national loan enforcement and insolvency frameworks.
6. Developing macro-prudential approaches to take the build-up of future NPLs.	13. Developing focal points on insolvency issues.
7. Enhancing disclosure requirements on asset quality and NPLs for all banks.	14. Enhancing the protection of secured creditors.

Source: European Commission, 2018

Bank Parikrama
Volume XLIV & XLV, Special Issue, September 2019-June 2020 (pp. 204-216)

National Savings: Mobilization and Allocation are the Key Challenges

- Zahid Hussain*

National saving rate in Bangladesh is not bad by comparable international standards. It has increased from 17.5 percent in the mid-1980s to 28.4 percent in FY19. Increase in per capita income and decline in the dependency ratio have contributed to the upward trend in the saving rate as did the rise in adult life expectancy. Research shows that gains in life expectancy are much more important than declines in child dependency. Population aging may not lead to lower saving rates in the future if life expectancy and the duration of retirement continue to increase. Changing gender relations may also have played a role in influencing aggregate saving. Research shows that shifts in women's relative bargaining power affect household saving rates, and by extension, domestic saving rates. Women's care responsibilities and their role in household management induces them to save more than men for precautionary reasons, due to a stronger perception of the need for smooth family consumption. Bangladeshi values attach a premium to savings. Frugality is considered a virtue generally, notwithstanding the conspicuous consumption tendencies among the ultra-rich.

Table 1: Gross National Savings and Per Capita Income

	GNI Per Capita, Atlas Method (Current US$) (Average: 2013-2017)	Gross National Savings (% of GDP) (Average: 2013-2017)
South Asia		
Bangladesh	1252	29.8
Afghanistan	602	23.2

*Dr. Zahid Hussain is a former Lead Economist and currently a Consultant of the World Bank, Dhaka Office. He joined the World Bank in 1995. Prior to that, he was a member of Academia, with 14 years teaching experience in a number of universities in Bangladesh and abroad. He has worked on several flagship World Bank reports on Bangladesh. Views expressed in this article are the author's own.

	GNI Per Capita, Atlas Method (Current US$) (Average: 2013-2017)	Gross National Savings (% of GDP) (Average: 2013-2017)
Bhutan	2646	32.8
India	1640	31.0
Nepal	784	43.2
Pakistan	1378	13.6
Sri Lanka	3716	31.0
East Asia		
Cambodia	1084	14.5
China	7804	47.4
Indonesia	3542	31.7
Korea, Rep	27176	35.8
Philippine	3494	24.1
Thailand	5766	30.2
Vietnam	1968	29.9

Source: *World Economic Outlook 2019* and *World Development Indicator (WDI)*

The saving-investment balance has changed recently. The investment rate has increased, and the national saving rate has declined since FY16. The fall in national saving as a share of Gross Domestic Product (GDP) over the last two years is due in part to a fall in government savings, reflecting rise in government consumption and stagnating revenue mobilization. Private savings have also declined with decline in international remittances. Increases in investment have mainly come from increases in public investment accompanied by extremely modest increases in the rate of private investment. This recent excess of investment over savings is not a major concern yet since the current account deficits have emerged after a prolonged period of current account surplus. External-debt to GDP has remained low and stable with a low risk of external debt distress. All external debt indicators are below their prudential thresholds. Future infrastructure projects will be financed with external debt, but favorable debt dynamics, contingent on maintaining decent growth rates above the cost of external financing, keep public external debt on a declining path.

Table 2: Saving-Investment Rates in Bangladesh
(Percent of GDP)

	FY14	FY15	FY16	FY17	FY18
National Saving	29.2	29.0	30.8	29.6	27.4
Public Saving	5.1	4.2	4.1	4.2	3.3
Private Saving	24.1	24.8	26.7	25.5	24.2
Domestic Investment	28.6	28.9	29.7	30.5	31.2
Public Investment	6.5	6.8	6.7	7.4	8.0
Private Investment	22.0	22.1	23.0	23.1	23.3
Saving-Investment Balance	0.6	0.1	1.1	-0.9	-3.8

Source: Bangladesh Bureau of Statistics (BBS) and Ministry of Finance (MOF), Government of Bangladesh.

Beware of Instability and the Dutch Disease. There are two reasons to be wary of that allow substantial current account deficits to persist. The first is the instability of international capital flows, especially into developing countries. No matter how justified investments initially are, the resulting capital inflows tend so often to overshoot and suddenly come to a stop, creating a crisis. The 1997 Asian crisis is the best example of this story. Bank lending tends to be extremely volatile and subject to herding behavior. Many governments are now wary of capital-inflow booms when such booms can suddenly – and perhaps irrationally - come to an end and force contraction in demand and real depreciations, all in crisis conditions. This instability of capital flows into developing countries also explains why so much of the flows from the savings-glut countries went to the United States (US).

The memory of the Asian crisis, and indeed also various Latin American crises, must have encouraged caution in many emerging market countries. By contrast, the US was a safe-haven despite its obvious potential fiscal problem. Clearly it helped that the dollar was the world's key currency. Unlike most developing countries, US could borrow in its own currency, something countries like Bangladesh cannot do. The second reason for the reluctance of many countries to allow substantial current account deficits is that the capital inflows are inevitably associated with real appreciations. These have adverse effects on the tradable sectors of economies.

Real appreciation is particularly undesirable when, as often, it is likely to be short-term owing to the capital-market volatility, and thus will soon have to be reversed. The inflow may finance investment that yields a high rate of return, so that there are mutual gains from foreign savings financing the country's investments. Both foreign savers and domestic industries where the investments take place again. Nevertheless, in the capital importing countries the industries and workers in the export and import competing industries may be adversely affected by real appreciation. This is the Dutch Disease effect.

What is the effect of an increase in the saving rate? The paradox of thrift, a famous conjecture popularized by Keynes, but already debated at least since the 18th century, suggests that an increase in the saving rate depresses economic activity. Saving more of one's income (a prudent move for an individual when future earnings are uncertain) is harmful for the economy. Decreased individual consumption lowers overall demand for goods and services, leading to job loss and decreased economic growth. Ultimately, individuals suffer - along with the broader economy - due to the behavior they thought wise. The idea lost luster in the 1970s, however, along with Keynesian economics generally. Critics pointed out that people have greater foresight than the paradox suggests. At most, it may be a short-term phenomenon. Markets adjust as needed, prices drop, and overall demand and production do not decline for long. Falling domestic prices lead to greater levels of exports, boosting the domestic economy as trading partners increase their imports. Increased saving gives banks more money to lend, thereby lowering interest rates and raising investment. The global financial crisis and its impact on personal consumption led economists to reconsider the paradox even when viewed through the lens of neoclassical economics, with flexible prices. The paradox did not die after all. The key takeaway from all these debates is that savings in themselves do not increase a country's capacity to produce, and hence do not supply the resources needed to provide the extra future consumption that the savers expect. This provision for the future requires not just saving but also extra investment, the latter being the responsibility of the financial sector.

Financial systems determine whether saving is vice or virtue. Financial markets facilitate economic growth by mobilizing capital, allocating capital to the best investments, and providing liquidity. Financial systems that are more effective at pooling the savings of individuals can profoundly affect economic development. Besides the direct effect on capital accumulation, better savings mobilization can improve resource allocation and boost technological innovation. By effectively mobilizing resources for projects, the financial system may play a crucial role in permitting the adoption of better technologies, thereby boosting growth. The farmer could provide his own savings to slightly increase the commercial fertilizer that he is now using, and the return on this marginal new investment could be calculated. The important point, however, is the virtual impossibility of a poor farmer's financing from his current savings the whole of the balanced investment needed to adopt the new technology. Access to external financial resources is likely to be necessary over the one or two years when the change takes place. Without this access, the constraint of self-finance sharply biases investment strategy toward marginal variations within the existing technology.

Financial development mainly refers to the increase in the quality and the quantity of financial services with lower transaction costs (Güngör *et al.,* 2014). Financial development leads to better mobilization of savings in the form of accumulated liquid assets, acquiring information about investments and allocation of resources. The development of these services by the financial sector is channeled into growth through capital accumulation and technological innovation. Financial development affects the volume of private savings through different channels over time. The life-cycle model predicts a positive effect on the ratio of private saving to income in response to an increase in growth of per capita income which has been supported empirically by numerous studies.

The well-known prediction of economic theory regarding the ambiguity of the impact of an increase in real interest rate on private saving rate is due to the opposing effects of substitution and income effects on saving-consumption decisions of households. There are several possible mechanisms through the financial development, which is usually highly correlated to financial liberalization, can affect private savings. Financial liberalization has had two major dimensions: one involving "internal financial liberalization" and the other one relating to "external financial liberalization". Liberalizing financial sector internally usually means lifting restrictions on interest rates (both for deposit and lending), reducing in reserve requirements, producing market based system of credit allocation by easing entry restrictions for new banks (including foreign banks), encouraging competition among banks and other financial intermediaries, state banks and allowing banks to offer new financial instruments (including foreign currency denominated assets and liabilities), developing more efficient capital market through the development of bond and equity markets, and reducing the size of directed and subsidized credit programs of the government.

External financial liberalization comes with the removal of restrictions on current account and capital account transactions. The channels through which both internal and external financial liberalization, and the ensuing financial sector development could affect private savings are diverse which, potentially, could have opposing effects over time. According to McKinnon (1973) and Shaw (1973), a switch to a competitive market-based financial system will lead to an increase in the volume of private savings particularly due to the increase in real interest rates that result from competition of banks to attract deposits. However, this hypothesis assumes that substitution effect dominates the income effect of a given increase in real interest rate in post liberalization era.

One of the most compelling arguments for a possible negative effect of financial sector development on private savings is based on the idea that financial sector development is likely to lower the degree of borrowing or financing constraints faced by the households and firms. Households unable to borrow freely in the financially repressed regime prevailing before liberalization are practically forced to consume less and save more than their intertemporally optimizing levels that would maximize their life-time utility. The process of financial liberalization under certain conditions may worsen the degree of liquidity constraints both for households and firms. If the increase in real interest rates (especially in terms of lending rates) in post liberalization era happen to exceed some critical threshold levels, relatively higher percentage of households and firms could effectively be constrained from borrowing.

Empirical studies find that the growth rate and real rate of interest have a positive impact on savings rate in Bangladesh. Financial sector reform has enhanced savings rate as well. Population per branch of commercial banks, on the other hand, is negatively related to savings rate suggesting that increased availability of bank branches can stimulate private savings (Rahman, 2012). This provides some support for the proposition that the provision of more financial institutions and financial services, which enhances financial inclusiveness, spurs private saving. Similar results have been found in other contexts. Financial development enhances the performance of commercial banks by way of savings mobilization (Deodat, n.d.) Financial deepening and increased banking density tend to encourage private savings. Development of insurance markets and liberalization of the financial system, however, tend to exert a dampening effect on private savings (Ang, 2010) Savings rise with the availability of risk-sharing financial instruments and an improvement in the financial system.

More depth and variety in financial services needed. Financial services such as investment funds can help people fund education, save for a home, or start a small business. The equity and bond market need to develop to offer better financial instruments for enhancing savings mobilization and economic growth. The mutual fund industry, for instance, mobilizes savings by issuing shares in their funds and using the proceeds to buy financial assets and real estate, thus helping transfer savings into investments. Mutual funds also offer an opportunity for retail investors to save and diversify their investments in a cost-effective manner. The private equity industry invests in start-ups and Small and Medium Enterprises (SMEs), venture capital and private equity funds to fulfill another important financial intermediation role. The funds meticulously mentor and monitor companies they have invested in. This allows the companies to become more creditworthy, and banks are more inclined to invest in them. The sovereign wealth fund industry fulfills an important macroeconomic role by investing surplus income for intergenerational wealth, fiscal stability, and other economic development. The public sector is central to the delivery of infrastructure services. Yet, in many countries, private investment funds finance infrastructure with public guarantees, playing an important role in reducing the infrastructure gap. The insurance market, stock market and bond market need to develop to enhance national savings.

Returns to savings are not that great, given the high inflation rates and limited access to risk free nominal deposit rates. We have certain public sector operative schemes such as postal savings, National Saving Certificates (NSCs) and wage earner bonds; very limited insurance services besides the saving opportunities in the banking system. If the national saving schemes are managed judiciously, then the people would shift more towards the deposits available in the banks. The private sectors will also get a scope to develop better instruments to mobilize financing and play a key role in national savings. The way national savings scheme is currently managed is hindering the development of local debt markets. NSCs provide a yield of around 11 percent whereas government bonds of similar maturities yield between 5 and 6 percent. Increase in government schemes is not the solution for the lack of variations in the savings schemes. For example, in case of pension funds, there is a pension scheme for the government employees. But to boost national savings, it is important to introduce pension in the private sector as well. Capital flight is not insignificant reflecting weak overall governance and investment climate. These savers seek safe havens more than a high return.

Does public saving and fiscal policy matter? Some writers (i.e., Barro, 1974) have argued that private saving behavior reacts to government savings in the opposite direction (known as Ricardian equivalence). that will eventually occur. A rise in the budget deficit due to a tax cut will be entirely offset by a rise in private saving as households associate additional government debt issuance (due to the deficit) with higher future taxes or the faster inflation. They increase saving to offset the anticipated liability. The conventional view, in contrast, holds that private saving will only partially respond to a rise in budget deficits – perhaps because households are not "forward looking" or altruistic, do not attempt to smooth consumption over time, or because of institutional factors, such as liquidity constraints and difficulties in obtaining information about the public finances.

The response of private saving to government fiscal policy is much more complicated than generally recognized. Changes in the structure of government expenditure and taxes typically influence private decisions in a variety of ways, each of which may have an impact on private saving. The combination of both the direct demand on saving represented by government budget deficit finance and their indirect effect on private saving working through incentives created by changes in the level and composition of government tax and expenditure policy may either reinforce or offset each other. There is a lack of conclusive evidence on whether there is a stable and reliable private saving response to government policy, either over time or across countries. This is partly due to the changing nature of government policy and institutional features of economies. But a more fundamental problem is our limited understanding of what determines private saving and the weak empirical support for even the most basic theories of saving behavior. However, some aspects of fiscal policy in Bangladesh are not saving friendly, particularly excise on deposits, taxes on retained earnings and the VAT which is more of an excise than a consumption tax.

The role of public policy. Should governments have national savings goals, or is this something best left to individuals and families to decide for themselves? It is hard for governments to induce people to save more than they otherwise would and to increase the share of Gross Domestic Product (GDP) that is paid in taxes. If Government is concerned about the low level of national savings, the most effective remedy would be to reduce public spending on items that substitute for private savings (like supporting private pension programs), though they may be constrained by the political and social consequences of such changes. The government can do more to address concerns relating to the safety of private savings because of limited options for diversification of saving portfolio and the brewing crisis of confidence in the financial system, particularly the banks and the stock markets. There is limited deposit insurance and even that has not been tested yet. Another key problem is misallocation of savings to wasteful uses. The most appropriate role that the government needs to play is enforcing laws that will mitigate the loopholes in the system and build trust in both the buyers and sellers to carry out transactions in the financial market. Investment funds, for instance, are deterred by a lack of information on nascent markets, by hurdles in the legal and regulatory environment, and by the lack of opportunities to profit while exiting the investment. Instead of making schemes on their own, the government should facilitate financial market development. It needs to be a much better umpire than a player in the provision of financial services.

Conclusions: Savings depend positively on income growth and negatively on the age dependency ratio. This suggests that the rising growth rates maintained by Bangladesh over the last few decades have facilitated sustained high private savings. The increase in the proportion of the population of working age has significantly raised private savings. The persistent decline in age dependency, however, poses challenges to the government since private saving may fall in the next phase of demographic transition. Financial development will then become even more important. Hence, it is important for the government to further develop the financial system in order to facilitate the mobilization of savings to achieve sustainable development goals.

The real effects of financial sector development have continued to be the focus of empirical and theoretical research for decades. In particular, the effects of financial liberalization policies and financial sector development in general on key macroeconomic variables such as income growth, private and national rates of saving and investment, growth of efficiency in resource allocation and total factor productivity have been extensively analyzed for a variety of countries and time periods using different econometric methodologies. One fundamental insight that has emerged from the mixed and contradictory findings of this literature is that the nature of the effects could vary from one country to another depending on a variety of factors.

The severity of the effects of recent global crises has reconfirmed the lessons learnt from the Mexican peso crises in 1995, East Asian crises in 1997, Turkish Crises in 2001 and the Global financial crisis in 2007-09. The liberalization policies in general and financial liberalization in particular may not automatically ensure financial and real stability and generate sustainable economic growth. In other words, the critical role that McKinnon and Shaw envisioned for a market based, competitive financial system in terms of both mobilization of savings and their welfare maximizing allocation among alternative uses may not be easily attained simply by the presence of a competitive financial sector. Our system of banking is fragile. When regulatory and other governance tasks are not clearly assigned or are fragmented among various institutions, it may be difficult to prevent crises and may make them harder to manage when they occur. Fuzziness of the regulatory framework in place invites gaming, shirking, and blaming—the characteristic deficiencies associated with overly complex but underspecified regulatory regimes. Without a countervailing public including watchdog groups, think tanks, activists and the like demanding transparency and accountability, the influence of private actors on legislation and regulation may remain largely uncontested, leading to normative voids.

Suggested Readings

Alper, C. E. and Ziya Anis (2003), "The Turkish Banking System, Financial Crises and the IMF in the Age of Capital Account liberalization: A Political Economy Perspective", *Paper* presented at the Fourth Mediterranean Social and Political Research Meeting, Florence & Montecatini Terme 19-23 March, organized by the Mediterranean Programme of the Robert Schuman Center for Advance Studies at the European University Institute.

Ang, James (2010), "Savings Mobilization, Financial Development and Liberalization: The Case of Malaysia," Monash University.

Bacchetta, P. And S. Gerlach (1997) "Consumption and Credit Constraints: International Evidence", *Journal of Monetary Economics*, Vol. 40(2), pp. 207-238.

Bandiera, O. G. Caprio, P. Honohan and F. Schiantarelli (2000), "Does Financial Reform Raise or Reduce Savings?" *Review of Economics and Statistics*, Vol. 82(2), pp. 239-263.

De Brouwer, G. (1996), "Consumption and Liquidity Constraints in Australia and East Asia: Does Financial Integration Matter?" *RBA Research Discussion Paper rdp 9602*, Sydney, Reserve Bank of Australia.

De Melo, J. And J. Tybout (1986), "The Effects of Financial Liberalization on Savings and Investment in Uruguay", Economic Development and Cultural Change, Vol. 34(3), pp. 561-587.

Deodat, E. Adenutsi (n.d.), "Financial Development, Bank Savings Mobilisation and Economic Performance in Ghana: Evidence from A Multivariate Structural VAR," Graduate School of Business University of Stellenbosch, Cape Town, Republic of South Africa.

Gehrel, F. (1991), "Essays in Macroeconomics of an Open Economy", New York, Springer-Verlag.

Handroyiannis, G. (2006), "Private Saving Determinants in European Countries: A Panel Cointegration Approach", *The Social Science Journal*, Vol. 43, pp. 553-569.

Güngör, Hasan, Serhan Çiftçioğlu and Mehmet Balcılar (2014), "Does Financial Development Increase Private Savings? The Case of Turkey", *International Journal of Business and Social Science*, Eastern Mediterranean University, Turkey, Vol. 5, No. 2, February.

Hebbel-Schmidt, K and L. Serven (2002), "Financial Liberalization, Saving, and Growth", Paper Presented at the Banco de México Conference on "Macroeconomic Stability, Financial Markets, and Economic Development", Mexico, DF, November 12-13.

Japelli, T. and M. Pagano (1994), "Saving Growth and Liquidity Constraint", *Quarterly Journal of Economics*, Vol. 109(1), pp. 83-109.

Levine, Ross (1997), "Financial Development and Economic Growth: Views and Agenda," *Journal of Economic Literature*, Vol. XXXV, pp. 688-726.

Lewis, W. Arthur (1995), *Theory of Economic Growth*, Allen and Unwin, London.

Loazya, N., K. Schmidt-Hebbel and L. Serven (2000), "What Drives Private Saving Across the World?" *The Review of Economics and Statistics*, Vol. 82(2), pp.165-181.

Rahman, M. Mafizur (2012), "Saving Mobilization and Its Impact on Economic Growth: A Case Study on Bangladesh," University of Southern Queensland.

Mavrotas, G. (2005), "Savings and Financial Development: Assessing the Evidence", in "Finance and Development – Surveys of Theory, Evidence and Policy", Ed. Green J.C., Colling Kirkpatric and Victor Murinde, Edward Elgar Pub. Ltd., UK. pp. 29-61.

McKinnon, R. P. Ed. (1973), *Money and Capital in Economic Development*, Washington D.C., Brooking Institution Press.

Modigliani, F. (1970), *The Life Cycle Hypothesis of Saving and Inter-country Differences in the Saving Ratio*, in W. A. Eltis, M.F. Scott and J.N. Wolfeleds., Induction, Growth and Trade, Clarendon Press, Oxford.

Quartey, P. (2005), "Financial Sector Development, Savings Mobilization and Poverty Reduction in Ghana", *United Nations University Research Paper No. 2005/71,* Ed. Perron, P. (1989).

Rodrik, D. (2000), "Saving Transitions", *World Bank Economic Review*, Vol. 14 (3), pp. 481-508.

Shaw, E. (1973), "Financial Deepening in Economic Development", New York, Oxford University Press.

PUBLICATIONS OF BANGLADESH INSTITUTE OF BANK MANAGEMENT

Type of Publication	Name of the Publication	Year of Publication	Price
Journal	1. Bank Parikrama – A Quarterly Journal of Banking & Finance **Bank Parikrama – Latest Issue (Inside Articles)** i. Too Connected to Fail: Politics, Public Policy and the Financial Sector ii. Heterogeneity in the Intellectual Capital and Performance of Indian Commercial Banks: Panel Data Quantile Regression Analysis iii. Does Female Representation in Top Management Affect Cost of Debt? A Study of Australian CEO Gender Perspective iv. Resources and Small Firm Financial and Non-Financial Growth: Empirical Evidences from Bangladesh v. The Consequences of Monetary Variables on GDP Growth of Bangladesh: An Empirical Study vi. Government Spending and Socio-Economic Development in Namibia: A Time Series Analysis	Regular	Tk. 400 US$ 20
	2. Bank Parikrama - Special Issue (For the Celebration of 40 Years Independence of Bangladesh) **Inside Articles** i. Financial Services at People's Doorstep ii. Financial Sector Reforms iii. Microcredit: A Panacea or A Villain? iv. Transparency and Accountability: Must for Good Financial Management v. Forty Years of Banking Sector: Progress and Future Challenges vi. Challenges and Opportunities for Further Development and Expansion of Bancassurance and Microinsurance Business in Bangladesh vii. Role of the State in Bangladesh's Underdevelopment viii. Two-Sector Short-Run Macroeconomic Model for Return Migration and Exchange Rate Adjustments ix. India's Recent Market Access Initiatives	2013	Tk. 250 US$ 12

Type of Publication	Name of the Publication	Year of Publication	Price
	for the LDCs: Realising the Potential Opportunities x. Debt Default in Banks xi. The History and Evolution of Bangladesh Bank as a Central Bank		
Magazine	BIBM Bulletin – A Quarterly-Periodical of BIBM	Regular	Tk. 100
	BIBM's Risk Enlightment	Regular	-----
	Venture Brief	Regular	-----
Independent Review	1. Bank Review 2010-2017 (7 Issues) 2. Review of Non-Bank Financial Sector 2010-2017 (7 Issues)	2012-18 2012-18	Tk. 300 US$20 Tk. 300 US$20
Policy Brief	BIBM Policy Brief 2017-2019	2017-19	-------
Conference Proceeding	1. Compilation of Annual Banking Conference held in 2012-2017 (6 Issues) 2. Compilation of Regional Banking Conference-2018.	2013-18 2020	Tk. 500 US$20 Tk. 500 US$20
Nurul Matin Memorial Lecture	1. Ethics in Banking (Compilation of Ten Years Memorial Lectures) **Insides Speeches of** i. Justice Shahabuddin Ahmed ii. Justice Muhammad Habibur Rahman iii. Professor Rehman Sobhan iv. M. Syeduzzaman v. Professor Wahiuddin Mahmud vi. Professor Nurul Islam vii. Dr. Bimal Jalan viii. Professor Muzaffer Ahmad ix. Dr. Akbar Ali Khan x. Professor Dr. Mohammad Farashuddin	2011	Tk. 300 US$ 25
	2. Ethics in Banking 11th Lecture - Dr. A. B. Mirza Md. Azizul Islam 12th Lecture - Dr. Yaga Venugopal Reddy 13th Lecture - Professor Sanat Kumar Saha 14th Lecture - Dr. Amiya Kumar Bagchi 15th Lecture - Dr. Mohiuddin Alamgir 16th Lecture - Dr. Duvvuri Subbarao 17th Lecture - Dr. Qazi Kholiquzzaman Ahmad 18th Lecture - Dr. Junaid Kamal Ahmad 19th Lecture - Dr. Atiur Rahman	2011-20	Tk. 200 US$5

Type of Publication	Name of the Publication	Year of Publication	Price
A K N Ahmed Memorial Lecture	Central Banking 1st Lecture - Dr. Chakravarthi Rangarajan 2nd Lecture - Dr. A. B. Mirza Md. Azizul Islam 3rd Lecture - Dr. Kaushik Chandra Basu	2018-20	Tk. 200 US$5
Banking Research Series	Compilation of Research Workshops of BIBM held in 2010-2018 **Banking Research Series 2019 (Inside Papers)** i. Addressing Trade Based Money Laundering in Bangladesh ii. Effectivene3ss of Risk Management Division of Banks-An Assessment iii. Business Facilitation in Special Economic Zones by Banks in Bangladesh iv. Digitalization of Documents in banking Operation v. Addressing Challenges of Transferable LC in Bangladesh vi. Use of Information Technology in Enhancing Efficiency of Internal Control System vii. IT Vulnerability Assessment and Penetration Testing in Banks	2011-18	Tk. 400 US$20
Banking Review Series	Compilation of Review Workshops of BIBM held in 2012-2019 **Banking Review Series 2019 (Inside Papers)** 1. Credit Operations of Banks 2. Trade Services Operations of Banks 3. Treasury Operations of Banks 4. Internal Control and Compliance of Banks 5. Human Resource Management of Banks 6. IT Operations of Banks 7. Islamic Banking Operation in Bangladesh 8. Review of the Sustainable Banking Activities of Bangladesh 9. Review on Regulatory Reporting Requirements by Banks	2013-19	Tk. 500 US$20
Roundtable Discussion Series	Compilation of Keynote Papers of Roundtable Discussions held in 2014-2019 **Roundtable Discussion Series 2019 (Inside Papers)** 1. Practices of Obtaining Credit Report of Foreign Counterparts in Trade Services- Is It Working? 2. Development of Bond Market in Bangladesh	2015-19	Tk. 400 US$20

Type of Publication	Name of the Publication	Year of Publication	Price
	3. Costs for Compliance with Regulations in Banks		
	4. Credit Guarantee Scheme for Promoting Access to Finance for SMEs		
Book	1. Inclusive Finance and Sustainable Development	2013	Tk. 1000 US$20
	2. A Review of the Supervisory Initiatives by Bangladesh Bank	2014	Tk. 200 US$10
	3. Trade Services of Banks in Bangladesh (3rd Edition)	2017	Tk. 500 US$20
	4. Green Banking in Bangladesh	2014	Tk. 400 US$20
	5. Green and Sustainable Banking in Bangladesh (2nd edition)	2018	Tk. 400 US$20
	6. গ্রীন ব্যাংকিং পরিবেশ রক্ষায় ছাদে বাগান	2015	Tk. 200
	7. Bangladesh Vision 2030	2015	Tk. 1000 US$20
	8. Growth with Equity: Contemporary Development Challenges of Bangladesh	2018	Tk. 600 US$ 15
	9. Dimensions and New Horizons of Credit Operations in Banks	2018	Tk. 500 US$ 10
Research Monograph	1. Implication of the Use of Information and Communication Technology in Channeling Workers' Remittances to Bangladesh	2011	N/A*
	2. Deposit Behavior in Banks of Bangladesh	2011	N/A*
	3. SME Financing: Demand Side Problems and Supply Side Responses	2013	N/A*
	4. SME Credit Risk Model	2013	N/A*
	5. Innovations in Rural Banking: Farmers Accounts and Sharecropper Financing	2013	N/A*
	6. Inclusive Banking and Inclusive Growth: Bangladesh Perspective	2013	N/A*
	7. Information System Security in Banks: Bangladesh Perspective	2014	Tk. 150
	8. Millennium Development Goal and Financial Sector Development	2014	Tk. 150
	9. A Critical Analysis of Monetary Policy in Bangladesh,	2014	Tk. 150
	10. Bank, Stock Market and Economic Growth: Bangladesh Perspective	2014	Tk. 150
	11. Data Center and Disaster Recovery Management in Banks: Current Status, Problems and Prospects	2014	Tk. 150

Type of Publication	Name of the Publication	Year of Publication	Price
	12. International Financial Regulations: Necessity and Implications for Banks in Bangladesh	2015	Tk. 150
	13. Non-legal Measures for Loan Recovery in the Banking Sector of Bangladesh	2015	Tk. 150
	14. Large Loan Financing by Banks in Bangladesh: Implications and Challenges	2015	Tk. 150
	15. ATM Banking in Bangladesh: Current Status, Hindrances and Remedies	2016	Tk. 300
	16. SME Cluster Development: Implication for Banks	2016	Tk. 300
	17. Deficit Financing, Crowding Out and Economic Growth: Bangladesh Perspective	2016	Tk. 300
	18. Costing, Accessibility and Environmental Aspects of Annual Report of Banks in Bangladesh	2016	Tk. 300
	19. Financing Public-Private Partnership (PPP) Projects in Bangladesh: An Assessment for Future Strategy	2016	Tk. 300
	20. Training Effectiveness in the Capacity Building Process of Banks	2016	Tk. 300
	21. Bank Finance in Light Engineering Small Enterprises in Bangladesh: Challenges and Possible Innovation	2016	Tk. 300
	22. An Assessment of On-site Supervision of Bangladesh Bank	2017	Tk. 300
	23. Issues and Challenges for Islamic Finance and Banking in Bangladesh in the Perspective of Global Development	2017	Tk. 300
	24. Promoting Green Economy through Green Banking: Bangladesh Perspective	2017	Tk. 300
	25. Implication of Loan Rescheduling and Write-Off on the Performance of Banks	2017	Tk. 300
	26. Handling Credit Risk of Banks in Bangladesh: Demand, Supply and Regulatory Perspective	2017	Tk. 300
	27. Corporate Governance in Banks- Impact on Profitability	2017	Tk. 300
	28. SME Finance and Inclusive Growth: Bangladesh Perspective	2017	Tk. 300
	29. Impact of Adopting Basel Accords in the Banking Sector of Bangladesh	2018	Tk. 300
	30. Financial and Non-Financial Issues in Implementing PPP in Bangladesh: An Examination of PPP Projects in Pipeline	2018	Tk. 300

Type of Publication	Name of the Publication	Year of Publication	Price
	31. Sustainability Reporting Practices in Banks of Bangladesh	2018	Tk. 300
	32. A Study of the Perception and Behaviour of the Depositors in the Banking Sector of Bangladesh	2018	Tk. 300
	33. Impact of Mobile Banking on Financial Inclusion in Bangladesh	2018	Tk. 300
	34. Addressing Disaster Risk by Banks: Bangladesh Perspective	2018	Tk. 300
	35. Impact of Social Safety Net Programs on the Performance of SOCBs	2018	Tk. 300
	36. Impact of SME Financing on Banks' Profitability: An Enquiry Across Banks in Bangladesh	2019	Tk. 300
	37. Private Commercial Borrowing from Foreign Sources in Bangladesh: An Anatomy	2019	Tk. 300
	38. Product Diversification of Islamic Banks: Prospects and Challenges	2019	Tk. 300
	39. Centralized and Decentralized Banking: A Study of the Risk-Return Profile of Banks	2020	Tk. 300
	40. Funds Transfer Pricing of Commercial Banks: Status and Measures for Implementing in Banks of Bangladesh	2020	Tk. 300
	41. Leadership Approaches, Governance and Emotional Intelligence: The Case of the Banking Industry of Bangladesh	2020	Tk. 300

Note: *N/A refers Not Available for Sale. Only available at BIBM Library.

Communication should be addressed to:

Publications-Cum-Public Relations Officer (PPRO), Bangladesh Institute of Bank Management (BIBM), Mirpur, Dhaka-1216. Tel: 9004981, 9003031-5 (Ext. 120), Fax: 880-2-9006756, E-mail: office@bibm.org.bd

Support Team **Md. Al-Mamun Khan,** *Publications-cum-Public Relations Officer*
Papon Tabassum, *Research Officer*
Sk. Md. Azizur Rahman, *Research Assistant*
Md. Morshadur Rahman, *Proof Reader*

Inner Design **Md. Awalad Hossain**
Abdul Alim

Published in October, 2020

Published by Bangladesh Institute of Bank Management (BIBM)
Plot No. 4, Main Road No. 1 (South), Section No. 2
Mirpur, Dhaka-1216, Bangladesh
PABX : 9003031-5, 9003051-2
Fax : 88-02-9006756
E-mail : bibmresearch@bibm.org.bd
Web : www.bibm.org.bd

Printed by Evergreen Printing Press, Shambazar, Dhaka-1100.

ISSN 1019-7044

Bangladesh Institute of Bank Management

Price : BDT. 600.00
USD. 20.00