Price Inflation in Bangladesh: How to cope with it?

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Abstract :

Price inflation or simply inflation, which is defined as the continual or persistent rise in the general price level has a special connotation in economics. Inflation reduces purchasing power of money thereby reducing aggregate demand in the economy, other things remaining unchanged. Inflation also affects the distribution of income. Overall, it creates a sense of uncertainty among the consumers as well as the producers. This is why macroeconomic policies of any government are often directed towards controlling inflation. The rise in the inflation rate has prompted two views of the sources of higher inflation in Bangladesh. One is the demand - pull inflation that occurs when aggregate demand (AD) in an economy outpaces the aggregate supply (AS) and the other is the cost - push inflation which is typically caused by supply shocks (natural calamities such as flood , drought, international price hike, etc.). Hence it is crucial for Bangladesh to formulate policies to curb present inflation for which, however, the magnitude, nature and causes of inflation are needed to be carefully studied. It is said that inflation is not necessarily bad. Creeping inflation is almost universally acceptable. Economic theory suggests that there is a trade-off between inflation and unemployment.

Indeed creeping inflation may prove essential for economic growth and employment generation. Even if unemployment is very high, inflation falls little if the economy is moving too rapidly out of the recession. Hence as the Phillips curve indicates, a strategy of rapidly reducing unemployment will tend to increase the inflation rate. There is a choice to be made between a growth recovery that rapidly reduces unemployment and a slow growth recovery that cuts into inflation, but at the cost of sustained unemployment. But Bangladesh's recent trend in inflation which touched the double-digit mark can be termed as running inflation. Because in a resource scarce populous country like Bangladesh, inflation not only erodes saving and investment it may as well decelerate the pace of growth. It also causes living standards of general people to dwindle rapidly which might give rise to even political turmoil.

We know that inflation has both the short run and long run impacts on the economy. Theoretically demand - pull inflation generally tends to be accompanied by increased output and decreased unemployment as excessive demand pulls prices up. Cost - push inflation, on the other hand, tends to reduce output and raised unemployment by increasing costs against stagnant demand. If inflation does not, by itself, tend to increase unemployment then its effects are mainly redistributional. Real income is shifted from people with fixed incomes to those whose wages rise, and from savers to debtors if nominal interest rates do not adjust fully. One important effect of inflation is to change the real values of assets. This redistributional effect

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operates with respect to all assets fixed in nominal terms, in particular money, bonds, saving accounts, insurance contracts, and some pensions. It implies that realized real interest rates are much lower than nominal interest rates on assets and possibly negative. Obviously it is an important effect since it can wipe out the purchasing power of lifetime savings. Though nominal wage rates for all sectors of the economy show a rising trend, the corresponding changes in real wages are not spectacular. In recent years, real wage indeed remained stable. Table 1 presents the relevant statistics.

Table -1: Changes in Wage Rate and CPI
(Base year 1969-70=100)

FiscalYear	Nominal wage rate General	Rate of Inflation (Changes in CPI)	Change in Real Wage rate	Agriculture	Fisheries	Manufactu -ring	Construction
2002-03	(10.96)	4.38	6.58	7.96	6.30	15.37	7.39
2003-04	(6.32)	5.83	.49	5.69	8.28	7.55	1.69
2004-05	(5.85)	6.48	-0.63	5.33	6.58	6.63	3.36
2005-06	(9.79)	7.17	2.62	11.12	8.82	10.70	6.90
2006-07	(4.52)	7.22	-2.7	4.45	3.55	4.30	6.32

Source: Bangladesh Economic Review, 2007.

Table 1 shows that the nominal wage rate for the economy increased by 4.5 percent in 2006-07. The wage rate in agriculture, fisheries, manufacturing and construction increased by 4.45 percent, 3.55percent, 4.30 percent and 6.32 percent respectively in 2006-07, as compared to 11.12 percent, 8.82 percent, 10.70 percent, and 6.90 percent respectively in 2005-06. It appears that the incomes of different sections of people increased at a lower rate than the inflation rate that resulted in lower purchasing power of the population.

The objective of the present paper is to enlighten the general readers about where the present inflationary pressure in Bangladesh coming from and how to rein it in a broad brush way. With this objective in view, the paper has been arranged in the following way. Section II analyes the magnitude of inflation in terms of available secondary data. Section III and IV are designed respectively to explore the relevance of demand-related and supply-related factors for the present inflation in Bangladesh. Section V discuses the efficacy of policy measures pursued by the government to contain inflation and also proposes some other measures from both short-term as well as long-term perspectives. Section VI provides summary and conclusions.

II. Magnitude of Inflation

The general price level of Bangladesh has been showing a rising trend particularly since the beginning of 2006 which is at present observed to have crossed the two-digit level. According to the Bangladesh Bank, in June 2006 the rate of inflation of Bangladesh was estimated at 7.54 percent, while in the same month of 2007 it was observed to be 9.2 percent. During the first ten months of the current fiscal year the rate of inflation has been 10.48 percent. On an annual average basis, the inflation rate reached 10 percent in March 2008, up from 7.2 percent in June 2007 (The Financial Express, May 19, 2008,). The reliability of the data provided by government is dubious because the methodology used for its estimation is controversial. Generally, GDP (Gross Domestic Product) deflators, not CPI (Consumer's Price Index) or PPI (Producer's Price Index), are used in such estimation. We should remember that GDP deflators represent overall price indices of the economy where prices of all goods, services, raw materials, capital goods, construction materials, basic indices of the economy where prices of all goods, services, raw materials, capital goods, construction materials, basic inputs, etc. are averaged. If only the prices of daily necessities like rice, flour, meat, vegetables, edible oil, house rent, transport costs, were considered which are fairly captured by CPI, the estimated rate of inflation would have been much higher in recent years. As presented in Table 2, the rise in food prices has been consistently higher than the general price level since 2003-04. Again, the rate of inflation in an economy depends on the type of index used for its estimation and the categories of commodities included in the construction of that index. For example, the Consumers Association of Bangladesh (CAB) has estimated that the cost of living and the prices of essentials which had gone up respectively by 9.77 percent and 6.32 percent in 2005, soared by 13.52 and 15.22 percent respectively in 2006. For 2007, the corresponding figures are estimated at 18.42 and 19.72 percent. Table 2 presents the CPI and the rate of increase in inflation. According to the current national index, in FY 2006-07, the rate of inflation is 7.22 percent which was 7.17 percent and 6.48 percent in the previous two fiscal years. Table 2 further shows that food price inflation increased at a higher rate of 8.12 percent in 2006-07 as compared with 7.76 percent increase in 2005-06, while the non-food inflation has increased at a lower rate by 5.90 percent in 2006-07 as compared with 6.4 percent increase in 2005-06.

Table 2: Consumer Price Index and Inflation

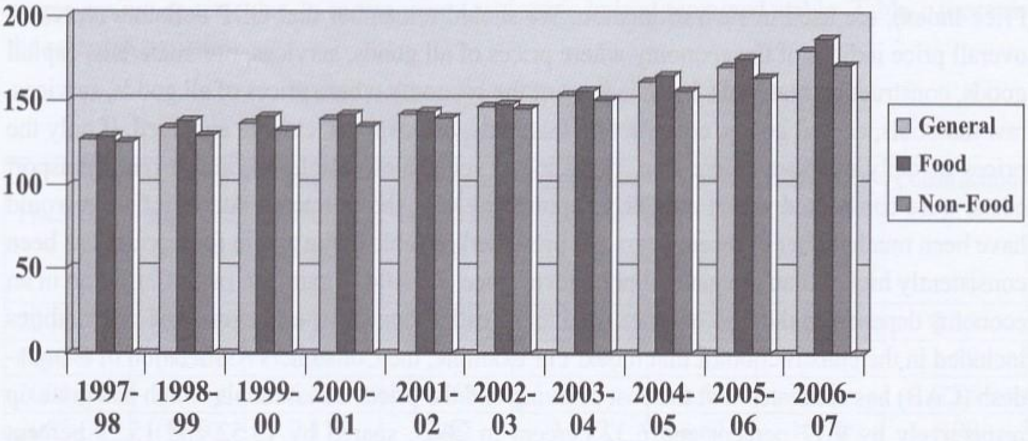
(Base year 1995-96 = 100)

Index	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
General	112.96	120.94	124.31	126.72	130.26	135.97	143.90	153.23	164.21	176.06
(% change)	(8.66)	(7.06)	(2.79)	(1.94)	(2.79)	(4.38)	(5.83)	(6.48)	(7.17)	(7.22)
Food	114.51	125.16	128.52	130.30	132.43	137.01	146.50	158.08	170.34	184.18
(% change)	(10.46)	(9.30)	(2.68)	(1.38)	(1.63)	(3.46)	(6.93)	(7.91)	(7.76)	(8.12)
Non-food(% change)	110.73 (5.99)	115.10 (3.95)	118.84 (3.08)	122.25 (3.04)	127.89 (4.61)	135.13 (5.66)	141.03 (4.37)	147.14 (4.33)	156.56 (6.40)	165.79 (5.90)

Source: Bangladesh Economic Review,
2007. Ministry of Finance, Govt. of the Peoples' Republic of Bangladesh.

Figure 1 that plots the information presented in table 2, represents the trend in the inflation rate. The graph suggests that inflation trended upward during the period between 1997-98 and 2006-07 with food prices rising faster than the prices of other commodities.

Figure 1: Trend in inflation in Bangladesh.



III. Demand-Related Factors Contributing to Inflation in Bangladesh:

Factors responsible for price inflation in Bangladesh can be divided into two broad categories – demand-related and supply-related. This section analyzes the demand related factors while the supply- related factors are taken up in the next section.

1. Remittance

The most prominent factor responsible for creating inflationary pressure in Bangladesh is the rise in nominal income. The main factor that contributed to this rise in nominal income is unrequited foreign transfer which is popularly known as remittance in Bangladesh. It is observed that a massive amount of Taka 45 to Taka 50 thousand crore flows into Bangladesh every year in the form of remittance. In 2006, the amount was Taka 45,000 corers. (The Financial Express, February 16, 2008, p.5). In the first nine months of fiscal year 2007/2008, a record 29.54 percent growth over that of the same period in the last fiscal has already been observed (The Financial Express, Saturday, April 19, 2008). Officials concerned projected that the amount of remittances by the end of the year 2008 will be well over Taka 50,000 crore. (The Financial Express, Sunday, February 18, 2008, p.8).The existing price situation also contributes to higher remittance inflow because of request from the family. Table 3 presents the trend in remittances. Remittances have a multiplier effect in that they augment aggregate demand in the economy. Recent boom in the real estate business and development of dazzling shopping malls are two popular examples in support of this observation.

Table 3: Recent Trend in Remittances

Fiscal year	Amount of remittances			
	Million US$	Percentage change	Crore Taka (%)	Percentage change (%)
1997-98	1525.43	3.39	6951.20	10.26
1998-99	1705.74	11.82	8213.00	18.15
1999-00	1949.32	14.28	9825.40	19.63
2000-01	1882.10	-3.45	10266.00	4.48
2001-02	2503.44	32.81	14390.19	40.17
2002-03	3060.31	22.25	17719.58	23.14
2003-04	3372.49	10.20	19872.39	12.15
2004-05	3848.30	14.11	23646.97	18.99
2005-06	4801.88	24.78	32210.87	36.22
2006-07	5978.47	24.50	41303.93	27.88

Source: **Bangladesh Economic Review**, 2007.

2. Public Expenditure

Reckless increase in public expenditure particularly in the last five years has further added fuel to the already existing inflationary pressure in Bangladesh. Between 2002/2003 and 2006/2007, the compound or actual rate of growth of public expenditure was more than 14 percent per annum. (Bangladesh Economic Survey 2006, Economic Adviser's Wing, Finance Division, Ministry of Finance, GOB, p. 36. and The Financial Express, Monday, September 10, 2007, p.8). Govt. expenditure marked a record rise of nearly 42 percent in the first seven months of fiscal 2007/08. Table 4 shows the rising trend of public expenditure in recent years. The total of public expenditure was Tk. 59811 crore in FY 2006/07, among which Tk. 41201 crore was allocated for non-development expenditure and Tk. 17206 crore for development expenditure that constitutes respectively 68.88 percent and 28.77 percent of total expenditure. Subsidies grew by 41.47 percent during the same period. Such an unprecedented growth in expenditure puts the government under tremendous pressure in maintaining a prudent fiscal management. Higher expenses on subsidies have been attributed to a sharp escalation in the prices of commodities

Table 4: Recent trend in Public Expenditure (in crore Taka)

Particulars	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Public Expenditure (a +b +c)	40757	42075	47184	53903	59031	59811
(a) Non-development expenditure	22700	25307	28390	33324	36618	41201
(b) Development expenditure (ADP)	15050	15271	16817	18771	19473	17206
(c) Other expenditure	3008	1497	1977	1808	2940	1404

Source: **Bangladesh Economic Review**, 2007.

Table 5: Amount of direct subsidies (Billion Taka)

Direct Subsidies	2004-05	2005-06	2006-07	2007-08
Original	14.97	16.88	12.26	59.99
Revised	21.57	17.3	31.72	116 (Provisional)

Source: **The Financial Express**, March 06, p.7.

(Note: The amount of subsidies mentioned in Table: 5 exclude indirect subsidies offered to BPC on account of petroleum, oil and lubricants (POL) and some other areas. The subsidies of 2007-08 exclude BPC's liabilities worth Tk.75.23 billion.)

To meet this excessive expense through subsidy, government had increased its borrowing. In the year 2006-07, Government has borrowed Tk 9098.20 crore from domestic sources (Bangladesh Bank +Scheduled Bank +Non Bank sources) and as a loan and grant US $1631 million from foreign sources(Bangladesh Economic Review, 2007.). Government borrowing from the banking sector especially the one which is prone to volatility in terms of liquidity has a classic crowding out impact on the private sector as it may reduce the private sector's capacity to lend. According to macro update report, budget deficit was hovering around 4.8 percent of GDP by January2008.

3. Strong Export Demand

The country's exports grew at an impressive 21.25 percent in March amid soaring shipments of key garments items. Export in March was $1.224 billion (Export Promotion Bureau), for the third consecutive month it posted over 20 percent growth. During the 1st, 2nd, and 3rd quarters of the running fiscal (2007-2008) the export growth rate was 5.37 percent, 4.42 percent and 12.43 percent respectively (The Financial Express, May 6, 2008, Vol. XV, No-169). Manufactures and analysts attributed the impressive growth in March to weak Taka, which made Bangladeshi products cheaper in the world and a loss of competitiveness by China, the key competitor of Bangladesh. Table 6 provides the recent trend in export growth.

Table 6: Export Growth and Composition

Commodity Classification	% of total export			Growth rate (%)		
	2004 -05	2005-06	2006-07	2004 -05	2005-06	2006-07
1. Primary commodities	7.49	7.34	6.83	17.15	19.19	7.72
2. Industrial goods	92.51	92.66	93.17	13.57	21.82	16.32
Total export	100.00	100.00	100.00	13.83	21.63	15.69

Source: **Bangladesh Economic Review**, 2007.

4. Growth rate of money

Theoretically, an increase in the growth rate of money shifts the aggregate demand (AD) curve up by exactly the same percentage as the rise in the growth rate of money. Hence an increase in the growth rate of money causes both output and price level to rise. But the rate of inflation is less than that of the growth rate of money. Thus in the short run, a one percent increase in money growth produces a less than 1 percent increase in inflation because some of the effects of increase in money stock show up in the higher output (Dornbush and Fischer, 1990). Accelerated growth of broad money (M2) has also strongly contributed to the shift of aggregate demand for goods and services in Bangladesh. The year-on-year growth rate of broad money increased from 11.9 percent in June 2004 to 18.2 percent in May 2007 (Basher and Khan, 2007) .Table 7 presents the trend in money supply in Bangladesh.

Table- 7: Money Supply in Bangladesh (M2)

Year (Balance up to June)	Growth of Broad Money (M2) (in %)
1999-00	18.62 %
2000-01	16.60%
2001-02	13.13%
2002-03	15.60%
2003-04	13.84%
2004-05	16.81%
2005-06	19.51%
2006-07	17.02%

Source: **Bangladesh Economic Review**, 2007.

These four factors together have largely contributed to the increase in the level of money income which has directly helped increase the general price level. It should be mentioned here that had there been a corresponding increase in real investment during the same period following the decline in real rate of interest (actual cost of borrowing after adjusting for inflation), price level may not have increased. Even if it increased, it would not be as high as it is now being experienced in the country. According to Bangladesh Bank, in July of 2006-2007 fiscal year, capital machinery worth Taka 1114 crore was imported. But in the same month of current fiscal year (2007-2008), the value of machinery import has come down to only Taka 792.4 crore (The Financial Express, August 17, 2007, p.1.). Foreign private investment has also decreased significantly in Bangladesh. According to the recent World Investment Report published by UNCTAD, foreign investment in Bangladesh has declined by about 6.30 percent in 2006 as compared to 2005 and 20 percent in 2007 as compared to its flow in the previous year. Thus the main reason for rapid increase in aggregate demand has not been an increase in investment expenditure, but due to the spectacular increase in consumption, unproductive government expenditure and money supply.

IV. Supply-Related Factors

On the supply side, increase in the cost of production has been certainly an important factor. Repeated increase in the price of basic inputs like power, gas, mild steel rod, bricks, water, etc, rise in transport costs following the fuel price hike, widespread corruption, terrorism, extortion, bribing, etc, - have all contributed to price inflation in Bangladesh through raising the costs of production. For example, sharp rises in iron price might have affected the country's GDP as construction work- both public and private, are adversely affected by this spiral. The iron rod price hike may also affect the economy badly via poor implementation of the ADP that is directly related to development activities Second, rise in import price of most essential items like rice, wheat, lentil, ginger, onion, garlic, sugar, edible oil, etc. has also been significant in aggravating the inflationary situation of Bangladesh. Because the international prices of major commodities that we import from abroad has also increased by significant margins. Imports during July- February of the current fiscal rose sharply by 21 percent over the corresponding period of fiscal 2007 (The Financial Express, May 19.2008, p.7, Vol XV, No-182).

International food prices are rising due to strong demand from developing countries, a rising global population, more frequent floods and droughts caused by climate changes and the biofuel industry's appetite for grains. The largest ethanol consumer (USA) is using corn as a raw material for biodiesel ethanol and for higher bio-diesel which use soybean and other edible oil as well. Soybean prices in February 2008 hit an all time high of $14.22 a bushel while corn price jumped to a fresh 12 year high of $5.25 a bushel. Table- 8 shows the changes in international prices of selected commodities.

Table 8: **Changes in International Prices of Selected Commodities** (in Percent)

Commodity	2003	2004	2005	2006	2007 (Up to June)
Petroleum	15.8	30.8	41.3	20.4	(–) 4.1
Cotton	37.1	(–) 2.3	(–)11.0	5.2	0.0
Rice	4.0	23.2	17.1	5.5	5.7
Wheat	(–)16.0	7.3	(–) 2.8	25.8	5.4
Palm oil	25.0	5.9	15	13.4	52.2
Soybean oil	22.1	18.0	(–) 1.6	11.2	27.9
Sugar	8.8	12.2	(–).4	(–) 0.7 1.3	6.7

Source: **International Financial Statistics**, IMF, 2007.

Rise in import cost was also due to decline in the exchange rate (depreciation of Taka) following the implementation of floating exchange rate system in 2003. In 2003/2004, average exchange rate between Taka and Dollar was $1 = Tk.58.9353 while in 2006/2007, the rate went up to about Tk.69.0318 (Bangladesh Economic Review 2007). Table- 9 presents the recent trend in Taka – Dollar exchange rates.

Table 9: Average Nominal Exchange Rate (with US Dollar)

Financial Year	Taka – Dollar average exchange Rate
2000-01	53.9592
2001-02	57.4347
2002-03	57.9000
2003-04	58.9353
2004-05	61.3939
2005-06	67.0797
2006-07	69.0318

Sources: **Bangladesh Economic Review**, 2007.

Third, imperfections of the markets of many essentials and obstacles prevailing in the supply and distribution chains in a number of sectors of the economy have also been playing key roles in creating inflationary pressure in Bangladesh. **Fourth,** oligopolistic market structure or syndication as loosely termed also has played an important role which has been rampant particularly with respect to the markets of essential commodities where a handful of dominant suppliers determine prices that are immediately followed by others in the market. **Fifth**, natural disasters like cyclone, floods, etc contributed to price inflation by disrupting transportation and breaking natural supply chain. There is a concern that the natural disruption of the supply chain, already partly broken by imprudent administrative measures in the name of anti-hoarding drive after the current government's takeover, would turn the situation into a long term syndrome. The rural economy is adversely affected by these conditions and the rural people become more vulnerable. The food inflation rate now approaching a double digit figure turned the poor into destitute.

Bangladesh government is now making rice available to the poor and lower middle classes on a limited scale at subsidized prices. But that has not helped much in bringing down the prices of rice. **Finally**, scarcity of agricultural inputs like irrigation, fertilizer, insecticide, seeds, etc. have adversely affected the overall supply scenario of the essential consumer items of the country.

V. Policy Appraisal and Suggestions

Since both the demand-related and supply-related factors are held liable for price inflation in Bangladesh; policy measures are to be designed to manage both aggregate demand and aggregate supply simultaneously. Theoretically we know that demand- pull inflation tends to be accompanied by increased output and decreased unemployment as excessive demand pulls prices up. Cost- push inflation on the other hand tends to reduce output and raise unemployment by increasing costs against stagnant demand. As mentioned earlier, while creeping inflation is often acceptable, the running inflation in Bangladesh needs to be curbed. Inflation policies must have two goals – a) to minimize the impulse to inflation from domestic sources especially by demand management mistakes and b) to minimize the damage done by whatever minimum rate of inflation is inevitable. Policies aimed at these two goals can be conveniently discussed under two headings **general or macro policies** that may apply across the whole economy and **specific or micro policies** that are aimed at a particular sector.

Macro Policies

1. **Monetary Policy:** Central Banks usually pursue contractionary monetary policy to fight inflation. Under a contractionary monetary policy a central bank decreases money supply in order to raise the interest rate. The higher interest rate reduces consumption and investment spending. As a result, aggregate demand falls causing both inflation and output to decline. In the short run, there is a trade- off between inflation and real GDP growth. But in the long run, there will be no trade- off between them. Bangladesh Bank (BB) has followed a tight monetary policy over the period between January 2006 and December 2007. The Bangladesh Bank has designed its monetary policy aiming at a GDP growth rate of 7 percent in 2008.The Bangladesh Bank has given higher priority to a higher rate of economic growth than pulling down the inflation rate. But under the veil of cautious monetary policy, Bangladesh Bank was basically undertaking expansionary monetary policy to validate government expansionary fiscal policy especially during the period January 2006 to June 2007 that was evident from the growth rate of the broad money (M2). The year on year percentage change in the broad money increased from 14.2 percent in June 2005 to 18.2 percent in May 2007 as we mentioned earlier. As a result, the real interest rate decreased to approximately zero or negative leading to higher consumption, investments spending, huge government borrowing and thus higher inflation.

For aggregate demand management, monetary policy, in the context of Bangladesh, has proved to be less effective than fiscal policy because remittance flow and government expenditure virtually have no relation with the monetary policy. Tight monetary policy may rather discourage domestic private investment which may further worsen output and employment. In such a situation, fiscal policy should be designed quite carefully primarily to curtail unproductive government expenditure and restrain conspicuous private consumption .The present government has belatedly decided to follow this policy. But in that case attention should be given so that public expenditures on social sectors like health, education, subsidy on agricultural inputs and fuel like petrol/diesel, etc. is not curtailed.

2. Reducing Import Duties

Import duties particularly on essential items and LC margins should further be reduced in order to boost imports of necessary commodities. As an example it may be mentioned that, to control the price of MS rod government is going to take the decision to reduce the tariff and to open the import of scrap. It should be emphasized here that increases in imports may not necessarily help reduce domestic price level if the prices in the international markets soar as is now happening in the case of most of the essential items including food. In that case, the only alternative open to government is to boost domestic production which is albeit a long-term measure.

3. Boosting Domestic Production

Notwithstanding the economy's diversification, a very substantial part of the gross domestic product (GDP) of Bangladesh is derived from agriculture. Over 90 per cent of the people of Bangladesh are still concentrated in the rural areas where agriculture or related activities dominate over other activities. Thus, a downturn in agricultural production adversely affects the economic conditions of the majority of people who are close to the subsistence level.

But the agricultural sector as a whole was badly hit by two countrywide floods of longer duration followed by a devastating storm in quick succession. The main crop rice of the year perished on a large scale due to these calamities. Thus, according to an unofficial estimate, Bangladesh may have to import some 3.2 million tons of food-grain to meet the food gap that has been caused by reverses in local food production.

Production activities in other areas of the rural economy such as fisheries also suffered heavily. The handloom industry is a major employer in the rural areas after agriculture. It also suffered serious production setbacks by natural calamities. The poultries have been emerging as a major economic sector, especially in the non-urban areas. But the bird flu epidemic has crushed the poultry sector. The net results are negative both in terms of output and employment. The entire rural economy thus has been badly affected by natural disasters inflicting big losses in terms of output and opportunities for employment and income generation.

But natural disasters are not the main reasons for low productivity in the rural areas. A declining trend in the production of food grains was noted even in 2006 (Pricing in terms of Bangladesh Context, www.nation.ittefaq.com/artman/publish). The country enjoyed relatively fair weather. It was brought on by man-made factors such as utter mismanagement in the distribution of key agricultural inputs such as fertilizers, seeds and irrigation water. Farmers were also deeply harassed by scarcity and unreasonable prices of these inputs last year.

Industrial production as a whole is also not considered as particularly impressive. Both local and foreign investments in the industrial sectors have been remarkably low in the last year due to the current anti-corruption drive. Many potential entrepreneurs and existing ones have been discouraged by fiscal policies such as drastic reduction of tariffs on a whole range of products that they produce locally or intend to produce. In some cases, local producers have been forced to reduce their production on these grounds to avoid higher losses.

To boost up the agricultural production the Government of Bangladesh regularly provides large subsidies to fertilizer production and for fuel oils. But fertilizer is reportedly smuggled out to Myanmar and India where the prices of these commodities are substantially higher than in Bangladesh. Therefore, it is imperative to control smuggling out of these goods with an iron hand while giving subsidies on them. But this has to be done effectively. Fertilizer distribution system should be improved to avoid delays in distribution.

Furthermore distribution system, production, import and subsidization should be reviewed to ensure timely access of farmers to this key input. The judicious use of the proposed WB funding should enhance the effectiveness of the national agricultural technology system, strengthen national institutions involved in agricultural research and extension which will help increase and diversify the sources of income for small and marginal farmers while at the same time fostering farmer – market linkages. The government must undertake massive investment in infrastructure development particularly in water and transportation. This will provide benefit to the rural areas. A key to improving crop yield would be the use of modern technology with a special emphasis on growing high yielding varieties of grains by encouraging free flow of technology transfers and investment from countries such as China, India, and Mexico.

Specific Policies:

1. Controlling the Exchange Rate from Further Devaluation

The earlier exchange rate regime in Bangladesh was an adjustable basket peg using a real effective exchange rate target. With a given nominal exchange rate, the corresponding real effective exchange rate is estimated. Then it adopted a floating exchange rate regime in which the nominal exchange rate is determined by the market forces of demand and supply related to foreign exchange. Devaluation or fixing a rate lower than it would be in a free exchange market has been a key feature to stimulate export and discourage imports in a weak economy like ours. Unfortunately, Bangladesh is an import-based economy and depreciation of taka will make costs of imports shoot up. For example, import payments during 2002-03 and 2006-07 grew at an annual average rate of 15.04 percent. As a penalty, cost of exports would also go up, making Bangladesh uncompetitive in global market. Since 1990-91 to 1999-00 the devaluation rate of Taka against US Dollar was 41.02 percent and since 2000-01 to 2006-07 it was 27.93 percent. As a result, import cost rises over time. Table 10 presents the trend of imports by major commodities. The discussion of inflation in the context of exchange rate regime becomes relevant because of two major considerations. First, a change in the exchange rate causes a change in the domestic prices of tradables.The prices of non-tradable are also likely to be affected. As a result, the depreciation of the Taka places an upward pressure on the price level.

Table 10: Value of Imports by Major Commodities (Billion Taka)

Commodity	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
a) Major primary goods	1046	812	1133	1339	1676	1854	2069
b) Major Intermediate goods	1380	1311	1548	1910	2662	3001	3569
c) Capital machinery	482	554	548	729	1115	1458	1929

d) Other goods	6427	5863	6429	6925	7694	8434	9590
Total imports (a + b +c + d)	9335	8540	9658	10903	13147	14746	17157
Annual change (%)	11.50	-8.5	13.1	12.9	20.6	12.2	16.4

Source: **Bangladesh Economic Review,** 2007.

Recently The Bangladesh Bank (BB) has steadily intensified its intervention in the inter-bank foreign exchange market to help the banks settle their import bills for food grains, scrap vessels and gasoline. It also started intervening in the inter-bank dealings in foreign exchange through selling US dollar since October 2007, aiming to keep the foreign exchange market stable, sold a total of US $ 472 million to the commercial banks as part of its ongoing intervention in the market. Furthermore, Bangladesh bank has also started buying back government securities aiming to inject fresh funds into the money market that may ensure sufficient liquidity in the country's money market (*The Financial Express*, May 8, 2008, p.8).

2. Food Buffer Stock and Export Control

One of the Specific policies that may be used to reduce the inflationary pressure according to the economic theory is to create a food buffer stock. A food buffer stock reduces uncertainty and external dependence and provides a sense of security among the masses. Temporary export controls can be effective also in holding down domestic prices when there is a drop in domestic supply of goods which (1) are both exported and consumed at home, and (2) have domestic demand which is relatively insensitive to price changes. A good example is food. When total output shrinks, export controls can maintain the domestic supply at its previous level, shifting the burden to the world market. There are two reasons why these measures should be used frequently. First, Export controls are a clear attempt to shift the burden of a domestic shock onto the rest of the world. If all countries were to act similarly, no one would gain. Second, by reducing the domestic price, export controls reduce the income of the sellers of the controlled commodity, clearly shifting income away from them. Bangladesh also banned export of rice except aromatic varieties and moved fast to procure 1.4 million tones of rice in the Boro season. This will boost the millers and the farmers to sell their stocks directly to the government.

3. Price Control

Direct price controls on specific items give much the same kind of domestic controls as export controls. They shift income away from sellers in the controlled sector and increase expenditures on non-controlled items. Price controls may be justified as a temporary measure, while a needed structural change is being made in an industry. But price control is not at all a sensible measure to curb price inflation in market economy like Bangladesh because it encourages development of illicit markets, worsens deficits, benefits middlemen and thereby helps dry up investment by the actual producers. As a short-term measure, government may directly participate in the distribution chain to enhance aggregate supply. This measure will, however, help curb price inflation if the volume of supply constitutes a dominant part of the retail market. But it cannot be a long-term measure because its administrative cost is very high. In a free market economy, price level basically depends on the levels of demand and supply. The role of government in such an economy is only to promote competition and remove market imperfections through either fiscal or monetary policy or by any other means judged suitable for the government. In the context of present situation, a commission can be constituted that will constantly monitor the supply situation particularly of daily necessities and suggest the government necessary policy measures time to time.

Further to fight against the inflation the government may;

(i) Increase taxes on non- productive areas (such as import of cars or other luxury goods) or those not under the tax net to reduce deficit.
(i1) Allow duty free import of all food items to lower inflation as a short-term measure and make increase in crop yields a top priority.
(ii) Cut taxes on productive areas (c. g manufacturing) to boost production & exports.
(iv) Eliminate guaranteed profits to oil companies to lower or minimize increase in oil prices
(v) Undertake rightsizing of government bureaucracy.

The areas where tax policy needs a review include

(i) A cut in income tax rates for the publicly listed companies (excluding financial sector) to 15%.
(ii) Imposition of tax on capital gains from land & property.

Summary and Conclusions

The current inflation, particularly the food price inflation, has affected the majority of the population of Bangladesh. Inflation is caused by multiplicity of factors and, therefore, there is no single solution to the problem. A prudent macroeconomic policy would address all the sources of inflation. Besides, piecemeal measures need to be undertaken as part of a continuous fine-tuning process. The present paper points to selected macro and micro economic policies as solutions to the prevailing inflation in Bangladesh. The primary objective of the paper being to suggest policies that can potentially combat inflation, it has reviewed the nature and magnitude of recent inflation in Bangladesh. The paper also analyzed the demand – and supply – related factors contributing to the current inflation in Bangladesh. The study finds that inflation has trended upward in recent years and that food price inflation has been consistently higher than the nonfood price hike. Overall, the present inflation may be termed as running inflation as far as its magnitude is concerned. It has also been evident that nominal wages hardly kept pace with the inflation .As a result real wages tumbled. Increased remittances inflow, soaring public expenditure, strong export growth and hefty growth of money are identified as the principal factors responsible for the rising aggregate demand and, therefore, the demand-pull inflation. The cost – push inflation, on the other hand, has been engineered primarily by escalated oil price as well as other basic inputs, rising international prices, market imperfections and decel erated agricultural production owing to high input prices. The study suggests that prudent monetary policies alongside enhanced domestic production and reduced import duties may help reduce inflation. The above macroeconomic policy measures may be supplemented by selected piecemeal policies such as the creation of a food buffer stock, changes in exchange rates, and price control.

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