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Notes from the Founding Editor

The production and reproduction of knowledge and its wide dissemination, in all probability, constitute an inescapable presupposition for development. The magnification of the domain of information, in a true sense, imbibes essence of knowledge from the infinite universe every moment, and reveals the marvels of creation before the world of mankind. There is no gainsaying the fact that the attainment of enlightenment takes its origin from the production and reproduction of knowledge. And this is appropriately ascribable to any area of knowledge irrespective of time and space. It is highly probable that human enlightenment is directly proportional to easy access to knowledge, no matter whatever the means of imparting knowledge might be.

Keeping the aforementioned truth in view, as chairman of the Janata Bank Ltd, last year, I raised an issue, in one of our Board meetings, on the necessity for publication of a Journal related to Money, Finance and Development. The Board was unanimous – for various reasons – about the extreme need for having such a Journal in Bangladesh. That is the brief history of the origin of this first volume of the *Janata Bank Journal of Money, Finance and Development*. Certain it is that this is the start of a noble initiative that goes unpracticed in the bygone period in the country's Banking and Financial Sector. I have cherished a long-held dream to view the blooming state of Janata Bank, so that the organization might emerge as a brand bank not only in Bangladesh but also in South Asia. The publication of this Journal will, in a facilitative manner, provide a gateway towards that particular mission as regards the development of knowledge-based society. The routes of Journal will prove, as I think, efficacious and instrumental not only in equipping the banking sector and the finance community with the abundance of knowledge and skill but also in playing a contributory role in expediting unstoppable production and reproduction of knowledge necessary for humane development.

Prof. Abul Barkat, PhD
Chairman, Janata Bank Limited, and
Founding Editor, *Janata Bank Journal of Money, Finance and Development*

Editorial Notes

On the occasion of this first issue of *Janata Bank Journal of Money, Finance and Development* I welcome all readers including the academicians, practitioners, researchers and students in relevant field of Bangladesh and beyond. It is a historic moment for us as we are going to present a professional journal on the issues of development.

Janata Bank Limited has a full-fledged Research Division comprising of two departments, namely (i) Research, Planning and Statistics Department and (ii) Management Information System Department. This division is entrusted with the responsibility to manage the daunting tasks of publishing this half-yearly journal. It gives us a great pride that most likely we, at Janata Bank Limited, are the pioneer in the country's banking sector that carries effective and applied research activities and has regular publication of professional journal.

For Janata Bank Limited, publication of such professional journal has become possible owing to the prudence, foresight and earnest eagerness of the Bank's Hon'ble Chairman, Professor Dr. Abul Barkat, who is an eminent economist of international repute. In publication of this first issue of the journal we have faced – due to our lack of prior experience – various difficulties and obstacles that we overcame with his wise suggestions at every steps.

The Journal contains a number of high quality articles of noted academicians and practitioners. The key focus areas of articles in this first volume move around issues like globalization, global and local securities market, banking concerns such as capital adequacy, green banking, foreign trade and so on. This journal provides a platform for professional dissemination of applied pro-people initiatives in the Banking and Financial sector. In this regard worth mentioning is the article dealing with the Janata Bank's *Interest and Collateral-free Loan Programme* for the landless and marginal farmers; an unprecedented loan scheme in purview of world economy. The scheme has been invented by Professor Abul Barkat and implemented by Janata Bank Limited since 2009, which is an ongoing poverty eradication initiative of Janata Bank Limited and has already been recognized by the

Central Bank– The Bangladesh Bank, which has issued circular to all the related banks to replicate this programme in rural Bangladesh.

We are extremely grateful to the Advisory Board and Editorial Committee of the journal, and to the contributors to this journal. I express my heartful gratitude to Professor Dr. Ashraf Uddin Choudhury for his every kind of cooperations and suggestions.

We are fully aware of the fact about the sustainability of the Journal, and I am convinced that publishing of this Journal with quality articles will become an integral part of Janata Bank Limited.

Md. Afzalul Bashar
General Manager, Research and Planning Division, Janata Bank Limited, and Managing Editor, *Janata Bank Journal of Money, Finance and Development*

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Globalization, Economic Growth and Bangladesh Economy

Mirza Azizul Islam*

Abstract Globalization has become a hotly debated subject. The admittedly limited objective of this article is to evaluate the role of economic globalization in accelerating growth of GDP. Ex-ante, it can be argued that economic globalization can accelerate growth, but can also pose serious risks. On balance, empirical evidence suggests that over the medium to long term gains dominate the losses. The pace of Bangladesh's integration into the global economy has been rather modest with correspondingly modest acceleration of growth. For Bangladesh, there remains considerable scope for deeper integration which is likely to provide added boost to the country's growth, while remaining alert to the potential risks.

Keywords Globalization, Electronic Commerce, Transnational Corporate, Capital Accounts, Import Multiplier.

Globalization has become a hotly debated subject in recent years. Much of the debate is propelled by the ideological predilections of the proponents of globalization and its opponents. The ideological differences arise partly from the multi-dimensional nature of the term globalization. It has social, cultural, political, environmental and economic dimensions. This article focuses on the economic dimensions of globalization and examines Bangladesh's participation in the process as well as resultant impact on the country's growth.

1. Definition and Indicators of Globalization

Joseph Stiglitz a Nobel laureate economist defines globalization as "closer integration of the countries and peoples of the world…" (Stiglitz, 2003, P.9). From the viewpoint of economic dimension, globalization essentially implies increasing integration of product and factor markets across national boundaries (Islam, 1999). A similar view is that economic

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globalization "refers to the integration of national markets, characterized by a relatively unrestricted movement across national borders, on a significant scale, of goods and services, capital, labour, technology and information" (Islam, 2004, P.1). It is generally acknowledged that the pace of economic globalization has intensified since the 1980s. There could be many indicators of the intensification. A few of those noted by the International Monetary Fund are presented below (International Monetary Fund, 2008).

- The value of trade (goods and services) as a percentage of world's GDP increased from 42.1 per cent in 1980 to 62.1 per cent in 2007.
- Foreign direct investment increased from 6.5 per cent of world GDP in 1980 to 31.8 per cent in 2006.
- The stock of international claims (primarily bank loans) increased from about 10 per cent of world GDP in 1980 to 48 per cent in 2006.
- The number of foreign workers increased from 78 million (2.4 per cent of world population) in 1965 to 191 million (3.0 per cent of world population) in 2005.
- Economic performance measured by GDP growth and globalization measured by selected indicators of some Asian countries are given in Appendix Table 1.

2. Factors Behind Increased Pace[1]

2.1 Market and Technology Related Factors

Perhaps the most important market-related factor is the intensification of competition in the international economy. This is encouraging for firms and nations to seek out the most profitable markets for exports and the cheapest sources for imports. The increasing emphasis on allocative efficiency and productivity growth in developing countries and the economies in transition provide an impetus to greater engagement in international trade and efforts to attract FDI.

The pressures of competition are providing a strong incentive for transnational corporations to minimize costs. One way of achieving this is to undertake locational specialization along the value-added chain. Transnational corporations are demonstrating increasing willingness to

[1] This section draws on United Nations, 1997. The author substantially contributed to and directed the preparation of this publication in his capacity as the Director of Development Research and Policy Analysis Division of United nations Economic and Social Commission for Asia and the Pacific.

locate parts of various functional activities (for example, research and development, finance and accounting as well as production) wherever they can be performed most efficiently. This allows participation of a greater number of countries in different parts of the value-added process. The relocation of manufacturing industries is a distinct element in this process. A growing range of manufacturing activities, associated not only with labour-intensive products but also with many components of low-wage, routine tasks in hi-tech industries, have been shifted to offshore locations. This has led to enhanced flow of goods in international trade. Growing imports of components produced or assembled abroad into the home country of transnational corporations, or to affiliates at other locations, constitute a high proportion of world trade in industrial goods.

The management of global networks requires service facilities, including transport and communications, and a variety of professional business and financial services. Transnational corporations have come to play a significant role in the production and sale of those services as well. They have become important in the international delivery of a wide range of services through wholly owned foreign investment, joint ventures and various forms of contractual arrangements. These deliveries consist, *inter alia*, of professional services such as accounting, advertising, management consulting, legal and computer services. Some developing countries are also participating in the growing trade in some of the professional services, notably computer software and financial services, along with the traditional services rated to transport and travel.

A series of developments in the financial markets involving innovations in institutions and instruments, the creation of offshore banking centres, and the establishment of regional markets have served to internationalize the financial industry. These have contributed to a vast increase in the volume of international flows of finance and related services.

The trend towards urbanization, which usually accompanies a production mix with higher shares of manufacturing and services, is a major force in the globalization process. Urban life everywhere tends to develop similar tastes, preferences and demand patterns that easily take on a global character, backed up by easy access to information in urban locations. The increasing convergence of consumer tastes across national boundaries is helping to boost the globalization of the market for goods ranging from apparel to electronics. The process has been aided again by the growing involvement of large transnational corporations in the related consumer services. The possibilities of economies of scale in the delivery of such services, and the increasingly open and expanding markets for them have induced large corporations to produce the consumer services that used to be produced only by small, single-site local firms. This is evident in a wide variety of services, such as hotels, restaurants, movie theaters, car rentals, photo-processing and development, real estate, movement and storage, various repair services and retail outlets for a broad range of consumer goods.

Movement of capital, goods and services has been paralleled by the movement of labour. Millions of people have migrated from their countries of origin. People have migrated for various reasons. Many of them, however, have been motivated by economic considerations. The recent upsurge in FDI, in part associated with the relocation of production to low-wage developing countries, has not succeeded in bridging wage differentials across countries. Lack of adequate employment opportunities at home and expected high potential earnings abroad continued to induce people from developing countries to migrate to more economically advanced countries. The market-related factors propelling the globalization process have been aided by technological advances. Technology permits greater "componentization" of production and creates the scope of producing different components in different countries. At the same time, advances in informatics and telecommu-nications have contributed to the convergence of demand patterns and have increased the capacity to process and communicate the information required for cross-border transactions, while reducing the cost.

Electronic commerce is increasingly facilitating trade through the systematic rationalization of procedures and documentation for international trade. The delivery of a wide range of services, including financial services, across national borders would be severely constrained in the absence of improvements in information and communications technologies that have been taking place over the past few years. Transnational corporations depend heavily on information technology to coordinate their activities throughout the value chain located in different parts of the world. Similarly, developments in transport technologies have facilitated the globalization process through faster and cheaper movement of goods and people.

2.2 Policies at the National and International Levels

The market and technology-related forces leading the globalization process have been reinforced by the policy stance adopted at the national and international levels. At the international level, there is an increasing emphasis on securing multilateral agreements on the rules affecting international transactions and increasing the transparency of those rules. At the national level, restrictions and controls on domestic and international transactions of goods as well as wide variety of services have been and are being progressively removed or eased. Investment rules have been liberalized to encourage foreign investment in the domestic economy. Financial transactions have been eased by removal or relaxation of controls on capital movements as well as entry and operation of banking and other financial institutions.

Most of the developing countries and the economies in transition are seeking to open their economies to international trade on the basis of comparative advantage. This has often entailed trade liberalization measures, including reductions in tariff rates and relaxation of quantitative controls or other non-tariff barriers to trade. Since the late 1970s and the early 1980s, most of the developed countries have removed existing statutory regulations governing their financial institutions, particularly those relating to controls on the movement of funds, interest rates and the separation of areas of business of commercial banks from those of securities firms. To varying degrees, similar measures are also being adopted by developing countries. There has been a discernible move in many developing countries towards deregulation of interest rates, relaxation of directed credit requirements and easing of entry and operating conditions for foreign banks. The deregulation has facilitated the internationalization of the financial market with participation of investors and borrowers from all over the world.

The globalization of financial markets has also been aided by developments in foreign exchange regimes. There has been wider adoption of flexible exchange rates. Many developing countries have not only removed restrictions on foreign exchange transactions under the current account but have also substantially reduced controls on capital accounts. There has been a marked policy shift, particularly in developing countries, towards FDI. The policy objective appears to be increasingly one of the promotion of, rather than restriction on, such investment. The measures used typically include opening up sectors previously reserved for domestic investors (public or private), relaxing performance requirements and providing fiscal and financial incentives. At the international level, WTO provides the framework for a further push towards globalization by freeing the markets for goods, services, finance and technology. Other international institutions such as the World Bank, International Monetary Fund, regional development banks etc. have also been playing important role in influencing national policies that promote globalization.

3. Positive Impacts of Globalization on Growth and Attendant Risk[2]

3.1 Positive Impacts

Trade orientation has a significant impact on growth. The benefit of trade espoused in neo-classical international trade theory is that it promotes efficient allocation of resources in consonance with the comparative advantage of nations. In addition to allocative efficiency, trade policies are likely to enhance the efficiency of resource use in particular activities. Export-promoting policies, in combination with a liberal import regime, facilitate greater capacity utilization, reduce the need for excessive stocks of inventories and discourage installation of excess capacity with a view to producing premium-fetching import licenses. All these determine the capital/output ratio and the volume of output that can be produced with a given amount of investment.

Apart from static efficiency gains, favourable trade policies can generate dynamic impulses for growth. There are empirical studies which lend support to the view that exports have a positive influence on domestic savings. In addition, the nature of trade policies affects inflow of foreign savings. By generating confidence in a country's capacity to service debt, exports can promote inflow of foreign capital, both from private and official sources. Moreover, export-promoting policies encourage foreign direct investment in export industries to take advantage of cheap raw materials or labour. Insofar as certainty and convenience of repatriation of profits affect foreign investors' investment location decisions, export-promoting policies are likely to have a salutary impact.

Exports facilitate many other dynamic gains. Most export products of developing countries, particularly manufactures, comprise a small proportion of the world market. In consequence, it is possible to produce at a scale way above what would be feasible if output were constrained by domestic demand. This permits adoption of improved technologies, costs of which might be prohibitive at lower production levels. Access to foreign technologies can also assist in expanding the production frontier and structural change through product diversification. And the knowledge of the existence of such technologies is largely gained through participation in international trade. Furthermore, producers in the export market are subjected to intense competition which forces entrepreneurs to reduce costs and improve product quality.

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[2] This section draws on an earlier article by the author (*see* Islam, 1999).

Most empirical studies investigate the relationship between exports and growth, but there also exits a close link between imports and growth. The gains from competition hold with respect to producers of import-competing products. Imports relieve bottlenecks created by the failure to produce raw materials, intermediate goods, capital equipment and technology. In other words, in developing countries, there may be a valid concept of import multiplier. Moreover, where scarcity of wage goods causes high inflation with adverse impact on domestic savings and volume and pattern of investment, the import of consumer goods also facilitates growth. To sum up, the principal mechanisms through which trade promotes growth are the following:

- The growth of exports permits economies of scale, a degree of specialization and a level of production that cannot be sustained by domestic demand.
- The growth of imports alleviates growth-retarding supply shortages, especially of goods and services used in production and contain increase in the costs of wage goods, raw materials, capital equipment, technology and services.
- Participation in international trade generates positive externalities, particularly through competition and opportunities for learning that can expand the production frontier.

Financial flows play two roles in improving a country's growth performance: these supplement domestic savings and investment and assist in overcoming the foreign exchange constraint imposed by the imbalance between foreign exchange earnings and import needs. In other words, these flows play an integrating role between countries with surplus savings and countries with deficits. This transfer of savings makes available a higher volume of imports, including capital goods, to the countries with lower savings, thus enabling the two sets of countries to improve their structures of output and growth.

FDI plays a similar role as above. But its contribution extends well beyond relaxing savings and foreign exchange constraints. Transnational Corporations (TNCs) which are the principal actors in FDI are often in possession of technological assets vitally required to upgrade the quality of products for sale in the domestic or external market. These assets relate not merely to "hard" dimensions embodied in machinery and equipment, but also to "soft" aspects such as product design, factory layout and organization of production as well as management. Another major asset that TNCs possess is their capacity to exploit established marketing links (both intra-firm and extra-firm) or to create new ones to promote exports. Transnational corporations play this role under a variety of arrangements that may encompass wholly-owned affiliates, majority or minority joint ventures, subcontracts and other non-equity links. In consequence, domestic enterprises can benefit substantially from the assets possessed by TNCs and contribute to growth. Finally, export of labour and associated remittances promote growth by sustaining domestic demand, relaxing foreign exchange constraints and, if properly utilized, bridging domestic savings investment gap. In addition, some of the nationals employed abroad may return to the home country, set up productive enterprises and transfer skills through other means.

3.2 Attendant Risks

The reliance on trade as an engine of growth is not free from risks. The classic argument against free trade relates to infant industry protection. Given the unrealistic nature of many of the assumptions underlying the espoused benefits of free trade (particularly those relating to identical production functions across countries and the absence of externalities), it is quite possible that potentially viable domestic industries may be wiped out as a result of premature exposure to competition from imports.

A higher proportion of exports in GDP may also expose an economy to the vulnerabilities arising from external events beyond its control. These may take many different forms: a sudden drop in the demand for major export items, a devaluation of the currency of a competitor country, a recession in trading partners, a change in the marketing strategy of TNCs in situations where they spearhead a country's exports, or imposition of restrictions against imports by trading partners through tariff and (increasingly) non-tariff barriers such as anti-dumping measure and regulations relating to health, labour and environmental standards.

The dependence on external financial flows, particularly private flows, to finance investment and accelerate growth is fraught with many risks. First, the sustainability of these flows does not entirely depend on the recipient countries' policies. For example, a rise in interest rates in the source countries for their own domestic macroeconomic reasons may dry up new inflows and even cause an outflow. Second, these flows inevitably generate return flows in the form of repatriation of principal, interest and dividend and thereby create pressure on the balance of payments. Third, the pressure on the balance of payments may severely undermine the prevailing exchange rate regime with grave implications for the real sector of the economy. Unless effectively supervised by regulatory authorities, pressure on the balance-of-payments can be aggravated through a maturity mismatch as well as a currency mismatch. For example, funds borrowed with short-term maturity may be used to make investments which yield returns only after a long period and borrowed funds may be invested in non-tradable which generate returns in local currency while servicing costs are denominated in foreign currency. Fourth, excessive dependence on external financial flows exposes an economy to the double jeopardy of an exchange rate crisis and a financial sector crisis which reinforces each other and causes a vicious spiral (Kaminsky and Reinhart, 1999). An expectation of devaluation, for reasons not necessarily having to do with the wrong fundamentals in the host economy, changes the future profile of returns, as viewed by the creditors and short-term investors. The perceived benefits of early withdrawal encourage repatriation of funds abroad. This leads to depletion of reserves and forces a devaluation of the currency. The withdrawal of funds by foreign creditors and short-term investors also causes a drain on the host country's financial intermediaries, affecting their liquidity and even solvency. Fifth, financial markets in general, especially international financial markets, are inherently prone to 'asymmetric information', 'moral hazard', 'adverse selection' and 'contagion' (Wiplosz, 1999) and 'herd reaction'. Asymmetric information refers to the discrepancy of information between lenders and borrowers, causing inefficient intermediation. Moral hazard often leads to excessive contraction of the credit market. Contagion is the phenomenon of sharp changes in flows into or out of a country being triggered by event elsewhere. Herd reaction is the case when as one leading actor moves, others follow suit. Sixth, financial flows tend to be pro-cyclical. These pour in when an economy is booming and tend to rush for the exit door with the first signs of trouble. Finally, dealing with a financial crisis may entail significant fiscal or quasi-fiscal costs.

The aforementioned risks are less relevant for FDI. Nevertheless, there are some commonalities. The infant industry argument may apply with respect to FDI as well. The question of sustainability of FDI inflows remains a matter of concern, despite its generally stable pattern. This assumes particular relevance because technological changes driving the process of global expansion of FDI flows tend to make more and more industries increasingly foot-loose. While this may widen the opportunities for some countries to attract FDI, other, may be deprived. FDI also generates reverse flow of resources in the form of repatriation of profits and capital and exerts pressure on balance of payments, especially when foreign investments are concentrated in domestic market-oriented or non-tradable sectors. With increasing competition among countries to attract FDI, undue incentives may be offered without causing any net increase in FDI. Besides, much of the potential benefits of FDI can be realized only if a host country satisfies certain preconditions.

There may be problems associated with remittances as well. If these are primarily due to earlier migration of skilled labour and professionals, a country may be deprived of the benefits that could accrue from the development of its human resources.

4. Policy Changes in Bangladesh Favouring Participation in Globalization and Impacts[3]

4.1 Policy Changes

Since the mid-1980s and more pronouncedly since the early 1990s, Bangladesh has introduced a variety of policy changes to actively encourage the country's integration into the global economy. Particularly relevant in this context are the changes in external trade, exchange rate and foreign direct investment (FDI) policies. The important highlights of these changes and their impacts are briefly presented below.

i. Trade Policy Changes
- Virtual elimination of quantitative restrictions on imports;
- Reduction in the highest rate of custom duty from 40 per cent in FY1989 to 60 per cent in FY1995 and to 25 per cent in FY2009;
- Reduction in dispersion among duty rates;
- Reduction in the number of import duty slabs from 18 in FY1991 to 7 in FY1995 and to 4 by FY2009;
- Simplification of import clearance procedure through *inter alia,* removal of import license requirements, introduction of pre-shipment inspection system and computerized customs valuation system;
- Incentives for exports through bonded warehouse, import duty drawback and allowing back-to-back import LCs;
- Subsidy for selected export items;
- Establishment of export processing zones;
- Concessional interest rate on export credit.

ii. Exchange Rate Policy Changes
- Initial start with single currency peg;
- Widening of band within the framework of single currency peg;

[3] For further details on limitations and impacts see Islam (2012), and Hossain and Kabir (2012).

- Adoption of peg to trade-weighted basket of currencies;
- Finally, adoption of floating exchange rate system with active intervention by the Central Bank to stabilize the real effective exchange.

iii. FDI Related Policy Changes

- Opening most sectors to FDI;
- Allowing FDI in banking, telecommunications and services;
- No restriction on repatriation of profits and capital;
- No equities restrictions;
- Organizing road shows to attract FDI.

4.2 Impacts

In light of the earlier discussion in this paper three indicators of Bangladesh's achievement in integrating itself into the world economy are used. These are: growth of exports to indicate movement of goods and services, growth of remittances as proxy for movement of people and growth of FDI stock to indicate the country's attractiveness to foreign capital.[4] Relevant data are presented in the attached table. In order to get a comparative perspective of the country's integration, the same data are presented for 11 other Asian countries. The conclusions that emerge from these data are:

- Export performance of Bangladesh over 2000-2010 period has been reasonably satisfactory. The country ranks sixth among the 12 countries in the sample in terms of growth of exports. However, as of 2010 the country's export/GDP ratio was 18 per cent, the lowest among the sample countries.
- Bangladesh has performed much better in respect of remittances. It had the fourth highest growth rate and in terms of absolute amount its receipt of inward remittance in 2010 exceeded that of Indonesia and Pakistan both of which had larger population.
- However, the country's performance in respect of attracting foreign direct investment (FDI) is rather dismal. The growth of FDI stock was the second lowest. Only Malaysia had a lower growth rate, but its stock of FDI in 2011 stood at USD 114.6 billion as against USD 6.2 billion in Bangladesh whereas the population of Malaysia was less than one-fifth of that of Bangladesh.
- Overall, Bangladesh's achievement in growth of GDP was also reasonably satisfactory. It ranked seventh. This is not surprising,

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[4] Note that non-FDI private capital inflows are not considered because such flows are of minor significance for Bangladesh.

given the country's poor performance in attracting FDI. However, it should be noted that with rather modest achievement of the country's integration into the world economy, its GDP growth performance has also witnessed modest improvement, rising to 5.9 per cent during 2000-2010 from 4.8 per cent during 1990-2000 and 4.3 per cent during 1980-1990.

The above picture suggests that there remains considerable scope for further deepening of Bangladesh's integration into the world economy and that is likely to add stronger stimulus to growth of GDP. In particular, it is desirable to increase exports through efforts to capture greater shares of the markets for existing products, upgrading the quality of the products, diversifying the basket of export commodities and exploring new markets. Efforts should also be directed towards attracting greater volumes of FDI. This would require determined actions to remove the well-known bottlenecks arising from inadequacy of access to land, deficiencies of infrastructure, regulatory complexities, limited availability of qualified human resources and confrontational politics which inhibit both domestic and foreign investment.

5. Concluding Observations

This article has attempted to evaluate the role of integration into the global economy in accelerating growth in terms of both ex-ante arguments and empirical evidence. It should, however, be emphasized that growth of GDP is not the only objective of development. Therefore, policy makers should be mindful of the impact of globalization on other objectives such as poverty alleviation, income inequality, workers' welfare and environmental quality.

The risks of globalization were starkly demonstrated by the Asian economic crisis of 1997-1998. In the latter year, Indonesia, Malaysia, Korea and Thailand suffered significant negative GDP growth. However, these countries recovered fairly quickly and over the period 2000-2010, they averaged positive growth rates of 4-5 per cent which can be considered quite satisfactory in view of their earlier astounding growth rates leading to high levels of per capita GDP. The recent slowdown of growth across a broad spectrum of developing countries can also be traced to the recessionary condition in most of the developed countries. Nevertheless, the message that I would like to convey is that risks of globalization do not call for withdrawal from participation in the process, but for alertness in monitoring global developments and adoption of appropriate domestic policy measures to mitigate potential adverse impact.

Appendix

Table 1: Growth and Selected Indicators of Globalization of Some Asian Countries

Country	GDP Growth (2000-2010)	Growth of FDI (2000-2011)	Growth of Exports (2000-2010)	Growth of Remittance (1990-2010)
Bangladesh	5.9	9.5	13.0	13.2
Cambodia	8.7	13.3	15.0	3.1
China	10.8	11.8	22.4	27.7
India	8.0	22.8	19.9	15.6
Indonesia	5.3	17.6	11.0	8.8
Korea	4.1	10.0	12.4	10.6
Laos	7.2	13.2	19.6	6.6
Malaysia	5.0	7.0	9.2	6.9
Pakistan	5.1	10.5	9.6	7.9
Singapore	6.0	14.0	12.0	16.8
Sri Lanka	5.6	10.9	5.9	11.7
Vietnam	7.5	11.5	19.4	10.3

Sources: World Development Indicators and World Investment Report (various issues).

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Realising the Potential Opportunities of India's Market Access Offer to Bangladesh

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Abstract The importance of Bangladesh's bilateral trade and economic relationship with India cannot be overemphasised. India's recent offer of duty-free market access, virtually for all items of export to India from Bangladesh, has opened up significant opportunities for enhancing Bangladesh's export and diversifying her export basket. However, Bangladesh will need to address, on an urgent basis, a number of issues including those related to attracting investment from India and other countries to Bangladesh which is geared towards the Indian market, reducing trade transaction costs, enhancing trade facilitation, dismantling non-tariff barriers and building supply-side capacities to access the growing Indian market. The article argues that Bangladesh should design a comprehensive strategy to realise the full potential opportunities of the Indian market access offer.

Keywords Market Access, Non-tariff Barrier, SAFTA, Rules of Origin, Product Diversification, Market Diversification

1. The Backdrop

India remains an important trading partner of Bangladesh and this importance has been on the rise in recent years. In view of this, the offer made by the Indian Prime Minister at the Seventeenth SAARC Summit in Malé in November, 2011 to grant duty-free (and quota-free) market access for virtually all export products originating from the SAARC LDCs demands special attention and consideration. This offer should be seen as an initiative having significant positive implications for Bangladesh in terms of advancing her trade and investment interests. Since the other SAARC LDCs (barring Afghanistan) have already been enjoying preferential (duty-free) market access in India for virtually all products of exportunder variousbilateral arrangements, as a matter of fact it is Bangladesh (along with Afghanistan) which stands to gain the most from this initiative. Indeed, by any reckoning, among all the five

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SAARC LDCs, Bangladesh's supply-side capacity and competitive strength to take advantage of this preferential market access is by far the most promising. The decision by India to do away with the negative list, and offer duty-free access to virtually all items of export from Bangladesh ought to be considered as having created *a favourable window of opportunity* to enter the fast-growing Indian market from a position of strength. The offer would mean that, of the more than 5,050 items imported by India (at 6 digit level), Bangladesh will now be able to gain duty-free market access for all but 25 items (these 25 items include arms, tobacco and liquor which do not have significant trade value for Bangladesh). Subject to compliance with Rules of Origin (RoO), all other items should now enjoy duty-free status at the Indian customs points.

Indeed, the Indian offer goes much beyond what was stipulated in the free trade agreement, and the preceding the preferential arrangement. As may be recalled here, under the four rounds of the SAPTA (SAARC Preferential Arrangement) negotiations (1995–2006), carried out on the basis of *offer* and *request lists*, a large number of items of export from Bangladesh were given preferential treatment in the Indian market, with the preferential margin varying from 0–100 per cent on MFN duties. However, majority of the items of export from Bangladesh continued to remain outside the purview of SAPTA. Consequently, these had to enter the Indian market by paying the MFN (most favoured nation) duties at customs points.

When the SAFTA (South Asia Free Trade Agreement) was put into effect in July 2006, the conditions for Bangladesh's market access in India experienced positive changes. However, SAFTA falls far short of a truly free trade area. As may be recalled, according to the Trade Liberalisation Plan (TLP) under the SAFTA, 763 items continued to remain in the negative (sensitive) list of India. This meant that these items could enter the Indian market only by paying MFN duties. Between 2008 and 2011, through two rounds of revisions and pruning, the number of items in the sensitive list of India was brought down to 480. However, many items of export interest to Bangladesh, including apparels, continued to remain in the list. The aforesaid 480 items in India's sensitive list included 154 RMG and 326 non-RMG items. It is important to recall, however, that as a gesture of goodwill India offered, on a bilateral basis, duty-free access to Bangladesh's RMG items, albeit under a quota regime – initially for 6 million pieces, which was later on increased to 8 million pieces and then further to 10 million pieces. After some initial difficulties, Bangladesh was able to exhaust the full quota; export of apparels beyond the quota could be exported to the Indian market only by paying MFN duties. To be fair, it should be noted here that Bangladesh herself also had a long of 1,152 items in her sensitive list when she signed the SAFTA accord. It has been agreed that sensitive lists will be further reduced by 20 per cent and will thus be subject to the trade liberalisation plan.

2. Current State of Bilateral Trade

India, as may be recalled, is the second most important import source for Bangladesh (USD 4,740.7 million in FY2012-13), conceding only to China (USD 6,307.6 million in FY2012-13). If informal trade with the country is factored into the trade equation, India could as well turn out to be Bangladesh's foremost trading partner. To compare, Bangladesh's ranking in terms of India's import sourcing was 62nd in FY2013 whilst India's ranking in Bangladesh's export was 12th. Till now, Bangladesh has not been able to take advantage of the increasingly large Indian import market in any significant manner. True, and it is satisfying to note this, in recent years Bangladesh's export to India has experienced quite a robust growth, rising from USD 144.7 million in FY2005 (Bangladesh's import from India over the corresponding year was USD 2,026.0 million) to USD 563.9 million in FY2013. Nonetheless, her bilateral trade deficit with India has been on the rise over the corresponding period – between FY2005 and FY2013 bilateral trade deficit with India, through the formal channel, has more than doubled, from USD 1,882.0 million to USD 4,176.7 million. Share of Bangladesh's export in the global import of India (490.7 billion in FY2013) was an insignificant 0.1 per cent; to compare, Bangladesh's own import from India accounted for about 16.3 per cent of her total import (34.1 billion) in the same year, indicating India's importance as an import source.

The issue of trade deficit needs to be treated with some nuance. It is true that in a globalised world it is the global trade deficit which should be of concern to countries, not bilateral trade deficit. Additionally, as is well-known, a large part of the Indian import includes raw materials that go for export-oriented industries in Bangladesh. If one looks at the structure of imports from India, it will be seen that a significant share in Bangladesh's import was accounted for by imports of cotton, yarn and fabrics, as also other inputs which are used by Bangladesh's export-oriented industries including the readymade garments. As India's supply-side capacities diversified, technology improved and power to compete strengthened, Bangladesh's producers, entrepreneurs and traders started to import more from India since they found Indian goods to be competitive and good value for money. Indeed, imports from India help Bangladesh maintain a healthy and hefty trade surplus with some of her other important trading partners such as the USA

(Bangladesh's bilateral trade surplus with USA was to the tune of about USD 4,882.0 million in FY2013). As is known, a large part of Bangladesh's export to the USA (have them 90 per cent) constitutes apparels, some of which are made from cotton, yarn and fabrics imported from India.

Having conceded the above, one ought to also keep in mind that, a persistent and widening bilateral trade deficit with India should necessitate a closer examination of the factors that are not allowing Bangladesh to ensure a more prominent presence in the growing Indian market for imports.This question will now become more relevant and pertinent in view of India's duty-free market access offer. It is from this perspective that the offer by India calls for a careful examination and scrutiny with a view to identify concrete measures to take advantage of the enhanced market access. Realising the potential opportunities of higher export to the Indian market will enable Bangladesh to bring down her bilateral deficit. It is from this perspective that the Indian offer is so critically important for Bangladesh.

3. Indian Offer as an Opportunity

It is reckoned that the Indian offer has high significance for Bangladesh on several counts. Firstly, the composition of Bangladeshi products exported to the Indian market is distinct from that of Bangladesh's overall export destined for the global market. Export to India from Bangladesh is dominated by non-RMG exports; this is a distinguishing feature when compared to Bangladesh's traditional export markets of the US, Canada and the EU. Whilst RMG constitutes about four-fifths of Bangladesh's global export, more than three-fourths of Bangladesh's export to India is accounted for by non-RMG products. These include traditional export items such as raw jute and jute goods, frozen-food items, dry-cell batteries, fertiliser, and chemicals, but also new goods such as plastic items, cement, ceramic and melamine products, leather and footwear, juice and accessories. As a result, exporting more to India should help Bangladesh not only in terms of *market diversification* (away from the traditional markets of the EU and North America) but also *product diversification* (beyond the RMG). This *twin diversification* possibility is of crucial importance to Bangladesh.

4. Realising the Opportunities

It will be in Bangladesh's interests to deploy appropriate measures to take advantage of the Indian offer. Bangladesh's capacity to take full advantage of India's market offer will depend on a number of factors. Firstly, this will hinge on putting in place the needed supply-side capacities in Bangladesh by encouraging domestic investment geared towards the Indian-market. Since most of the exporters to the Indian market are SME producers, ability to cater to their specific needs will be of high importance. CPD analysis indicates that there are a large number of items where Bangladesh has the supply-side and export capacity but these are not at present exported to the Indian market; however, India is importing many of these items from other countries but not from Bangladesh. These items should receive priority attention on the part of Bangladesh's policymakers as well as exporters. Supply-side capacities should be built around these items with high export potentiality.

Secondly, the issue of FDI is key to realising the full potentials of the Indian offer. Indeed, attracting FDI, both from India, and from other countries, targeting the Indian market, to take advantage of the duty-free market access, should be given the highest priority. For many items, ability to comply with the *Rules of Origin* requirements under the DF offer will also depend on Bangladesh's capacity to attract new investment in backward and forward linkage industries. Till now, investment flows from India to Bangladesh has been rather paltry; total FDI flow to Bangladesh, whilst rising in recent years, was only about a billion dollar in FY2012. Ability to attract Indian market oriented FDI will depend crucially on Bangladesh's ability to ensure an environment that is conducive to investment, particularly from the perspective of providing the needed infrastructural facilities for the potential investors.

Thirdly, as is widely known, addressing the Non-Tariff Barriers (NTBs) is of utmost importance. NTBs pose formidable challenges for Bangladeshi exporters in accessing the Indian market. Ability to tackle the NTBs upfront will be a necessary precondition. As is known, a large number of NTBs in place in India relate to health-hygiene and SPS-TBT related concerns and compliance requirements. In this context, Bangladesh will need to put in place the needed supply-side capacities at enterprise level, and also take steps to strengthen the capacities of the BSTI (Bangladesh Standardisation and Testing Institute) to cater to standardization, certification, laboratory testing and other forms of quality control requirements. It is good that progress is being made with regard to signing of *a framework agreement* for mutual recognition relating to testing, certification and issuance of accreditation certificates (India is also providing some technical assistance to BSTI in these areas). The envisaged SARSO (South Asia Regional Standardisation Organization), to be established in Dhaka, is a very welcome recent development in this connection which should help Bangladesh to build the necessary capacities to address the NTBs.

Fourthly, priority should be given to put in place measures towards better trade facilitation. In order for Bangladesh to take full advantage of the duty-free offer, appropriate steps will need to be taken towards customs harmonization, speedy crossing of goods across borders and better infrastructure facilities at border points. Investment in these areas will be helpful both for exporters and importers since these will reduce cost of Bangladesh's imports from India, with attendant benefits accruing to investors, exporters, producers and consumers alike. As is known, some important initiatives are being considered at present towards greater and more efficient transport connectivity with India and within the region. These initiatives will hopefully contribute to raising trade-related efficiency and lead to reduction of transport costs. This could also help reduce Bangladesh's bilateral deficit with India through export of services if connectivity related fees are appropriately designed and negotiated with India.

5. Concluding Remarks

It needs to be appreciated that, whilst the duty-free initiative of India is a promising development, as the aforesaid discussion bears out, that actual realisation of the potential opportunities and benefits originating from this initiative will critically hinge on how effectively Bangladesh is able to undertake the needed homework. Some of the key areas which have been identified in this paper include dealing with the NTBs, promoting domestic investment and FDI targeting the Indian market, enhanced cooperation in trade in services would reinforce and support trade in goods, greater transport connectivity with India and within the region, and more efficient trade facilitation. Initiatives in all these areas will enhance export competitiveness of Bangladesh's goods in the Indian market. Together with duty-free market access these suggested measures are expected to give Bangladesh the competitive edge to enter the growing Indian market. If the attendant tasks can be adequately addressed, then in all likelihood it will be possible to attain the ambition, voiced by some, that Bangladesh should be able to take her export of goods and services to India up to one billion dollar worth by FY2015. Evidently, if Bangladesh has her priorities right and does the needed homework in a strategic manner, establishing a strong foothold in the growing Indian market could prove to be a highly realistic proposition.

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Janata Bank's Special Programme of Interest-Free and Collateral-Free Loan to Landless and Marginal Farmers: An Impact Study

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Abstract Janata Bank Limited has introduced a special programme of interest-free and collateral-free loan to marginal and landless farmers to help them tide over resource constraint for income generating activities and thereby improve their socio-economic wellbeing. The objective of this study, based on a survey result of the farmers who took loans during 2009-2010 and 2010-2011 IRRI/*Boro* paddy seasons. Results of the survey show credible economic and social upgradation of the relevant farmers. Improvements in economic aspects include increase in household income, household food consumption and household consumption of better quality foods etc. apart from repayment of loan. This has been possible because of, in part, the mechanism Janata Bank adopted in selecting beneficiaries and the procedures it followed to disburse loans. The success of this experiment has important lessons for eradication of poverty of the marginal and landless farmers. Bangladesh Bank may create a mechanism to support and encourage this type of activity for the banking sector.

Keywords *Aila*, *Monga*, *Sidr*, Loan Repayment, Marginal Farmer, Landless Farmer, Collateral

1. Introduction

Janata Bank has undertaken a special programme on interest-free and collateral-free loan for landless and marginal farmers for supporting paddy cultivation and thereby enhancing economic wellbeing of farmers' households in the *Aila*, *Monga* and *Sidr* affected regions of the country

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and bringing the target farmers out of the coverage of loans from the NGOs and the *Mahajans* who provide loans at exorbitantly high rates of interest. The target farmers are landless, owning up to 49 decimals of land, and marginal farmers, owning land between 50 decimals to 149 decimals. The loans were meant for on-farm usage, focusing on paddy cultivation during the IRRI/*Boro* season, and cultivation of other crops or other agriculture related productive activities.

The loans were disbursed from the Janata Bank's Corporate Social Responsibility (CSR) fund was for maintaining continuity of the Programme in future. The total number of borrowers was 1,247 and 2,194 respectively in 2009-10 and 2010-2011 from *Monga*, *Sidr* and *Aila* affected regions of Rangpur, Nilphamari, Kurigram, Lalmonirhat, Gaibandha, Khulna, Bagerhat, Satkhira, Barisal, Pirojpur, Jhalokathi, Patuakhali, Barguna, Bhola, Madaripur, Shariatpur and Gopalganj. The size of this loan for six months ranged from BDT 5,000 to 10,000. To receive loan a farmer has to be a permanent resident of the project locality with experience of loan use from a bank/financial institution including those of 'micro credit' from NGOs and is not a convict per any criminal case. The Janata Bank officials identified the target borrowers by visiting them in person at their households, taking support of the elites, administration and school teachers of the survey area. The loans were disbursed in region-specific local meetings attended by the selected borrowers and the local elites consisting of the Union Parishad Chairmen/Members, concerned Ward Members and school teachers etc.

2. Objectives

The general objective of the study is to see whether interest-free and collateral-free loans to marginal and landless farmers are sustainable on two counts: whether the farmers can repay such loans, and whether any economic and social well-being is brought about by the usage of the loans. The specific objectives of the study are manifold as stated below:

- To make an investigation into the appropriateness of the process followed for identification and selection of the target borrowers and whether they received loans within the stipulated loan sizes.
- To make an assessment of the actual usages made of the borrowed loans as against the purpose of Janata Bank.
- To look into the extent of benefits received by the borrowers from use of the loans, as compared to the loans from the *Mahajans* and the NGOs.
- To assess the contribution made to the households' well-being of the borrowers due to the use of these interest-free loans.

- To explore whether the borrowers are willing to receive loans in a similar way in the future including their willingness to pay possible rate of interest on such loans.

3. Methodology and Data

This impact analysis has made use of both primary and secondary data. The primary sources of data are the borrowers of the programme who received interest-free loans during the IRRI/*Boro* paddy season in 2009-2010 and 2010-2011. In all, a total of 2,182 borrowers were interviewed, with the help of structured questionnaire. The secondary sources of information included minutes of meetings of the Board of Directors of the Janata Bank and the related records on loans disbursed in various regions of the country under the coverage of the programme.

The survey method followed was interviews of 2,182 borrowers selected on the basis of stratified random sampling. First, areas were selected purposively to cover the target borrowers. Then random sampling method was applied to select respondents from the borrowers to whom a structured questionnaire was directed. The survey process was facilitated by the officials of the Bank's regional area and branch officers who assisted field enumerators and field supervisors in locating the areas of households of the project borrowers. Care was taken to ensure unbiasness and transparency of survey. Survey was conducted with no intervention or interference from any quarter. The sample of the study comprised 15% landless farmers and 85% marginal farmers.

4. Loan Management Procedure

Janata Bank adopted a number of criteria to select target borrowers. For identifying and selecting the borrowers field-level household survey data was collected by the agriculture clerks/supervisors of the bank. On the basis of the survey, 78.51% of the loanees were selected. Then 19.39% loanees were selected following recommendations of the local elite, consisting of such members as the Union Parishad Chairmen/ Members and School teachers etc. By means of other processes – recommendations by friends and relatives, and local borrowers and shopkeepers of local *haats* and other commercial areas – 2.1% borrowers were selected.

For disbursement of loans various methods were followed. Loan disbursement among 1,288 out of 2,182 i.e. more than 50% of the total borrowers, was made in meetings attended by local elite both on and outside of the office premises of the local Janata Bank branches. Out of these 1,288 borrowers, around 50% received their loans from the bank premises and the remaining from outside the bank premises. Others received their loans at different locations, such as bank managers' chambers, bank counters, local UP offices, marketplaces and assemblies of borrowers and bankers convened through public announcements using mobile loud speakers.

Total amount of loan disbursed was BDT 19,471,000 at the time of the survey. The bulk (1,947, i.e. 89.23%) of the loans were for six months, followed by merely 13 of the loans for a duration of less than six months and 222 (i.e. 10.17%) for more than 6 months. Size of the loans though primarily planned to be between BDT 5,000 and BDT 10,000 but it varied in practice between BDT 3,500 to BDT 25,000. Loan size below BDT 5,000 was significantly smaller in number. It was only 20 in total. The majority of the loans were at the levels of BDT 10,000 (a total of 1,453 of the cases), BDT 7,000 (266 cases), BDT 8,000 (132 cases), and BDT 5,000 (113 cases). There were 16 loan cases where the respective loan amounts disbursed were between BDT 12,000 and BDT 25,000. The highest amount, BDT 25,000, went to only three borrowers. This significantly higher ranges of loan sizes and the high loan recovery rate (99%) in Phase II of the programme points out the increasing economic solvency of the target borrowers.

This special loan programme of Janata Bank was meant especially for the very poor farmers. An assessment was made to find out how many the incidental expenses for receipt of the loans were bearable by the borrowers. Though Janata Bank decided not to make the borrowers incur any processing fees, there were cases of certain amounts of fund spent by borrowers in order to process and expedite loan sanctioning and disbursement. It was found that these borrowers had to incur nominal amounts of money in order to get their loans applied for or processed. Janata Bank did not realize any money from the borrowers for the purpose of loan processing. But the borrowers had to spend small amounts of money for purpose of sheer documentation in the bank branches. It was found that 1,213 (i.e. 55.59%) borrowers out of the total 2,182 had to incur various expenses mostly for purpose of loan applications and disbursement of their loans. The remaining 969 (i.e. 44.41%) reportedly spent no money for loan application or its processing. The highest amount of money spent by a borrower for such purposes was BDT 1,000 in Phase II as against BDT 1,700 in Phase I of the money programme. The loan processing costs include application fees, brokers' fees, bribe (speed money), making photocopy, account opening and transportation cost. The percentage of borrowers who spent money for processing loan disbursement is 0.90 in Phase II against 1.24 in

Phase I of the programme. Out of total 2,182 borrowers, three largest groups spent money for loan processing specifically for printing of photographs, application fees and opening their bank accounts (i.e. 53.62%). Other borrowers, few in number, spent money for necessary land-related documentation including payment of land tax, lifting of land-related documents from the local land offices etc.

5. Usage of Loan

Loans under the programme were given mainly for on-farm activities, especially paddy cultivation in the IRRI/*Boro* season. Though 97.80 per cent of borrowers mentioned before disbursement of the loans that they would use the loans for purpose of paddy cultivation, 95.19 per cent used their loans for this purpose. The following shows activity-wise intended and actual usage of loans.

Table 1: Number of Borrowers According to Usage of Loan

Usage	Intended use (Multiple Responses)	Actual use (Multiple Responses)	Difference between intended and actual use
Paddy Cultivation	2,134	2,077	-2.67
Cultivation of Other Crops	84	81	-3.57
Fishery	1	1	-
Cattle Rearing	14	35	+150.00
Fruits Cultivation	4	4	-
Small Business (Trading)	10	17	+70.00
Purchasing Rickshaw, Van	14	23	+64.29
Daughter’s Marriage	1	5	+400.00
Not Reported	14	21	+50.00

Source: Survey.

Information in the table shows that the numbers of borrowers who finally deviated from their respective officially declared purposes of loans ranged purpose-wise between -2.67 percentage points and +400 percentage points. Larger deviations took place in the cases of small number of borrowers, i.e. a total of 85 (3.90%) of the borrowers. Field results show that the agricultural loans disbursed by Janata Bank were largely in line with the mandated purpose. Various other activities undertaken exclusively or in addition to paddy cultivation were fishery, fruits cultivation, small business, cattle rearing, purchasing rickshaw, vans and in a small number of cases part of loan money was spent for daughters' marriage.

Information regarding usage of loans for inputs are given in Table 2. Farmers spent an amount of BDT 32,790,479 which is 40.6% higher than the loan amount during the 2010-2011 IRRI/*Boro* season. Of the total expenditure on inputs, 59.38% was provided from Janata Bank's programme loans. The borrowers had to borrow additional funds from other sources.

Table 2: Expenditure on Various Inputs

Type of input	Amount of Loan Money Spent (BDT)	
	Expenditure (BDT)	Per farmer expenditure (BDT)
Crop Seed	3,911,048	1,792.40
Fertilizer	8,203,620	3,759.70
Irrigation	5,474,451	2,508.90
Insecticide/Pesticide	2,381,305	1,091.30
Hiring of Tractors	9,975,805	4,571.90
Labour	2,209,950	1,012.80
Fishery	3,72,600	170.80
Furniture	65,500	30.00
Daughter's Marriage	30,000	13.70
Maize Production	64,000	29.30
Others	102,200	30.20
Total	32,790,479	

Source: survey.

Among various inputs costs of tractors, fertilizer, irrigation, seed, pesticide and labour rank respectively 1, 2, 3, 4, 5 and 6.

It is of interest to know the sources of additional funds used. In total, 381 borrowers (i.e. 17.46%) reported that they had to manage funds from sources other than Janata Bank to financing their IRRI/*Boro* cultivation and other economic activities during the season. The major sources of such additional funds were own savings, NGOs, *Mahajans*, other banks, friends and relatives. The rates of interest of these loans were exorbitantly high ranging from 10% for loans from relatives and friends to 300% for loans from *Mahajans*. Apart from these farmers used other means to obtain funds. They are sale of poultry, sheep and goats, loans from neighbouring groceries (without interest), sale of gifts from marriage of sons/daughters, purchase of insecticides/pesticides on credit from local shops, sale of jewellery, sale of own labour, sale of fruits from own fruit-bearing trees, proceeds of trade in betel leaves and betel nuts and own rickshaw-pulling etc.

As regards usage of balance funds a total of 102 (i.e. 4.67%) of the borrowers possessed some balance of funds after completion of their purported activities. Of these farmers, 46 (i.e. 2.11%) spent their balance funds to meet various non-food household needs while 14 (i.e. 0.64%) purchased foodstuff for themselves and their household members. About 11 (i.e. 0.5%) of these borrowers invested their balance funds in various small businesses and 14 (i.e. 0.64%) spent their surplus funds for other purposes.

6. Loan Repayment Status

The borrowers who fully repaid their loans by the time of the survey constituted 92.20% of the total, while only 0.82% repaid their loans partially and the remaining borrowers had full outstanding loan amounts. Loan repayment of 92% of the borrowers within a period of less than a year is exceptional compared to the records of other commercial banks' agricultural loans. It deserves to be mentioned that the repayment of loans by the farmers have been voluntary and not due to pressure or under any obligatory influence.

Factors responsible for non-repayment of loans by a small percentage of farmers are due to consumption of the harvested crops by the household members, crop damage due to natural disasters, delay in crop sale in view of speculative prices and other reasons. Other reasons include purchase of cows, supporting daughters' marriages and unfavourable cash flow.

7. Impacts of Using Loans

7.1 Loan Repayment and Socio-Economic Impacts

In total, 1,619 (i.e.74.20%) of the 2,182 borrowers sold their harvested paddy after harvest. This is an indication of their subsistence level of economic status. Borrowers who had repaid their loans in full were 1,994 in number, about 23% higher than the number of borrowers who sold harvested paddy suggesting the fact that the farmers who fully repaid loans include other households earning income from other activities.

About 71.0% paddy-growing borrowers were able to sell their harvested crops within 30 days following the harvests while 91.60% were able to sell their paddy within 60 days of the harvest. The factors that contributed to the ability of farmers to grow and sell paddy is effective utilization of loan funds, timeliness of the disbursement of loans, specificity of purpose of the loans, precision in identification of borrowers and loyalty of the borrowers to Janata Bank. Some borrowers mentioned that the hope for receipt of future loans from the bank was one of the reasons that encouraged them to repay loans timely.

As to impacts on the household status a number of impacts were reported by the borrowers. The relevant information are given in Table 3. The most significant impact was the increase in household income of 91.06% of the total households followed by quantity of food consumed in 70.26% of the households. The other impacts were increase of quality of foods of 55.91% households.

Table 3: Economic Impacts (multiple responses) on Households

Type of Impact	Districts with Highest Impacts	Districts with Lowest Impacts	All districts*
Increase in HH Income	Barisal: 79 (100%), Gopalganj: 45 (100%) and Rangpur: 218 (100%)	Khulna: 37 (52.86%)	1987 (91.06%)
Increase in Food Intake	Satkhira: 188 (94.47%)	Bhola: 85 (40.48%)	1533 (70.26%)
Increase in Other Consumptions	Lalmonirhat: 57 (39.86%)	Madaripur, Nilphamari: (0%), Rangpur: 4 (1.83%)	351 (16.09%)
Increase of Better Quality Foods	Khulna: 70 (100%) followed by Satkhira 183 (91.96%)	Rangpur: 20 (9.17%)	1220 (55.91%)
Others	Gaibandha: 11 (4.64%)	Barisal, Gopalganj, Madaripur, Lalmonirhat and Nilphamari: Nil (0%)	44 (2.02%)

Note: Figures indicate number of farmers; figures in parentheses indicate percentage in total of the relevant district.

*Impacts of other districts which fall in between the highest and lowest impacts.

Socio-psychological impacts of loan use include ‘peaceful sleep without tension regarding repayment of the loans’, reported by 1,748 households (i.e. 80.11%). Learning transactions with banks (73.51%). In addition 78.23% households said that they had no more need to take loans at exorbitant rates of interest from the Mahajans. The borrowers reported their enhanced ability to pay children’s tuition fees, do house repairs, release of mortgaged lands etc. Coming to attitude of farmers towards future loan on interest, as low as 59 (i.e. 2.73%) said that they would not be willing to receive any loan on interest, while only one farmer of the total 2,182 mentioned that he would be ready to borrow such loans at a rate of interest as high as 11% per annum. The largest number of borrowers, 586 (27%) quoted a rate of interest of 2% per annum as their choice. However, only 18 of the total 2,182 were unable to assess at what specific rate of interest they would avail such loans in future. Thus it transpires that fixation of the annual rate of interest on similar loans in future for the same type of borrowers at about 4% per annum may allow loan disbursement to as many as 800 (i.e. 38%) of the relevant farmers.

8. Concluding Observations

Janata Bank's special program of interest-free and collateral-free loan to landless and marginal farmers deserves special attention. The programme can be termed 'successful' in view of full repayment rate of loan of 93% and appreciable economic impacts on the farmers: increase in household income, food intake, better quality foods and other consumables. Similarly there have been credible benefits as regards some socio-psychological elements of the households including peaceful sleep, learning bank transaction procedures etc.

The success of the programme owes to the loan management programme of Janata Bank which includes targeting the beneficiaries, mechanism of selecting the targeted farmers, deciding the size of the loan, procedure of loan disbursement, etc. The example set by the Janata Bank is replicable and sustainable. Other banks may follow suit in the greater interest of eradicating poverty of the marginal and landless farmers. In this regard, there is a need for the Bangladesh Bank to establish a mechanism to support this type of activities. Bangladesh Bank may take the lessons of Janata Bank programme to the institutions engaged in microcredit projects and programmes.[1]

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[1] Bangladesh Bank has, in the meanwhile, approved such programme for the state-owned and specialised banks to be implemented in line with Janata Bank's approach. For reference please see minutes of Bangladesh Bank Monthly Meeting held on November 22, 2014 regarding "Development Activities under Agricultural Loan Disversment, Realisation and Agricultural Loan Policies of the State-owned and Specialised Banks."

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Recent Trends in the Global Securities Market

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Abstract The sovereign debt crisis in the euro zone countries produced long-term repercussions for the financial markets, particularly in the bond market. Both the sovereign debt market and the corporate debt market– the two principal segments of the debt market underwent structural changes. Yields on sovereign bonds of some of the strong euro zone countries such as Germany and Switzerland declined sharply and even turned negative. And bond yield spreads of trouble-torn countries relative to stronger economies widened substantially. Global investors, especially of international institutions moved largely to emerging Asian countries. In its wake, Asian countries experienced price inflation and asset bubbles that prompted tightening of monetary policy. Some forward guidance about the direction of interest rates in US, UK also helped capital outflows to Asia and other emerging countries. It can be mentioned that the corporate bond market especially in US offered good returns to investors belying the estimates. The debt market is expected to retain its dominant position in the world financial market in the years ahead.

Keywords Asset Bubble, Sovereign Debt, Yield Spread, Debt Market, Bond Market

1. Introduction

The global financial crisis, especially the euro zone crisis originated in Greece inflicted many casualties. The global bond market also bore the brunt of the crisis. Development in the bond market tends to produce repercussions not only for the financial market, but also for real economy. A robust, liquid and active bond market is productive in a number of ways. The most important role a bond market plays is the financing of budget deficits. For almost all the countries in the world, budget deficit is a common phenomenon. Bond market, particularly Government bond market, helps government to finance deficit and keep economies moving. On the other hand, a thriving corporate bond

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market makes it possible for companies to mobilise funds to finance operations. From the stand point of investment, bond market helps investment diversification in the context of risk-reward trade-off. Theoretically, most bonds have limited potential or scope for capital appreciation but if they are well chosen, they provide a steady flow of cash. And if the worst happens and a company fails or goes bankrupt, bondholders get paid before the shareholders who are sometimes left with nothing at all. The bond market thus serves useful purposes for governments, individuals, investors, borrowers and a sound bond market is most desirable in any economy.

The debt market which has long been viewed as comparatively stable market underwent uneasy periods witnessing bubble in the past few years. Several factors caused the debt bubble. Firstly, there was huge accumulation of reserves by a number of countries, particularly the oil and commodity exporting countries due to boom in the oil and commodities market earlier caused global imbalance of reserves. Secondly, the low level of nominal and real interest rates worldwide pushed investors to search for yields by investing in high yield securities which were perceived to be safe. Thirdly, the accommodative and expansionary monetary policies notably in the United States exacerbated the asset bubble including the debt market. In view of the predominant significance of bond and debt markets in the financial markets and the real economy, this study is concerned with examination of these markets in the recent past keeping in view the financial crises. The study is based on secondary data.

2. The Bond and Debt Markets

2.1 The Bond Market

The USA has been the largest and dominant actor in the global debt market. It is also regarded as the most liquid debt market in the world. Of all the various types of debt securities issued by US, treasury securities are, by far, the most popular with foreign governments. The fact that the US dollar as a reserve currency accounts for almost 60% of the global financial transactions make the treasury securities appealing to investors. Further, the relative decline in the issuance of high quality credit instruments and the need to recapitalize balance sheets continue to make treasuries an attractive asset class. Yields on US treasury securities are the virtual benchmarks for interest rate fixation and global yield trends. As of June, 2012, the amount of treasury securities outstanding stood at USD 15.8 trillion out of which foreigners, mostly governments, held 33.5%, i.e. USD 5.3 trillion. US government trust funds held USD 4.8 trillion worth of treasury securities. Positions of treasury securities owned by top ten foreign investors as of June, 2012 are as Table 1.

Table 1: Country-wise Treasury Securities of Top Ten Investors in 2012

Country	Treasuries Owned (in USD)	Per cent of the Total Debt
Peoples Republic of China	1.15 trillion	7.2
Japan	1.13 trillion	7.1
OPEC Nations	267 billion	1.7
Brazil	251 billion	1.6
Caribbean Banking Centers	240 billion	1.5
Taiwan	200 billion	1.3
Switzerland	196 billion	1.2
Russia	163 billion	1.0
Luxemburg	148 billion	0.9
Hong Kong	136 billion	0.9

Source: US Department of Treasury.

Though China is the largest foreign holder owning USD 1.15 trillion worth treasury securities, Japan owns almost as much, USD 1.13 trillion. In the near future, Japan is most likely to surpass China as the largest holder of treasuries as China's holding has been declining recently. In May, 2011, China's holding amounted to USD 1.31 trillion. This appears quite logical as China is allowing its currency to slowly appreciate against dollar. Nevertheless, US treasuries continue to capture the status of safest debt securities.

2.2 The Debt Market

The debt market is mainly divided in two principal segments— sovereign debt market and corporate debt market. Lessons of debt market reveal that generally sovereign debts, i.e. government debts precede corporate debt market growth. Sovereign debts with its perceived safety and liquidity create the conditions for expansion of the corporate debt market as the investors gradually come to terms with the workings of the market.

Traditionally, the debt market is largely dominated by the US which accounted for about 40% to 43% of global debt market. As on March, 2012, the size of the global debt market was nearly USD 100 trillion. Domestic bonds accounted for 70% of the total while about 30% was accounted for by international bonds. Japan was the second largest market constituting about 14%. World debt market attained phenomenal growth in the recent times. As a percentage of GDP, debt market was 80% a decade ago, 119% in 2008 and 140% in 2011. In March, 2012, the global debt market of USD 100 trillion was much higher than the USD 53 trillion global equity market, as measured by market capitalization. A market as big as this intensely is monitored by big institutions, high net worth individuals and central banks and by governments. At the same time, the bond market is very reactive to changes in interest rate, both actual and anticipated, as well as to inflationary expectations. Rise in inflation or increase in inflationary expectations impact bond prices and yield substantially. Yield curves enjoy high consideration in monetary policies and public finances.

3. Development of Bond and Debt markets

3.1 Debt Crisis: Origin and Developments

Almost a decade ago, government bonds in Europe and US were universally regarded as safe assets and unmatched by any other asset class. Further, bond market, because of its lead role in deficit financing and, of its influence on macroeconomic policies was regarded as capable of forcing the governments to adopt important policy changes. However, this situation has changed quite dramatically. The deterioration in economic and financial conditions in US and Europe resulted in a persistent financial crisis which, in turn, has unleashed a debt crisis with lasting repercussions. The escalating public debt as per cent of GDP led to significant fiscal imbalances. The aggregate budget of the euro zone countries which was almost balanced in 2,000 turned into a deficit of about 6% in 2010. Further, the Euro zone's debt stood at more than 85% of GDP in 2010. On average total debt stood at more than 400 per cent of GDP recently in the 11 developed economies – US, UK, Germany, Japan, Italy, France, Canada, Greece, Spain, Portugal, and Ireland. The debt crisis in Europe was the result of the bloc's inability to repay the debts piled up in the past decade. The global economy has been vulnerable with weak growth since the financial crisis of 2007-2008 in US. Some European countries notably, Greece, Portugal, Ireland, Italy and Spain could not achieve the growth rate needed to repay the massive amount of debt they owed to the creditors.

The sovereign debt crisis which originated in Greece spread to Spain, Italy and Portugal, and even Cyprus. The Euro zone countries grappled with the crisis and found no credible and implementable solutions. For these countries (Greece, Spain, Portugal, Italy) the bond yield i. e. the cost of borrowing went up steeply putting further strains on public finance. In a couple of occasions, the auction of sovereign bonds failed to attract desired demand. The spectra of exit of Greece from Euro zone aggravated the adverse situation as exit from the Euro zone could create, what is called, denomination risk. For example, if Greece would abandon the common currency, the euro, the value of Greek currency could erode drastically so that bank deposits and other reserves, denominated in Greek currency may experience drastic fall in value. These could prompt flight of deposits and capital to other relatively strong economies, e.g. Germany and perhaps France.

3.2 Bond Market: Structural Change

Bond yield of some other stable euro zone countries declined considerably highlighting investors' concern for safety of investments. In fact, yields of some countries turned negative for the first time in 20 years. Two-year government bond yields were negative in July, 2012 in six European countries – Switzerland, Denmark, Germany, the Netherlands, Finland and Austria. Movement of two-year bond yields, shown below in Table 2, of the strong euro zone countries in the last five years further demonstrate the investors' rush for safe assets.

Table 2: Movement Two Year Bond Yield in Selected Countries

(Figures are percentages)

Country	2008	2009	2010	2011	2012
Germany	3.9	1.6	1.6	1.6	0.1
Finland	4.1	4.5	1.0	1.3	0.1
Switzerland	2.0	1.5	1.4	0.3	(-) 0.3
Denmark	5.0	2.9	1.5	1.9	(-) 0.2

Source: Wall Street Journal– Market Data Centre.

Negative or low bond yields are a reflection of investors' eagerness to pay to the borrowers for safekeeping of their money. The negative or low bond yields tend to upset the long established lender-borrower relationship. Positive change in ten-year bond yield spread provides an alternative asset to safeguard money. These happened in the case of Spain and Italy. From January, 2012 to November, 2012, ten-year bond yields of Spain rose from 2.1% to 5.8%. In the same period, Italy's ten-year bond yield rose from 2.2% to 3.9%. Long term high quality bond attracted investors away from the rather short term volatile bonds. Outside Europe, the divergence between safe and risky assets has widened. This is shown in the following Table 3.

Table 3: Interest Rate, Yield and Yield Spread of US and Some Euro Zone Countries

Coupon (%)	Country/ Maturity (years)	Latest 17.12.12	Yield (%)		Spread Vis-a-Vis US Treasuries (in basis point)	
			Month ago	Year ago	Latest	A year ago
	US					
0.250	2	0.258	0.246	0.234		
0.875	5	0.734	0.610	0.809		
2.000	10	1.772	1.580	1.855		
	UK					
2.250	2	0.341	0.256	0.317	8.30	80.30
1.750	5	0.876	0.757	0.886	14.20	7.70
4.000	10	1.883	1.733	2.037	11.10	18.10
	France					
2.500	2	0.041	0.116	0.863	(-)21.70	63.00
0.750	5	0.492	0.629	1.952	(-)24.20	114.30
3.250	10	1.885	1.960	3.056	11.30	120.10
	Germany					
0.250	2	0.002	(-)0.041	0.219	(-)25.60	(-) 1.50
0.750	5	0.361	0.280	0.808	(-)37.30	(-)0.10
1.750	10	1.371	1.334	1.844	(-)40.10	(-)1.10
	Spain					
6.750	2	2.864	3.227	3.380	260.60	314.60
3.000	5	4.236	4.693	4.386	350.20	357.70
3.500	10	5.420	5.863	5.258	364.80	340.20
	Italy					
3.000	2	1.998	2.243	5.235	174.00	500.10
4.750	5	3.342	3.577	6.074	260.80	526.50
5.000	10	4.517	4.815	6.437	274.50	458.20
	Portugal					
5.450	2	3.260	5.349	15.360	300.20	1512.30
4.200	5	5.250	7.586	15.331	451.60	1452.30
3.850	10	7.005	8.662	12.183	523.30	1032.80

Source: Wall Street Journal Market Data Centre, various issues.

The table above reveals that government bond yields for Spain, Italy and Portugal were quite high in the third week of December, 2012 contrasted with those of Germany, France, UK and USA. Yield spread relative to US treasuries was very high in December, 2011 for Spain, Italy and Portugal. The data also show upward yield curve for UK, Germany, France and Italy. The long-term interest rates are lower than short-term rates in case of Spain and Portugal apparently because the investors generally shunned the long-term securities of these two countries suffering from deep economic problems. Large scale sale by investors of long-term securities of Spain, Portugal and Greece also contributed to the decline in demand and accompanied rise in yields. The yield position of US treasuries is the manifestation of the fact that US Fed's efforts to bring down long-term interest rates were largely fruitful.

A rough and inconclusive classification of safe assets includes sovereign debts (with debt rating above A/BBB), investment grade corporate debts, and gold as well as highly rated securitizations and covered bonds. The IMF estimates that there are about USD 75-80 trillion of such safe assets today. But this scenario is changing fast. Before 2007-2008, when the US housing bubble burst, about 70% of the sovereign debt for the world's most advanced countries was assigned – AAA rating. But recently this rating has been applied for only 50% of these countries, a decline which affected roughly USD 15 trillion in 'safe assets'. According to one forecast, more than a dozen countries could be excluded from the class of safe assets. It further observed that by 2016, the total pool of 'safe assets' might be reduced by above USD 9 trillion. US and Japanese bond yields continue to reach lows though both these countries have very high level of public debt. In case of US, noted earlier, treasuries are considered a highly liquid instrument. There also appears to be general perception that US treasury securities have low probability of default because its status as reserve currency and the 'Federal Reserve Board's money printing authority. Another reason is the maturity structure of the treasury debt. A large portion US debt is in treasury notes which mature from one to ten years. In recent years, the average maturity has been more than five years implying that US is rolling one-fifth of debt every year giving it much more flexibility. The central banks of the major countries responded to the financial crisis by engaging in multiple rounds of large scale asset purchase programs typically financed with creation of excess reserves.

4. Performance of Bond Market

4.1 Performance in 2011

Bond market performance in the year 2011 was substantially influenced by the adverse position of the world economy. The near-zero interest policy of the US Fed unleashed renewed interest in high-risk, high yield bonds and other debt securities at different stages in 2011, but this development was over-shadowed by the far-reaching implications of the European debt crisis. The US economy started to slow down from April-May, 2011. European debt crisis persisted with new dimensions. These dominant factors forced investors to take refuge to the relatively safe assets i.e. US treasuries. This 'flight to quality' led to sharp decline in the yield on the 10 year treasuries to 1.70%, lowest in the year in September from 3.31%-3.50% in the first quarter. Yields on treasuries with maturities of five years and less plunged below 1% in the last quarter. Paradoxically, the popularity of the treasuries occurred at a time when Standard & Poor's downgraded US credit rating in August. Again, this reflected investors' confidence in the commanding position of the US economy and in its ability to weather economic storm at least in the near future. It is a further reflection of investors' deep concern about the direction of the European countries' economies as the debt crisis raged on and their high preference for safe investments. Corporate bonds, high yield bonds and EMBs did fairly well in 2011.

4.2 Performance in 2012

Global bond markets generated good returns for the investors with major asset classes performing quite well. Review by Barclays Aggregate US Bond Index reveal that investment grade bonds registered the eighteenth years of gain. As stated earlier the policy of drastically low interest rates adopted by US and other major countries which lowered yields and raised prices of short-term securities and government bonds influenced the bond market in 2012. The low yields on safer government bonds drove investors to look for alternatives in the higher-yielding but higher risk securities as sought by the central banks in these countries. The bond market's performance was also aided by weak global growth, featuring sluggish economic performance in the US, the advent of recession in Europe and Japan and brake in growth in China. These factors made investors believe that the major countries' central banks would not be in a position to raise interest rates in the near future. The Fed even pledged that it would not hike interest rates until 2015. Despite persistent crisis, growth in the US, though subdued, was in positive territory indicating strength of the US economy and of the good financial positions of the issuers of debt securities. This environment was propitious for the bond market as investors was enthusiastic about US bonds and treasuries.

Emerging Market Bonds EMBs turned out to be the top performer in 2012. Comparatively better economic and financial position, benign macroeconomic scenario, impressive GDP growth, attractive yields created conducive conditions for EMBs. Bond performance in 2012, as measured by returns of main bond Exchange-Traded Funds (ETF), shows that returns on EMBs was 16.40% compared to lower returns on some other bonds like investment grade US bonds (3.62%), corporate bonds (10.61%), high yield bonds (10.84%) and international government bonds (6.36%). EM sovereign debts witnessed extraordinarily successful year with record inflows of money into EM debt funds. Even debt issues by frontier markets received huge over-subscription. Investors' hunt for higher yielding investments and assets was also blessings for emerging market corporate bonds. One important reason of brisk movement in emerging market corporate bond had been the strengthening of the risk-reward relationship pertaining to these bonds. Investors sought higher premium for EM companies (more risky) than for counterparts in US. Accordingly, EM companies generally offered better yields than the yields delivered by US companies. These sometimes created forceful and tempting yield opportunities for long-term investors and for those who were able to assume higher risk and enhanced volatility.

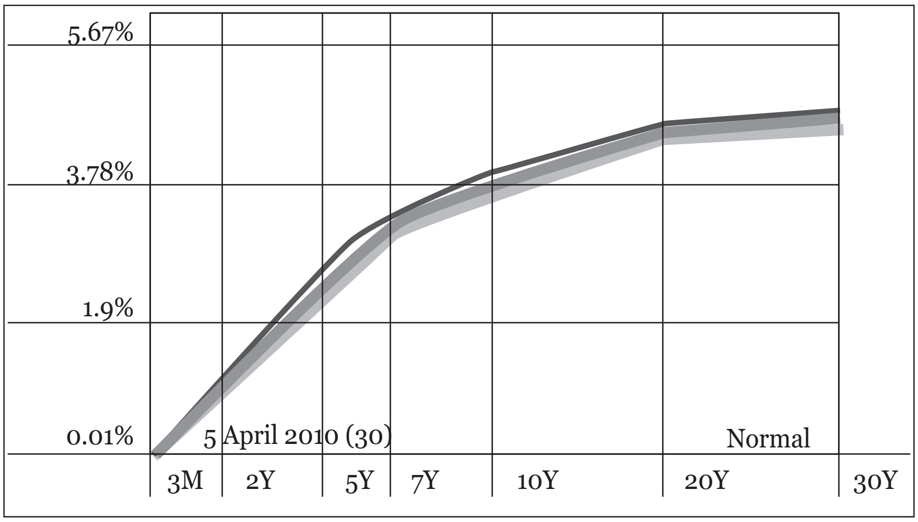
Corporate bonds yielded excellent returns in 2012 (10.61%). These bonds generated much more returns than government bonds offering very little returns. Another reason was that, though modest, earnings of US companies beat estimates on average. Further, in developed countries, particularly in US, companies accumulated record amount of cash signifying comforts in payments to bond holders instilling confidence in corporate bonds. The declaration by Fed to maintain very low interest rates for at least another two years made the higher rated bonds more rewarding. Investors were compensated reasonably well for taking higher risk. Global bond market's redeeming feature was restoration of risk appetite of the investors at the fag end of 2012. High-risk bonds and other debt securities benefitted from this trend. The consequence this was salutary to overall investment activity.

5. Quantitative Easing and Operation Twist

In the backdrop of financial crisis beginning with the sub-prime mortgage crisis in USA in 2007-2008, the Fed launched a non-conventional monetary tool called Quantitative Easing (QE) in November. It involves purchase by the US central bank, the Federal Reserve Board (Fed) of debt securities primarily, US treasury notes and Mortgage Backed Securities (MBS). The Fed issues credit to buy the bonds. The credit to buy the bonds has the same effect as printing money. QE's target is to push down the mortgage interest rates and supply liquidity to the mortgage market providing banks and other financial institutions a greater incentive to provide loans as loans were almost frozen after the crisis. But, because of credit creation, the balance sheet of the Fed increases significantly. Through the QE, the Fed has been buying the treasuries auctioned by the US federal government increasing demand for the securities. And as demand goes up, yields go down because price of treasuries increase. Treasury yields being the basis of all long-term interest rates help maintain a low interest rate regime particularly for long-term securities thereby accelerating economic growth.

The first round of QE was launched on November 26, 2008. The Fed began purchasing USD 600 billion in MBS and USD 100 billion in other debts. The Fed slashed its Fed funds rate (overnight interest rate) and its discount rate to near zero. The Fed even started paying interest to banks for their reserve requirements. But results of all these expansionary monetary policies did not match expectations. Banks and financial institutions were not providing loans to the extent Fed wanted, on the plea that there were very few companies and individuals eligible for loans. The Fed halted this program temporarily as the economy was showing signs of recovery. But, after two month as the economy slowed down, the Fed renewed QE. When the QE1 ended in the first quarter of 2010, it had purchased MBS of USD 1.25 trillion and other debt securities of USD 175 billion. In the month of November, 2012, the Fed made public its decision to expand QE, i.e. second round buying of USD 600 billion of treasury securities by the end of second quarter of 2011. The QE2 was carried out for seven months from November, 2010 to June, 2011. In QE2 the Fed bought securities from the banks to provide liquidity to them. The Fed launched the third round of QE on September 13, 2012. It was set to expand its QE operations by purchasing long-term bonds amounting to USD 85 billion a month until employment falls to 6.5%. In between, the Fed launched Operation Twist (OT) in September, 2011. Under OT, the Fed sold short-term securities of USD 45 billion each month and utilized the proceeds to buy long-term securities of equivalent amount. OT was aimed at twisting the normal upward sloping yield curve and at minimizing the difference between long-term and short-term securities. The ideas are that the sale of short-term securities would depress the price of such securities and push up the yield (interest rate) while on the other hand, the purchase of long-term securities would generate demand for such securities and increase the price and reduce the yield. The fall in long-term securities yield would pave the way for lower long-term interest rates in the economy, spurring economic growth by encouraging consumption. The strategy was to transfer capital from investors and lenders to consumers. It was thought that moving money from investors to consumers and into risky assets may enthuse demand and consumption leading to wealth effect. Operation twist which expired on 31st December achieved mixed results. The Fed almost exhausted its holdings of short-term securities, making the short-term and long-term securities swap ineffectual. But as the economy was still to gather pace, the Fed announced in September, 2012 to purchase USD 85 billion of bonds every month. In effect, the Fed would maintain the USD 40 billion per month purchase of MBS and add another USD 40 billion in treasuries.

It is of interest to see the outcome on yield curve owing to the non-conventional monetary policies. It can be seen in the curve below that US treasury yield turned flatter at the long end of maturity.



Source: Choudhury, 2003.

Figure 1: Yield of US Treasury over Maturity

The yield on long-term treasury securities have been pulled down by QE and OT signifying that the Fed's goal has been achieved, even if partially. Not only the US Fed, but central banks in UK and Japan also resorted to liquidity enhancing programmes to buttress their economies. The Bank of England, embarked on asset purchase programmes totaling GBP 375 billion. The European Central Bank (ECB) initiated purchases of up to EUR 60 billion (almost USD 80 billion). In October, 2010, the Bank of Japan unveiled a JPY 5 trillion asset purchase programme. This programme was revised a number of times and stood at JPY 76 trillion (USD 906 billion) in December, 2012. As a result of increased globalization and integration of financial markets, the QE, OT and other asset purchase programmes resulting in very low or near zero interest rate had somewhat uneasy implications for emerging and developing countries. Institutional and large investors borrowed fund in the countries with low or negative yield and perked the money in developing and emerging countries. There have been significant capital outflows from US to emerging countries in the last two years.

This trend contributed to pressures on price inflation and asset inflation and to unwarranted and untimely surge in liquidity and misallocation of capital particularly in developing countries. For this reason, these countries resorted to tightening of monetary policies. For the developed countries wrestling with financial, the unconventional monetary tools like QE and OT and the asset purchase programmes created conditions to avoid or postpone reforms in crucial areas necessary to receive bail-out and rescue packages to get out of the woods. However, despite apprehension, QE did not give rise to inflation chiefly because credit flow did not increase as lending institutions were shy to extend credit on the plea of lack of eligible proposals. But there had been rise in inflationary expectations. The spread between yield on normal debt securities and US Treasury Inflation Protected Securities (TIPS) attests to this behavior. To a certain degree, increase in inflationary expectations is desirable because people are driven to consume more at the present times fearing rise in consumer prices later.

The average interest rates have remained historically low for the last few years in US and some large Euro Zone countries. This low interest regime may consequently come to a halt in the near future for a number of reasons. If interest rates are raised and if consequently there are signs of inflationary trend, GDP growth in US and other Euro Zone countries go up, and US dollar vis-á-vis other major currencies appreciate. Such increase in interest rates will generate losses for the existing holders of debt securities as prices of existing securities, in all probability, will plummet with investors moving to debt instruments carrying higher interest rates. It is important to state here that in 1994 debt holders incurred huge losses when US Fed raised interest rates.

6. Conclusion

The debt market, more specifically the bond market, plays a very crucial role in financial market deepening. Cross country evidences show that strong bond markets help investors to balance their investment portfolios by blending bonds with equities and other securities. Generally, when equities remain sluggish for a long time, bonds provide the much needed cushion.

A healthy bond market offers a number of benefits. First, it reduces the dependence on bank loans as issuers can raise required funds by offering bonds in sync with equities in keeping with debt – equity structure. Second, public issue of bonds involves more scrutiny of the issuers at different stages leading to more transparency and disclosure. Third, an active secondary bond market allows banks to exit their direct bank loans, if needed. Fourth, a buoyant domestic bond market paves the way for accessing the global bond market.

In Bangladesh, bank loans and other institutional term loans overwhelmingly dominate the debt market. The primary market for bond is insignificant, let alone secondary market for bonds. Earlier attempts to develop a bond market in Bangladesh were not fruitful. But Bangladesh needs to have a vibrant bond market at the earliest.

Issue of particularly convertible bonds by sound government entities can greatly promote the bond market. Issue of bonds by private companies is likely to follow suit.

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Insider Trading: An Obstacle to the Development of Stock Market

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Abstract This study attempts to look into the nature of insider trading and its detrimental effects on the stock market. It is found that price, dividend, EPS, and right issues are the major parameters that are used by the insiders to disseminate inside rumour-based information to exploit investors. About 44 per cent investors think that market gets volatile due to insider trading and nearly 30 per cent lose confidence over the market. Company directors, employees, Bangladesh Securities and Exchange Commission officials and Dhaka Stock Exchange officials and security houses are mostly responsible for these unethical practices. Stock market development can be ensured by enacting stringent insider trading laws and their enforcement.

Keywords Insider Trading, Right Issue, Dividend Declaration, Volatility, Syndication

1. Introduction

For economic development, a well functioning stock market is extremely important as it facilitates long term financing for such important sectors as infrastructure, housing and private sector development. Interest of investors can be protected if the stock market is developed such that it ensures free flow of information, investors' confidence and stability of stock market and termination of insider trading. Insider trading reduces the investors' confidence and creates disadvantageous condition for them. Persons having access to undisclosed price sensitive information about listed companies can use the information to manipulate share prices. It causes some investors to even withdraw from the market because of the perception that only the insiders can get profit from

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market transactions. If the extent of market withdrawal is wide scale, the market will get illiquid and inefficient.

Over the last few years, the capital market of Bangladesh has witnessed significant growth. Yet there is lack of efficient regulation over the securities market for which the healthy development of the securities market is not in sight. Insider trading is rampant causing a situation of asymmetric information. Consequently, outsiders follow the insiders in buying and selling shares. As such dividend announcement does not convey meaningful guide and shareholders are misled. In this backdrop the Securities Exchange Commission felt the need of stricter 'insider trading' rules. This circumstances warrant examination of the nature of insider and insider trading in Bangladesh. In doing do it is important to point to the detrimental effects of such practices to the stock market and then to give some hints of policy implications.

The rest of the paper has been organized as follows: Section 2 describes the methodology employed. Section 3 presents the concept of insider trading while Section 4 deals with global practices to combat insider trading while Section 5 presents Bangladesh scenario. Section 6 discusses the injurious side of insider trading. Finally Section 7 presents the conclusion.

2. Methodology

The study is mainly based on secondary information. Also primary data collected by a sample survey with the help of a structured questionnaire are used. The questionnaire was designed to get views of investors, numbering 630, selected by random sampling method. Besides, views of stakeholders particularly executives of Dhaka Stock Exchange and experts were taken by purposive sampling technique.

3. Concept of Insider Trading

The concept 'insider trading' employed in business ethics has broad meaning. It includes anyone's ability to make deals based on not yet publicized knowledge of business opportunities. Insider trading is the trading of a corporation's stock or other securities e.g. bonds or stock options etc. by persons with potential access to non-public information about the company. Persons having unpublished price sensitive information regarding a company can purchase, sale or otherwise transfer company's share on the basis of that information for yielding a chunk profit. Generally the following form the issues/matters of inside information concerning a company.

- Half-yearly or yearly profit and loss condition.

- Declaration of dividend such as interim dividend, final dividend etc.
- Issuance of right share, bonus share, preference share etc.
- Merger, takeover, amalgamation etc.
- Any major expansion plan.
- Any information which may affect the earnings of the company.
- Changes in policies, plans or operations of the company.

Very few persons like members of the Board of Directors, high officials and auditors have access to the information before making available for general public. But some intruders, making these confidential inside information available to them, reap profit or avoid losses on stock market. Thus the level playing field is lost and the general investors who buy or sell their stock without having the benefit of inside information become losers.

An insider can be defined thus as one who is in possession of inside information before public release are considered insiders. A corporate insider is someone who is privy to information that has yet to be released to the public. A person is liable for insider trading when he or she has acted on privileged knowledge in the attempt to make a profit. In the United States and many other jurisdictions, 'insiders' are not just limited to corporate officials and major shareholders where illegal insider trading takes place but can include any individual who trades shares based on undisclosed information in violation of the duty of trust. The SEC of USA has outlined three nonexclusive instances that call for a duty of trust or confidentiality which are:

- When a person expresses his or her agreement to maintain confidentiality.
- When history, pattern and/or practice show that a relationship has mutual confidentiality.
- When a person hears information from a spouse, parent, child or sibling.

Trades made by these types of insiders in the company's own stock based on undisclosed information are considered fraudulent since the insiders are violating the trust or the fiduciary duty that they own to shareholders.

The European Community Directives on Insider Trading contains a more comprehensive definition of an 'insider'. According to the directives, an insider is one:

- Who possesses inside information by virtue of this membership of the administrative, management or supervisory bodies of the issuer;

- Who possesses inside information by virtue of his holding in the capital of the issuer;
- Who possesses inside information because he has access to it by virtue of the exercise of his employment, profession or duties;
- Who, with full knowledge of the facts, possesses inside information, the direct or indirect source of which should not be other than a person belonging to one of the above categories.

The Securities and Exchange Board of India (SEBI) provides an yet wide notion which defines an insider as any entity who has received or has accessed to unpublished or unknown price information.

Thus two types of insiders can be distinguished. One, 'primary insiders' who are directly connected with unpublished information and two, 'secondary insiders' who are deemed to be connected with unpublished information.

4. Global Practices to Combat Insider Trading

Among the countries of the world that undertook policies to curb insider trading, the USA stands out to be one that deserves special mention because it was the first country to enact a statute that especifically dealt with securities. The Securities Exchange Act 1934 had been suitably amended time to time to provide statutory protection against insider trading. The Securities Exchange Act prohibits short swing profits (from any purchases and sales within any six month period) made by corporate directors, officers or stock holders owning more than 10% of a company's shares. It also sets forth to prohibit fraud related to securities trading. It also prohibits misrepresentations and other "fraudulent, deceptive, or manipulative acts or practices" in connection with tender offers. The Insider Trading Sanctions Act of 1984 and the Insider Trading and Securities Fraud Enforcement Act of 1988 provide for penalties for illegal insider trading to be as high as three times the gains or loss achieved from the illegal trading. The Securities and Exchange Commission of New York keeps a close watch on the functioning of the corporate sector as well as the stock markets. The Commission is empowered to impose heavy financial penalties for such wrong doings. Likewise, the Racketeer Influenced and Corrupt Organizations Act (RICO) has often been used to prosecute insider-trading violations.

After the USA, the case of the United Kingdom which has largest number of enactments to regulate both stock market and corporate sector is presented. There are four important legislations in this regard: The Company Act, the Companies Securities (insider dealings) Act, the

Financial Security Act, and the Prevention of Fraud (investment) Act. The various Acts deal with the prevention of insider trading and provides for imposition of various punishments such as fine, imprisonment etc.

Australia has one of the broadest prohibitions of insider trading in financial product in the world. The Corporations Act 2001 prohibits insider trading or procuring trading, or communicating that information where trading is likely to take place. Insider trading prohibition cover financial products like options over unissued shares, derivatives, interests in a managed investment scheme, debentures, stocks or bonds issued or proposed to be issued by a government, superannuation products (other than prescribed products) or any other financial products that are traded on a financial market. Breach of the insider trading provisions is a serious criminal offence, carrying a maximum penalty of five years imprisonment as well as substantial fines and possible liability under the civil penalty provisions.

In India, insider trading is generally believed to be as rampant as any other malpractice in capital market. Markets do experience fluctuations in certain scripts because of insider trading. The Companies Act 1956 or the Securities Contracts (Regulation) Act did not provide for any punishment for indulging in these trading. These acts were passed almost fifty five years ago. But now there is a serious effort on the part of the Securities and Exchange Board of India (SEBI) to put a cap on these practices. First SEBI come out with a draft regulation on insider trading in December, 1991. The draft defines insider, unpublished price sensitive information, communication or counseling by insider investigation proceedings, prosecution and penalties. The Stock Exchange Board of India (SEBI), the statutory body authorized to prohibit insider trading was established by an act of parliament in 1992 "to protect the interest of investors in securities and promote the development of, and to regulate the securities markets and for matters connected therewith or incidental thereto."

In Bangladesh, generally in most of the cases price of shares goes beyond the normal expectation prior to the official declaration but just after declaration it goes down. One of the major reasons of such event is insider trading, i.e. information become available to some persons before it was made public (Ali and Chowdhury, 2010). The gravity of the situation can be gauged by the fact that the directors realized a profit of BDT 7,500 crore by selling their own holdings during July, 2009 to December, 2010 (Ahmed, 2011). It is very common in stock market in Bangladesh that the general investors buy shares at a rising market with little market analysis. For this, general investors become losers. To combat illegal insider trading the Securities and Exchange Commission formulated regulations defining "inside price sensitive information" and 'insider' and imposing restrictions. The commission also sanctioned penalties for supply of price sensitive information for insider trading.

5. Debilitating Effects

5.1 Effects to Market

It is important to know the significance of various factors the investors consider for making investment. The following table shows this information.

Table 1: Importance of Factors to Investors

Parameters	Investors' Views (%)
Earning per share	39.85
Dividend including cash & bonus	26.15
Net asset value	18.38
Price-earnings ratio	11.47
Right issue	4.13

Source: Survey.

Table 1 shows that about 40% investors consider earning per share as their first choice for making investment decision in a security followed by dividend declaration. Net asset value and price-earnings ratio occupy the third and fourth considerations while right issue is considered by a small percentage of investor's investment decision. Insiders seek opportunity to disseminate price sensitive information focusing the parameter which investors value most. Generally, insiders spread rumour-based information to the effect that price will increase to a certain amount or dividend will be declared at a certain higher rate, or a higher percentage of rights will be issued or a good profit will be achieved by the company. In most of the cases investors get deceived by price, dividend, right issue and EPS related rumours. Other studies also report such finding (Khaled et al, 2011; Ahmed, 2011). By spreading rumours, insiders sell their shares and reap huge profit.

Table 2 shows how the market is affected by insider trading. According to investors (43.94%), insider trading causes market volatility which gives rise to the opportunity of syndication. These have, according about to 29% investors, chain effects causing loss in market confidence. About 83% investors of Bangladesh opine that they will back out from trading if market confidence is lost. The statement of legislative report of the insider trading and Securities Fraud Enforcement Act 1988.

Table 2: Consequences of Insiders' Trading

Parameter	Investors views (%)
Volatility	44
Syndication	27
Loss of confidence	29

Source: Survey.

The small investors in particular will be reluctant to invest in the market if they feel it will be rigged against them. Thus the loss of market confidence will substantial and this in turn, will shrink the volume and liquidity of stock market. As the market becomes illiquid, cost of equity increases. Insiders sometimes delay information disclosure for the purpose of exploiting insider trading opportunities. In that case insiders withhold non-public price sensitive information, so that they can make profit from trading on the basis of the information. This practice, according to survey results, would result in delaying disclosure of material information which in turn would decrease market efficiency.

5.2 Effects to Companies

Insider trading is harmful for issuers and all listed companies in the market. A company's performance is ultimately measured by its share price, which is consistent with the objective of wealth maximization. As insiders try to manipulate the price, the company's performance indicators get distorted. About 82% management personnel think true performance is not reflected for insider trading. Our survey results indicate that insider trading affects the activities of listed firms in a number of ways: it create moral hazard; it leads to selection of riskier projects; it causes distrust among top management including entrepreneurs and the system of internal decision making process get badly affected. The net result is the loss of performance efficiency of the company.

5. Conclusion

Insider trading is a result of basic structural weakness of capital market where some investors have special access to information and also desire to make significant gains out of such information. Rules and regulations are not sufficient to control insider trading in Bangladesh. To address the issue several measures are necessary. There is a need that Securities and Exchange Commission form a surveillance committee to monitor the activities of all concerned. The Securities and Exchange Commission should have its own tribunals to prosecute the culprits within shortest possible time. The definition of insider should include anyone connected with the offence including officials of Securities and Exchange Commission. Penalties/punishments of the offence be severe. Lastly, there is a need of collective ingenuities: political will, administrative skill and a set of corporate and stock market ethics.

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A Commodity Exchange System for Bangladesh[1]

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Abstract In this study an investigation has been attempted to explore benefits and risks arising out of the operation of commodity future exchanges. A commodity exchange is simply a central place where sellers and buyers meet to transact in an organized fashion under certain clearly specified and transparent *rules of the game*. Although, in principle, any commo-dity fulfilling required conditions may be traded in a commodity future exchange, trading of limited number of commodities in the initial few years of its inceptions is desirable. More specifically, these are: For Bangladesh these would include potato, jute, spices and pulses, gold and silver. The choice is governed by the evidence of distress selling of goods like potato and jute, to encourage production via risk management (i.e. hedge) and discovering fair prices and linkage with global market. Experiences of other countries suggest that effective regulation over-seeing contract, monitoring actions of the actors, finding out innovative solutions are critical pre-requisite for success of a commodity future exchange. Furthermore, there is need of Specialized Regulatory Frame-work for successful operation of the commodity future exchange.

Keywords Commodity Exchange, Speculative Practice, Futures Market, Price Discovery, Hedging

1. Background and Objective

Agriculture and process food account for about 23 per cent of GDP employing around 54 per cent of total workforce and 64 per cent of rural workforce (BBS, 2011). Despite their important roles and contribution, these sectors have been beset with impediments such as low investment; poor state of rural market infrastructure; market imperfections; absence of risk minimizing instruments; fragmented markets; information

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asymmetry; inadequate technical know-how and financial resources of farming communities. These constraints resulted in incoherent supply responses, fluctuations of prices, unfair prices faced by the farmers, presence of large numbers of speculators driving a significant wedge between farm gate and retailers' prices, low productivity and exposed to risks adversely affecting the rural development, rural welfare and poverty situation. The adoption of a commodity future exchange appears an effective tool to address the above-mentioned impediments and hence may encourage the authorities to assess the feasibility of introducing such a system in Bangladesh.

The prime objective of the study is to assess the feasibility of introducing a commodity future exchange for Bangladesh on the basis of global experiences as well as on the socio-economic conditions prevailing in the country. The specific objectives are to identify the eligibility of commodities for the CES in Bangladesh; to critically assess the performance of the CES in other countries; to explore the long term effects of having the CES upon the economy at large; to identify the statutory regulator of the CES and the global practices of the same; and to suggest practical recommendations for Bangladesh.

The rest of the paper is composed of five sections. Methodology and data are described in Section 2. Section 3 presents the main features of a CES. Impacts of CES from the perspective of country experiences are presented in Section 4. Section 5 discusses the feasibility of a CES Bangladesh perspective. Recommendations are provided in Section 6.

2. Methodology and Data

The study is based on both primary and secondary information. Secondary information were obtained using two sources: extensive literature search via 'Internet' browsing and field visit to Multi-Commodity Exchange (MCX) in Mumbai by members of research and study monitoring team. The secondary information have been supplemented by information gathered from primary surveys and focused group discussions/interviews. The primary surveys were conducted to obtain information on value chains of two selected commodities – potato and jute – with a view to examining the possibility of introducing CES for these two types of commodities. Several factors were considered while selecting these two commodities for data collection: (i) seasonality and price variations; (ii) export (realized and potential) orientation; (iii) evidence of distress selling; and (iv) contrasting differences in the number of steps in value chain formation. Field surveys were conducted during September-October, 2008 with the help of structured pre-tested questionnaires. Around 500 respondents were interviewed during the field surveys. A separate structured questionnaire was also used to gather perceptions of the 'stakeholders' drawn from business communities, think-tank and research institutions, and academicians.

3. Understanding Basics of CES

A commodity exchange is simply a central place where sellers and buyers meet to transact in an organized fashion under certain clearly specified and transparent *rules of the game*. More elaborately, a CES is an organized market place where trade, with or without the physical commodities, is channeled through a single mechanism, allowing for maximum effective competition among buyers and sellers. The single market mechanism, which brings together the myriad buyers and sellers at any point in time, effectively results in the greatest concentration of trading for a given commodity. This market mechanism, such as a price bidding system or an auction system, results in what is known as "price discovery." The mechanism thus brings out the true market-clearing price for a good at a particular point in time due to the highest possible concentration and competition among buyers and sellers.

The major objectives of a CES are to bring together largest numbers of buyers and sellers of any product at any point in a time to allow maximum effective competition; to find out the true market-clearing price for a good at a particular point in a time via the highest possible concentration and competition among buyers and sellers; to remove the fundamental problem of achieving self-coordinating market order in the trade of agricultural products, which by their nature, are risky; and to increase market volume and liquidity and reduces risk via a low cost environment. Most CESs, even when they have a virtual or electronic trading system, operate in a physical place, with an exchange floor on which trading take places. A common misperception is that a CES establishes the prices of traded commodities. This is incorrect. Prices are determined solely by supply and demand conditions. If there are more buyers than sellers, prices will be forced up and vice versa. Thus, purchase and sale orders, which are channeled to the exchange floor for execution, are what actually determine prices.

CES operates under certain set of rules or conventions that are widely known. These rules pertain to four key dimensions of the market: (i) the product; (ii) its price determination; (iii) the actors, and (iv) the contractual relations that bind them. These rules and modalities together create much needed integrity and trust in the system. Although in principle, any commodity can be traded at the CES, primary commodities (e.g. storable commercial agricultural product as well as precious metals – gold, silver, copper, aluminium etc.) are usually traded.

Products traded on an exchange must be standardized according to some known standards of quality and quantity. The grading and certification of grade must be done by licensed inspectors who are qualified and regulated.

A CES operates a given system of price bidding that is aimed at publicly displaying purchase and sale offers in a transparent and low-cost manner. Some exchanges operate on the basis of an *open outcry* system in which market actors on the exchange floor cry out their bids and orders in a public fashion. Alternatively, an exchange may operate with an actual or a virtual "bulletin board" on which bids and offers are posted publicly. The key is that the price bidding is done openly rather than privately.

In order to ensure adherence to prescribed rules, exchanges operate with membership-based trading. The membership is based on the ability to comply with the rules of the exchange and to meet certain standards. The membership in an exchange is fixed to avoid chaos which may result if membership were continuously open to increasing numbers. In addition to an annual fee, the actual membership on an exchange floor is paid for with an initial price, much like a share, and can be bought or sold on the market. This ensures that members have a stake in the performance of the market and thus uphold its trust and integrity. Since membership is limited or fixed, how can an exchange then ensure participation of large numbers of buyers and sellers? This is ensured by the brokers. Brokers are the key set of actors in a CES who trade on behalf of an unlimited number of buyer and seller clients. The function of brokers is to advise their clients on buying or selling subject to the best market opportunities and information. Through such functions, brokers provide significant empowerment to market participants. Since they hold central roles, brokers must be specifically licensed and inspected in their function. The integrity of brokers is at the core of the integrity of the exchange itself.

Through its own functioning, according to the four dimensions noted above, the CES creates market information (i.e. data base) about the underlying supply and demand conditions in the economy for any particular commodity. Thus, contrary to popular perception, a CES does not require an external market information system as a pre-requisite to its proper functioning. A CES itself becomes the market information system as it undertakes its function of price discovery based on the public posting of buying and selling orders. When the volume of trade in a CES is sufficiently large enough to ensure the occurrence of true market fundamentals, it justifies price discovery and the dissemination of the information of market prices provides a great service to the market and to the wider economy. It is thus argued that this fact alone is a compelling reason to justify a CES.

A common misperception is that a warehouse receipt system is primarily a price stabilization system. On the contrary, first and foremost, it is a system of financing. Although the receipt is an important mechanism for farmers to reduce their cash constraint, it may also entail speculative activity by farmers, with high risk implications. The speculative activity emerges as the farmers who are receipt holders may take a position in the market with some judgment about the future direction of prices. This factor alone has led to the demise of many inventory credit schemes (e.g. due to the high risk associate with speculation, over the past few years the system reported to have collapsed across sub-Saharan Africa). To minimize the aforementioned risk, warehouse receipts can be made transferable, so that farmers can transfer the speculative risk through the sale of the receipts. Thus, through linking a receipt program to a commodity exchange, receipts can be traded on the CES and can enable the transfer of risk in an organized fashion. The chances of success for a warehouse receipts system are considerably higher if it is linked to a functioning exchange on which receipts can be traded.

A CES reduces transaction costs by facilitating effective contacts between buyers and sellers; enabling centralized grading of products; ensuring that contracts are enforceable; providing mechanism for price discovery; simplifying transactions with standard contracts; and transmitting information about prices and volumes. Moreover, a CES creates trust, order, and integrity in the market. It enables transfer of price risk. Furthermore, a CES provides a mechanism for increasing market liquidity; and it enhances market transparency through generating and disseminating information.

4. Impacts of CES: Review of Country Experiences

Impacts of commodity exchange system are assessed from a global and a country specific (Indian) perspective. The main focuses are on discussing the development impacts, recording performance and spread of the CES, highlighting pre-requisites of a successful CES; and pointing out some of the areas for concern.

4.1 Impacts of Commodity Exchange: Global Perspective

In order to examine the development impacts through fulfilling the functions of the commodity future exchanges a study, titled “Development Impacts of Commodity Futures Exchanges in Emerging Markets,” was conducted by UNCTAD. This was a comprehensive study covering

5 markets of emerging economies– Brazil, China, India, Malaysia and South Africa. The prime objective of the study was to identify, analyse and assess the impacts arising out of commodity future exchanges on economic growth, and poverty reduction with particular attention to the agricultural sector and small commodity producers– areas which lie at the heart of developmental concerns of the developing nations.

The aforementioned study provides a conceptual approach for identifying and assessing 81 developmental impacts of agricultural commodity futures exchanges by assembling them into a coherent framework of range of impacts. This study also identifies indicators and data sources – both quantitative and qualitative – for their measurement. Moreover, the impacts, that have occurred as a result of commodity futures contracts, have been assessed from both quantitative and qualitative perspectives. The impact assessments were carried out according to six broad functions. In total, 81 impact hypotheses were examined in the survey– 37 were specific or mainly for the farmer, and the rest 44 were for the wider commodity sector or for the overall economy. The results of the survey are summarized in Table 1.

Table 1: Summary Assessment of Development Indicators

Functions	Farmer Impact Identified	Other Impact Identified	Total Impacts Identified	Impacts featuring in only one country
Price Discovery	8	5	13	4
Price Risk Management	4	4	8	0
Venue for Investment				
Positive Impacts	1	6	7	1
Negative Impacts	1	2	3	0
Physical Trade Facilitation	4	9	13	4
Finance Facilitation	4	3	7	3
Market Development	9	9	18	5
Total Positive	30	36	66	17
Total Negative	1	2	3	0

Source: UNCTAD, 2007.

As mentioned in Table 1, the survey found positive responses for the 76 impacts hypotheses and negative for other five. Evidence to support 66 of 76 positive impact hypotheses was found in one or more of the featured markets. Out of the 66 positive hypotheses, 30 were farmer related and rest 36 associated to the wider community. However, 38 of these 66 hypotheses could not be quantified and were based on secondary information. Moreover, of the 66 positive hypotheses, 17 occurred in only of the markets under consideration. The survey findings thus suggest that all five exchanges generate positive impacts in the core functions of price discovery, price risk management and as a venue for investment. Each exchange offers liquid markets, a central counterparty to all but eliminate counterparty risk, market data that is freely and transparently disseminated, and futures markets that are well-correlated with spot markets to enable effective price risk management. The above findings tend to vindicate the positive contributions of commodity future exchanges on broad developmental goals adopted in the study.

According to UNCTAD (2006a: 3) report "75% of the 1.2 billion people living on less than USD 1 a day live and work in rural areas, about half of the world's hungry people are from smallholder farming communities, another 20 per cent are rural landless and about 10 per cent live in communities whose livelihoods depend on herding, fishing or forest resources." It has been further noted that "improving the productivity of small farmers has a ripple effect that spreads benefits throughout poor rural communities ... boosting the incomes of the rural population as a whole, including landless labourers who make up a large part of the population of the poor and hungry in many countries (FAO, 2004: 34)."

Although there is little disagreement on state of smallholders for rural development, it is less clear how to pursue this goal. The relevant question is – whether to encourage or de-emphasized the smallholder farming model. In the former case, the important task is to make small-farmers competitive in domestic as well as in international commodity markets (both markets have experienced significant structural changes in recent times). In the later case, the task is to find out the alternatives and the ways to pursue them. Acknowledging the strong arguments for both sides, a recent paper by IFPRI (Hazell et al, 2007) concludes that "the case for smallholder development as one of the main ways to reduce poverty remains compelling." The challenges are compelling both in production and marketing. Market liberalization and deregulation, the reduction and withdrawal of government support services and dominance over supply chains are some of the recent paradigm shifts in agricultural economy which led to corresponding impacts on the debate. Thus it is further argued that "the challenge is to improve the workings of markets for outputs, inputs, and financial services to overcome market failures. Meeting this challenge calls for innovations in institutions, for joint work between farmers, private companies, and NGOs, and for a new, more facilitating role for ministries of agriculture and other public agencies." (Hazell et al, 2007: ix)

In response to challenges to promote rural economy a number of models emerged. *First* is the organization or commercialization programme. In many countries, smallholder organization and commercialization programmes are being promoted as a means to boost productivity and competitiveness (e.g. the Ninth Malaysia Plan or the new law that came into force in July, 2007 promoting farmer cooperative development in China). Cooperatives are thought to bring greater scale that allow improved access to extension services, education, capacity-building, input supply, credit and other market mechanisms. *Second* type of models promotes diversification into non-farm activities. The OECD (OECD, 2007) is a strong proponent of this approach, arguing that "the long-term future for most semi-subsistence farming households lies outside agriculture, so there is a need for measures that facilitate income diversification and the exploitation of non-farm activities." One may cite Chinese experience where rapidly developed non-farm rural industries in the 1990s absorbed surplus rural labour leading to massive reduction in rural poverty. However, in most cases such models have exacerbated the rural income inequality thereby discounted full impact on poverty reduction. The *third* model is do nothing strategy. However, previous experiences envisages that no action would culminate unsustainable levels of rural unemployment, malnutrition and poverty forcing migration of rural people to urban areas creating spill over effects on urban infrastructure-unable to absorb a rapid flow of migrants. The *fourth* model is the reduction of transaction costs through commodity future exchanges. Small farmers typically face the steepest transaction costs when they want to participate in markets. This is driven by factors such as poor transportation, storage and communications infrastructure, a lack of access to information and expertise, and limited sources of financing based on a lack of collateral. It is argued that this predicament often compel such producers to subsistence livelihoods. "Through the innovative application of emerging information and communications technologies, commodity exchanges can catalyse the integration of small producers into supply chains. They can extend access to markets, imposing quality requirements as a precondition to trade, disseminating price informa-tion, efficiently managing collateral and providing a mechanism for the management of price risk." (UNCTAD, 2007: 15). Small farmers are not expected to participate directly in futures markets– at least, not until they build up the necessary knowledge, resources and capacity. Instead, dissemination of pricing and other market information, coupled with training of small farmers about how to use it, is one way of enhancing farmers' capacity and resilience.

As to the pre-requisites for successful commodity future exchanges high volume of transactions – 'liquidity' is the key indicator. Lack of liquidity, may allow movement of the market price relatively easily with a single transaction, thereby leaving it exposed to potential manipulation. Without liquidity, market participants (i.e. buyers and sellers) may not easily enter or exit from positions in the market due to a lack of available counterparties. In such conditions, participants may have to accept highly unfavourable prices. Liquidity is also a prerequisite for effective hedging (i.e. risk management), and hence for the participation of commodity sector agents/actors. Without liquidity, the future price for a commodity will not correlate with the underlying cash markets, and in these circumstances hedging would be ineffective and futile.

Shim (2006) investigated the conditions necessary for the success of commodity future exchange via case studies in seven countries across the developing world. Five of these have more or less established good levels of liquidity and the other two of which have not. The author concluded that: Macroeconomic stability and government regulations that are favourable to futures trading were almost prerequisites for successful local future exchanges. Meeting these preconditions, a contract that is significantly different from existing ones or with a large basis risk backed by a large physical market was an essential element for a new exchange to attract a viable level of liquidity. Even with all these set and subset of conditions, a market could fail if well-developed financial intermediaries were not present. Financial intermediaries are the distribution channels of future markets, and when these channels are blocked, the market extension is hard to accomplish (Shim, 2006: 46).

It is important to know the spread and performance of the commodity exchange system. Following the speed of market liberalization across the globe, emerging exchanges are rapidly growing in developing or transition countries to fill the gap left by marketing boards and fixed price systems. There are currently more than 100 of these exchanges across developing countries: 28 in Latin America (15 of them in Brazil), more than 20 in Asia, 3 in Africa, 4 in Eastern Europe, and several in Russia. Most of these exchanges have been created since 1992. Among the South Asian countries it is being operated in India, Pakistan and Nepal. Measured by contract volumes, 9 of the world's major 22 exchanges are now operating in the developing countries. Most of these exchanges were established during 1980s and 1990s in response to government liberalization of commodity markets. Two of three Indian exchanges, which were formed only in 2002/3, already featured among the top ten exchanges of the world.

As Table 2 indicates, during 2003 and 2006, the annual average growth rate of volume of commodity exchanges in developing economies were double of that found in their counterparts in OECD countries. Looking at the disaggregated data by sectors (i.e. agriculture, metal and energy) over the 2003-2006 period, it is found that sectoral growth rates in developing economies are higher than the growth rates observed for the OECD countries. In particular, exchanges in developing countries experienced higher growth in metal commodities and significantly larger growth in energy products compared to their counterparts operating in the OECD countries.

Table 2: Growth Performance of Commodity Exchanges

Indicators	OECD Exchanges	Non-OECD Exchanges
Annual compound growth rate (2003-2006)	16%	32%
Agriculture growth rate	18%	26%
Metal growth rate	6%	25%
Energy growth rate	20%	163%

Source: OECD (2005, 2006, 2007) and UNCTAD, 2007.

The success of commodity future exchanges depends to a great extent on the performance of the regulatory body. The main objectives of the regulatory bodies are (i) to ensure that market efficiently promotes the twin economic functions– price discovery and price risk management; (ii) to maintain market integrity and financial integrity across the market, the exchange and the intermediaries (e.g. brokers, warehouses, and assayers etc.). Major tools used by regulators for market regulations are:

- Maintaining Financial Integrity – assessing the capital adequacy of exchanges and intermediaries; and ensuring payment of adequate margins by Intermediaries.
- Maintaining Market Integrity – conducting effective surveillance and monitoring; and audit of exchanges and intermediaries.
- Ensuring Alignment of Future and Spot Prices – ensuring final settlement based on correct spot prices
- Investor Protection – overseeing fair and even headed conduct of the exchanges; and providing protection against unscrupulous intermediaries.
- Fairness and Transparency in Trading Clearing and Settlement Process – setting up demutualised exchanges; introducing electronic trading; and establishing corporate governance in the exchanges.

Predominantly two sets of systems are in operation for regulation. In one case, separate regulatory body is established to regulate the commodity derivates market. In other case, common regulatory bodies are regulating both the financial derivates market and the commodity derivates market.

4.2 Impacts of Commodity Exchange: Indian Experience

India has a long history of commodity futures trading since the beginning of 20^{th} century. Futures markets were active for commodities such as Bullion, Oilseeds, Wheat, Jute and Cotton etc. Trading in futures was suspended during the Second World War which continued until late 1990s. Future trading was permitted in an increasing number of commodities (e.g. Coffee, Jute, Sugar, Edible oilseed complex etc.) after 1991. The 'National Agricultural Policy' announced in July, 2000 emphasized the need for allowing futures trading in agricultural commodities for risk management and price discovery. Trading in futures was permitted in all commodities since April, 2003. The Indian Government, realizing need for improved risk management practices in a globalized economic setup, brought legislations to facilitate setting up of three demutualised electronic multi commodity future exchanges at the national level.

Currently three national and 24 regional commodity exchanges are operating in India. The three national exchanges hold about 94 per cent of market share and around 100 commodities are being traded on the futures exchanges (*see* for criteria used in India for selection). Huge success of the Indian commodity futures markets has been clearly evident by average daily transaction volumes amounting to INR 15,000 crore. A notable fact in India's commodity futures is the successful trading of large number of commodities like Potato, Gram, Mentha Oil, Black Pepper, Cumin Seeds, Rubber, Cardamom, Gold, Silver, Copper, Aluminium, Zinc, Crude Oil, Natural Gas etc.

Future prices of all listed commodities are available in the public domain through 45,000 trading terminals in 500 cities, websites in as many locations and tickers in 3,000 APMCs, railways stations on a real time basis. Furthermore, future prices and indicative spot prices at different mandis are published in more than 300 print media (including vernacular language) and are covered in *Doordarshan* and other private TV channels. Exchanges expected to empower the farmers by disseminating future prices in the APMC and mandi level. The impacts of commodity future exchange on Indian economy are as follows:[2]

- Availability of price data over longer duration across the local boundaries of the physical markets discovered through a number

[2] This section draws from UNCTAD, 2007; Sahadevan, 2007 and research reports published in various issues of 'Commodity Vision', is a quarterly journal of MCX Academia of Economic Research.

of transactions (or in other words through a number of negotiations between consumers, producers, traders, financiers, investors hedgers etc.) is a major benefits to the market participants. Furthermore, the discovered prices are transparent due to the electronic platform in which these transactions happen. These prices are disseminated nationally with proper audit trail to check their veracity. The entire value chain seeks out this price and trusts it.

- The theory and empirical studies say that establishment of commodity exchanges in fact enhance smoothening of price fluctuations through continuous transparent price discovery by participants involved in commodity eco-system. Evidence suggests *reduction in price fluctuations* in some selected commodities after the introduction of commodity future exchanges in India. The reductions in price fluctuations between lean and pack seasons have been recorded for commodities namely Chana, Tur, Urad and Wheat. Fall in price volatility had been particularly significant for potato.
- Future prices could be predicted at least 3-6 months in advance through electronic negotiation of prices between numerous users. The spot prices of any commodity post harvest could be *predicted with price accuracy of 5-10% at least 3-6 months in advance* enabling more secure decision making. This has led to better decision making and supply response.
- Exchanges have trained farmers and traders on aspects of grading and standardization for making deliveries on exchanges. This leads to better awareness on grading and standardization across mandis and uniformity of farm practices. All these factors encourages *price integration across the mandis and creates a national common market*.
- With improved price transparency and efficient price realization as in case of Potato and Mentha led to a *significant increase in its acreage*. The same was the case for other agro commodities as well. Since the launch of Mentha futures, farmers have become more aware of prices (spot and futures). About 90% farmers in the Mentha-growing belt said that MCX spot prices have helped them realize better returns thereby enabling them to take more appropriate farming decisions. Around 80% of the respondents said they are getting higher prices due to the price transparency created by MCX. The Mentha acreage increased from 1,00,000 hectares in 2004 to 2,50,000 hectares in 2006, and production from 12,000 tonnes in 2004 to 32,000 tonnes in 2006.

- Availability of prices for next few months helps producers decide the best time to sell and provides them option of adding value to producers. About 60 per cent of the farmers surveyed in 2006, following future prices, held back their produce in expectation of better prices. Prices of Urad, harvested during September, were hovering around INR 3,000 a quintal in September, 2006. But, the 60 per cent who held back their produce for one-two months realized prices in the INR 3,200-3,900 range.
- National reference prices strengthen the production and marketing related decisions of the farmers. National prices and nationally accessible markets meant that all the spot prices take into consideration of the future prices and therefore, high correlation between spot and future prices makes sure that farmers would get these prices on the spot markets even if they do not participate on the futures.
- Commodity storage capacities over 1.3 million metric tons in over 333 centres across 18 states have been made available at competitive prices. Four million metric tons of commodities were brought under the purview of the professionally managed collateral management services. All the warehouses are professionally managed and daily reports on store availability and inventory are made public.
- 'Warehouse Receipt' financing arrangements are made with over 24 banks to provide easy access for collateral lending. With assured returns from hedged positions on futures market, the banks are now offering a hair-cut (i.e. the margin or difference between the actual market value of a security and the value assessed by the lending side of a transaction) to 80% in place of 50% in earlier days. Increased availability of loans from the financial institutions due to enhanced creditworthiness on the hedged positions. More than INR 300 crore credit disbursement was done through NBHC covering more than 22,000 farmers.
- As many as 25 functional quality testing laboratories and 125 mobile quality assurance laboratories are functional across the country.

There were concerns in India that the upward price pressures of essential agricultural commodities in recent past may be influenced by the exchange level future trading in those commodities. The hypothesized association between the operation of future exchanges and inflation has turned out to be a major concern and accordingly studies were conducted to examine this issue. The findings of some of these studies are reported here.

According to a research report by of MCX (MCX, 2007), it is argued that the main problem lies with the fact that most of the agricultural commodities have a long value-chain with a number of middlemen performing the roles and functions of brokers, commission agents, processors, wholesalers and retailers etc. Mark ups are being added at each stage of the value-chain. Furthermore, transport margins are added on the trade margins (mark ups of the value chain) before arriving at the consumer prices. Thus depending on the number of middlemen involved in the marketing system, the amount of value addition being done by them, varying transport costs capturing the geographical distance between producers and consumers, a huge margin is usually charged on the consumers over and above what is being received by the producers as costs of their basic products. In most of the cases, the charges being levied by middlemen do not really reflect real value of the economic function being performed by them in carrying over commodity from farm gate to the consumer. In such a case, it results in a biased marketing system, wherein the markets offers the least to the producer while charges the consumer the most.

Comparative data presented in Table 3 reveals that the future prices are in line with the spot prices but that the retail prices are almost double that of the wholesale prices. "Multiplicity of middlemen in the markets, through whom the commodity moves, due to the spatial and temporal lags in these commodities are produced and consumed, makes the marketing a costlier proposition. Large number of producers spread across major producing regions in the country and consumers stretched over the country with least information about the fundamentals of commodities leaves the markets vulnerable to manipulation by the value-chain intermediaries for their self interest." Thus according to this report the operations of futures cannot be blamed for price escalations.

Table 3: Price Spread between Futures and Retailers

Commodity	MCX		Retailers		Price Spread	
	Spot	Futures	General (RG)	Organized (RO)	RG	RO
Urad	30.8	27.7	60.0	58.0	48.7	46.9
Chana	22.3	22.2	40.0	39.0	44.3	42.8
Tur	15.6	16.1	40.0	45.0	61.0	65.3
Masoor	17.7	17.4	38.0	36.0	53.4	50.8
Wheat	8.6	8.7	18.0	15.5	52.2	44.5
Sugar	19.5	19.0	23.0	22.0	15.2	11.4

Source: MCX Research Report, 2007.

To assess this concern the 'Department of Consumer Affairs' formed committee under the chairmanship of Professor Abhijit Sen, member of the Indian Planning Commission.[3] Among others the study concluded that "it was not possible to arrive at any conclusive answer to this question, particularly on the matter of causation, since the period of operation of futures trading was too short to provide statistically meaningful results." While maintain this conclusion, the report argued that the "only way that futures trading can increase prices actually received by farmers who themselves do not trade in futures is if the causality runs from futures to spot prices. This can be through discovery of future spot prices that help farmers make better cropping decisions and by increasing spot prices at harvest: either by providing higher reference prices against which local spot trades settle or enabling traders in the physical market to build more stocks at harvest. Such transmission, by providing informational anchor or enabling access to additional liquidity for spot trading, can benignly serve both producers and consumers by reducing local monopolies and allowing better inventory management. But it also means that the same transmission mechanisms could sometimes less benignly cause speculation in futures markets to spill into spot markets.

In addition to inflation causality assessment, report examines the experiences in India against the benefits expected from future exchanges namely price discovery, provision of more reliable risk management tools or reduced spot price volatility. The report noted that the spectacular growth of National Exchanges has not yet deliver significant benefits due mainly to few factors such as: (i) poor state of infrastructure in spot markets; (ii) lack of awareness; (iii) improper contract design and delivery; and (iv) poor participation of farmers paving the way to speculators etc. On these points, the conclusion of the report is pragmatic and forward looking. It concludes that "these Exchanges, the trading community and the regulator are all in a learning phase. Experience is required before there is adequate knowledge about the stable nature of the underlying basis before these markets start delivering positive results. Having found no conclusive evidence that futures trading always caused inflation, the report has followed the approach of giving such trading the benefit of doubt on the matter of less benign transmissions and to chart out some requirements that would strengthen positive aspects."

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[3] This section is based on the 'Supplementary Note' by Professor Abhijit Sen, Chairman, ECFT. A full draft of the report can be accessed at the following URL http://www.livemint.com/2008/04/29235240/90E86794-2780-49D4-A1FF-59552D10AC40ArtVPF.pdf

5. Commodity Exchange: Bangladesh Perspective

5.1 Stakeholder Perception and Field Survey

In order to supplement some of the findings and impacts of the desk research on global and Indian literature, primary surveys and focused group discussions/interviews were conducted. In particular, the primary surveys were conducted to obtain information/data on value chains of two selected commodities – potato and jute. Field surveys were conducted between during September-October, 2008 using structured pre-tested questionnaires. Key findings are discussed here.

- Most of them in principle favour introduction of a commodity future exchange in Bangladesh since they believe a properly regulated future exchange would benefit agriculture through price discovery, risks management, coherent supply response, inflow of investment to improve rural market infrastructure (i.e. spot market, warehousing and quality control etc).
- There are some differences regarding the identification of commodities for futures trading. Some of commodities identified by them are: (i) potato; (i) jute; (iii) tea; (iv) sugar; (v) gold; and (vi) silver etc.
- Although most of them opined of having a separate regulatory body to oversee the commodity future exchanges, some of them prefer a phased progress towards an independent regulatory body. That is, at the initial stage Security Exchange Commission (SEC) may oversee the activities of future exchange through a specialised division which in due course based on market expansions and needs turned into a separate regulatory body.
- Regarding time frame within which they like to see introduction of a commodity future exchange in Bangladesh ranged between six months to 36 months (i.e. the perception survey was conducted in 2008).
- One important aspect was noted from the perception survey is the 'lack of awareness/knowledge' on the system among various market participants. Thus launching of a massive 'awareness' campaign involving market participants have been recommended.

5.2 State of Bangladesh from Pre-requisites Perspective

The strengths and weakness that are prevailing in Bangladesh in establishing a commodity exchange are discussed below in terms of the pre-requisites for a successful implementation of a commodity exchange. The observed strengths are stable macro economy; broad market infra-structure; presence of an active regulatory institution with adequate provision to incorporate other derivatives. Weakness may lie in the areas of warehousing, quality assurance facilities and banking network.

Stable macroeconomy has been one of the strongest areas in Bangladesh during last decade. Most of the key macro variables either experienced improvements or remained stable during the last decade. Macroeconomic performance has been reasonably stable in a period of global economic uncertainty; and elevated food and fuel prices. During the 1990-2011, the growth rate expanded significantly leading to over 5% per annum on a 10 year average, but importantly exceeding the 6% mark for a number of years in 2000-2011. The rising long-term growth trend gives optimism that even higher growth (i.e. over 6%) is possible provided policy reforms further strengthen the determinants of past growth. Bangladesh is also well placed to attain most of the millennium development goals. Economic outlook over the medium term also projected to be strong and stable. The Perspective Plan targets annual real GDP growth rate to rise to 8.0% by 2015, and further to 10.0% by 2021 with significant improvement in living standards through substantial rise in employment, higher output and export growth as well as drastic reduction in poverty while maintaining macroeconomic stability. Per capita annual income is projected to rise to about USD 2,000 (at constant 2,013 dollars) by 2021, thus crossing the middle income threshold. To achieve and sustain the high rates of growth, gross domestic investment will reach 38% of GDP, with gross national savings at 39%, and headcount poverty dropping to only 13.5%.

Market infrastructure for agricultural products in Bangladesh is extensive with diverse economic activities and market players including producers, collectors, and a myriad of traders, wholesalers, and retailers. Compared to most countries in the region, the density of the market network in Bangladesh is very high, surpassed only by some of the more developed Indian states such as the Punjab. For example, in the Northwest of Bengal, the population served per market averages around 16,000 persons per market.

According to the Upazilla-based Local Government Engineering Department (LGED) of Bangladesh, there are 17,121 rural markets, while a survey by the Department of Agricultural Marketing (DAM) states there are 16,476 rural markets. Rural markets can very broadly be classified, in terms of size and economic activity, as follows: (i) Primary Markets; (ii) Assembly Markets; (iii) Secondary Markets; (iv) Terminal/ Wholesale Markets; and (v) Other Channels.

In a survey of markets in 1994-95, DAM identified around 5,000 rural primary markets, 3,000 assembly markets, 55 urban wholesale markets, 182 urban retail markets and 40 urban combined wholesale/ retail markets. In reality, few, if any, Haats are purely primary, secondary, or terminal in function. However, the majority of high valued crops are sold by farmers at assembly markets (65.6 per cent) and through on-farm or farmgate sales (19.6 per cent). Distances to both primary and secondary markets in the Northwest of Bengal, for example, are very short, averaging 2.4 km and with catchment areas of around 10 villages per market. In light of the global and local prices hike of agricultural commodities, a more efficient haat/market system has the potential to enable the poor farmers and producers of agricultural-goods in Bangladesh to generate more revenue. Reports by CPD and the Power and Participation Research Centre (PPRC) identifies lack of government policy support (e.g. anti-hoarding policies, proper allocation of fertilizer & seeds, and price of diesel, kerosene), and low market information availability, as constraints leading to market inefficiencies. A report by the Palli Karma Sahayak Foundation (PKSF) largely concurs with this view, but also adds infrastructural shortcomings and lack of access to finance of farmers/producers and traders as further constraints.

The Securities and Exchange Commission has been regulating the financial derivates since its inception in 1993. The rules and laws of the SEC allow regulation of commodity derivates in addition to the financial derivates. Securities and Exchange Commission Act 1993 provides two main functions of the Commission which are regulating the business of the stock exchange or any other securities market and registering and regulating the business of stock brokers, sub brokers, share transfer agents, merchant bankers and managers of issues, trustee and trust deeds, registrar of an issue, underwriters, portfolio managers, investment advisers and other intermediaries in the Securities Market. The Commission shall make rules to fulfil its objectivity as mentioned in the Act.

Information on ware housing and quality assurance facilities in Bangladesh are sketchy and hence it is difficult to delineate a clear status of these linked elements of commodity market system. However, growth of these linkage industries (or facilities) is likely to happen with satisfactory performances/growth of the commodity exchange system. Their growth will be demand driven. The Indian experience is worth mentioned in this case. Even if these facilities are inadequate at this stage, on the basis Indian and global experiences it may be safe to suggest that adequate and propose facilities in the areas of ware housing and quality testing would come up fast with the expansion of the commodity exchange market.

Commodity Exchange System will have three separate divisions in line its function, namely: (i) operation; (ii) accounts and administration; and (iii) information management. The chief officers of these three divisions will be responsible for the smooth and efficient functioning of their respective divisions. They will report to the managing director or the chief executive officer. The performances of the commodity exchange will be reported to the 'board directors'. Chairperson will preside over the board meetings and managing director/CEO will act the secretary to the board. The chairman will be selected among the board members as per company act.

6. Concluding Remarks

In this paper an investigation has been attempted to explore benefits, potential and observed, and risks arising out of the operation of commodity future exchanges. The investigation relied on primarily secondary sources drawn from studies commissioned by UNCTAD, IFPRI, FAO, Planning Commission of India, various other Indian research institutions, Research department of Multi Commodity Exchange of Mumbai and individual researchers. In almost of all these studies, benefits are reported to be higher than the risks.

Although, in principle, any commodity fulfilling certain conditions may be traded in a commodity future exchange trading of limited number of commodities in the initial few years of its inception is desirable. The choice is governed by the evidence of distress selling (e.g. potato and jute), encouraging production via risk management (i.e. hedge) and discovering fair prices; and linkage with global market. More especifically, these are potato, jute, spices, pulses, gold and silver.

Investment requirements for this venture are large and a significant part of the resources are needed for acquiring automation and related technology. This is a technology and human resource based activity and hence success of this venture would depend critically on engagement of appropriate experts and technology. There is little scope for experiment with technical aspect of the commodity exchange. Both local and foreign entrepreneurs who are conversant in this field would most likely to come forward to investment in this venture.

Warehouse receipts may be allowed to trade in the proposed commodity exchange. This measure will encourage rural financing via warehouse/cold storage as well as open up scope for direct participation of the producers in commodity sale. Quality and quantity control of commodities traded in an exchange is an integral component of the exchange. Quality and quantity control task may be only be entrusted to the private sector organizations thereby paving scopes for the participation of private institutions. In order to avoid potential volatility in agriculture, in line with 'speculative' practice followed by 'Dhaka Stock Exchange', controlled future trading is desirable to safeguard the interest of actors involved in the exchange.

Trading of commodities in commodity futures exchanges a new concept in Bangladesh. The responses of field/perception surveys indicate low knowledge on potential impacts of commodity exchange. As is true with any instruments, the success depends on optimal use of an instrument. Lack of knowledge could surely deter stakeholders taking the full advantages of the system. Thus to reap full benefits with wider participants of stakeholders massive awareness campaign must be initiated at all levels of the system. Government, private sectors, media, development partners, Non-government organizations, and civil society activists should be encouraged to participate in the awareness programmes.

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Marketing of Agricultural Products in Bangladesh: Prospects of Commodity Exchanges

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Abstract Efficient commodity markets have favourable functional impacts on primary producers, exports, imports, government revenue and other enterprises. In a number of economies, organized agricultural marketing systems, known as agricultural commodity exchanges, have efficiently linked farmers and agricultural producers with consumers at home and abroad. The paper attempts to sketch the state of agricultural commodity exchanges in developing economies and thereby make out the potentials for establishing efficient agricultural marketing system in Bangladesh. It is observed that commodity exchanges are helpful to discover efficient price systems and resolve contractual disputes thus offering a fast and low cost mechanism. For sound operation of a commodity exchange, it is important that the government plays proper role in matters of policy and regulations. Specifically, a well functioning warehouse receipts system is to be installed to offer finances to the farmers. A long term plan would entail establishment of a mechanism for consultation and coordination among different government agencies, central bank, farmers' associations, financial institutions and civil society organizations.

Keywords Commodity Exchange, Warehouse Receipts, Farmers' Association, Payment Modality, Derivatives

1. Introduction

Price instability of agricultural products and absence of effective agricultural marketing system have been among the main concerns for developing economies, especially for those having considerable dependence on agriculture. Particularly farmers are adversely affected due to

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seasonal price variation concomitant with governments' budgetary problem in carrying out agricultural price support programme. Absence of efficient agricultural commodity market system leaves a country vulnerable to exports earnings, government revenue and enterprise income. In a number of developing countries including Bangladesh, performances of the markets for agricultural commodities are often hampered by poor infrastructure, inadequate information and high transaction costs.

Against this backdrop, there have been efforts to develop agricultural commodity markets. Particularly the case for agricultural commodity exchanges has arisen in the wake of liberalization of agricultural trade and withdrawal of government support to agricultural producers. In a number of economies, organized agricultural marketing system known as agricultural commodity exchanges have efficiently linked farmers and agricultural producers with domestic and international consumers through establishing effective value chain, reducing transaction costs, and handling price volatility (Goggin, 2007).

The basic purpose of a commodity exchange is to discover the price at which willing buyers and willing sellers are prepared to trade. In developed countries, and in an increasing number of developing countries, such exchanges typically act as a platform for spot transaction for immediate delivery or standardized contracts for future delivery. Commodity exchanges have also been acting in a broader range of ways to stimulate trade in the agricultural commodity sector, for example, financing against warehouse receipt or forward contracts on the basis of warehouse receipts.

The agricultural sector is characterized by layers of middlemen. Most of the agricultural producers are small farmers who have inadequate access to market price and are vulnerable to price shocks. Under this condition, it is essential to develop an efficient system of price discovery, financing and trading. Some issues crop up in this connection. The issues relate to the requirements of establishing an efficient agricultural marketing system as also possibility of introduction of derivative products for handling commodity price fluctuation.

In view of these issues, the paper attempts to examine the basic requirements of setting up of an agricultural commodity exchange, look into the possibility of establishing an efficient agricultural marketing system and introducing commodity hedging instruments in Bangladesh. The study is mainly based on secondary data supplemented by some information on policy and operational issues from knowledgeable persons like bankers and experts.

The paper is organized as follows. The introduction is followed by discussion on conceptual aspects of the emergence of agricultural commodity exchanges and hedging instruments in the context of developing economies. Section 3 covers issues on basic requirements for establishing agricultural commodity market. Current status of the commodity market in Bangladesh is discussed in Section 4. And Section 5 sums up with potentials for Bangladesh.

2. Agricultural Commodity Markets in Developing Countries: Concepts and Literature

Agricultural Commodity exchanges are organized setup where multiple buyers and sellers trade commodity-linked contracts on the basis of certain laid down rules and procedures. The commodity transactions or contracts include spot or cash commodity market, exchange traded standardized derivatives and Over The Counter (OTC) derivatives i.e. swaps and options. Spot is the basic transaction of a commodity exchange. Commodity trading through derivative allows the buyers and sellers to hedge against price changes that may adversely affect their business to make an informed decision to increase profits or cut losses (Narender, 2006).

UNCTAD (2007) identified 66 positive impacts that commodity exchanges have made in the areas of price discovery, price risk management, facilitation of physical trade, facilitation of finance, and general market developments. Puri (2007) made the case of commodity exchange by mentioning pre-and post transaction benefits. Pre-transaction commodity exchange helps finding counter parties, determining an acceptable price, ascertaining product quality, securing finance to fund transaction, and defining appropriate delivery and payment modalities while post-transaction exchanges help managing credit and cash flows, overseeing delivery, validating quality, arbitrating disputes, and taking action against defaulters.

The commodity trading practice has received boost because of faster increase in commodity prices in the recent period. According to IFSL Commodities Trading Report (2008), global physical and derivative trading of commodities (agricultural, metal, and energy product) on exchanges increased more than a third and agricultural contracts trading grew by 32 per cent in 2007. The report estimates, in the five years up to 2007, the notional value outstanding of commodity OTC derivatives increased more than 500 per cent and commodity derivative trading on exchanges more than 200 per cent. Recent data reveal that developing countries' growth is outpacing that of the developed countries (UNCTAD, 2007). Among the different regions, the developing Asia is leading the charge (BIS, 2008).

Inspite of the fact that there has been commendable increase in global commodity derivatives during recent years, the use of risk-hedging instruments has been limited to the developed and some high-income developing economies. In South Asia, India has experienced an unprecedented boom in transactions of agricultural commodities. Especially India's National Commodity and Derivatives Exchange (NCDEX) demonstrates stupendous performances in spot and future transactions in agricultural produce. The use of commodity derivatives started in the exchange in 2002 and future trading in commodities crossed USD 1 trillion mark in 2006. In Pakistan, National Commodity Exchange Limited (NCEL) started operation in 2003 where rice, cotton, wheat and palm oil are commonly traded and it started future trading in rice in the last quarter of 2008. In Sri Lanka, the government has been looking at the possibilities of an exchange for trading commodities in products like tea and vegetables.

There are three large commodity exchanges in Latin America, which trade both spot and derivatives and are performing well (Westcamp, 2007). Small commodity exchanges mostly trade a variety of spot but not derivatives. Some of these small exchanges are struggling to survive in the face of political uncertainty and small markets. Mexican exchanges have enjoyed rapid but volatile growth. Brazil has Latin America's largest exchange for trading spot and derivatives contracts. Activities of small agricultural commodity exchanges in Argentina have been intervened by government from time to time and only limited exchange services have been allowed. Colombia's National Agricultural and Livestock Exchange developed a whole range of instruments covering agricultural commodities, poultry and live cattle (Boada, 2007).

In East and Central Europe, commodity exchanges are well placed. Notable among these are Turkey Derivative Exchange, Rumanian Commodities Exchange, Budapest Clearing and Settlement House, Warsaw Board of Trade etc. Agricultural commodities and fuels are transacted in these exchanges. Russia, Ukraine and Kazakhstan also have a few dozens of agricultural commodity exchanges. Though derivative products have been introduced almost in all of these exchanges, transactions are limited to spot in most exchanges (Ozcan, 2007).

With the exception of South Africa, Africa has been the region with the least progress in developing commodities exchanges. Commodity exchanges have been established in early 1990s in Zambia and Zimbabwe mainly for Maize contracts. Ghana and Kenya have also been offering basic services through commodity exchanges. Since April, 2008, Ethiopia opened a commodity exchange to trade in six agricultural commodities. The African commodity markets are commonly characterized by poor market information, lack of competition, absence of the systems of quality standards, lack of transparency, and absence of enforceable dispute resolution mechanism (Goggin et al., 2007). Small farmers are also coming out as beneficiaries of these commodity exchanges. Particularly by means of their participation through cooperatives in a number of developing countries (Berg, 2007). The exchanges also help facilitating credit to the farmers against warehouse receipt. Thus credit against warehouse receipt is a very important financing tool to the agricultural producers and farmers.

Although there are no dearth of success stories, many developing countries face challenges in operating agricultural commodity exchanges. Education and knowledge gap on contracts and hedging instruments among producers and consumers is a major obstacle in the success of commodity exchanges. In some occasions problems arise as a result of unfavourable weather conditions, drought, unexpected bad yield, etc. when goods cannot be delivered or received. In most exchange houses, there is a minimum amount specified for a contract which may be high to the small farmers and traders of low-income countries. It would seem then that for effective working of the system, it requires arrangement for licensed warehousing, laboratory for classification, and arrangement for liquidity.

3. Commodity Markets and Exchanges: Regulation, Finance and Information Network

Benefits from the establishment of an agricultural commodity exchange are not unconditional. An exchange that is badly structured is unlikely to deliver the services expected of it. UNDP (2007) lists three elements of orderly trading in an exchange: clearly defined contractual terms, financial stability and stringent rules against manipulation. Market manipulation destroys price formation. Contractual terms offer certainty in the market. Moreover, those who enter into contracts for future delivery need to be confident that on the day in which the delivery is due to take place the other party is in a financial position to honour the contract. Government is responsible for establishing and implementing the framework. Fostering close and constructive relations between exchanges, regulators and other governmental stakeholders is a crucial imperative for well-functioning of commodity exchange.

Development of commodity exchanges commonly passes through two broad phases. In the first phase, exchange becomes a market place for willing buyers and willing sellers who want to make or take delivery.

In the second phase, the volume of trading on the exchange is driven by those willing to trade price risk. An exchange will not make the transition from the first phase to the second phase unless the prices discovered from trading on the exchange are accepted as the best indication of the underlying value of the commodity. And no exchange would develop from the first phase to the second phase unless it is properly regulated and is seen to be regulated by those who use it (O'Hegarty, 2007).

For a commodity market to work efficiently, it is necessary to have a sophisticated, cost-effective, reliable and convenient warehousing system (Richard and Panos, 1996). Warehouse receipt provide farmers with an instrument that allows them to extend the sales period of modestly perishable products well beyond the harvesting season. Warehouse receipt can be combined with price-hedging instruments and help attaining efficiency of commodity exchanges. Farmers may also obtain higher financial facility from banks. For example, the PTA Bank in Kenya finances coffee exporters by taking their warehouse receipts as collateral and also offers them a put option, purchased at the London Commodity Exchange, that guarantees sellers a minimum price for the coffee they have in storage (Goggin, 2007). By assuring a floor price for the stored coffee, the PTA Bank can provide finance for a higher percentage of the value of coffee than it could justify in the absence of the floor price. Unfortunately, the use of warehouse receipts is limited in many developing countries because of institutional and structural shortcomings which include lack of incentives for the development of a private storage industry owing to government intervention in agricultural market– usually by setting support prices, lack of an appropriate legal, regulatory and institutional environment to support a system of warehouse receipts, and limited familiarity and lack of initiatives by the banking community.

A sound Marketing Information System (MIS) is one of the main preconditions for the success of agricultural commodity exchanges. The modern MIS uses information technology to collect, process, update and disseminates market information so that farmers can negotiate for better price in the market place. For designing and implementing an effective MIS, there must be especially tailored database to manage information. Information may be disseminated through different channels. These may include rural market information points, mobile phone messaging service, interactive voice response, internet, radio etc. Thus, widespread internet connectivity and ability to access and use information are crucial. For an emerging MIS to be sustainable an appropriate institutional arrangement needs to be in place: governments need to be involved for the 'public goods' aspect of the information; and the private sector should be part of the system.

Arrangements for quality testing and performance risk mitigation are among the determinants of effective operation of commodity exchanges. Independent labs or quality testing centres should be set up to certify the quality, grade and quantity of commodities so that they can be appropriately standardized and there are no shocks waiting for the ultimate buyer who takes the physical delivery. Moreover, there should be strong strategic alliances among banks, grading farms, collateral management companies, courier service, ICT related firms, traders and farmers. The exchanges need to be able to respond to a rapidly changing trading environment, including integration of the economy into a wider regional and international network. As a crucial step of being integrated with international exchange, membership of different associations of exchanges is very helpful.

4. Agricultural Commodity Market in Bangladesh

The agricultural commodity market of Bangladesh is fragmented and dominated by layers of middlemen. Bangladesh's agricultural commodities include rice, jute, tea, vegetables, wheat, oil seeds, sugarcane, spices etc. Crops are mainly produced for domestic supply and transaction cost is high. Price instability, asymmetric price information, dependency on monsoon, irregular flow of credit, reliance on money lender and lack of warehousing infrastructure denote the characteristic features of commodity market. There are problems of commercializing smallholders and integrating them within the supply chains. Export market of agricultural commodities is very limited. Export items include tea, raw jute and a few other agricultural products, which account for only around 2 per cent of the country's exports. However, the country imports considerable volume of agricultural commodities which include rice, wheat, cotton, oil seeds etc. Bangladesh needs to import food grains almost every year to meet domestic requirements.

Financing rural and agricultural production has not been proved to be commercially viable to banks. Farmers engaged in agricultural production and entrepreneurs in agricultural processing still heavily rely on informal sources to meet their financing requirements. Generally, the crop loans provided by specialised and public banks are hypothecated loans that are to be repaid by the farmers just after the harvesting period. There is hardly any scope for farmers to get credit facilities for availing the benefits of price rise of their produce. Credit benefit from rising prices is available to the traders who avail cash credit facilities of banks to purchase these crops for storage. Currently some public banks are implementing a project in the rural areas under which loans are provided to the farmers against warehouse receipts.

An operative marketing information system is missing in the agriculture sector of the country. The Department of Agricultural Marketing (DAM) of Bangladesh has launched a website as part of a project with the assistance of FAO to offer price information. The DAM database collects price information on some agricultural commodities from 42 districts and uploads to the database. The project with low outreach, however, is not functioning as expected mainly due to inappropriate technology solution and absence of channels for local dissemination. Currently, DAM is experimenting mobile phone-based agricultural information dissemination arrangement under a donor-funded project. There have been a number of private sector initiatives for setting up telecentres (information centre) in the rural areas to disseminate information on agricultural production, marketing, health, education, employment, disaster management, legal and human rights etc. Some TV News Channels and Radios broadcast market price of essentials that hardly serve the purpose of the farmers. Bangladesh Bank (BB) has recently allowed OTC transactions to hedge price risk subject to its permission. The BB took the move against the backdrop of price volatility of some essential commodities in the international market to help importers and exporters reduce their risks. Commercial banks must completely hedge the commodity price risk arising from the commodity hedge transactions by booking back-to-back transactions with banks having international standing or their branches operating in Bangladesh.

5. Summary and Conclution

Commodity exchanges offer a more secure and low cost mechanism for discovering prices, trading, and resolving contractual disputes. In a country like Bangladesh integration of small farmers in the system should receive priority. For proper functioning of commodity exchange, government's role in the form of offering policy and regulations to bring transparency and integrity of transactions and to provide security to the exchange users is important.

Warehouse facilities provide multiple benefits including credit to the farmers. However, the currently offered credit facilities are not for retaining goods for getting the opportunity of price rise of their produce. Bangladesh Bank is required to undertake the needed initiative for promoting the integration of agricultural commodities with the financial sector through greater participation of financial institutions and creation of financial products for effective agricultural marketing.

Rather than going for a domestic future exchange for managing price risk, there should be exchange for facilitating trade in the spot commodity markets. Existing international exchanges may provide solutions to commodity price movements of exports and imports. The recent initiative of Bangladesh Bank for hedging commodity prices may be helpful to the traders. Availability of a local commodity exchange and MIS would support the traders. Traders may also be able to use the services of international exchanges through banks. Small farmers are generally not expected to participate directly in derivative markets. Yet, cooperatives or/and banks may help small farmers to receive benefits of price risk management.

There have been piecemeal initiatives, on experimental basis, to support agricultural commodity markets in Bangladesh. It is imperative to establish national level agricultural commodity exchange, set up government warehouses, licensing of private warehouses, local level service points, and expansion of the provision of finance against ware-house receipt. An integrated approach of all these initiatives together with the cooperation of different government agencies, central bank, farmer cooperatives, financial institutions, and civil society organiza-tions and support of media, academia and civil society is what is needed for the success of commodity exchange programme.

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Banking Business: Quick Response Strategy for Competitive Edge

Muhammad Mohiuddin*

Abstract Banking business deals with service which is intangible, perishable and non-storable. With little or no technological difference in the industry 'quick response' strategy is a good way of attaining competitive edge. The strategy builds customers' changing attitude and expectations into service and instantly responds to keep them with the bank. Commitment of top management, availability of well trained service providers, reduction of lead time, reduction of delivery time, good and cordial human relations with customers, immediate resolution of customer complaints and providing variety of innovative and creative services are the ingredients of quick response strategy.

Keywords Tangibles, Corporate Strategy, Quick Response, Empathy, Management Information System

1. Introduction

Bangladesh like many other countries of the world is well in the process of globalization. Open market policy has brought domestic and foreign firms of many industries including the banking industry in head-to-head competition. This condition warrants competitive strategy for the firms to survive and prosper. This paper deals with the issues of competitive strategy in the banking industry.

2. Competitive Strategy

2.1 Concept and Prologue

Strategies are integrated, comprehensive and unified plans to commit organizational resources such that the firm can compete in the market successfully and achieve the objectives of the organization effectively. Ireland, Hoskinsson and Hitt (2011) mentioned that a strategy is an integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage. In

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other words, strategy is the game plan management used to stake out a market position, conduct operations, attract and please customers, so as to compete successfully and achieve organisational objectives (Thompson and Strickland, 2003).

Strategy is classified into corporate strategy, business strategy, functional strategy, operating strategy and global strategy. Business strategy is meant for creating competitive advantage in the market for the product of the firm and thus it is called competitive strategy. Sometimes, it is called generic strategy. Business strategy gives a company a specific form of competitive position and advantage over its rivals that results in above-average profitability (Hill and Jones, 2009). The central thrust of business strategy is how to build and strengthen the company's long-term competitive position in the market. There are many routes to competitive advantage, but the most basic is to provide buyers with what they perceive as superior value – a good product at a low price, a product that is worth paying more for, or an offering that represents an attractive combination of price, features, quality, service, and other attributes (Thompson and Strickland, 2003: 149). On the basis of primary focuses, business strategy is divided into cost leadership strategy, differentiation strategy, focus strategy and quick response strategy.

The popular and widely used competitive or business-level strategies are cost leadership strategy and differentiation strategy. Cost leadership strategy is a plan to produce and deliver the product or service at a lower cost that of competitors. It involves with two approaches – low-cost provider and best cost provider strategies. Low-cost provider strategy appeals a broad spectrum of customers based on being the overall low-cost provider of a product or service and best-cost provider strategy intends to give customers more value for the money by incorporating good-to-excellent product attributes at a lower cost than rivals; the target is to have the lowest (best) costs and prices compared to rivals' products with upscale attributes (Thompson and Strickland, 2003:150). On the other hand, differentiation strategy attempts to create unique bundles of products and/or services that will be valued by customers. The influence of these two strategies is on the wane as firms have been successful in using either or combination of these two strategies such that customers accept these strategies as granted. This situation forces firms to think about other strategies to take competitive advantage over others in the market which gave rise to quick response strategy during 1990s. In today's economy, the company that survives will be the one that can develop, produce, and deliver products and services to customers faster than its competitors. Under this circumstance, speed is the strongest weapon to firms today to win competition and to sustain in the market successfully.

2.2 Quick Response Strategy

Quick response refers to the speed with which a new product, an improved product or even a managerial decision that affects the customer can be made available, rather that the firm's relative level of differentiation or low cost. It is the capacity of a firm to change immediately with the changes of environment to exploit the best opportunity first. Thus, it calls for flexibility of a firm. The firm that can do the needed changes rapidly before the competitors, that firm is flexible and will gain the market.

There was a time in Bangladesh when clientele of banking business had to wait hours together to encash a cheque, not to mention of other services. The situation was so acute that one branch of a bank in Dhaka city hung a notice inscribing "if you (a client) do not get cash against your cheque within one hour of its deposit, contact with the manager." During that time a bank, Bank of Credit and Commerce International (BCCI) started its operation in Bangladesh and gave an advertisement in the daily news paper that "No delay, no sweating, you will get your cash." It was nothing but a promise for quick response to meet customers' needs. This contributed to make the bank different and attractive to the people and the bank got a sound footing in the market.

3. Quick Response Strategy: Competitive Edge Builder

"Always with the change" is the founding motto of quick response strategy. It is the only strategy that allows a firm to keep pace with the dynamic nature of environment in which a banking firm of today operates. Close watches on customers' shift of choices, preferences, habits, buying times, price sensitivity, behavioural expectations etc. are the fundamental sources of changes in service structure as quickly as possible to accommodate customers' expectations into the service package. Quick response strategy may be applied in many ways to win customers' confidence. Berry and Parasuraman (1991:16) maintain that banks' competitive ledge depends on the following:

- Reliability: The ability to perform the promised service dependently and accurately
- Responsiveness: The willingness to help customers and to provide prompt service
- Assurance: The knowledge and courtesy of employees and their ability to convey trust and confidence

- Empathy: The provision of caring, individualized attention to customers;
- Tangibles: The appearance of physical facilities, equipment, personnel, and communication materials.

The quick fulfillment of any kind of gap that exists between customers' expectations and present service of banks will give competitive edge in the market over other competing banks. Parasuraman, Zeithaml, and Berry (1985) and Brady and Crorin Jr. (2001) have pointed out five gaps that cause unsatisfactory delivery. These are:

- Gap between consumer expectation and management perception of what customers want;
- Gap between management perception and service-quality specification;
- Gap between service-quality specifications and service delivery due to poorly trained or incapable or unwilling to meet the standard or due to conflicting standards.
- Gap between service delivery and external communication which distorts the customer's expectations.
- Gap between perceived service and expected service due to misperceived service quality by the customers.

Strategic actions warrant that these gaps are filled up speedily.

4. Conclusion

In the competitive market, modern banking business involves understanding on the part of the management relating to target customers and their needs as well as various dimensions of customer characteristics. There is a need of a market and management information system to monitor market changes and transmit market information to the service design unit to convert those into technical requirements to structure a service package.

All employees are well trained in quality concept, quality measurement techniques, quality control tools, good human behaviour and customer care services, socialized with organizational culture etc matters to make them knowledgeable, competent and committed to the quality service. By this way, employees will be involved with the total process of service generation and rendering of such service efficiently and effectively within reasonable minimum time. Some of the quick response elements are one stop delivery system, mechanizing processing and delivery system and concurrent reengineering, etc.

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Sustainable Green Banking: The Case of Bangladesh

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Abstract Sustainability has been increasingly recognized as a key objective of developing market economies. For the financial sector, this represents both a demand for greater social and environmental responsibility. Green banking refers to the effort of the banking industry to consider social, ecological and environmental factors while financing investment for commercial projects. Green finance as part of Green banking makes great contribution to the resource efficient and low carbon industries. This paper begins with the wider concept of sustainable and green banking and then highlights the green banking programmes adopted in Bangladesh so far with its achievements.

Keywords Green Banking, Global Warming, Carbon Emission, Carbon Footprint, Environment Disclosure

1. Introduction

Climate change as a result of global warming has become one of the most important issues in the recent years. In 2007, the Intergovernmental Panel on Climate Change reported that there would be an estimated rise in the average global temperature between 1.1 and 6.4°C within the next 100 years. It has also been predicted that a meager 2°C increase in temperature would greatly hamper many ecosystems and would cause an increase in the sea-level that would adversely impact the lives of people living particularly in coastal zones. The emission of the greenhouse gases like carbon dioxide is considered to be the major contributor to global warming. Therefore, in today's world of rapid economic development, it is important to see the link between carbon dioxide emissions and sustainable development through different possible channels.

The banking sector can play intermediate role between economic development and environment protection by promoting environmentally sustainable and social responsible investment. Hoepner and Wilson (2010) highlighted the importance of social, environmental and ethical

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issues for the risk management, reputation and performance of banks and other financial institutions. Thus, encouraging environment friendly investments and careful lending should be one of the responsibilities of the banking sector. The concept of green banking, which was initially developed in the western countries, is well recognized worldwide now-a-days. Green banking refers to the effort of the banking industry to consider social, ecological and environmental factors with an aim to protect the environment and conserve natural resources. Green banking is a general term, which can cover a multitude of areas from a bank being environmentally friendly to how and also where their money is invested. In other words, a green bank is a bank that encourages environmental and social responsibility but runs as a traditional community bank and provides quality services to investors and clients. A green bank is also called ethical bank, environmentally responsible bank, socially responsible bank, or a sustainable bank, and is expected to consider all the social and environmental factors (Thombre, 2011). Hence, by taking various measures to save the environment the banking sector can play a crucial role in promoting environmentally sustainable and socially responsible investment. For banking professionals green banking involves the tenets of sustainability, ethical lending, conservation and energy efficiency.

Bangladesh is considered as one of the worst victims of the climatic changes. Bangladesh Bank is well aware of the environmental degradation situation and put different efforts to tackle the adverse shock of global environmental degradation. In collaboration with all the existing banks, Bangladesh Bank issued a circular in 2011 asserting to implement a comprehensive Green Banking Policy in a formal and structured manner in line with the global norms so as to protect environment degradation and ensure sustainable banking practices. The main objective of green banking initiatives taken by the central bank is to train practices towards optimum usage of natural resources, make necessary effort for environmentally friendly activities, to ascertain required measures to save the environment and reduce pollution while serving or financing customers and improve in-house environment management through efficient and effective use of resources in all the branch and head offices of banks. Commercial banks are also required to ensure necessary measures to protect environmental pollution while financing a new project or providing working capital to the existing enterprises.

2. Concept of Green Banking

In general, Green Banking means stimulating environment friendly practices and limiting carbon footprint from the regular banking activities. It can benefit the environment either by reducing the carbon footprint of consumers or banks. Green banking may emerge in different ways. Example includes using online banking instead of branch banking, paying bills online instead of mailing them, opening up Current and Deposit Accounts and money market accounts at online banks instead of large multi-branch banks or the local banks. Any combinations of the above personal banking practices are assumed to benefit the environment. Additionally, Green banking involves pursuing of financial and business policies that are not hazardous to environment but help conserve environment. The broad objective of green banking is to use resources with responsibility and giving priority to environ-ment and society. It is more about focusing on 'mother planet and its sustainability,' shifting from a traditional approach on 'profit' or even 'people'. Green banking is not just another Corporate Social Responsibility (CSR) activity; it is all about going beyond to keep this world livable without much damage.

Basically, green banking avoids as much paper work as possible—from go-green credit cards and go-green mortgages to all transactions done online. It forms responsiveness around business people about environmental and social obligation, enabling them to adopt environment friendly business practices and follows environmental standards for lending. When a person is awarded a loan, the interest is less than normal banks because ethical banks give more importance to environment-friendly factors – they do not operate on consideration of high interest rates.

Green banking helps reduction of external carbon emission and internal carbon footprint. To support the reduction of external carbon emission, commercial bank should finance green technology and pollution reducing projects. Internally the banking activities have noticeably increased the carbon footprint of banks owing to their enormous use of energy e.g. lighting, air conditioning, electronic/electrical equipment, IT, high paper wastage, lack of green buildings etc. Therefore, to implementing green banking, bank should adopt technology, process, and products which result in considerable reduction of their carbon footprint as well as develop sustainable business.

Green banking is a multi-participants' effort where banks have to work closely with government, central bank, NGOs, consumers and business communities to reach the goal. Green initiatives by banks include internal environment management, environmental financing/ product ecology, environmental disclosure and reporting, formulating and adopting principles and promoting other stakeholders.

3. Banking and Sustainability

The efforts towards sustainable development through the banking sector have mainly taken two directions. First, through environmental initiatives such as recycling programs or improvements in energy efficiency and socially responsible initiatives such as support for cultural events, improved human resource practices and charitable donations. Second, through the integration of environmental and social considerations into product design, mission policy and strategies. Examples include the integration of environmental criteria into lending and investment strategy, and the development of new products that provide environmental businesses with easier access to capital. The later initiative has the potential to influence business on a larger scale. By integrating sustainability into a bank's business strategy and decision-making processes, institutions can support environmentally or socially responsible projects, innovative technologies and sustainable enterprises. Banks are part of complex human, social and environ-mental ecosystems, so it is in their own self-interests to keep those ecosystems going. Sustainable banking is where self-interest and altruism meet.

Sustainable banking has many labels: Corporate Social Responsibility (CSR), Corporate Responsibility (CR), Corporate Citizenship, Environmental and Social Governance (ESG) and other variants. And sustainability issues fall into three broad categories– economic (including customer), social and environmental. The economic aspect of a bank's sustainability program refers to managing the impact that its products, services and customer relationships have on the financial sector. First and foremost, a bank must give customers what they want fairly, responsibly and transparently. At the same time, it must provide good working conditions for staff and deliver profitable growth for shareholders. On top of these, a bank's activities should contribute to overall economic growth and stability with minimal negative impact on the environment or society.

Sustainable banking in the customer context means that when credit is scarce in some respects, banks must continue to lend to healthy small and medium-sized business to keep the economy on a good track, provide mortgages to credit-worthy borrowers to keep the housing market afloat, provide basic bank accounts to the less well-offs to reduce financial exclusion and develop innovative products and services to meet customers' needs and to enhance relationships. The social aspect of a bank's sustainability refers to manage the impact of its activities on society. It does it by removing or mitigating any negative impacts it may have and by taking positive steps to help communities through its employment practices, fundraising, volunteering and charitable giving.

The former requires that a bank create a set of ethical business principles that must be followed to ensure it is a responsible provider of financial services to customers so that bank-financed customer activities do not harm others. A bank's lending, investing and asset management policies should have built-in respect for human rights. The latter includes employment policies such that employees come from diverse background in respect of gender, race, religion and other criteria allowing or encouraging employees to get involved in fundraising and volunteering activities to help disadvantaged people and communities; investing in communities by making donations, providing loans and giving other assistance to charities and other good causes; persuading suppliers to act in a socially responsible manner; and gaining the support of shareholders for all of these initiatives. The environmental component of a bank's agenda refers to bank's policy to minimize any negative impact their activities may have on the environment. It represents demand for greater social and environmental responsibility.

4. Green Banking in Bangladesh

4.1 Bangladesh Bank Directives

Bangladesh Bank outlined a detail policy guideline in 2011 for implementing green banking in Bangladesh in line with global standards to protect environmental degradation and ensure sustainable banking practices. In conformation to this policy, the adoption of green banking envisaged three phases. The first phase involved policy formulation, incorporation of environment, initiation of in-house environmental management, introduction of green finance, creation of climate risk fund, introduction of green marketing, online banking, supporting employees training, consumer awareness and green event, and reporting green banking practice. The second phase involved sector-specific environmental policies, green strategic planning, setting up green branches; improve in-house environment management, formulation of bank specific environmental risk management plan and guidelines, rigorous programmes to educate clients and disclosure and reporting of green banking activities. In phase three with December 31, 2013 as completion deadline, banks will accomplish designing and introducing innovative products and reporting in standard format (Appendix Table 1). Bangladesh Bank declared several preferential treatments for the commercial banks undertaking green banking.

4.2 Major Achievements

Outcomes of the green banking policies in Bangladesh are outlined below.

- Commercial banks have disbursed about 42 per cent of the total revolving fund among the entrepreneurs who vowed for green banking scheme. A large number of banks under the scheme have formed green banking units, introduced green office guides, have been powered by solar energy and have been facilitated with online coverage.
- A good number of banks, state-owned and private, and also a non-bank financial institution have shown interest in environment-friendly electricity projects to get green energy by 2015. Likewise, other banks have undertaken strategies to finance biogas plants, solar assembling plants, solar irrigation system and solar power plant projects.
- Environmental Risk Rating (EnvRR) has been done for 3,703 projects during April-June, 2012.
- Bangladesh Bank's activities have been fully automated: Bangladesh Automated Cheque Processing System (BACPS), Bangladesh Electronic Fund Transfer Network (BEFTN), National Payment Switch (NPS), Enterprise Data Warehouse (EDW), e-tendering, and e-recruitment are major instances of automation.
- Bangladesh Bank has done environmental risk rating for a large number of projects.

5. Conclusion

Traditional banking business through financing activities is likely to contribute to environmental pollution. Bankers generally consider themselves to be in a relatively environmentally friendly industry in terms of emissions of harmful gases and pollution. However, given their potential exposure to risk, they have been slow to examine the environmental performance of their clients. The significance of banks in sustainable development cannot be overemphasized.

Western European countries are among the forerunners to take initiatives to improve the sustainability agenda. Bangladesh has experienced some positive developments in sustainable green banking. It has identified some major challenges in this regard. These include co-ordination among the concerned authorities, awareness and capacity building, concentration on sectoral lending policies and procedures, and shifting of some industries such as, garments, textiles and tanneries to proper locations.

Appendix

Table 1: Phases of Green Banking Initiatives in Bangladesh

Phase I: Deadline: 31.12.2011	Phase II Deadline: 31.12.2012	Phase III Deadline: 31.12.2013
Policy Formulation and Governance	Sector Specific Environmental Policies	Designing and Introducing Innovative Products
Incorporation of Environmental Risk in CRM	Green Strategic Planning	Reporting in Standard Format with External Verification
Initiating In-House Environment Management	Setting up green Branches	
Introducing Green Finance	Improved In-House Environment Management	
Creation of Climate Risk Fund	Formulation of Bank specific Environmental Risk Management Plan and Guideline	
Introducing Green Marketing	Rigorous Programs to Educate clients	
Online Banking	Disclosure and Reporting of Green Banking Activities	
Supporting Employee Training, Consumer Awareness and Green Event		
Reporting Green Banking Practices		

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Development of Capital Adequacy of Various Banks in Bangladesh Following Basel Accords

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Abstract Adequate capital is required to protect depositors' interest as also ensure health of banking business. This paper is an attempt to assess the development of capital adequacy in the banking industry following Basel Accords. It uses banks' capital as a major risk absorbance fund. It also considers lending default rate as indicator of banks' performance. Judged by these criteria the banking industry has acquired a minimum risk management culture and the Basel framework is found to be an effective lighthouse in this respect

Keywords Basel Accord, Risk Resilience Capacity, Risk Absorbance Fund, Lending Default Rate, Risk Weighted Asset

1. Introduction

Banks form very important financial intermediaries in Bangladesh. Adequate capital serves the twin objectives of protecting depositors' interest and ensuring the survival of banking business. Capital adequacy depends on risk resilience capacity or the fund maintained on the basis of risk weighted assets. In Bangladesh, banks are fairly allowed to invest in capital market with limited exposure and subject to strict regulation. Yet the share market debacle in 2011 suggested banks maintained sufficient resilience capacity against market risk. Moreover, the recent 'Hall Mark-Destiny' scandals point to the need that the banking industry ensures better risk resilience capacity against operational risks. In this backdrop a question has arisen as to whether banking sector has enough preparation to protect their assets from any such or other undesired events. Therefore, it is worth analyzing the real development of risk resilience capacity of the banking industry.

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2. Objective and Mathodology

In view of the foregoing discussion, the study attempts to assess the state of capital adequacy of the banking sector in Bangladesh. More specifically, the study will appreciate the status of risk resilience capacity of the banking sector as assessed by the central bank in the light of the Basel II implementation process. In doing this, the steps taken by the central bank will be also examined.

Risk resilience capacity is measured by the size of capital which is also called risk absorbance fund and lending default rate. Increased risk absorbance fund and decreased lending default rate give positive indication of banks' risk resilience capacity. The analysis is done by comparing the situation between pre and post Basel II implementation periods. Secondary data form the basis of the study.

3. Risk Management and Basel Framework: Concepts

3.1 Risk and Risk Management

In general, risk can be defined as the possibility of damage, injury, liability, loss, or other negative occurrences, that could be caused by external or internal vulnerabilities. It is exposure of a proposition which is uncertain. Thus risk has two essential elements: exposure and uncertainty (Holton, 2004). In the financial sector, risk is characterized by some special factors of market and externalities which affect an organization's performance.

Risk management involves identifying, analyzing, and taking steps to reduce or eliminate the exposures to loss faced by an organization or individual. The practice of risk management utilizes many tools and techniques including insurance to manage a wide variety of risks. Every business encounters risks some of which are predictable and controllable while others are unpredictable and uncontrollable. Thus organizations endeavour to methodically address the risks of their various activities by means of various strategies and tools. In the words of Kloman (1990) "Risk management is a discipline for living with the possibility that future events may cause adverse effects." In regard to the banking business, a bank actively and willingly go for risks, because the bank's return does not come without taking any risk. In fact, risk management is the core competence of a bank or an insurance company. By using its expertise, market position and capital structure, a financial institution can manage risks by repackaging them and transferring them to markets in customized ways.

3.2 Basel I and Basel II Accords

Basel is a city in Switzerland which has long experiences of formulating banking rules and policy. Bank for International Settlement (BIS) is officiated there. Nowadays global banking community has convergence to the Basel policy to promote confidence over all internationally active banks, commonly known as Basel I, Basel II and Basel III. Basel II is the second of the Basel Accords (now extended and effectively superseded by Basel III) having recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision. Basel II, initially published in June, 2004, was intended to create an international standard for bank regulators. One focus was to maintain sufficient consistency of regulations so that this does not become a source of competitive inequality amongst internationally active banks. Advocates of Basel II believed that such an international standard would help protect the international financial system from the types of problems that might arise should a major bank or a series of banks collapse. In theory, Basel II attempted to accomplish this by setting up risk and capital management requirements designed to ensure that a bank has adequate capital for the risk the bank exposes itself to through its lending and investment practices. Generally speaking, these rules mean that the greater risk to which the bank is exposed, the greater the amount of capital the bank needs to hold to safeguard its solvency and overall economic stability. Although Basel Capital Accord (Basel I) has been in place in Bangladesh since 1996, the regime of risk-based capital adequacy for banks was adopted in Bangladesh in 2007. In 2009 Bangladesh adopted Basel II framework with parallel run of Basel I. And Bangladesh saw the full implementation of Basel II in January, 2010.

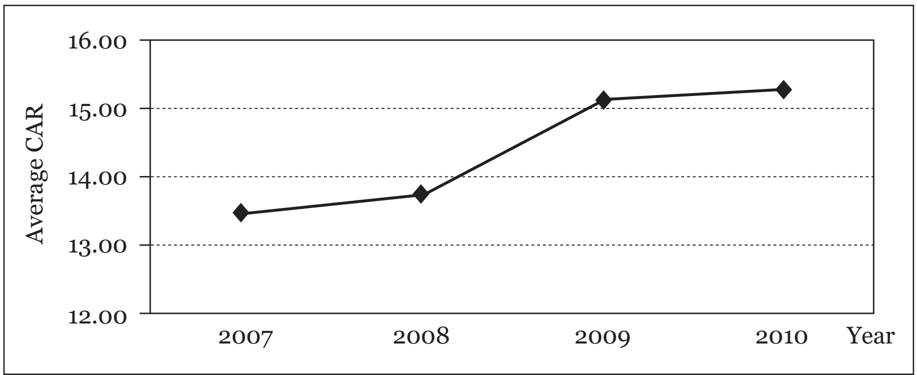
3.3 Capital Adequacy Assessment

According to the Basel Committee on Banking Supervision (BCBS) banks are in good health when Capital Adequacy Ratio (CAR) is at least 8% of the Risk Weighted Assets (RWA). This would ensure depositors' interest as well as banks' foundation. However, the Bangladesh Bank has set a minimum requirement of 10% of the ratio. Minimum capital of a bank is the stipulated assets must be hold by the banking company to ensure shock absorbance against in the event of insolvency for credit, market and operational risks. In Bangladesh, banks are required to maintain a minimum capital adequacy ratio (MCAR) of 10% of the RWA or BDT 4,000 million whichever is higher. In line with Basel II framework credit, market and operational risks are considered for calculation of RWA where credit risk is considered to be the possibility that a bank borrower or counterparty fails to meet obligation in accordance with agreed term, market risk is the probability of losses on account of on and off balance sheet positions arising out of variations in market prices, and operational risk. The Bangladesh Bank has earmarked minimum capital adequacy ratios of 8%, 9% and 10% respectively for the periods January, 2010-June, 2010, July, 2010-June, 2011 and July, 2011 onwards.

4. Development of Risk Absorbance Funds

4.1 Global Development

Financial Stability Institute surveyed Capital Adequacy Ratios of emerging Asian economies for the periods from 2007 to 2010 following Basel II and Basel III Accords. The overall result is shown in Figure 1. Appendix Table 1 contains country-wise information. The figures reveal that the emerging Asian countries as a whole has improved risk absorbance fund over the period. All individual countries also have demonstrated improvement of risk absorbance fund over the period as shown in the Appendix Table 1.

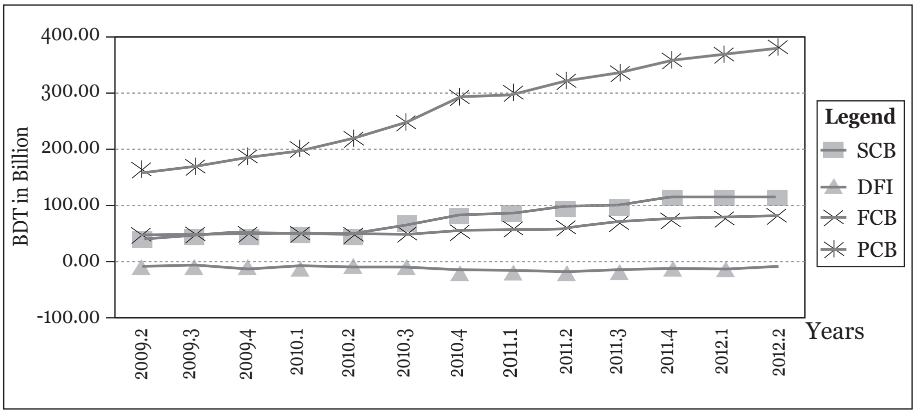


Source: Ahmed and Pandit (2011).

Figure 1: Capital Adequacy Ratio of Emerging Asian Economies

4.1 Bangladesh Perspective: Developments after Basel II Accord

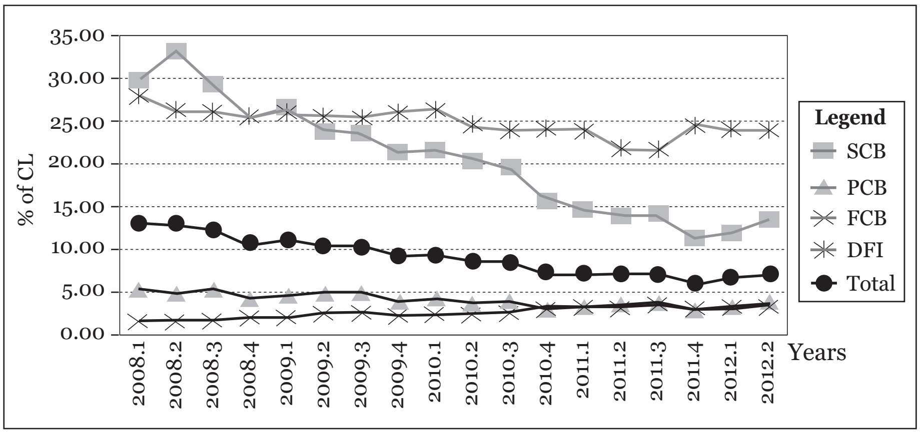
Since implementing Basel II framework in Bangladesh in 2009, the overall sectors' risk resilience capacity measured by CAR has moderately improved (Figure 2 and Appendix Table 2). The Foreign Commercial Banks (FCBs) and State-owned Commercial Banks (SCBs) have come out with moderately improved performance over the years. Records of the public commercial banks are commendable with highest risk absorbance fund in absolute terms as well as percentage improvement over the years.



Source: Bangladesh Bank Reports (undated).

Figure 2: Development of Risk Absorbance Fund of Different Categories of Banks in Bangladesh

Lending default rates of these categories of the banks are shown in Figure 3 below. It can be seen that overall banks' lending defaults have been reduced. A more detailed information are in Appendix Table 3.



Source: Bangladesh Bank Reports (undated).

Figure 3: Development of Lending Default Rates of Different categories of Banks in Bangladesh

In sum, excepting Development Financial Institutions (DFIs), banks in Bangladesh have acquired a significant positive change in its overall risk resilience capacity after implementing the Basel II framework. This performance has been concomitant with positive movements of macroeconomic variables such as stable economic growth, tolerable inflation rate, trade and investment.

4. Conclusion

The banking sector in Bangladesh is performing better following Basel Accords: the Basel framework has helped improves the level of capital adequacy as well as reduce lending default rate. These improvements have been concomitant with better macroeconomic performance of the economy. Therefore, further implementation of Basel II with some rationalization by the Bangladesh Bank will further improve risk management capacity of the banking sector of Bangladesh.

Appendix

Table 1: Capital Adequacy Ratios (CAR) of Emerging Asian Economies

(in per cent)

Economy	2007	2008	2009	2010
China	8.40	12.00	11.40	12.20
Hong Kong	13.40	14.70	16.80	15.90
Indonesia	19.30	16.80	17.40	17.20
S. Korea	12.00	12.70	14.60	14.70
Malaysia	12.80	12.20	14.90	14.40
Philipines	15.90	15.70	16.00	16.50
Singapore	13.50	14.70	17.30	18.60
Taiwan, China	10.60	10.80	11.60	12.00
Thailand	15.40	14.10	16.10	16.20
Average CAR	**13.48**	**13.74**	**15.12**	**15.30**

Source: Ahmed and Pandit, 2011.

Table 2: Development of Risk Absorbance Fund (Capital) in Banks

(in billion BDT)

Year\Banks	SCB	DFI	FCB	PCB	Total
2009.2	40.83	-9.29	47.05	160.94	239.53
2009.3	44.36	-9.27	49.33	166.80	251.22
2009.4	44.34	-10.56	49.21	186.31	269.31
2010.1	46.97	-10.17	48.48	199.51	284.79
2010.2	46.49	-6.38	47.58	219.79	307.48
2010.3	65.37	-7.15	49.85	243.62	351.69
2010.4	81.54	-17.87	53.89	294.36	411.93
2011.1	85.70	-17.34	57.87	298.99	425.22
2011.2	96.42	-18.62	61.66	322.24	461.70
2011.3	97.40	-19.16	67.84	337.06	483.15
2011.4	113.21	-11.86	74.34	360.31	536.00
2012.1	115.49	-11.97	77.09	369.32	549.93
2012.2	112.99	-11.25	80.61	379.67	562.01

Source: Bangladesh Bank.

Table 3: Trend of Banks' Lending Default Rates

Year/ Bank	SCB			PCB			FCB			DFI			Total
	Outstanding	Classified	% of CL	Outstanding	Classified	% of CL	Outstanding	Classified	% of CL	Outstanding	Classified	% of CL	% of CL
2008.1	473.83	142.13	30.00	1060.42	57.46	5.42	147.16	2.27	1.54	130.93	36.33	27.90	**13.15**
2008.2	461.43	152.89	33.13	1164.21	57.5346	4.94	152.61	2.30	1.51	142.13	37.25	26.21	**13.02**
2008.3	488.93	143.44	29.34	1243.39	67.17	5.40	156.23	2.50	1.60	143.67	37.62	26.18	**12.34**
2008.4	501.78	127.64	25.44	1284.21	56.99	4.44	150.98	2.68	1.90	146.65	37.32	25.45	**10.79**
2009.1	500.47	132.60	26.49	1323.64	62.46	4.72	150.03	2.68	1.91	146.30	37.95	25.94	**11.12**
2009.2	495.02	119.25	24.09	1387.76	67.57	4.87	150.74	3.68	2.44	153.78	39.23	25.51	**10.50**
2009.3	506.62	119.54	23.60	1453.34	71.73	4.94	145.49	3.75	2.58	153.82	39.07	25.40	**10.36**
2009.4	549.32	117.47	21.38	1574.71	61.769	3.92	153.25	3.49	2.27	162.50	42.11	25.91	**9.21**
2010.1	560.91	121.63	21.69	1629.86	67.71	4.15	152.38	3.66	2.40	162.95	42.91	26.33	**9.41**
2010.2	588.69	120.66	20.50	1765.36	65.11	3.69	161.99	3.91	2.41	179.22	44.11	24.61	**8.67**
2010.3	614.67	120.79	19.65	1871.80	71.56	3.82	170.74	4.27	2.50	185.71	44.26	23.83	**8.47**
2010.4	687.02	107.57	15.66	2044.42	64.30	3.15	184.86	5.53	2.99	205.78	49.69	24.15	**7.27**
2011.1	737.30	109.39	14.84	2130.33	71.80	3.37	187.98	6.11	3.25	209.45	50.22	23.98	**7.27**
2011.2	785.58	110.65	14.08	2197.88	77.73	3.54	208.12	6.48	3.11	224.63	48.99	21.81	**7.14**
2011.3	790.21	111.96	14.17	2274.24	82.84	3.64	207.59	7.21	3.47	225.11	48.71	21.64	**7.17**
2011.4	814.05	91.71	11.27	2443.36	72.02	2.95	211.66	6.26	2.96	229.94	56.45	24.55	**6.12**
2012.1	839.09	101.20	12.06	2552.41	87.78	3.44	223.77	7.15	3.20	236.00	56.76	24.05	**6.57**
2012.2	869.49	117.72	13.54	2682.63	103.05	3.84	230.94	7.33	3.17	259.83	61.91	23.83	**7.17**

Source: Bangladesh Bank Reports (undated).

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Prospects of Financing Infrastructure and Energy Sectors in Bangladesh Through Bond Market

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Abstract In view of the inadequacy of funds of the government of Bangladesh to finance the development projects of infrastructure and energy sectors, this study makes an attempt to look for a new source of finance – the bond market. The country's capital market, in its present state of development, cannot fill in the resource gap. However, the potentiality of the market in this regard is enormous: success of bond markets of some countries of the world leaves important lessons for Bangladesh. The supply base institutions which are potential issuers of bonds has to be created or oriented. The demand base households, employees and institutions that are the potential sources of funds in the form of pension, provident fund has to be geared to be the suppliers of funds. The necessary institutional and legal frameworks are needed to be put in place for these purposes.

Keywords Bond Market, Securitization, Financial System, Debt Sustainability Indicator, Sovereign Bond

1. Introduction

To meet the need of increased investment in infrastructure and energy sectors, government of Bangladesh established an Infrastructure Development Company Limited (IDCL) in 2000 and subsequently in 2009 a strategy of Public-Private Partnership (PPP) was undertaken to overcome the shortage of funds and to deal with arrangements related

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to financing of related projects. Besides, the government has created a Bangladesh Infrastructure Development Fund Authority to manage the fund. Inspite of these measures the requisite resources for long term investment in these sectors are not forthcoming.

In quest of resources to meet large budget deficits, the government has been turning to other sources including internal and external borrowing with partial success. There are instances in other countries of financing large infrastructural projects through setting of bonds suggesting potential scope of resource mobilization from this source. In view of this, this paper makes an attempt to examine the prospects of introducing bonds for financing infrastructure and energy sector projects in Bangladesh. The next section is devoted to assessing infrastructure and energy sectors' resource needs. Section 3 deals with funds available in the financial system. Experiences of some selected countries in providing fund are discussed in Section 4. Prospects of bonds market in providing fund for infrastructure and energy sectors are discussed in Section 5. Section 6 presents conducting remarks.

2. Assessment of Investment Requirments

2.1 Transport and Communication

Components of physical infrastructure in Bangladesh are roads, railways, inland waterways, sea ports, maritime shipping and civil aviation catering for both domestic and international traffic. According to the Sixth Five-Year Plan FY2011-FY2015, there are about 21,040 km of paved roads; 2,835.04 km of railways (BG 659.33 km, MG 1,800.88 km and DG 374.83); 3,800 km of perennial waterways which increases to 6,000 km during the monsoon, 2 seaports and 2 international airports (i.e. Dhaka and Chittagong) and 8 domestic airports.

With praiseworthy development records, combined with rapid urbanization, Bangladesh is considered to be the potential hub of the regional and inter-regional connectivity and business of South Asia and South-East Asian regions. Keeping in view the current paucity of infrastructural facilities, current and future volume of domestic and regional traffic in the wake of the Asian High Way & Trans Asian Railway, if comes into effect, the Sixth Five-Year Plan (SFYP) FY2011-FY2015 has given special emphasis on developing a balanced and an integrated transport network through adoption of various strategies and programmes. Recognizing the importance of the infrastructural needs, the government has set physical targets of various components of the system for a large number of projects in the transport sector for implementation over medium to long term (by 2021 and over two five year plans starting from 2011). An estimated amount of USD 16.16 billion will be required for implementing major transport projects.

2.2 Energy

The major portion of the rural population has no access to gas and electricity, although there is high demand of these energies. Even in the cities, severe power crisis, power outage, load shading and power rationing are regular phenomena. The government has set physical targets in the Sixth Five-Year Plan (SFYP) FY2011-FY2015 to generate the required additional power on short, medium and long term basis to match domestic supply with growing demand. The envisaged power generation has been planned keeping in view the Perspective Plan (2010-2021) which has set a vision to ensure "Power for All" by 2021. In the SFYP, the government took initiative to generate additional electricity of 2166 MW by FY'11, 1178 MW by FY'12, 3176 MW by FY'13, 2333 MW by FY'14 and 2410 MW by FY'15 in the public and private sectors.

In addition to power generation there is the need of power transmission and distribution networks to ensure efficient and uninterrupted power supply. Transmission of newly generated power to the doorsteps of customers, new transmission and distribution infrastructure will be needed in addition to renovation and preservation of old networks. Moreover, natural gas, the major source of energy, will also need huge investment for exploration, development and distribution. Recognizing its importance in business and household consumption the government places top priority in allocating resources to this sector with an average annual investment of USD 1.31 billion during the SFYP. Thus government's planned annual investment requirement for transportation, communication and energy sectors comes to be USD 2.55 billion annually during the Sixth Five-Year Plan and afterwards. As infrastructure sector include telecom, water and sanitation, air transport and tourism etc. the actual requirements of investment for developing the infrastructure sector is much higher than what the above estimation shows. It is already stated that to meet the huge shortfall of resources, the government emphasized the need for financing the infrastructure and energy sector projects through PPP arrangements and investments from the local and foreign enterprises. But resource mobilization by means of these arrangements has not been successful. Alternative options are required to be sought.

3. Current State of the Financial System to Provide Funds

It is worthwhile to bring into light the current state of orientation of various institutions of the financial system of Bangladesh. Commercial banks are constrained by their provision to make large investment in the infrastructure sector. Because for banks with the existing fund limit of a maximum of 15% of total capital to any single borrower, the average level of investment capacity of a single bank works out to be USD 20 million at the end of December, 2011, which is too small to finance any large infrastructure or energy sector project. However, since mid 2011 this limit has been removed especially for power sector projects. Second, commercial banks are largely constrained to making loans to a maximum term of 5-7 years and generally require equity levels of 25%-35% which are also considered to be major barriers to finance infrastructure projects. Because of these considerations, scheduled banks have had limited exposure to the infrastructure sector. At the end of 2012, only about 3% of total loans and advances of the scheduled banks was provided to various sub-sectors of infrastructure.

Non-bank Financial Institutions' (NBFIs) important role in financing projects of infrastructure and energy sectors is well established from global experiences. The major constraints to the prospects of the NBFIs in Bangladesh lies in their inability to optimally utilize their capital and balance sheet through mechanisms like securitization. Chiefly for this reason, NBFIs were unable to provide large amount of loans and advances to power plants and other infrastructural development projects. During 2008-2011 only 7.92 % to 9.37% of their total loans and advances were provided to power plants and other infrastructure projects. It may be noted that FDR, shares and debentures of Joint Stock Companies constitute the major portion, 81% to 87%, of their total investment while government securities and others constitute the rest.

Insurance companies in Bangladesh have almost no exposure to energy and infrastructure development, basic reasons being regulatory restrictions, the under-developed corporate bond market and absence of efficient risk transfer mechanisms (such as securitization, credit derivatives, credit insurance etc.). Of note is that FDRs with banks and financial institutions, and shares and debentures of joint stock companies constitute around 60 per cent of their total investments while the rest goes to government securities, i.e. treasury bills and treasury bonds.

Capital market financing for infrastructure and energy sector development can occur both in equity and debt forms. Normally, equity financing for infrastructure are raised through listed infrastructure funds. On the other hand, depending on the future cash flows from selected specific infrastructure projects, bonds can be issued in the capital market. But till March, 2013, there was no listed infrastructure fund in Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange

(CSE). And eight listed companies of the energy sector had limited exposure to capital market only 9.29% of the total market capitalization (Table 1).

Table 1: Capital Market Exposure to Energy Sector up to March 31, 2013 (BDT in crore)

Listed Companies	Market Capitalization			
	31 May 2012	30 June 2012	31 December 2012	31 March 2013
Total Energy Sector	16,406.76	16,691.24	15,437.10	15,235.36
Total Market Capitalization	194,012.30	192,585.80	182,840.70	163,973.20
Energy Sector as % of Total	8.46	8.67	8.44	9.29

Source: Dhaka Stock Exchange Monthly Review, various issues.

Capital market in Bangladesh remains underdeveloped partly because the corporate bond market is small and unable to offer diversified range of financing products. Generally, large-sized infrastructure investment requires about BDT 100 billion per project. The Dhaka Stock Exchange with market capitalization of only about BDT 1,639 billion as on 31 March, 2013 can hardly support financing of infrastructure projects. Complexity of ownership right of infrastructure projects, absence of required fixed income funds, and a lack of benchmark bonds are the major problems of developing the bond market and financing the infrastructure projects through capital market in Bangladesh. A proper regulatory framework in the capital market is required to effectively provide a linkage between savings and the preferred infrastructure investments. The right regulatory framework will come about through gradual restructuring and building up public confidence in the capital market.

Apart from the financial institutions, the government embarked on an yet another source. Public-Private Partnership (PPP) programme introduced in FY2009-10 represents a new initiative in Bangladesh relative to that in the United States in 1953 and some other countries in the world. The government sanctioned BDT 16 billion to this programme for the development budget in FY2009-10. But there has not been any meaningful progress in this regard. Interest of private participation is yet to be noticeable for following reasons:

- Project preparation requires technical, financial and legal skills which the government sector lacks.
- Private sectors are generally enthusiastic about the projects which entirely benefits them and no benefit accrues to other investors as by-products or otherwise.

- Costs of feasibility analysis of a large infrastructure projects are generally high which discourage private investors to undertake the projects. Private sectors need adequate supports from the government for implementing the project which are reportedly not obtained.
- In the pre-project evaluation, government agencies assume leading role focusing more on the benefit of the country rather than the interest of the private investors making the project unattractive to the private investors.

The government needs to address these issues apart from ensuring infrastructural facilities needed for the projects.

4. Cross Country Experience

4.1 Cross Border Experience

Different countries have adopted different strategies to address their infrastructure financing problems. Experiences of a few of these would be instructive. The United States Municipalities use revenue bonds extensively to finance a wide range of public projects such as ports, airports, highways, sewerages, hospitals, and colleges. On the other hand, Korea uses 'social overhead capital bonds' to finance infrastructural projects. There have been six cases of Social Overhead Capital (SOC) bond issuance in Korea finance heat and power plants at the Inchon International Airport in 1999. Because of the special tax treatment SOC bonds were a popular type of instrument in the wake of 1997 financial crisis. In recent years SOC bonds made have turned less attractive due to relatively low expected rate of return and high transaction costs involved. Hong Kong's Special Administrative Region (HKSAR) raised HKD 6.0 billion in 1999 by securitizing revenues from the tolled infrastructure facilities consisting of the five tunnels and one bridge/ road link. Hong Kong's securitization scheme was successful chiefly because of steady cash flows generated by the operationally matured tolled facilities and strong government support in the form of direct payments to mitigate certain pre-specified risks.

Coming to experiences from Asia, Malaysia's case is noteworthy. In Malaysia on average infrastructure bonds accounted for 36% of the total bond issuance between 1993 and 2006. A sharp decline in issuance in 1998 and 1999 was caused by the Asian financial crisis. The subsequent sharp rise from 2000 on wards was partly the result of corporate debt restructuring that saw the substitution of short-term bank borrowings and bond facilities with long tenured bonds to address the funding and maturity mismatches that contributed to the financial distress of infrastructure companies. The power sector is the largest issuer with total value issued amounting to MYR 45.0 billion or 41.5% of the total of MYR 108.4 billion issued between 1993 and 2005. Transport is the second largest with MYR 39.0 billion or 36.0% of the total issue value. The other two sectors, water and telecommunications, account for the remaining amount of MYR 13.7 billion (12.6%) and MYR 10.7 billion (9.9%) respectively during the period as mentioned above. A special feature of the bond market is that it is the major provider of funds for infrastructure financing in the private sector of Malaysia. The total value of bonds issued by the infrastructure sector amounting to MYR 108.4 billion represents 72% of the MYR 150.3 billion invested in infrastructure by the private sector.

The next door neighbor, India, started developing, as part of its financial institution reform with US assistance, market-based bond market since 1994 involving national, state and local governments. Several Urban Local Bodies (ULBs) and utility organizations issued bonds and mobilized over INR 12,249 million through taxable bonds, tax-free bonds and pooled financing up to 2007. To boost municipal bond market, the Government of India provided tax-free status to municipal bonds. Provision of tax incentives for municipal securities provided a basis for national government subsidy for ULBs bond offerings thus substantially reducing interest cost of financing local infrastructure projects. Tax-free status helped local governments improve their fiscal management enough and investment capability in infrastructural projects.

A tour of the world bond market shows that it provided resources for not only the infrastructure and energy sectors but also for other development needs. It is noteworthy that up to 2001 bond market constituted about 126 per cent of GDP in the USA and 143 per cent in Japan. In Asia, outstanding local currency denominated bonds as percentage of GDP in Malaysia, Korea Republic and Singapore were 93.4, 69.3 and 37.4 respectively in 2001 (Table 2). The figures are higher in the recent years.

Table 2: Outstanding of Local Currency Denominated Bonds, 2001 (% of GDP)

Countries	Public Sector	Financial Institutions	Corporate Sector	Total
China, People's Rep. of	19.6	8.3	0.7	28.7
Hong Kong, China	11.9	12.0	3.1	26.9
Korea, Rep. of	18.3	23.2	27.8	69.3
Malaysia	35	7.9	50.6	93.4
Philippines	—	—	—	32.0
Singapore	32.9	0.0	4.6	37.4
Taipei, China	—	—	—	17.0
Thailand	26.2	2.5	5	33.7

Source: ADB (2003); Data of Indonesia, Philippines and Taipei and China's are for 2000, 1997 and 1998 respectively.

4.2 Bangladesh Experience

In contrast to the global experience the amount of local currency denominated bonds was only 1.40 per cent of GDP in Bangladesh in july 2003 which rose to 7.38 per cent in June 2012 (Table 3). The bond market links the issuers having long-term financing needs with investors willing to place funds in long-term interest bearing securities. It makes the financial market more competitive by generating market based interest rates reflecting opportunity cost of funds at each maturity and reduces high dependence on the banking system.

Table 3: Outstanding Local Currency Denominated Bonds in Bangladesh (BDT in crore)

Items	Outstanding	
	as on 30/06/2003	as on 30/06/2012
GDP	300485	914780
Bonds (less than 5 years)	202.00 (0.07)	884.00 (0.10)
Bonds (above 5 years)	4015.00 (1.34)	65944.55 (7.21)
Corporate Bonds (Market cap)	—	658.17 (0.07)
Total	4217.00 (1.40)	67486.72 (7.38)

Source: Annual Report, Bangladesh Bank and Monthly Review of Dhaka Stock Exchange. Figures in parentheses indicate % in GDP.

Bond market in Bangladesh is less diversified and hooked to banks. In a mature bond market investor base is generally well diversified with banks, financial institutions, mutual funds, and contractual savings institutions such as pension funds and insurance companies as constituting parts. Bangladesh needs to strengthen its regulatory regime in a comprehensive manner covering all institutions dealing with both household savers and institutional investors (Mujeri and Rahman, 2008).

The size of the bond market depends on issuance of bonds for both domestic and overseas markets. Bangladesh's bond market is very small. The corporate bond market is the least developed. Trading in Bangladesh corporate debt market is insignificant, and most of the issuances are currently on a private placement basis. Bangladesh is yet to mark its debut on issuance of sovereign bond and as such there is no experience and exposure in the international capital market. An integrated financial system provides competitiveness. Bangladesh's bond market is not well integrated with the rest of the markets in the financial system. Thus price differentials for assets of similar type exist in Bangladesh financial system rendering the bond market less attractive to the investors.

Infrastructure projects usually involve high upfront cost and long payback period. Domestic investors are generally low risk takers and are more focused to short payback strategy. For expanded market Bangladesh has to maintain a favorable sovereign rating for making Bangladeshi debt instruments attractive to the foreign investors. Moreover, There is a lack of benchmark bonds in Bangladesh for which Bangladesh debt securities market has not taken off. Without benchmarks in place, all other fixed-income instruments, including corporate bonds, have lacked a pricing base.

Lengthy issuance period and high issuance costs are also constraining factors. On average, it takes between 25 to 30 weeks to complete legal formalities in issuing a bond in Bangladesh. This period is much longer than time is required for taking a bank loan. As such corporate borrowers find it easier to access credit from banks than to comply with the governance standards required for raising funds through the bond market or to meet the disclosure requirements for listing on one of the exchanges. Corporate borrowers find it easier to access credit from banks than to comply with the governance standards required for raising funds through the bond market or to meet the disclosure requirements for listing on one of the exchanges. Coming to issuance cost, Bangladesh is one of the top countries in the world in this regard. In particular, the registration fees, stamp duties, annual trustee fees on outstanding amounts, and ancillary charges have stifled demand. Registration fees for debentures, however, have been significantly reduced in recent years.

5. Prospects of Bond Market

Although the current bond market of Bangladesh is underdeveloped, Bangladesh's conditions give reasons to expect that it will fare well in the future if appropriate measures are taken. It is worthwhile to mention a few of these favourable conditions.

5.1 Favourable Conditions

Bangladesh has a good track record of debt servicing and never defaulted on its internal or external debt obligations despite the Asian and global financial crises, occasional social unrest and natural disasters. This solid track record combined with healthy macroeconomic feats put the country on a high rating with low risk of debt distress by

Debt Sustainability Analysis (DSA) developed by the IMF and the WB. On the macroeconomic front, apart from stable economic growth and less than double digit inflation rate, Bangladesh presents two types distinctly favourable conditions. One, Bangladesh has been a country of surplus resources when national savings-investment scenario is considered (Table 4).

Table 4: National Savings and Investments in Bangladesh during FY09-12 (% of GDP)

	FY09	FY10	FY11[P]	FY12	FY13
Investment	24.4	24.4	25.2	26.5	26.8
National Savings	29.6	30.0	28.4	29.2	29.5
National Savings-Investment Gap	**5.2**	**5.6**	**3.2**	**2.7**	**2.7**
CAB of BOP	**2.7**	**3.7**	**0.8**	**1.4**	—
Leakage in National Savings	**2.5**	**1.9**	**2.4**	**1.3**	—

Source: Annual Reports, Bangladesh Bank.

Robust remittance flows have caused the surplus resource condition. The excess of savings over investment is a sign of leakages in our savings away from investment. It shows that a big amount of savings are not channeled into productive investment. Utilization of these savings for productive purposes is a big challenge. A comprehensive plan is needed for diversion of funds from unproductive uses to productive investments particularly in the infrastructure and energy sectors. Two, key sustainability indicators of sovereign bond issuing country are important considerations for overseas investors. In these respects, Bangladesh is ahead of some comparators in the South and South East Asia (Table 5).

Table 5: Bangladesh's Overall Government Debt, External Debt and Currency Ratio as Compared with Other Regional Countries, 2010 (as % of GDP)

Country	Sovereign Rating	Government Debt	External Debt	Debt servicing Ratio
Bangladesh	Ba3	40.6	22.4	2.8
Pakistan	B3	61.6	32.1	8.2
Sri Lanka	B1	74.8	46.1	10.6
India	Baa3	64.5	28.3	2.8
Cambodia	B2	41.5	35.9	2.0
Vietnam	B1	42.2	13.1	2.8

Source: S & P Sovereign Risk Indicators December, 2010.

Bangladesh has attained a relatively good sovereign credit rating by the two world renowned rating agencies, Standard & Poor and Moody's. Sovereign credit rating of "BB-" by S&P and "Ba3" by Moody's in 2010 remain unchanged by Bangladesh's credit ratings are higher than these of several Asian countries including Vietnam, Cambodia and Sri Lanka. This good image is helpful for raising funds from international capital markets through issuance of sovereign bonds.

Bangladesh's overall debt level is lower than all the comparators mentioned in the table. Also, Bangladesh's external debt is quite low, lower than all countries compared except Vietnam. It can be seen that India like Bangladesh has comparatively big space for issuing sovereign bond to get foreign fund. Also, Bangladesh's debt servicing costs are not higher compared with its regional comparators. The outlook for debt service burden also remains favourable since both exports and remittance receipts are expected to remain buoyant over the medium term. Bangladesh's current account surpluses have contributed to the build-up of respectable foreign exchange reserve. Despite some fluctuations associated with Asian Clearing Union (ACU) settlement in every alternative month, Bangladesh's foreign exchange reserve exceeded USD 18 billion on December 19, 2013.

5.2 Potentiality of Broadening Investors Base

Up to December, 2011, there were 47 scheduled banks, 30 Non-Bank Financial Institutions (NBFIs) and 62 Insurance Companies (ICs) in Bangladesh. Near about 200 thousand employees were working in these institutions and almost all of them were maintaining Provident Funds (PFs) with their employment authorities. These provided funds are a good source that can be brought under long-term financing for infrastructure and energy sectors through issuance of bonds. Information regarding provided funds from different organizations are given in table 6. The amount of PFs of the employees of NBFIs and ICs was BDT 7,402.81 crore (scheduled banks BDT 6,517.56 crore, NBFIs BDT 38.27 crore, ICs BDT 229.37 crore and Bangladesh Bank BDT 617.60 crore) at the end of December, 2011 which was invested in government securities, Treasury Bills and Treasury Bonds, Sanchaypatras (Savings Certificate like *Bangladesh Protiraksha Sanchaypatra* and *Bangladesh Sanchaypatra*) and in FDR. The amount invested in FDRs in banks accounts for about 60% (BDT 4,388.10 crore) of the total fund, which could easily be diverted to infrastructure bonds.

Table 6: Total Outstanding Balance of PFs of Banks, FIs and ICs as of December, 2011 (BDT in crore)

	Banks	Financial institutions	Insurance Companies*	BB**	Total
Outstanding Balance of Employees Provident Fund/Pension fund (A+B)	6,517.56 (88.04)	38.27 (0.52)	229.37 (3.10)	617.60 (8.34)	7,402.81 (100.0)
A. Investment from employees provident Fund/Pension fund	6,293.35	38.27	222.89	606.07	7,160.58
a. Govt. Securities	1117.53	3.74	26.20	38.02	1,185.49
b. Sanchaypatra	702.46	6.82	99.77	568.05	1377.10
c. FDR	4,287.70	23.84	76.56	—	4,388.10
d. Shares and Debentures	80.65	3.52	20.36	—	104.53
e. Other Investments	105.01	0.35	6.48	—	111.85
B. Cash in hand	224.21	0.00	0.00	11.53	235.74

* Up to end December 2010, ** Up to end June, 2011

Source: Data collected from the respective all institutions and compiled for the study purpose by authors' own. Figures are parentheses indicate percentage in total.

Accumulated PF amount of the employees of joint-stock companies, microfinance institutions approved by Microcredit Regulatory Authority (MRA) and garment industries under Bangladesh Garments Manufactures and Exporters Association (BGMEA) membership will make a sizable amount. These fund, if can be channeled properly will go a long way to make up the long-term financing gap of the infrastructure and energy sectors. For instance, there were 3.6 million workers directly working in the garments industries under BGMEA membership in December, 2011. As per minimum wage gazette of 31 October, 2010, the workers' salary range was from BDT 3,000 to BDT 9,600. If PF provision can be arranged for the garment workers, a big amount of money would be available which can be directed for investment in infrastructure and energy sectors. If the average gross salary of the workers is about BDT 6,300, a provision of PFs of 5% of the gross salary of their gross salary would create provident fund amounting BDT 1,360.8 crore a year. Alternatively for provision of PFs of BDT 100 per month per worker would create a fund of BDT 432 crore a year.

Similarly, PFs amount of the employees of jointstock companies, Microfinance Institutions (MFIs) approved by Microcredit Regulatory Authority (MRA) can emerge as important source of fund for investment in bond for financing infrastructure and energy sectors development. Furthermore, salaries of government civilian employees including teachers of all categories (government and MPO) can be counted as sources of PF, fund for bond market and then fund for infrastructural projects. A simple arithmetic will show the size. According to Bangladesh Bureau of Educational Information Statistics (BANBEIS), there were about 867 thousand teachers and other employees at the end of 2011. Considering their minimum pay scale, a monthly collection of provident fund at the rate of 10% of salary, would generate a fund of BDT 925.08 crore per year a big sum indeed.

6. Concluding Remarks

The financial system of Bangladesh is not developed and diversified enough to provide finance for the development of infrastructure and energy sectors. The budgetary allocations to these sectors fall short of the requirement and most importantly realized investments fall short of allocations. In view of the importance of these sectors to the national economy, the government of Bangladesh has earmarked some physical targets and corresponding resource allocation, which in effect are resource needs. The existing (traditional) sources of finance – tax revenue, internal and external borrowing and foreign governments' assistance cannot meet the expenses required. It is time to turn to a prospective new source – the bond market. Experiences of other countries like the US, Korea and India etc. can fruitfully be utilized to develop bond market in Bangladesh. Essentially there is need to address the demand and supply side constraints for the development of bond market backed by making available the needed regulatory framework. Some of these are mentioned below.

Bangladesh Infrastructure Development Bond (BIDB) can be issued by the Bangladesh Finance and Investment Company Limited both in Taka and US dollar terms. With an attractive rate of return, BIDB may help direct funds both from potential domestic and foreign sources (such as Bangladeshi expatriates and wage earners). At the same time, a special savings instruments such as Bangladesh Abokathamo Unnayon Sanchaypatra (Bangladesh Infrastructure Development Bond) can also be issued by the National Savings Directorate (NSD) to attract funds from the savings of local private individuals. The GoB may consider issuing its debut sovereign bond for transaction in the international capital market for the purpose of financing strategic infrastructure investments in Bangladesh. Initially, the size of the bond issuance could be between USD 500 million to USD 1,000 million. The timing of the issuance of the bond may be chosen that reflect healthy macroeconomic conditions.

For the development of the supply base by tapping pension and provident funds of the employees of the formal (organized) sectors and insurance companies especially, life insurance companies. This would require channeling of funds through issuance of infrastructure bonds. For the sake of broadening investors' base, protecting investors' interests and for channeling funds to infrastructure bonds, the Government of Bangladesh (GoB) may set up Bangladesh Provident Funds Authority (BPFA) as a regulatory body.

Securitization of existing infrastructures (like Jamuna Bridge) can also be a good option for financing new infrastructure projects. For this purpose, the GoB may be required to formulating a new law for allowing private entrepreneurs/individuals to buy the collateralized infrastructure bonds, backed by income stream from this collateralized asset, and use the proceeds to finance new infrastructure projects.

A market-based pricing mechanism for all the fixed income instruments including corporate and infrastructure bonds may be created and the secondary market for corporate bonds is needed to be strengthened. A market-based yield curve for government bonds is an essential step for creating a viable bond market. The government bond yield curve will serve as the benchmark for the development of corporate and infrastructure bond markets. Besides, the government is required to take steps in rationalizing the interest rate structure of all fixed income instruments including savings certificates issued by the National Savings Directorate (NSD).

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An Account of Trade Service Operations of Banks in Bangladesh

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Abstract The extent and quality of trade services affect trade flows. There is dearth of information on the practices of trade services in Bangladesh. Getting to know the trends, dimensions and problems connected with trade services offered by the banking industry is the first step towards the solution of the problems. In view of this, the objective of the study is accounting of the activities of trade service operations of banks. Some malpractices relating to trade services by banks are damaging the credibility of banks and creating distrust among banks engaged in interbank transactions. The study identifies several issues that deserve serious attention.

Keywords Open Account, Demand Guarantee, Bill of Exchange, Letter of Credit, Documentary Credit

1. Introduction

Bangladesh is closely linked to the global economy mainly through trade flows that have grown over the years. Banks facilitate payment and finance services to the traders and thus contribute to the integration of Bangladesh with global economies. Trade finance and related services contribute to international trade in four areas: finance, payment facilitation, risk mitigation and making available information about the status of shipments. The methods of trade payments and other trade services affect the bargaining power of traders. Credibility of traders, trade service providers or banks and regulatory framework importantly influence the extent, quality and efficiency of trade services. For the improvement of the trade services, it is important to know the operations, progress and trends of different trade services activities by the bankers, academicians and researchers of the relevant fields. Creating an environment of making available requisite information to pave the way for rectifying malpractices, facing challenges and under-taking future course of actions for greater efficiency is the met needed course

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of action in this regard. Review of these activities would provide opportunities for further research activities. Collective efforts of bankers, academicians and researchers are deemed necessary for improving trade services operations by banks.

Against the above backdrop, the broad objective of the study is set to review the activities of trade services operations – mainly trade payment and trade finance of banks. For carrying out the study, overwhelming dependence has been on secondary data. These are collected from different publications related to international trade payments and financing practices. ICC documents have been the major secondary data source. BIBM's review studies are used for recent information.

The study has been organized under several sections. The introduction is followed by Section 2 which deals with various trade services and their operational procedures. Legal frameworks of inter-national trade services are discussed in Section 3. Section 4 is concerned with the trends of trade services and some other related issues. Challenges and malpractices of trade services operations in Bangladesh are described in Section 5. Finally Section 6 contains concluding observations.

2. Trade Services and Their Operational Procedures

2.1 Methods of Trade Payment

Broadly, trade services include services related to trade payment and trade finance. Ideally four categories of trade payment methods are in use: cash in advance, open account, documentary collection and documentary credit. Many cases involve more than one of these elements. Open account is the most widely used form of trade payment method in global cross border payment transactions – about 80%-85% of trade transactions are settled on an open account basis. The next important trade payment method is documentary credit and documentary collection. Though documentary credit is a very reliable form of trade payment method, high cost involved with it limits its use. Cash in advance, most preferable to the exporter, comes next in respect of use. In Bangladesh traders are required to contact trade services departments of banks whatever may be the methods of payment. But in many overseas countries the fund transfer services for facilitating these methods are performed by different departments.

As regards trade payment mode, it is agreed upon in the purchase/ sale agreement. At the operational level, two types of payment processing mechanisms are followed: branch based and centralized. Under branch-based arrangement, AD branches of a particular bank conduct their trade service operation not only for their own customers but also for the customer of Non-AD branches. Under centralized arrangement, trade services are offered through a centrally managed department or unit. Sometimes a hybrid arrangement is followed under which customers of non-AD branches are served from a centralized unit and AD branches serve their own customers. Under centralized system, bank management can have control over the trade services activities and may ensure quality and better monitoring; however, banks with inadequate modern technology may not adopt the system. It is important highlight about a few methods of payment.

Cash in advance method of payment requires the buyer to place funds at the disposal of seller (exporter) prior to shipment of goods in accordance with the sales/purchase contract. In this method, purchase/sale contract is the guiding document. In Bangladesh, there are a few areas where cash in advance is used. In imports, the method can be used only for importing books, journals and under retention quota up to certain limit; however, import against cash in advance up to any limit is allowed in case of repayment guarantee by an overseas bank. In export there is no such restriction.

Open account is the reverse of cash in advance. This is an arrangement between the buyer and seller whereby the goods are manufactured and delivered before payment is required. The seller must have absolute trust that he will be paid on the agreed date. Through using the method, the seller can avoid a lot of banking charges and other costs, but he has no security that he will be receiving payment in due course. For this reason, the exporter may not be willing to accept this sort of mode of payment. Though it is the most popular method of payment in the world, there are relatively less instances of open account (mainly in EPZs) due to regulatory compulsion in the country. In export, there is no explicit restriction, however, of EXP signing requirement. Banker and exporter are considered equally liable if export proceeds are not received within 4 months following the date of shipment. There are some cases of direct handling of documents by clients (exporter and importer). In such a case though bank is involved at the stage of issuing EXP, the operational procedure is in line with open account method.

Documentary collection method provides a means of payment whereby the exporter can ensure that the buyer should not be able to take possession of the goods until it has paid or given a payment undertaking. In return for this payment or payment undertaking, the importer receives documents allowing possession of the goods. The system is appropriate to cases in which the seller is unwilling to provide the merchandise on open account terms but does not need a bank undertaking such as a documentary credit. Under the arrangement, the exporter hands over the documents to the remitting bank and asks it to collect payment or acceptance on its behalf using the service of one or more than one bank/banks (collecting and presenting bank). The method is regulated by one ICC publication known as Uniform Rules for Collection (URC 522). Purchase/sale contract is particularly important for the method. In case of export, the method is used in Bangladesh. Other than a few exceptions, documentary collection cannot be used in importation.

Documentary Credit is a classic form of international trade payment method that substantially reduces risks for both exporter and importer. This is an arrangement whereby the importer's or buyer's bank is committed to pay an agreed sum of money to the exporter/seller under some agreed conditions. Documentary credit or LC is an undertaking or commitment issued generally by a bank to pay the exporter a certain amount provided that the terms and conditions of the documentary credit are complied with. The conditions are about submission of certain documents in certain form. Documents must be in order to receive payment. Documentary Credit is guided by a classic form of set of rules known as Uniform Customs and Practice for Documentary Credits (UCPDC) published by ICC. In the payment mechanism of LC, banks have a very active role to play. Operational procedures of documentary credit in importation through land port is different a bit in the country, where in almost every cases goods are cleared against delivery order before receiving the documents by the issuing bank through banking channel. Short distance appears to be one of the main responsible factors for this. A copy of LC is generally sent to the land port authority directly. In some cases the LC and the delivery order are issued simultaneously and handed over to the applicant for onward submission to the land port authority.

Under the current version of UCPDC, LC means Irrevocable LC that cannot be amended or cancelled by the issuing bank without the consent of the beneficiary. Different types of LC are there in practice that includes transferable, confirmed, back-to-back, revolving, red clause and standby letter of credit. Of the different types, transferable and back-to-back are commonly observed in Bangladesh. Back-to-back is basically a financing technique. In connection with the operation of transferable LC, banks of Bangladesh and exporters have been facing some difficulties. It is mainly connected with the practice of 100 per cent transfers to the second beneficiaries in Bangladesh. This is an indigenous practice generally not common in other countries. In a few cases, confirmed LC is issued from Bangladesh. There are also some instances of receiving LC issued by reputed corporate (corporate LC).

These are very much within the framework of UCP. A bank is commonly involved in the process of transmitting LCs, documents and payments on behalf of an issuing corporate. J C Penny is one of such issuers of corporate LC to Bangladesh.

Mix-up payments is combination of more than one trade payment methods – is not unusual in the country. Mixture of LC and cash in advance is not uncommon in case of export from Bangladesh. There is no regulatory restriction in this connection as proceeds are received by the country before making shipment. In case of import, other than a few exceptions, such mixture requires permission (other than the cases of A type industry in the EPZ). Moreover, mixture of different modes within the same method of payment (in case of LC) is also observed. In such cases, generally certain amount is paid at sight and remaining at acceptance.

2.2 Documents of Trade Transactions

Commonly used documents in international trade transactions include commercial invoice, transport documents, insurance documents, bill of exchange etc. The extent and nature of documents required depend upon purchase and sale agreement. In case of LC, the documentary requirements are noted in the LC document paper itself. For selecting right documents, the trading parties are required to consider both domestic and international regulations carefully.

Invoice is the seller's bill for the merchandise. It is issued by the exporter, dated and bears the names and addresses of parties (exporter and importer). It commonly bears shipping marks, total weight or quantity of the goods, per unit and total price, etc. Usually, a commercial invoice is signed by the exporter/seller and submitted in multiple copies, as desired by the importer/buyer. Other types of invoices are consular invoice, customs invoice, certified invoice, and pro-forma invoice. In practice, sometimes, commercial invoice may not be signed. UCP 600 does not require a commercial invoice to be signed. But as per the domestic requirement of Bangladesh, commercial invoice has to be signed.

Transport documents assume the form of either single-modal or multi-modal. The various forms of single-modal transport documents include marine bill of lading, air way bill, truck receipt, railway receipt, courier or postal receipt, charter party bill of lading, etc. Some documents commonly used in relation to the transportation of goods, namely, delivery order, forwarder's certificate, mate's receipt, etc. do not contain a contract of carriage and are not transport documents. As in most of the other countries, bill of lading is the most commonly used transport document both in exports and imports in Bangladesh. Trans-shipment and partial shipment are some common phenomena in global transportation arrangement of international trade transactions. As per international rules, AWB, Truck Receipt etc. are not title documents and should not be issued 'to the order' of a bank (negotiable). However, domestic rules of Bangladesh requires exportable to be released to the order of a bank. Blank-back or short form transport documents are not accepted in the country.

Insurance document is the evidence of insurance coverage. International trade is very much risk-ridden and thus it is necessary to insure the goods against the risks of loss or damage to be indemnified. A policy becomes a complete set of documents only when appropriate clauses are attached. Three alternative sets of clauses, covering different types of perils are available for attachment: ICC(A), ICC(B) and ICC(C). Both the coverage and premium are minimum in ICC(C) and maximum in ICC(A). As per the domestic requirement of Bangladesh, insurance coverage is to be given by domestic insurance companies for imports.

Bill of exchange is an order issued by the exporter on a person or bank requiring to pay on demand or at a fixed or determinable future time a certain sum of money. Though conceptually bill of exchange is a redundant document to a group of experts in case of LC, it is commonly asked and issued. In Bangladesh, traditionally customs authority asks for bill of exchange at the time of releasing of goods. Under the Stamp Act the amount accepted in the bill of exchange for usance payment is dutiable.

Other documents may include certificate of origin, PSI certificate, weight list, phyto-sanitary certificate, health certificate, fumigation certificate, radiation certificate, quarantine certificate etc. In case of import to Bangladesh, barring a few exceptions obtaining certificate of origin is a regulatory requirement. Generally, PSI certificate is not required for the importable with the import duty of less than 5 per cent, importation of perishable goods, capital machinery, import under bonded warehouse, etc. Phyto-sanitary or health certificates are commonly required in connection with importation of foods.

2.3 Trade Finance Services

Exporters and importers need financing facilities to accomplish their cross-border purchase and sale. At different stages of production and payment, traders obtain financing facilities from banks. Financing pattern also vary in different methods of payments. Financing to the exporters can be grouped under pre-shipment and post-shipment financing; and financing to the importers can be categorized into pre-import and post-import financing. Pre-shipment credit to the exporter is obtained to meet expenses on purchasing raw materials, processing, transportation, insurance etc. These cash credit facilities are commonly provided against hypothecation, pledge and trust receipt. Packing Credit, the most popular form of pre-shipment credit, is extended against transport documents evidencing transportation of goods.

Back-to-Back Letter of Credit (BBLC) is a financing arrangement between bank and exporter, used generally to import raw materials for preparing exportable. Under this arrangement, the bank finances export by opening a letter of credit on behalf of the exporter who has received a letter of credit from the overseas buyer. The bank's credit related to BBLC is realized subsequently from export proceeds. 'Assignment of proceeds' is another method of repaying the lending bank from export proceeds under documentary credit arrangement. However, it is not that much practiced in Bangladesh. Under a red clause letter of credit, the opening bank authorizes the advising bank/nominated bank to make an advance to the beneficiary prior to shipment to enable him/her to procure and store the exportable goods in anticipation of his/her effecting the shipment and submitting a bill under the LC. Though it is not prohibited, it is very rare in Bangladesh. There is restriction on opening revolving LC. Exporter obtains Export Development Fund (EDF) facilities to meet foreign currency requirements mainly to import raw materials under back-to-back arrangement. Recently, the facilities have been extended to import of cotton fabrics in bulk item and packaging materials by the deemed exporters under certain conditions.

Post-shipment credit to the exporter is extended through negotiation of documents under LC, purchase of DP & DA bills, and advance against export bills surrendered for collection. Negotiation means purchase of the documents submitted under LC by a nominated bank. Under UCP 600, to call the purchase as negotiation, documents must be in order and purchase must be made before reimbursement or before the consent of reimbursement. Under collection, documents submitted under DA or DP is also purchased by banks (remitting bank). Banks generally accept export bills for collection of proceeds even though documents drawn against an LC contain some discrepancies. In such a circumstance the exporter may obtain an advance from the bank against the security of export bills. In addition to the export bills, banks may ask for collateral security like a guarantee by a third party or an equitable/registered mortgage of property.

Import financing is a technique for importers under which banks offer undertaking to make payment on behalf of importers. In Bangladesh the popular post-shipment import financing techniques are termed as PAD, LIM and LTR. Under PAD or Payment against

Documents, an Issuing Bank makes payment against documents on behalf of importer. Bank extends credit facility to the importer for retirement and clearance of the consignment known as Loan against Imported Merchandise (LIM). A definite repayment schedule is given to the importer to take delivery of goods. Here the possession of the merchandise remains with bank. In LIM, the bank should keep watch on the arrival of the ship. Advances against a Trust Receipt or LTR obtained from the customer are allowed to only first class tested parties when documents covering an import shipment of other goods pledged to the bank as scrutiny are given without payment. The customer holds the goods or their sale proceeds in trust for the bank, till such time, as the loan allowed against the Trust Receipts is fully paid off. The advance allowed against Trust Receipt must be adjusted within the stipulated period.

Shipping guarantees also called delivery order and airway releases, are import financing services offered by the banks to facilitate releasing of goods when goods arrived prior to the documents. Shipping guarantees are generally issued using the format of the shipping line and commonly for unlimited period of time without noting the quantity. No such formats are available for airway releases and delivery order. Generally banks use their own format to issue these.

Usance pay at sight against documentary credit has been popular in the form of red clause and BBLC. Another relatively recent innovative financing technique to offer post-shipment credit to the exporter or financing to the importer is popularly known as UPAS LC. This is a new feature in the LC process in response to the demands for immediate payment by the exporter and applicant's request for deferred payment. Banks render UPAS credit facilities to its valued customer in the following two ways: One, UPAS credit service through own Offshore Banking Unit (OBU); two, UPAS credit service through overseas Correspondent Bank.

Offshore banking license is provided by Bangladesh Bank to the banks in Bangladesh to offer services in foreign currencies. The banking unit opens up banking facilities for the Type-A, industry situated at EPZ area and extends discounting facilities to the ADs in order to meet up their obligations abroad at relatively lower interest rate. However, enterprise in the country may also enjoy foreign currency loan from the Offshore Banking Unit at lower interest rate subject to the approval of the Board of Investment. Presently, 7 foreign banks and 25 local banks are providing this facility. Practically, the major lending function as a part of core banking activities are basically captured by the OBU's belongs to foreign Bank due to availability of low cost fund and global network. OBUs of the local bank are basically concentrating on discounting business of its different ADs import Bills under UPAS credit arrangement. However, in recent time, OBUs started discounting services to the ADs local export bill as well.

2.4 Other Trade Related Services

These generally include Standby LC and demand guarantee services by banks. Standby may get coverage under UCP 600 but it is encouraged to use ISP 98 which is specifically designed for standby arrangement. In connection with Demand Guarantee, the recent ICC regulation known as Uniform Rules for Demand Guarantees (publication no 758) applies. Though these products have potential there is no specific guideline for these products and ICC publications from Bangladesh Bank.

Remittance Services are provided by banks. Other than the branch networks, a number of banks use online network, mobile network, and money transfer organizations in the process of faster channeling funds to the rural areas. Alongside using ICT tools and mobile technologies, banks have started using the services of each other networks/branches and services of MFIs more extensively.

Foreign currency account facility is given by Bangladesh Bank to ADs who may open different types of foreign currency accounts, without prior approval of Bangladesh Bank. These are: Private Foreign Currency Accounts; Non-Resident Foreign Currency Deposit (NFCD) Accounts; Resident Foreign Currency Deposit (RFCD) Accounts.

3. Regulatory Environment of Trade Services

Banks are required to follow a set of both domestic regulations and international rules while offering trade services. Some of these relevant rules and guidelines are summarized below.

Foreign Exchange Regulation Act 1947 has empowered Bangladesh Bank to regulate all kinds of foreign exchange dealings in Bangladesh. Accordingly Bangladesh Bank issues AD licenses to the selected bank branches for conducting trade payments, financing and other international banking operations. By the provisions of the Act, Bangladesh Bank issues circulars/guidelines to regulate trade payment, financing, remittance services etc. activities to be followed by the banks. These guidelines should complement the ICC guidelines for smooth operations of international trade payment and financing activities.

Guidelines for Foreign Exchange Transactions 2009 require dealers to follow Foreign Exchange (FE) circulars issued by the Bangladesh Bank. One cannot by pass the policy decisions and directives of the government in the form of Export Policy and Import Policy Order issued from the Ministry of Commerce of the country as empowered by the Imports and Exports (Control) Act 1950.

Import and export policies 2012-2015 came into effect from December 12, 2012. The present version of the import policy order cover relevant definitions, general rules for imports, fees related to imports, miscellaneous rules, and general rules for industrial imports, provisions related to the importers of government sector, import trade control committee, and recognized list of chamber of commerce and industry. Export Policy 2012-15 primarily aims at encouraging production of exportable commodities and promoting new exporters and helping the existing exporters.

Uniform customs and practice for documentary credits (UCP 600) is the collection of rules governing the issuance and execution of letters of credit in the cross border exportation and importation in the global economy. UCP 600 mainly covers the liabilities and responsibilities of different parties engaged in the process of LC which is meant for traders and bankers. It permits the user to modify or exclude any of the provisions of the rules by stating on the face of the credit. It offers flexibility of accommodating local regulations and necessary changes in the rules. In Bangladesh, LC can only be opened and received within the framework of UCP 600 since July, 2007.

International standard banking practice (ISBP 681) is the practices that are not specifically mentioned as among the best practices of documentary credit under 39 articles of UCP 600. However, such practices do not conflict with the provisions of UCP 600. For the information of the bankers, the ISBP 681 contains these standard practices. The ISBP mainly explains how documents examination practices referred to in the UCP 600 are applied by LC practitioners.

Bank-to-Bank reimbursements arrangement (URR 725) is made on behalf of the issuing bank by a third bank. The process is guided by a separate ICC set of rules which came into effect from October 1, 2008. The rules of URR assign liabilities and responsibilities of different parties involved in the process of reimbursement.

Uniform rules for collections (URC 522) contains a set of rules to guide collection process through banks, which is known as 'Documentary Collection'. The ICC Uniform Rules for Collections are a practical set of rules to aid bankers, buyers and sellers in the collections process. URC 522 underlines the need for the principal and/or the remitting bank to attach a separate document and the collection instruction to every collection subject to the rules that came into effect in 1995.

International standby practices (ISP98) reflects a distillation of practices from a wide range of standby users: bankers, merchants, rating agencies, corporate treasurers, credit managers, government officials and banking regulators. Like the UCP for commercial credits, ISP98 is designed to become the industry standard for the use of standbys in international transactions.

Demand guarantees (URDG 758) is the guiding framework applicable to the demand guarantee and counter-guarantee practices. This is new regulatory framework that succeeds URDG 458 and came into effect from July 1, 2010 and helps leveling the playing field among demand guarantee issuers and users regardless of the legal, economic and social system in which they operate.

Inco-terms 2010 stresses the need to use the terms appropriate to the goods, to the chosen means of transport and to whether or not the parties intend to impose additional obligations on the seller or buyer. In addition, there are Guidance Notes (and a diagram) at the front of each Inco-terms rule containing information to assist in making a choice on which rule to use.

DOCDEX rules and ICC Arbitration are about a service known as 'Documentary Instruments Dispute Expertise' that are provided in connection with any dispute related to ICC regulations/guidelines and their applications that are made available by the ICC through its International Centre for Expertise. The purpose of the ICC DOCDEX Rules is to provide parties with a specific dispute resolution procedure that leads to an independent, impartial and prompt expert decision for settling disputes involving the UCP, URDG, URR and URC.

4. Trend of Trade Services

BIBM survey data indicate the extensive use of documentary credit in import transactions in Bangladesh (Table 1). In 2012, payments of 84% of cases and 86.5% of volume were made through LC. These figures were higher in 2011. LC remains the single most common method in use. There is no significant difference in regard to the use of LC by different categories of banks. In EPZs, use of contract-based trade payment methods (mainly open account and documentary collection) is significantly higher. In terms of the number of cases, about 79% was by open account or documentary collection, and 21% by LC. But for both the modes indicating that LC is mainly used in case of big volume.

Table 1: Use of Methods in Import Payment (in %)

	2011		2012	
Method of payment	No. of cases	Volume	No. of cases	Volume
Cash in advance	1	0.5	5	2
Open account	1	1	1	0.5
Documentary collection	1	0.5	10	11
Documentary credit	97	98	84	86.5

Source: BIBM Survey (Habib et. al., 2013).

Table 2: Use of Methods in Export Receipts (in %)

Method	2011		2012	
	Number	Volume	Number	Volume
Cash in Advance	2	2	3	2
Open Account	2	3	2	3
Documentary Collection	30	35	35	40
Documentary Credit	66	60	60	55

Source: BIBM Survey (Habib et. al., 2013).

As in the case of import payment, LC was the most widely used method to receive payment by the exporters of Bangladesh during CY2012. Information in Table 2 shows that in 60% cases of exports, use of LC payment method was 55% in 2012. Use of LC decreased a bit compared to that of the CY2011 in consideration of volume.

As regards various documents specially transport documents needed in cases of documentary credit opening. Issuing banks asks for transport documents — bill of lading, airway bill, truck receipt etc. — and commercial invoice and certificate of origin. No change is observed in regard to the use of documents in between CY2011 and CY2012. In selecting documents, generally banks' dealing officers play a dominating role. Only in case of a few big firms, the applicants dictate terms and select documents. Insurance documents are rarely asked as according to the country's import policy, insurance is to be covered by domestic importers as a measure to restrict foreign currency outflow and promoting domestic insurance companies. In case of export LC, the documentary requirements are almost same. Insurance documents are less frequently asked in the LCs sent to Bangladesh exporters. Such practice points to the similar regulatory requirement in the trading partner countries under which insurance formalities are to be covered by their domestic insurance companies.

The most commonly used transportation mode that is in use is ocean mode. In a considerable number of cases truck receipts are asked for, which comes under RRI (Road, Rail, and Inland Waterway). Though the use of multimodal transport document increased a bit, in a very insignificant number of cases multimodal transport documents were used in CY2012. This contrasts the general practice in the trading countries where multimodal is the most widely used mode of transportation.

At the time of issuing an LC, issuing bank generally has an explicit financing arrangement with importer. Banks generally do not finance the entire LC amount and ask for some margin that varies from 0 to 100 per cent and from client to client. The margin is determined by the head offices or in some cases branch heads based on banks' relationship with the clients. The survey data reveal that the extreme cases of 0 per cent or 100 per cent are insignificant in number and in most cases the margins fall around 10 per cent.

Over CY2012, banks commonly advised letters of credit through advising bank. In most cases the foreign issuing banks selected their own advising banks. According to the opinions of survey respondent banks prefer to select those banks as advising banks with which they have correspondent relationships. Some banks also try to accommodate exporters' choice. It has been observed that a few banks are somewhat rigid in selecting advising banks because of maintaining their business relationship or commission sharing with the counter parties. To accommodate exporters choice banks also avail the services of second advising banks. Almost in all cases, confirming banks are selected by issuing bank. However, sometimes banks try to accommodate exporters' choice if they have arrangement with the banks. For amendment of letters of credit, generally importers approach to the issuing bank on behalf of exporters. Though, some issuing banks ask for letter, mail etc. to ensure exporters consent in this connection, they hardly find amendment risky for themselves. However, most of these amendments are practically go in favour of exporters and so risks of accepting or rejecting is minimum.

In regard to the availability of the credit, in most cases banks offer scope for negotiation. In most cases the LC issued from the country are freely available which means any bank is nominated bank at the counter which documents are submitted by the foreign exporter/beneficiary. In such a case, exporter can submit documents at the counter of its own bank in the country of his/her domicile. Some banks (mainly foreign and a few domestic private sector banks), however, prefer to restrict negotiation at the counter of certain banks having correspondence relationship. In most cases credits were made available on negotiation basis in both CY2011 and CY2012.

Late shipment and late presentation are the most common discrepancies in both export and import documents. According to the survey, in about 70 per cent cases the nominated bank of Bangladesh received discrepancy notices; whereas in 60 per cent cases local issuing bank issued discrepancy notices to the foreign counterparts presented in CY2012.

As methods of payment, cash in advance and open account are the simplest and cheapest, but they create the possibility for opportunistic misconduct by the trading partners. In line with the regulatory requirement of Bangladesh, LC is almost the single way to import which is the costliest form of trade payment method. Documentary collection is cheaper than LC, however, sometimes is risky for the exporter. At different stages of involvement, banks charge different rates of commissions. In a letter of credit operation, banks charge different rates of commissions as issuing bank, advising bank, negotiating bank, confirming bank, reimbursing bank etc.

The Spot or TC Buying rates are used in buying cash foreign currencies over the counter by the banks, both from the residents and the foreigners as well as encashment of Traveler's Cheque. Similarly, Spot or TC Selling rate is applied for selling cash foreign currencies to the people as well as issuing Traveler's Cheque. TT Clean Buying rate is deployed in purchasing any form of inward remittance along with conversion of export proceeds, brought in under Advance TT or open account method of payment. For procuring export proceeds under documentary collection TT Doc Buying rate is utilized. For purchasing export proceeds under sight LCs and deferred LCs OD Sight, EXP Buying rate and Usance Buying rates (with different tenors) are used. For arranging any category of outward remittance or affecting import payment under any mode other than LC, TT and OD selling rate are applied. For affecting import payment under LCs the prevailing rate is BC selling rate. Moreover, the banks are found to be quoting cross and forward rates.

In offering financing transactions, various interest rates are charged with banks. In pre-shipment export financing banks are required to follow BB guidelines and thus interest rates cannot exceed 7 per cent. But some of the banks extend SOD (Export Loan) at commercial rates instead of packing credits for serving the respective exporters' needs at pre-shipment stage. To meet the post-shipment financing requirements of both the deemed exporters and the conventional exporters, the banks are offering two products – LDBP, a product usually applied under deferred inland back-to-back LCs (30-180 days) and FDBP, which is meant for the conventional exporters. Currently, head office approval has been made mandatory (by the Bangladesh Bank) in every case of LDBP by any bank. In FDBP, the process is almost same with some variations. A set of banks negotiate the export bills at OD Sight EXP rates. As they don't offer exchange rate gain to the exporters so they offer interest gain to the clients up to 21 or 30 days, implying that they do not charge interest up to the mentioned periods. If they purchase the export bills at much higher TT Doc Buying rates, then the clients do not get the interest gain and the interest accrues from the very day of negotiation. In import financing, banks generally follow the market interest rates.

ICT based activities like internet banking on trade services, online reporting to BB, new avenues for remittance can be identified as adaptation of advanced ICT by the banking sector. Through the incorporation of state of the art software the banks have enhanced their operational efficiency. Basically, it has enabled them to go for faster decision making, prompt documentation and processing. Internally, quite a few banks are fully relying on software based operations. In most cases, the communications with foreign counterparts are done electronically through SWIFT (LC issuance, advising, confirmation, amendment and others). In the CY2011, some banks have taken initiative to route their local LC and all other LC related communication through SWIFT rather than mail. This is a great step to forbid misuse of LC by unscrupulous beneficiary. In this connection, remarkable change has taken place in CY2012 when most banks used SWIFT for all LC related communications in local LCs. Introducing Dashboard to monitor various trade service-related transactions by Bangladesh Bank is a remarkable step in this connection.

In most banks, executives working in the trade services departments have training exposures. Some banks regularly arrange on the job training for improving knowledge in regard to the international trade payment operation. A remarkable improvement in connection with the development of professional banker in the trade services area reflects with the growing number of Certified Documentary Credit Specialist (CDCS) in the banking sector of the country. The number of CDCS holders in the country was only 1 till 2008, which increased to over 100 by the end of 2012. Young bank professionals are also taking interests on professional courses on trade services like Finance of International Trade (FIT), Certificate in International Trade and Finance (CITF), etc. Moreover, ICC has also been offering a number of online courses for the trade practitioners. Alongside a group of inquisitive bankers, ICC Bangladesh has been playing notable roles in the human resource development of the trade services in banks.

5. Challenges in Trade Services

The period 2012 and onwards witnessed reduction in business activities. This has been concomitant with reduction of imports and exports in the periods. In this circumstances, to retain the clients, banks were undertaking undue risks bypassing the regulatory framework. Cases such as financing by the ADs to the exporters through opening BBLCs (deferred by 180 days) under open account trade or collection could be extremely risky if the foreign buyers default. As the concerned ADs are endorsing the transport documents to the foreign buyers directly, it could prove to be very risky. There are instances of advance payment and under-invoicing in importation that is clearly violation of Bangladesh Bank regulations.

Malpractices in trade services broadly take the form of irregularities or non-compliance of regulations and fraudulent activities that seriously affect banks. Addressing these are the key challenges. Though the malpractices (especially fraudulent activities) in trade services are not very frequent, these could prove to be very costly for banks and the concerned parties. The malpractices could be particularly detrimental for banks that are widely perceived to be more fragile than other firms. There are alleged occurrences of non-compliance of regulations and a few instances of fraudulent practices in trade service transactions in the country. Malpractices in cross-border transactions developed hand-in-hand with the increase in trade and cross-border transactions among nations. As the survey information reveal, in connection with Bangladesh, most of the cases of malpractices are related to non-compliance of regulation or guidelines. Some of these are intentional and many of these are due to knowledge gap of the service providers. Frequency of malpractices in the form of fraud is insignificant.

In LC operations, late payment has been found to be a common practice by the trade service providing banks in a number of instances. In spite of receiving compliant documents under sight LCs, the payments have been lingered. This practice is more prevalent amongst the SCBs which do not only harm their institutional reputation but also the country's image. Cases have been found where, in spite of compliant documents, the applicants requested the banks to lodge discrepancy notices to halt the payments momentarily on the grounds such as goods had not arrived or goods were of inferior quality. In few cases, it has been observed that in spite of the arrival of the consignment, the applicants approached issuing banks to linger payment through issuing discrepancy notices. Banks are also cooperating with them in some instances. These practices also inflate the confirmation charges of the LCs issued from Bangladesh.

High rate of document rejection has taken place in a number of instances. There is intense scrutiny of documents by some banks, eventually leading to higher rates of rejection that hardly reflect international standard banking practices. Rejection to delay payment or for harassing exporters is against the spirit of UCP framework. Such practices can simply make the tradables costlier and burdensome to the consumers.

For making the payments under local BBLCs (denominated in foreign currency) there are two alternatives for banks. Either they can use the Nostro accounts (using swift MT 202) or they can use the FC Clearing Accounts maintained with Bangladesh Bank, which is also preferred by the central bank. In practice, many banks utilize the services of foreign correspondents abroad as the payments are affected through the Nostro accounts which are maintained with them resulting in foreign currency outflow in form of charges from the country.

Some instruments of international trade services like LCs can be used for fraudulent or unethical practices in performing local trading activities. The issue of accommodation bill (payment without genuine consignment) related with shipment under local LCs is a huge concern for the entire banking sector. Recently, a case of huge forgery in regard to accommodation bill has been surfaced and stirred the entire banking industry. For domestically transferred transferable LCs, most of the local banks (SCBs and few PCBs) transfer through endorsement on the back of the master LCs. This practice gives rise to scope for fraudulent practices and forgery. According to the BB guidelines, for opening an LC, ADs should obtain confidential reports on foreign exporters for satisfying themselves regarding the standing of the exporters. Issuance of LC without credit report is a sheer violation of the GFET and basically raises the risks of both the issuing bank and the importer. However, in many cases, banks issue LCs without obtaining credit reports but only incorporating credit report clauses. There are also instances where banks undertake undue risks even bypassing the regulatory framework. Cases such as financing by the ADs to the exporters through opening BBLCs (deferred by 180 days) under open account trade/documentary collection could be extremely risky if the foreign buyers default.

There are cases of malpractices regarding endorsement of transport documents. The shipping lines are not permitted to issue Straight B/Ls (directly consigned to the foreign buyers) without the NOC from the local AD (the nominated/negotiating/remitting bank). It is also a vital condition for the shipping lines to obtain license from Bangladesh Bank. But there are complaints from some banks as regards violation of BB's regulation by some shipping license.

Banks are supposed to ensure minimum insurance coverage of 110% of importable at the time of opening of LC. But there are cases LCs opening with less than the minimum insurances coverage. And using only the minimum level of insurance coverage has been the regular feature.

There are cases of non-realization of export proceeds. ADs or banks are expected to behave responsibly and report to Bangladesh Bank in time. Instances where ADs did not report to the Bangladesh Bank are not unfamiliar and that banks cooperated with the exporters in fraudulent activities are not to be unfounded. In some recent cases banks are not receiving payment even after obtaining acceptances on several instances. This is particularly apparent in cases of local LCs. SCBs are found to be the major defaulters in honouring the accepted bills. As per a Bangladesh Bank's directives, banks are supposed to inform the central bank to undertake appropriate measures to settle the issue.

6. Concluding Observations

There are challenges for the banking sector with regard to offering trade services. The malpractices by banks are damaging the credibility of the trade services of banks and creating distrust among banks thereby adversely affecting interbank transactions. Addressing these issues is critical for improving the efficiency of trade services and ensuring sustainability of the banking industry.

The banking industry is somewhat maligned by the practice of untoward activities like providing very good compensation package, offering very high profits, and undertaking risky activities bypassing the regulatory framework on the part of some banks. Bangladesh Bank needs to review some of the traditional restrictions to close loopholes of pulse. And then enforcement of sound risk management practices by banks is essential.

Reporting of trade service activities to the Bangladesh Bank is an important task of the banks. There are lacks in this respect and evidences that banks cooperate with exporters in fraudulent activities are not to be unfounded. It is to be ensured that all types of violations and deviations of regulations are reported to Bangladesh Bank. Bangladesh Bank must crack down on such offences.

Lack of coordination among regulatory and enforcement authorities cause problems in handling the irregularities. According to the domestic guideline, ADs must have the copy of the customs BoEs or certified invoices at their disposal within 120 days from the remittance date. In some cases, the concerned ADs do not receive the BoEs. Thus despite penalty imposed by the Bangladesh Bank on the importers with overdue BoEs, concerned ADs face difficulties in dealing with the inspection teams from BB if they do not possess the BoEs in due time. There is, thus need of arrangement under which the ADs can direct get online access to the BoEs issued by the Customs. Easing out of the problem depends on the joint effort of Bangladesh Bank and customs authority.

Although Bangladesh Bank accepted the current version of UCPDC for cross border trade in June, 2007, there has been such circular about URR 725 that came into effect from October, 2008. Without guidelines from important ICC publications like URC 522, ISP 98 and URDG 758, there has been confusion over their uses and implications. A comprehensive guideline on the trade services practices in the EPZs would help remove the confusion among bankers and clients. Late payment has been a practice by some trade service providing banks. Inspite of respect of compliant documents under sight LCs, the payments have been lingered. This issue should be looked into.

Failure to meet commitment erodes confidence and grind down mutual trust in the banking industry. Denial of the accepted bill by a number of banks in recent time became a concern for all quarters in Bangladesh. This practice is more prevalent amongst the state controlled banks. Although Bangladesh Bank is working on these issues, it has limited regulatory and supervisory control over these banks. It is of importance that banking operations are properly and adequately regulated and supervised by the central bank.

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