



বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

State of the Bangladesh Economy in FY2017-18

Second Reading

CPD's Budget Recommendations for FY2018-19

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The CPD IRBD 2018 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

State of the Bangladesh Economy in FY2017-18

Second Reading

CPD's Budget Recommendations

SECTION I. INTRODUCTION

National budget for FY2019, the last budget of the incumbent government before the upcoming national election, is being prepared in the backdrop of the global economy transmitting mixed signals and the domestic economy experiencing emerging tensions with accentuated traditional ones. The upcoming budget will need to address these attendant concerns through renewed efforts at raising the quality of budgetary and fiscal planning at a time of election-related uncertainties. Consequently, a key objective of the forthcoming budget should be maintaining macroeconomic stability. This report highlights some of the key challenges which call for immediate policy attention, particularly from the perspective of macroeconomic management. The report puts forward a number of recommendations which, however, may not be possible for the government to implement before the national election. Nevertheless, it is reckoned that some of these issues should find place in the electoral debates that will follow the budget.

The report focuses on eight areas: (a) macroeconomic stance towards sustainable growth acceleration and enhanced employment generation; (b) banking sector; (c) capital market; (d) incentivising export-oriented sectors; (e) catalysing private investment; (f) social security and provision of human resources development for the disadvantaged; (g) budgetary implications of Rohingya crisis; and (h) a Trust Fund for SDG delivery. The report makes use of the most recent data from available official and credible international sources to review the trends of the relevant macroeconomic and development correlates and for purposes of analyses.

The present report is the second instalment of the State of the Bangladesh Economy in FY2018 prepared under CPD's flagship programme titled *Independent Review of Bangladesh Development (IRBD)*. The report will be followed by a comprehensive analysis of the Bangladesh economy covering FY2018, to be released prior to the placement of the FY2019 budget before the Parliament expected on June 7, 2018. The final instalment of this year's IRBD analysis will be released immediately after presentation of the FY2019 budget with CPD's immediate reactions to the fiscal-budgetary proposals in the budget.

SECTION II. THE MACROECONOMIC SCENARIO

Setting the macroeconomic benchmark for FY2019

As the preparation of the national budget for FY2019 come to its final stage, it is important that the policymakers take due cognisance of the current trends of key macroeconomic correlates while calibrating and designing the fiscal-budgetary measures and incentives. It may be recalled here that, CPD (2018) in its first interim review of Bangladesh's macroeconomic performance for the ongoing FY2018, released in January 2018, had drawn attention to the growing pressure on macroeconomic stability. Indeed, in the run up to the forthcoming national budget, the need for significant improvement in the quality of macroeconomic management has emerged as an urgent priority.

Economic growth is projected by BBS to cross the 7.5 per cent mark despite only marginal improvement in private investment

According to the provisional estimates by the Bangladesh Bureau of Statistics (BBS), GDP growth in FY2018 is expected to be 7.65 per cent. It is for the fourth time that in the course of the last two decades (since FY2007) that the GDP growth would exceed 7 per cent. Of the estimated growth rate of 7.65 per cent for FY2018, agriculture sector's contribution is estimated to be to the tune of 0.43 percentage points (0.44 percentage points in FY2017)¹, industries sector's contribution to be about 3.73 percentage points (3.10 percentage points in FY2017), and that of the services sector to be 3.21 percentage points (3.41 percentage points in FY2017) (Table 2.1). Indeed, the robust estimated GDP growth number has been primarily driven by manufacturing sector, followed by the construction sector.² Both these sectors have posted record-breaking growth figures. Indeed, if the growth rates of FY2017 (7.28 per cent) and FY2018 (7.65 per cent) are compared, of the additional growth of 0.37 percentage points, 0.54 percentage points is expected to be contributed by the manufacturing sector.

Table 2.1: Contribution to GDP growth over the last ten years *(in Percentage point)*

Sectors	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18(p)
Agriculture	0.61	1.07	0.78	0.52	0.41	0.70	0.53	0.43	0.44	0.43
Industries	1.71	1.77	2.31	2.47	2.59	2.27	2.74	3.24	3.10	3.73
Manufacturing	1.07	1.08	1.64	1.69	1.80	1.60	1.93	2.26	2.21	2.75
Construction	0.41	0.45	0.44	0.54	0.52	0.53	0.58	0.59	0.61	0.71
Services	2.66	2.89	3.25	3.43	2.88	2.92	3.00	3.21	3.41	3.21
Tax less subsidy	0.06	-0.17	0.12	0.10	0.13	0.16	0.28	0.24	0.34	0.28
GDP	5.05	5.57	6.46	6.52	6.01	6.06	6.55	7.11	7.28	7.65

Source: Calculated from Bangladesh Bureau of Statistics (BBS) data.

Note: p denotes provisional estimates.

Manufacturing sector's robust growth is drawn from the Quantum Index of Industrial Production (QIIP) estimates which posted 21.1 per cent growth for large and medium scale manufacturing industries during the first five months of this fiscal year. The somewhat modest recovery in export growth (6.6 per cent) during the same period was mainly dominated by RMG, which did not play a major part in QIIP growth.³ Other manufacturing industries, i.e., leather and related products (76.6 per cent), pharmaceuticals and medicinal chemical (44.7 per cent), textile (33 per cent) and food products (29.3 per cent) registered very high growth rates according to QIIP without a commensurate reflection in the export performance.⁴ For example, export earnings of leather and leather products, as a matter of fact, declined by (-) 3 per cent during the first five months of FY2018.

¹ Agricultural sector has been estimated to grow by 9.8 per cent, highest since FY2014.

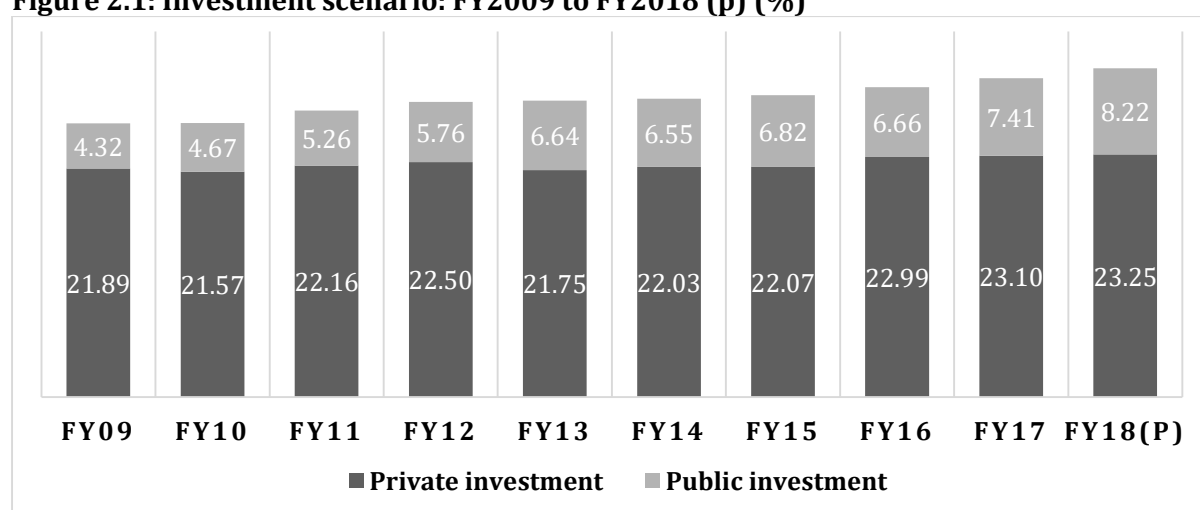
² Growth rates of manufacturing and construction sectors are estimated to be 13.2 per cent and 10.1 per cent respectively. No other sector was able to register a double-digit growth.

³ The manufacture of wearing apparel with a weight of 34.8 per cent in QIIP (large and medium), registered only 10.9 per cent growth during July-November of FY2018.

⁴ Combined weight of these four industries was about 38 per cent of total manufacturing production.

Investment as per cent of GDP is projected to increase by about one percentage point to 31.5 per cent in FY2018, thanks to the spurt in public investment (to 8.2 per cent). Regrettably, private investment as a share of GDP is estimated to increase only marginally (by about 0.2 percentage point) to 23.3 per cent (Figure 2.1). Meanwhile, the import of capital machineries recorded a 34 per cent growth during July-February period of FY2018. It may be assumed that majority of these capital machineries was imported for public sector investment which has been estimated to rise by 25.6 per cent in FY2018. It is reckoned that, the rise in the public investment estimate has considered the almost 90 per cent utilisation of the original allocations of the ADP for FY2018. As has been observed in previous years, the year-end public expenditure is likely to be much lower than the planned figures, not to also speak about the discrepancy between figures of MoF and IMED. CPD has been drawing attention to this last anomaly for the last several years.⁵ In all likelihood, the public investment and GDP figures will need to be revised accordingly when the GDP growth estimates will be finalised when the actual expenditure figures for full fiscal year become available.

Figure 2.1: Investment scenario: FY2009 to FY2018 (p) (%)



Source: Bangladesh Bureau of Statistics (BBS)

Note: p denotes provisional estimates.

Curiously, the growth rate of nominal GDP of 13.3 per cent was the lowest compared to the previous two fiscal years. It was indeed the relatively low GDP deflator growth (5.2 per cent) which resulted in the high real GDP growth rate. This rate was lower than the inflation rate (5.7 per cent) as of December 2017 which has been on an increasing trend since July 2017. This, thus, also raises concern as regards the quality of growth estimate.

Employment generation increased in FY2017 but real income had declined

As may be recalled, CPD (2018) in January 2018 had raised concerns about the slowdown in employment generation over the 2013 to 2015-16 period. On a positive development, according to the latest round of the Labour Force Survey, about 1.3 million additional jobs were created between 2015-16 and 2016-17 (BBS, 2018). Net employment was almost entirely generated in the services sector (3.7 million). In contrast, agricultural sector saw a decline of net employment by about (-) 0.7 million; while in industries sector only 262 thousand net jobs were added. As a result, share of total employment in agricultural sector reduced to 40.6 per cent in 2016-17 from 42.7 per cent in 2015-16 (Table 2.2). This share has been almost entirely seized by the services sector.

⁵ At the end of FY2017, the overall ADP implementation reported by IMED and MoF was 91.1 per cent and 69.8 per cent of the respective revised (as well as original) figures. The discrepancy stood at Tk. 23,574 crore.

Table 2.2: Employment by broad economic sectors

Year	2010	2013	2015-16	2016-17
Sectors	<i>Employed by broad economic sector (million)</i>			
Total	54.1	58.1	59.5	60.8
Agriculture	25.7	26.2	25.4	24.7
Industries	9.6	12.1	12.2	12.4
Services	19.1	19.8	22.0	23.7
Sectors	<i>Composition by broad economic sector (%)</i>			
Total	100	100	100	100
Agriculture	47.6	45.1	42.7	40.6
Industries	17.7	23.0	20.5	20.4
Services	25.5	32.0	36.9	39.0

Source: CPD calculation from BBS Data.

Furthermore, within the services sector, majority of the additional jobs created were in wholesale and retail trade, except of motor vehicles (0.7 million); land transport and transport via pipeline (0.6 million); food and beverage service activities (0.1 million); and activities of households as employers (0.1 million). In the industrial sector, major part of the additional net jobs was created in manufacturing of wearing apparel (178 thousand) and in construction of buildings (182 thousand). It may be recalled here that, between 2013 and 2015-16 period, employment in the manufacturing sector declined by about 0.9 million despite robust growth performance of the sector. Recent positive trend was not able to as yet compensate for the previous decline. It is to be noted that, many important manufacturing industries, including textile and food products, continued to experience loss in terms of net jobs. Hence, in FY2017, although, as per BBS estimates, a commendable pace of economic growth was registered thanks to accelerated rise in industrial value addition, this was not reflected in the employment outcome.

In FY2017, employment numbers increased only in three divisions viz. Dhaka (972 thousand), Chattogram (612 thousand) and Rangpur (238 thousand). In the other four divisions combined employment numbers declined by about 524 thousand.

An increased labour supply matched with increased demand helped keep unemployment rate constant at 4.2 per cent. Curiously, this has emerged as a distinct feature of the labour market in Bangladesh. Perhaps, this is due to the fact that the definition of employment is rather loose – a person working for only one hour in a week may be considered as employed. However, the concept of decent work in the SDG framework goes far beyond this definition, arguing in favour of rewarding employment on a long-term basis. In view of the SDGs that Bangladesh aspires to achieve, Bangladesh will need to significantly improve the context of this indicator. This is particularly evident in view of the fact that despite generating a significant number of employment in FY2017, unemployment rate among the relatively more educated labour force, particularly with secondary and tertiary education, had risen to 14.9 per cent and 11.2 per cent respectively (Table 2.3). In contrast, anecdotal information suggests that businesses find it difficult to find qualified job seekers for their enterprises. There is clearly a mismatch between demand and supply in the job market.

Table 2.3: Unemployment rate by education level (% of respective labour force)

Education Level	2010	2013	2015-16	2016-17
No education	2.8	3.2	2.2	1.5
Primary	3.8	2.7	2.5	2.7
Secondary	6.6	4.4	4.5	4.6
Higher secondary	13.7	7.9	13.8	14.9
Tertiary	8.3	6.7	9.0	11.2
Others				4.6
Total	4.5	4.3	4.2	4.2

Source: CPD calculation from BBS Data.

Besides, it is also important to note that the unemployment rate among the youth had increased further from 8.7 per cent in FY2016 to 10.6 per cent in FY2017 (Table 2.4). This was significantly higher than the national average figure (4.2 per cent). More than one-third of the total youth labour force with tertiary education (34.3 per cent) remained unemployed in FY2017. The corresponding figure for female cohort was even higher (42.5 per cent). The figures have also increased over time. While reading these numbers, one needs to consider the fact that a notable share of youth in FY2017 was not involved in employment, education or training (29.8 per cent). This is even higher for Bangladesh's young female population. It goes without saying that, with such high number of potential labour force remaining outside of the labour market (outside of also education and training), it will be hardly possible for Bangladesh to reap the potential benefits of the 'demographic window of opportunity'.

Table 2.4: Unemployment rate by education level (% of total youth labour force)

Education Level	2010	2013	2015-16	2016-17
No education – total	15.7	12.8	6.7	4.8
No education – male	13.4	5.1	6.1	2.3
No education – female	18.8	7.7	7.4	10.0
Primary – total	21.4	17.2	8.7	5.3
Primary – male	22.2	9.0	6.4	3.7
Primary – female	20.3	8.2	13.4	9.3
Secondary – total	49.0	34.7	10.7	8.7
Secondary – male	51.4	20.2	7.8	6.7
Secondary – female	47.4	14.5	17.6	11.7
Higher secondary – total	10.4	25.6	6.0	27.0
Higher secondary – male	10.3	12.4	6.1	22.7
Higher secondary – female	10.5	13.3	5.8	35.1
Tertiary – total	2.8	9.7	12.1	34.3
Tertiary – male	2.8	5.2	10.8	30.1
Tertiary – female	2.9	4.5	15.0	42.5
Total	7.4	8.1	8.7	10.6

Source: CPD calculation from BBS Data.

Despite the improved number of employment, average real monthly income had suffered erosion in FY2017, by (-) 2.5 per cent. The decline is higher for female labour, by (-) 3.8 per cent. It may be also important to note that between, 2013 and 2015-16, over three years, average real monthly income had also declined by (-) 3.9 per cent. Hence, not only that the declining trend in real income had continued, also the pace of deceleration has accelerated in FY2017. Decline in real income increased for urban male workers, although it did not reach the level of 2013 (Table 2.5). This development is being observed at a time when wages of formal labour force had been adjusted, particularly for those working in the public sector. No surprise, despite registering accelerated economic growth and generating employment, the pace of poverty reduction had slowed down. Indeed, what this indicates is that, in recent years the larger share of economic growth has been disproportionately captured by entrepreneurs and owners of land and capitals. The recent trends in the labour market dynamics thus further strengthen the need for refocusing Bangladesh's development objective from the existing 'GDP growth acceleration' centric strategy to a 'decent employment generating high economic growth' centric strategy, as was urged and advocated by CPD (2018).

Table 2.5: Average real monthly income (in Tk., adjusted with CPI)

Year	2013	2015-16	Change (%)	2016-17	Change (%)
National					
Male	14,309	13,844	-3.2	13,583	-1.9
Female	13,712	12,732	-7.1	12,254	-3.8
Total	14,152	13,602	-3.9	13,258	-2.5
Urban					
Male	17,930	16,957	-5.4	17,106	0.9
Female	15,558	13,847	-11.0	13,321	-3.8
Total	17,192	16,022	-6.8	15,912	-0.7
Rural					
Male	12,512	12,211	-2.4	11,708	-4.1
Female	12,464	11,532	-7.5	11,206	-2.8
Total	12,500	12,098	-3.2	11,608	-4.0

Source: CPD estimation from BBS Data.

Weak budgetary planning and implementation capacity persist

In FY2018, weak budgetary planning and implementation capacity continued to be a major concern. From the vantage point of the end of the first half (July-December) of FY2018, achievement of most of the fiscal parameters looks unrealistic and highly unlikely: revenue collection, ADP, net foreign borrowing and grant will need to grow by 65.3 per cent, 79.1 per cent and 564.3 per cent respectively over the remaining six months of FY2018 (Table 2.6).

Table 2.6: Fiscal framework (growth, %)

	Target FY17	Actual FY17	Target FY18	Up to Dec FY18	Required for Jan-Jun FY18
Revenue Collection	40.4	16.1	43.5	16.0	65.3
Total - Expenditure	42.4	9.3	53.1	7.8	79.1
ADP	38.3	-3.5	98.4	4.9	136.7
Non-ADP	44.4	15.7	34.0	8.7	50.7
Overall Deficit (Excl. Grants):	-47.6	8.4	-84.8	103.1	-107.6
Net Foreign borrowing and grant	133.8	-49.1	557.3	441.6	564.3
Foreign Grants	168.3	-57.4	529.1	-72.3	634.1
Foreign Borrowing-Net	128.5	-47.9	560.8	647.8	556.6
Domestic Borrowing	21.2	4.0	14.3	-143.5	35.0
Bank Borrowing (Net)	266.9	-180.2	431.2	32.0	339,940.0
Non-Bank Borrowing (Net)	-43.7	52.6	-47.6	-78.6	-37.8
Total Financing	52.3	-5.5	84.9	-103.1	107.8

Source: Calculated from MoF data.

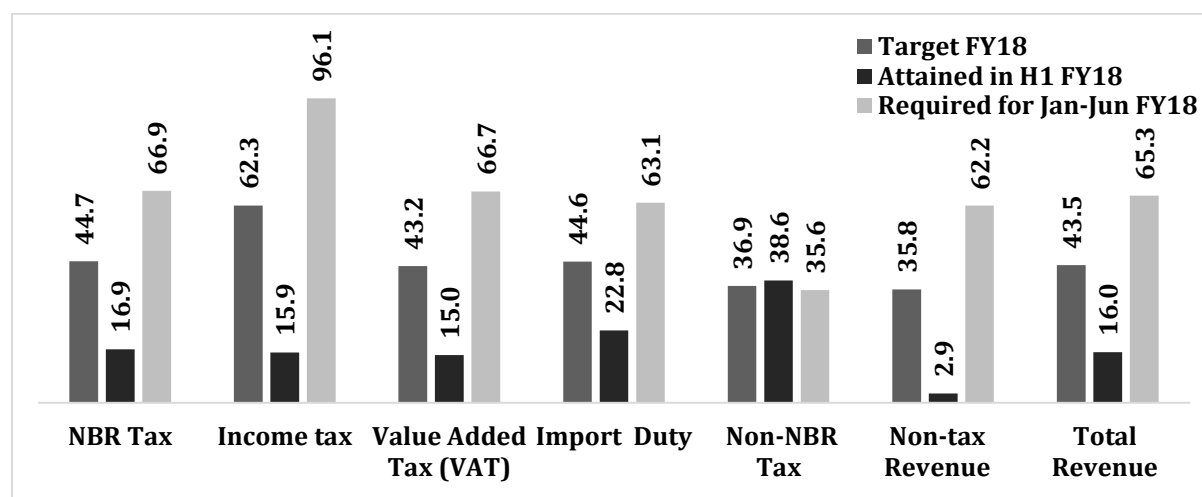
Revenue mobilisation is likely to fall short of target for the sixth consecutive year in FY2018

Revenue collection showed a marginally improved performance compared to the previous fiscal year during the first half of FY2018 registering 16.0 per cent growth (Figure 2.2). While tax collection had somewhat improved, non-tax collection had underperformed. According to MoF data, NBR tax registered a growth of 16.9 per cent during first six months of FY2018 as against the target of 44.7 per cent.⁶ However, due to unrealistic programming of the fiscal framework targets, a large shortfall in revenue has become a certainty. It may be recalled that, immediately after the national budget had been passed, CPD (2017) came up with the projection that the revenue shortfall in FY2018 was likely to be in the range of Tk. 43,000 crore to Tk. 55,000 crore. In order to attain the annual growth target of 43.5 per cent, total revenue would need to increase at a rate of 65.3 per cent for the remainder of the fiscal year – which is highly improbable to say

⁶ However, according to data reported by NBR, the NBR tax registered a growth of 17.9 per cent during July-November while it stood at 15.6 per cent during July-February of FY2018.

the least. Also, to be noted, there are signs of greater reliance on import-related revenue sources (22.8 per cent). Furthermore, growth of income tax collection during July-December of this fiscal year (15.9 per cent) was lower than the corresponding period of FY2017 (16.7 per cent). On a positive note, non-NBR tax registered a strong growth (38.6 per cent), but its share was only 4.1 per cent in the total revenue. CPD's overall projection is that, revenue shortfall in the current fiscal year is likely to be about Tk. 50,000 crore.

Figure 2.2: Growth rates of revenue collection components (%)



Source: Calculated from MoF data.

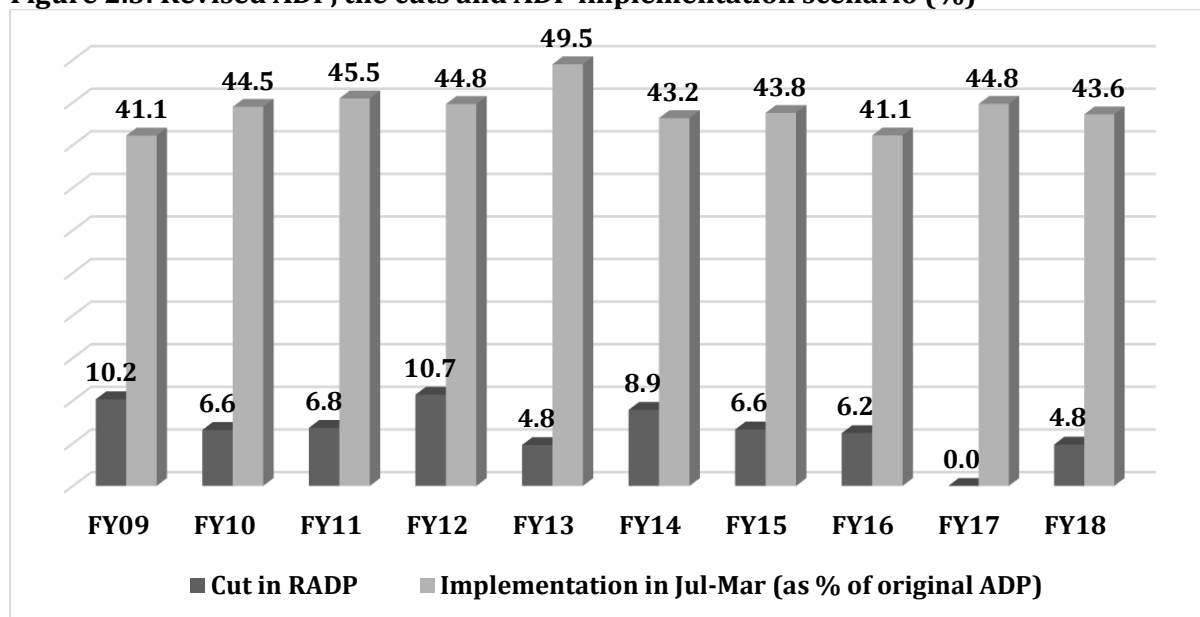
ADP implementation remains business as usual despite high project aid utilisation

Expenditure on account of the ADP is yet to mark any significant breakthrough in FY2018. According to the first nine months' (July-March) data, actual spending under ADP was 43.6 per cent of the originally planned allocation of Tk. 155,931 crore which is lower than the previous fiscal year for the corresponding period. Data discrepancy among MoF and IMED is also a major concern here.⁷ Higher utilisation (48.2 per cent) of foreign aid (highest since FY2006) is a positive sign in the context of budget implementation trends in FY2018, thanks almost solely to the Power Division. Meanwhile, utilisation of taka component (40.7 per cent) during July-March of FY2018 was the lowest since FY2008. Among the top 10 ministries/division having a share of 73.3 per cent in total ADP allocation for FY2018, only Power Division (79.9 per cent), Local Govt. Division (57.2 per cent) and Ministry of Science and Technology (51.8 per cent) had been able to spend more than the average amount of allocation during July-March of FY2018.

Due to slow pace of implementation, a number of major government agencies (e.g. Transport, Education and Religious Affairs, Science, Information and communication Technology, and Oil, Gas and Natural Resources) were subjected to significant cuts in the revised ADP (RADP) for FY2018. ADP for FY2018 was slashed by Tk. 7,550 crore (or 4.8 per cent) to bring the size down to Tk. 148,381 crore (Figure 2.3). Project aid component was reduced by Tk. 8,366 crore (or 13.8 per cent) while local resources (Taka) component was increased by Tk. 816 crore (or 0.9 per cent) although the rate of utilisation of the latter was the slowest since FY2008. Given the implementation status of the ADP, a more substantive rationalisation of ADP allocation was perhaps called for.

⁷ According to MoF data, ADP implementation during July-December of FY2018 was 15.3 per cent while IMED reported the implementation rate to be 27.1 per cent (almost double) for the corresponding period.

Figure 2.3: Revised ADP, the cuts and ADP implementation scenario (%)



Source: Estimated from the Implementation Monitoring and Evaluation Division (IMED) data.

On the other hand, delayed implementation, cost overrun and institutional weakness have undermined the effectiveness of the concerned projects. Consequently, these projects are yet to provide an impetus to private investment in Bangladesh. CPD (2018) in an earlier exercise found that in FY2016, of the 201 completed projects that had posted financial progress of more than 80 per cent, 93 projects had faced cost overrun with a cumulative amount of Tk. 5,640 crore.

High cost of borrowing for financing budget deficit continues

The scale of budget deficit may not be a major concern since the shortfall in revenue collection is likely to be offset by the inability to spend budgetary allocations. However, high cost of borrowing from NSD certificates will put pressure on debt sustainability in the medium term. Net sales of NSD certificates stood at Tk. 33,120 crore during July-February of FY2018 which is already 9.9 per cent higher than the annual target set for FY2018. It appears at the moment that, the government has no plan to cut interest rates for NSD certificates for the upcoming fiscal year. On a positive note, Net foreign borrowing and grant registered a growth of 442 per cent, to Tk. 2,459 crore, during July-December of FY2018. Meanwhile, inability to fully implement budgetary allocation will likely lead to further escalation of ADP project costs over the upcoming fiscal years.

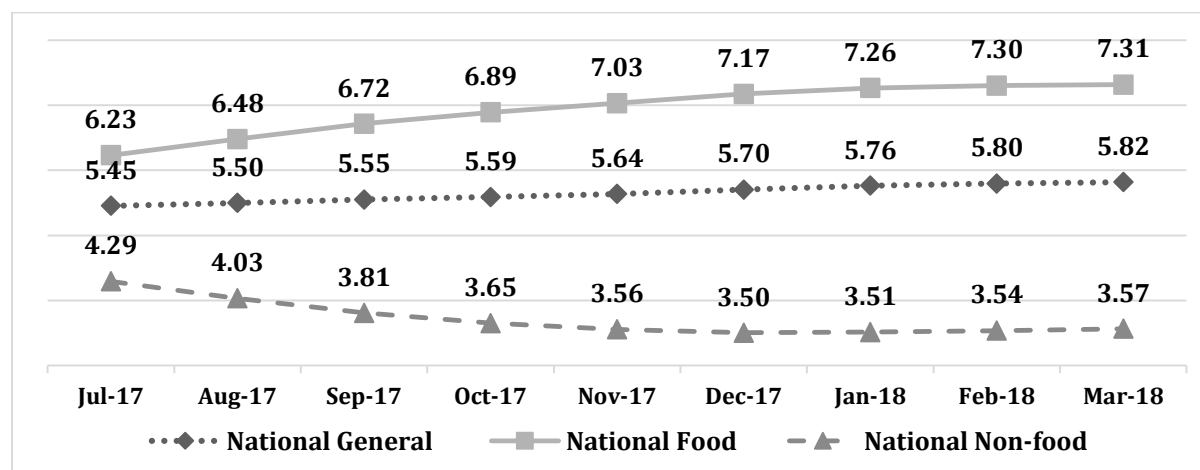
Inflation, although at a lower level, is slowly creeping up and is primarily driven by rising food inflation

The growth in annual average inflation reached 5.8 per cent in March of FY2018 (Figure 2.4) against the annual target of 6.0 per cent set in the Monetary Policy Statement (MPS) of the Bangladesh Bank for the second half of FY2018. However, an increasing trend can be observed since May 2017. The key reason behind this is the rising food inflation which, in turn, is mostly driven by increased rice prices. As of April 9, 2018, price of coarse, medium and fine rice exhibited 3.7 per cent, 13.0 per cent and 25.0 per cent increase on a point-to-point basis respectively.⁸ Indeed, retail price of coarse rice in Bangladesh was found to be approximately 8.1 per cent higher than the average wholesale price prevailing in Kolkata as of April 10, 2018. The increase in food inflation was somewhat offset by declining non-food inflation during the July-December period of FY2018. However, this trend had changed with increasing non-food inflation since January of FY2018. During the July-March time frame of FY2018, urban inflation showed a declining trend

⁸ In this estimation, 10 per cent cost and freight (c&f) charge was considered and relevant exchange rate conversions were carried out. Rice price for Bangladesh and India were taken from Trading Corporation of Bangladesh (TCB) and Department of Consumer Affairs, India respectively.

while the inverse is discernible for rural inflation. As a result, the gap between urban and rural inflation narrowed during the most recent months. As was noted, inflation was mostly driven by food prices irrespective of the location i.e. rural or urban.⁹ Rising global commodity prices, possibility of further depreciation of BDT, and relaxed monetary policy may exacerbate inflationary pressure in the economy over the coming months. In addition to these, the government needs to be vigilant to avoid any additional speculative pressure during Ramadan season.

Figure 2.4: Annual average inflation rate (%)



Source: Bangladesh Bureau of Statistics (BBS) data.

Growth of broad money supply remained well below the programmed level

Credit to public sector remained subdued as of February 2018 with a negative (-) 14.2 per cent growth thanks to the limited bank borrowing required by the government to finance the fiscal deficit incurred till now (Table 2.7). Net foreign assets, as of February 2018, posted a growth of 3.9 per cent against the end-June target of 0.1 per cent. However, with increasing pressure on balance of payments (BoP), the central bank may need to release more foreign exchange from the reserve which in turn is likely to further restrain the growth of net foreign assets. At the end of February 2018, broad money recorded a 9.8 per cent growth as opposed to the target of 13.3 per cent in June 2018. Credit to the private sector growth was 18.5 per cent as of February 2018 as opposed to the monetary policy target of 16.8 per cent for end-June 2018.

⁹ As per Food Planning and Monitoring Unit (FPMU) data, public stock of foodgrains at the end of March 2018 was 1,426 thousand Metric Ton (MT) – of which rice accounted for 963 thousand MT. The government has decided to distribute rice at Tk. 10 per kg to 50 lac extreme poor households. This initiative will require 750 thousand MT of rice over the months of March-April of FY2018 and September-November of FY2019. If equal amount of rice is distributed each month then additional requirement for the current fiscal year will be 300 thousand MT – creating further pressure on the public stock. Moreover, the government has decided to procure 900 thousand MT of rice at Tk. 38 per kg and 150 thousand MT of paddy at Tk. 26 per kg during the upcoming Boro harvest season (May-August, 2018). The cumulative pressure of these initiatives could exert further inflationary pressure on the economy.

Table 2.7: Growth of monetary indicators (%)

Components	Actual			Target	
	Jun 16	Jun 17	Feb 18	Jun 18 (Jul 17 MPS)	Jun 18 (Jan 18 MPS)
Net Foreign Assets	22.8	11.5	3.9	5.4	0.1
Net Domestic Assets	14.3	10.7	11.9	16.9	17.9
Domestic Credit	14.4	11.2	14.2	15.8	15.8
Credit to the Public Sector	3.3	-13.0	-14.2	12.0	8.3
Credit to the Private Sector	16.8	15.7	18.5	16.3	16.8
Broad Money	16.3	10.9	9.8	13.9	13.3
Reserve Money	30.1	16.3	10.1	12.0	12.0

Source: Bangladesh Bank data.

Interest rates for both deposits and advances showed upward trend

Interest rate for advances was showing a declining trend during the July-November period of FY2018 whereas the interest rate for deposits hovered around the 4.9 per cent mark. However, both rates have started to exhibit upward trend since December 2017. Overall, interest rate spread showed a generally declining trend and hovered around the 4.4 per cent mark since the beginning of 2018. The rise in deposit rate could be attributable to the government's recent move to reduce advance-deposit ratio (ADR) and subsequent drives to collect more deposits by non-compliant banks. Also, prevailing weaknesses in the banking sector including non-performing loans (NPL) and CAMELS indicators (discussed in details in section...) deter the banks from reducing the spread to any significant extent. As a result, lending rates had also risen in tandem.

Initiatives to boost liquidity supply contradicts government's earlier conservative monetary stance

As was mentioned earlier, Bangladesh Bank reduced the ADR to 83.5 per cent from an earlier 85.0 per cent in January 2018 as an attempt to curb the emergent liquidity pressure arising from aggressive lending. The initial deadline to implement this was set for June 30, 2018; this was revised twice and in the end cut-off date was set at March 31, 2019. At the same time, the central bank cut the cash-reserve ratio (CRR) by 1 percentage point to 5.5 per cent on bi-weekly average basis with a provision of at least 5.0 per cent on daily basis, effective from 15 April, 2018. Also, Bangladesh Bank decreased its repo rate from 6.75 per cent to 6.00 per cent while keeping the Reverse Repo rate unchanged at 4.75 per cent. It is to be noted in this connection that, these changes contradict government's earlier conservative approach, with the result of increasing money supply in the market. Questions may also be raised regarding the process which was followed in executing the recent changes.

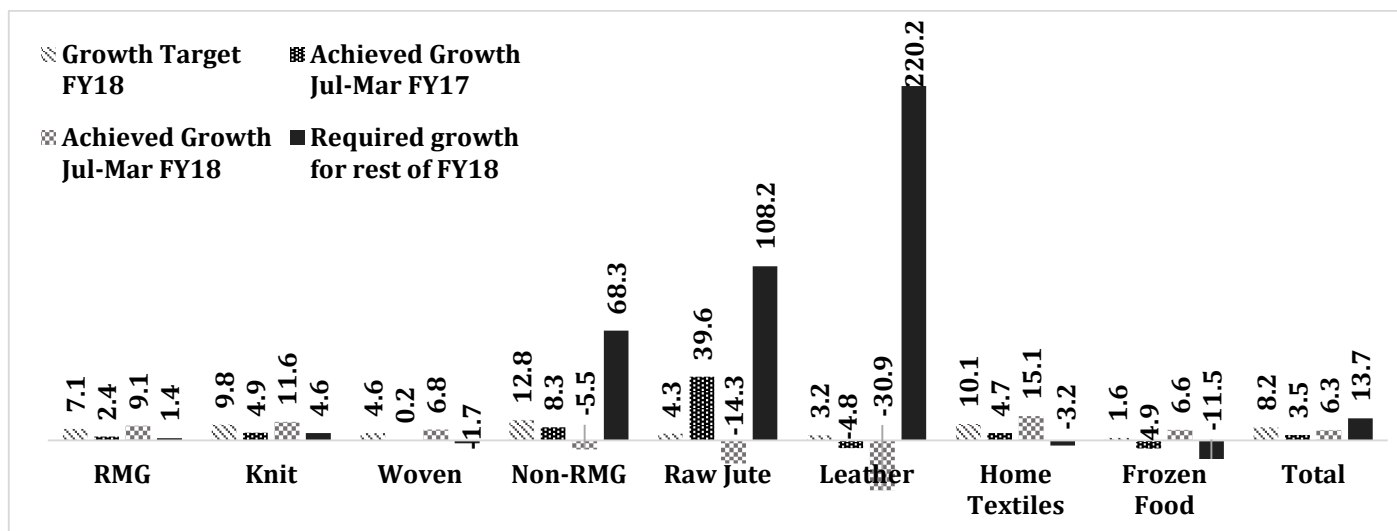
RMG-led export earnings exhibit resilient growth but slowdown in non-RMG export growth is worrisome

During the first three quarters (July-March) of FY2018, total export earnings have remained marginally below the strategic target but the attained export growth was significantly higher than the achieved annual growth rate of 1.7 per cent in FY2017. *First*, according to Export Promotion Bureau (EPB) data, total export earnings registered a 6.3 per cent growth during July-March of FY2018 against the envisaged annual target of 8.2 per cent. This was driven by robust performance in ready-made garments (RMG) export which recorded a 9.1 per cent growth up to March of FY2018 compared to the annual target of 7.1 per cent (Figure 2.5A). Export growth of both knit- and woven-RMG products (11.6 and 6.8 per cent respectively) during the aforesaid timeframe surpassed their annual growth target (9.8 and 4.6 per cent respectively). Regrettably, non-RMG items were not able to replicate this record. Growth of non-RMG exports during July-March of FY2018 was negative (-) 5.5 per cent as opposed to the annual target growth of 12.8 per cent; this would require an astounding 68.3 per cent growth for the remainder of the fiscal year for the annual target to be attained. This slump can be mainly ascribed to depressed export performances of leather and leather products, raw jute and engineering products. CPD, in its

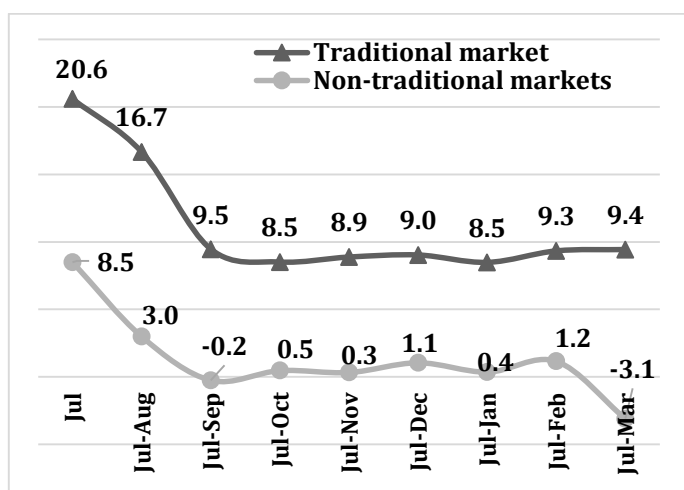
earlier analysis, asserted that growth of export value in major markets is mostly volume-driven. It was also observed that prices of Bangladesh's main export, RMG products, were declining over time and were also lower than comparator countries (CPD, 2018). Improvement in product quality and higher productivity are key to enhancing Bangladesh's export earnings through negotiation of higher prices.

Figure 2.5: Export scenario after three quarters of FY2018 (% growth)

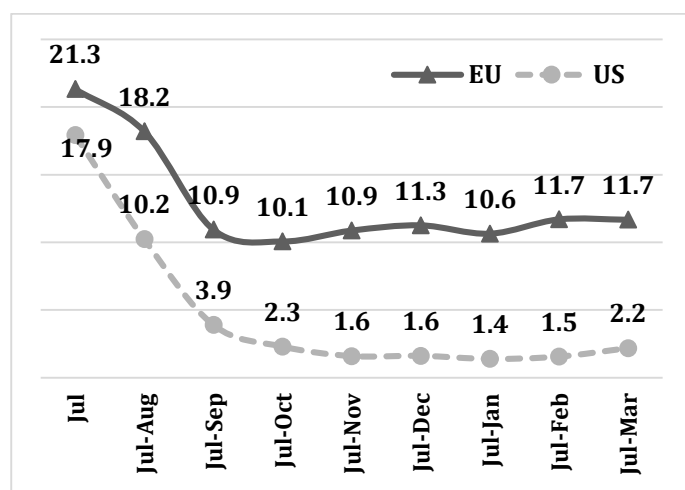
A. Target vs. Achievement



B. Traditional vs. Non-traditional



C. US vs. EU



Source: Author's calculation from Export Promotion Bureau (EPB) data.

Second, throughout the course of FY2018, export growth in non-traditional markets was lower compared to their traditional counterparts (Figure 2.5B). Indeed, export growth in non-traditional markets entered negative terrain during July-March of FY2018. The key reason behind this is the persistent poor performance of non-RMG exports in the non-traditional markets. Indeed, compared to March of FY2017, non-RMG exports to non-traditional markets experienced a decline of (-) 53.4 per cent in March of FY2018. This is a serious concern from the perspective of both product and market diversification.

Third, amongst the traditional markets, export growth in the US has been at a very low level in FY2018 (Figure 2.5C). Both RMG and non-RMG items exhibited subdued export growth during July-March of FY2018. Amongst the RMG exports to the US, woven items – which constitute the larger share, posted an insignificant growth of 0.6 per cent during July-March of FY2018.

Fourth, export growth in the EU market was 11.7 per cent during the first nine months of FY2018 (Figure 2.5C). This was driven by export of RMG products; export of the item to the EU market increased by 11.6 per cent. Both knit and woven items registered notable growth (12.5 per cent and 10.6 per cent respectively). Although growth of non-RMG exports to the EU has been relatively upbeat, it is displaying a gradually declining trend (from 48.2 per cent during July of FY2018 to 11.9 per cent during July-March of FY2018). In fact, the growth rate was negative (-) 4.2 per cent for March of FY2018 on a month-on-month basis.

Import payments driven by food grains and capital goods

During the July-February period of FY2018, import payments registered a significant 26.2 per cent growth over the corresponding timeframe of FY2017. This surge in import growth was primarily driven by foodgrains and capital goods which recorded 186.7 and 28.2 per cent growth respectively during the considered timeframe. Of the various foodgrains, higher import of rice continued in the backdrop of lower production, higher domestic retail prices, depleted public stock and reduced tariff. Import payments for capital machineries and other capital goods posted 42.3 per cent and 20.7 per cent growth respectively during the July-February period of FY2018. Intermediate goods, which account for nearly 51.0 per cent of the total import payment, exhibited a growth of 19.8 per cent. Within this category, raw cotton, yarn, and fabrics posted growth of 39.4, 18.9 and 15.2 per cent respectively. Of the consumer goods, edible oil and sugar recorded considerable import growth despite lower global prices of these commodities. Import payments for 'others import items (not specific elsewhere)' rose by 30.4 per cent during July-February of FY2018 when compared to the corresponding period of FY2017. Taking cue from these trends, earlier apprehension of CPD (2018) concerning overstocking of certain commodities, trade misinvoicing and capital flight remains valid and must receive policy attention.

Upturn in outward migration is reflected partially in increased remittance inflow

Compared to the corresponding timeframe of FY2017, outward migration from Bangladesh experienced a 5.2 per cent rise during July-March of FY2018; the number rose to a total of 692,236. Nearly half of the aforesaid migrants were destined for Saudi Arabia. Average monthly migration during July-March of FY2018 was 76,915, which is the highest since FY2012 for the considered timeframe. Similarly, remittance inflow to Bangladesh registered a 17.3 per cent increase during July-March of FY2018. However, this impressive growth ought to be seen in the backdrop of the dismal scenario prevailing in FY2017. Average monthly remittance inflow during July-March of FY2018 was USD 1,196 million, which is USD 33 million lower than average monthly inflow for the July-March period of FY2016.

Balance of payment (BoP) situation is not favourable as both current account and overall balance have crossed into the negative zone

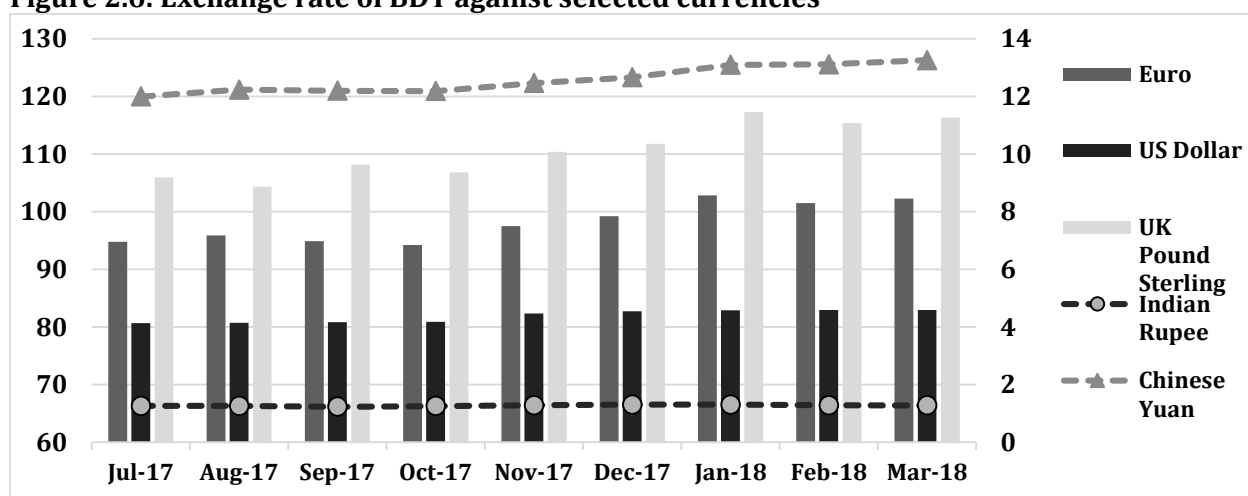
The adverse impact of escalated imports payment against relatively less impressive performance of export and remittances, is evident from the BoP scenario. Up to February of FY2018, trade balance stood at negative USD (-) 11.7 billion, which was almost twice the deficit than that of the corresponding period of FY2017. Current account balance, despite the aforesaid decent performance in export earnings and remittances, reached USD (-) 6.3 billion during July-February of FY2018. This figure was about USD (-) 1.0 billion during the corresponding period of FY2017. Within the financial account, net foreign direct investment (FDI) inflows recorded an insignificant 0.8 per cent growth. However, this was bolstered by a strong 86.3 per cent growth in medium and long-term (MLT) loans, and consequently, financial account balance rose to USD 5.7 billion. It must be taken into cognisance that, financial account surplus, thanks to hefty flow of MLT loans, is also partially linked with higher trade deficit. Indeed, higher imports payments was primarily required for imports related to the development projects which are often being financed through foreign inflows. Following these aforementioned trends, Bangladesh's overall BoP stood close to negative USD (-) 1.0 billion as of February FY2018, which was a surplus to the tune of USD 2.4 billion during the same period of FY2017. It appears that, in the backdrop of the growing imports,

Bangladesh's overall balance for the entire fiscal year is going to be in the negative terrain for the first time since FY2011.

Pressure on BoP is translated into depreciation of BDT against major currencies and slowdown in foreign exchange reserve accumulation

Over the July-March timeframe of FY2018, exchange rate of BDT against Indian Rupee has remained fairly stable. Apart from this, BDT has shown a generally depreciating trend against other major currencies such as USD, Euro, UK Pound Sterling and Chinese Yuan (Figure 2.6). In fact, the import settlement rate, or BC selling rate, of USD was BDT 83.5 as of April 10, 2018, exhibiting a 3.2 per cent increase in the exchange rate from a year ago. It may be assumed that the increased pressure on BoP has translated into depreciation of BDT. Similar trend was also found from the analysis of real effective exchange rate (CPD, 2018). As a consequence of the overall deficit, foreign exchange reserves came down to about USD 33.0 billion as of April 11, 2018 from the earlier USD 33.5 billion as of June 30, 2017.

Figure 2.6: Exchange rate of BDT against selected currencies



Source: Compiled from Bangladesh Bank data.

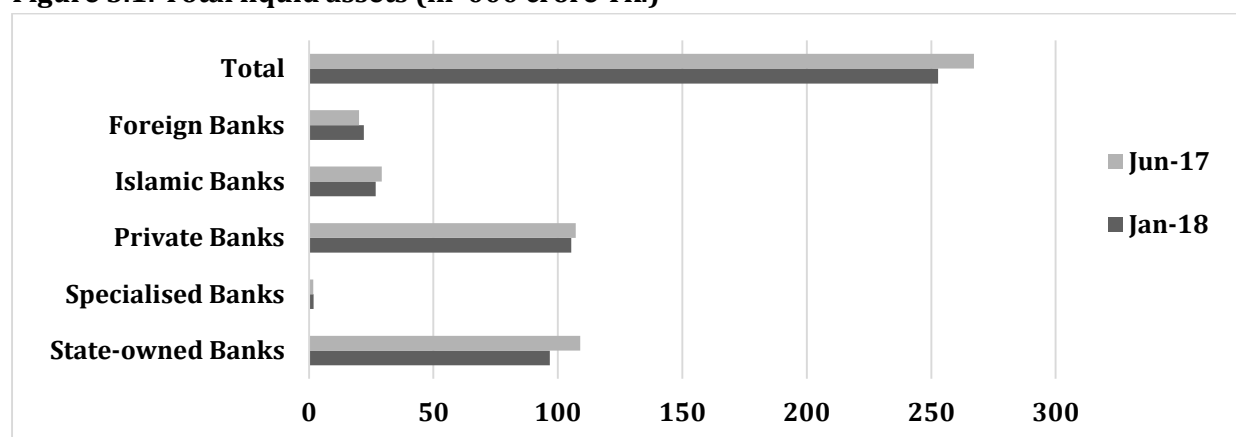
Note: Indian Rupee and Chinese Yuan are shown in the right vertical axis.

SECTION III. FROM EXCESS LIQUIDITY TO LIQUIDITY CRUNCH: THE CURIOUS CASE OF THE BANKING SECTOR

The banking sector of Bangladesh continued to be in a state of disarray as the fiscal year 2017-2018 draws to a close. In 2017, state-owned commercial banks and development finance institutions failed to meet the BASEL III requirement of maintaining capital to risk weighted asset ratio of 10 per cent (Bangladesh Bank, 2017). At the same time, both categories of banks had more than 20 per cent non-performing loans in 2017. These banks also recorded very high expenditure to income ratios in 2017, reflecting a poor state of management. Indeed, development finance institutions had an expenditure-income ratio greater than 100 for the third year in a row with consequent continuation of losses suffered. The foreign commercial banks, to compare, made the highest profit; however, their interest rate spread has consistently been higher than the average, and was above 6 per cent in 2017 (Bangladesh Bank, 2018). The overall non-performing loan (NPL) ratio in the banking sector also posted some rise, from 10.1 per cent in June 2017 to 10.7 per cent in September 2017.

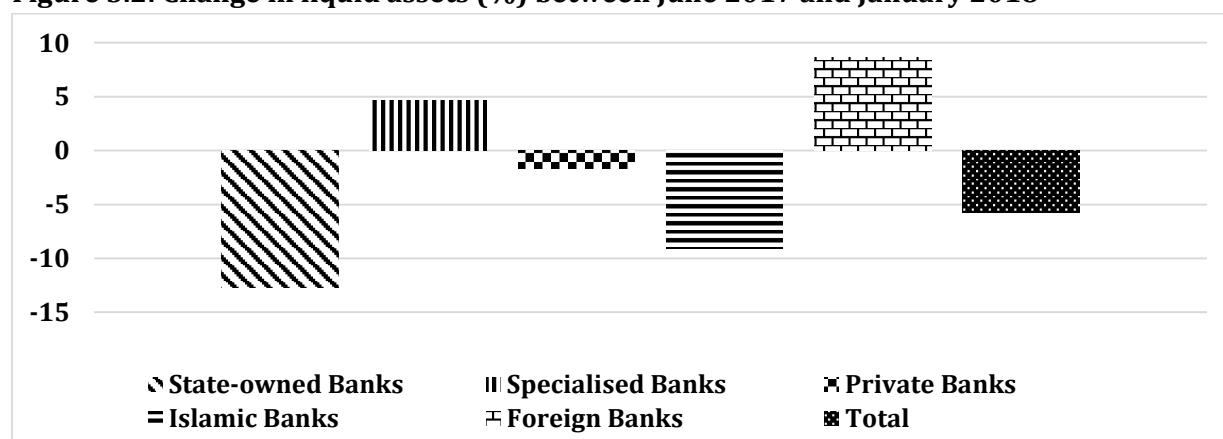
Apart from development finance institutions, banks in general did not face any major liquidity shortage in the early months of 2017. In fact, a build-up of excess liquidity in the banking sector led to concerns regarding the state of the general investment climate of the economy. However, liquidity position of majority of banks started to deteriorate thereon and by January 2018, there was widespread liquidity shortage in the banking sector (Figures 3.1 and 3.2).

Figure 3.1: Total liquid assets (in '000 crore Tk.)



Source: Major Economic Indicators, March 2018, Bangladesh Bank.

Figure 3.2: Change in liquid assets (%) between June 2017 and January 2018



Source: Major Economic Indicators, March 2018, Bangladesh Bank.

The sudden shift in the scenario from an excess liquidity situation to liquidity crunch in the banking sector begs the question where the money has actually gone. Questions have been raised concerning the quality of loans paid and the apprehension about a large part of loans in the end turning out to be bad debts. The central bank should also investigate the veracity of whether the recent liquidity crunch was originated from loan defaulters who chose to repay their loans from state-owned commercial banks by borrowing from private commercial banks.

As may be recalled, the recent liquidity crisis initially started in the scam-ridden fourth generation commercial banks. This problem has become more pervasive because of the knock-on impact on other banks, either through depositor behaviour or over cautious stance by the banks in the backdrop of rising NPL. In view of this situation, and to inject more cash in the system, the central bank issued a circular on 3rd April 2018 that the minimum cash reserve requirement (CRR) was to be reduced from 6.5 per cent to 5.5 per cent bi-weekly, and from 6 per cent to 5 per cent daily, starting from 15th April 2018. Additionally, it was decided that government agencies would increase their deposit of funds in private commercial banks from 25 per cent to 50 per cent. A more worrying sign is that these amendments were made primarily due to pressure from the powerful banking lobby bypassing the central bank. This has seriously undermined the independence of the central bank and has dented its credibility.

The attempt on the part of the Ministry of Finance to rescue the private commercial banks in this way was in fact similar to government's recapitalisation support for the state-owned commercial banks. These steps, taken irrespective of performance record of the private commercial banks was not justified under any pretext. Indeed, this was likely to encourage poorly performing banks to continue with their business-as-usual practices.

The decision to reduce the CRR is contradictory to the contractionary monetary policy announced by the Bangladesh Bank for January-June 2018. Reduction of the CRR will free up approximately BDT 101 billion of additional funds for banks to lend out. Such quantitative easing could lead to inflationary pressures, particularly if the loans against this money are of doubtful quality and goods and services are not produced in view of these. Particularly in an election year when there is a natural tendency for increased money supply the need for caution to be exercised should be much higher. Research has shown that in Bangladesh, a 1 per cent increase in the supply of broad money could increase the consumer price index by 0.80 per cent (Bahar & Rahman, 2014). The CRR change will likely affect the interest rates in the banking sector which is becoming visible in the economy. The apprehension is that the deposit rate may fall faster and to a larger extent than the lending rates. More worrying is the fact that the reduction in the CRR may encourage banks to lend more aggressively, and indiscriminately. This will raise the risk of increase in NPLs. The recent decision to allow higher share of government funds in banks could result in the money going to poor performing ones. For example, in December 2017, Farmers Bank failed to pay BDT 229 crore to Bangladesh Climate Change Trust Fund on maturity of its fixed term deposits. There should have been certain conditionalities attached to this newly introduced enhanced threshold of receiving government fund.

As for the state owned commercial banks, the government has continued to inject money into these banks. From FY2009 to FY2017, the government had allocated BDT 15,705 crore for the recapitalisation of state owned banks. This support, however, has not been translated into improvement in the performance of these banks; rather the amount of NPLs has piled up on a continuing basis over the past years. In all likelihood this monetary infusion will continue in this budget as well.

Recommendations

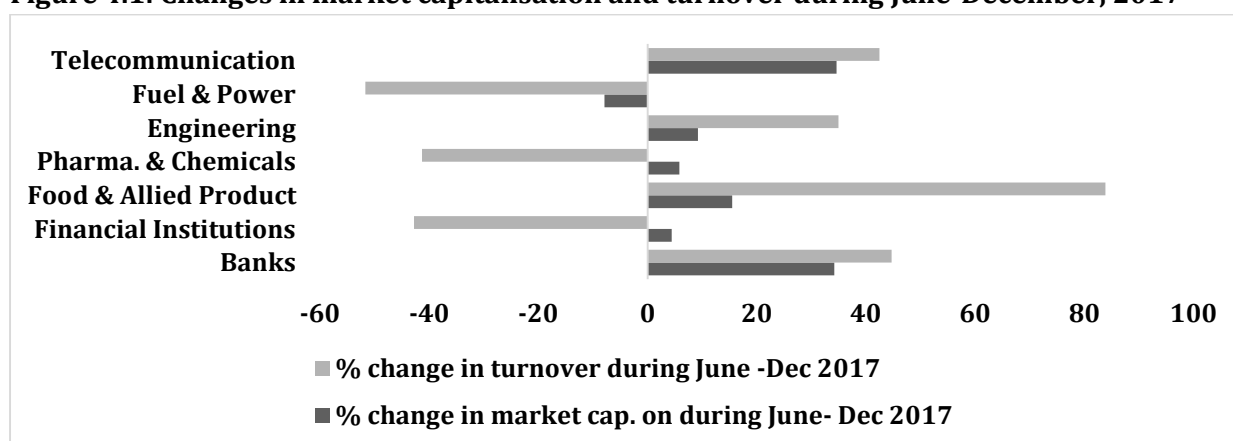
The core problem of the banking sector lies in the lack of good governance and the political commitment to remedy the emergent situation. While these issues are to be dealt with by keeping the medium term strategic perspective in the purview, the government should take a number of immediate measures to overcome some of the disquieting current developments afflicting the banking sector of the country. Measures which have budgetary implications are suggested here.

- Recapitalisation of state owned commercial banks year after year has to be stopped. Such practice of bailing out the losing banks with public money is economically unjustified and morally incorrect. There has to be a transparent exercise to find out what has actually been achieved through such funds, and when and how this type of recapitalisation of banks will be brought to an end.
- The decision to keep 50 per cent government funds with private banks goes against the spirit of central bank's monetary policy. Access to additional government funds as deposits should be contingent on performance of the particular private bank. Only banks with less than 5 per cent NPLs should be eligible for the additional available funds from government entities.
- CPD has earlier argued for setting up an independent commission for the banking sector in view of addressing emerging challenges. The broad terms of reference (ToR) of the commission will be to critically assess the problems and weaknesses of the banking industry. Such a commission will suggest concrete recommendations for prudential banking, and prepare guidelines regarding management, automation, risk management, and internal control. The budget should allocate adequate funds for setting up this commission.

SECTION IV. BULLISH AND BEARISH TRENDS IN THE CAPITAL MARKET: ROLE OF INSTITUTIONAL INVESTORS AND REGULATORS

Despite some hiccups, the capital market has maintained bullish trends (in terms of key indicators) in the course of calendar year 2017. Key indices of the Dhaka Stock Exchange (DSE) (i.e. DSEX, DSE30 and DSES) have registered a rise of 10-12 per cent between January 2017 and January 2018, although total turnover declined by 70 per cent during the same period. Major companies in the DSE such as those related to the banking and telecommunication sector, which comprises over 38 per cent of total market share in the DSE, have experienced a significant rise both in terms of market capitalisation and turnover during the June-December 2017 period (Figure 4.1). The bullish trend in the stock exchange is mainly attributed to the significant amount of investment made by institutional investors, particularly by bank and non-bank financial institutions prior to and during this period. After getting the permission in July, 2016 for transforming loans into paid up capital of bank subsidiaries, and thereby reducing the exposure of banks' investment in the capital market within the permissible limit, a number of banks got the opportunity to make additional investment in the capital market.¹⁰ In the backdrop of the very high amount of excess liquidity in the banking sector in 2017 (which amounted to Tk. 1.06 trillion crore at the end of June 2017), banks had made large investments in the stock market. Indeed, this contributed, in part, to the bullish trend in the market. According to reports published in national dailies, as many as 21 banks were alleged to have invested in the stock market beyond their exposure limit in this period; this was exposed in an investigation carried out by the Central Bank.¹¹ Alongside that, some of the banks misused the weekly reporting system by making investment exceeding the exposure limit. The system was manipulated by exceeding the limit for a number of working days in order to make short term gains. Adjustments were made just before the weekly reporting to the Central Bank. This type of market behaviour reflects a lack of responsibility on the part of banks as institutional investors in the capital market. According to the Bangladesh Bank, in the first half of FY2018 (July-December, 2017) banks have disbursed about Tk. 13,100 crore as credit to the private sector, which exceeded the target set for this period; a part of this credit is likely to be invested in the capital market by banks.

Figure 4.1: Changes in market capitalisation and turnover during June-December, 2017



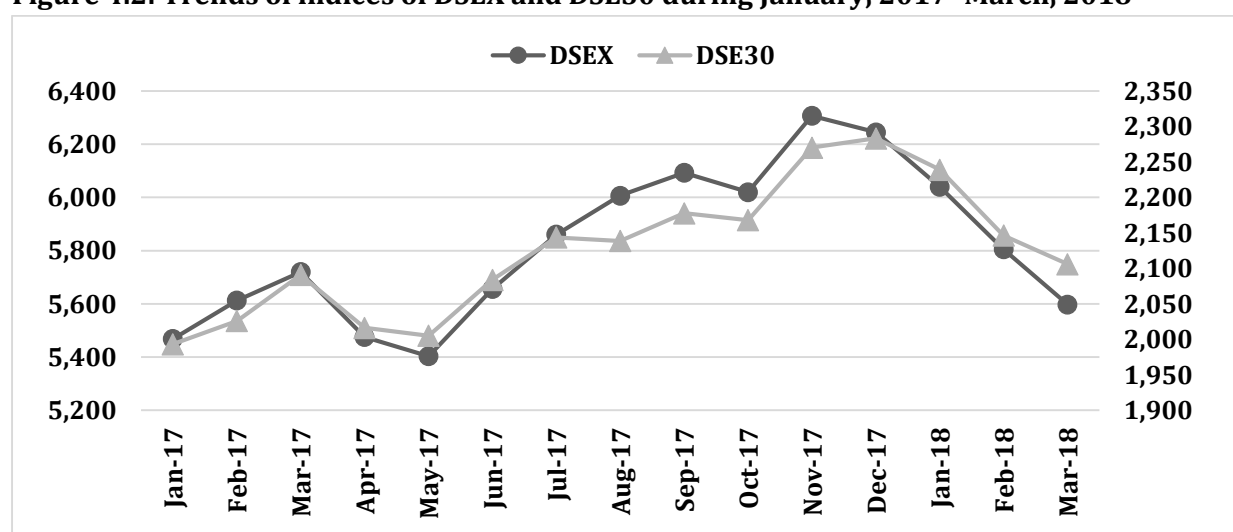
Source: Dhaka Stock Exchange (DSE) data.

¹⁰ Loans worth Tk. 19.84 billion of 13 banks turned out to be paid up capital of their subsidiaries (The Daily Prothom Alo, 9 October, 2017). This allowed them to lower the total investment in the stock market.

¹¹ Exposure limit for banks to invest in the stock market: 25 per cent of its paid up capital, share premium, statutory reserve and retained earnings.

The bullish trend in the market had given way to a bearish outlook since December 2017 (Figure 4.2). With a view to tightening the money supply further during the second half of FY2018, the monetary policy for H2 of FY2018 had set the target of lowering the rate of credit growth (from 18.1 per cent to 16.2 per cent). The advance-deposit ratio (ADR) was also supposed to be reduced to 83.1 per cent (which was over 85 per cent) by June 2018. The announcement pushed banks to sell a part of their shares in order to comply with new targets set for credit growth and ADR. It is important to investigate which banks had sold their shares in this time and how much of that sale was related to complying with new directives of the Central Bank; most importantly, whether some of the banks as institutional investors played a responsible role to stabilise the market or not. During this period, the Central Bank, as regulator, had moved back from its own monetary policy stance of tightening money supply and credit growth – by extending the timeline for adjustment of ADR twice; first till December 2018 and the second till March 2019, and also reducing the CRR by one percentage point. These steps helped make available about Tk. 10,000 crore to the commercial banks for credit disbursement. A new directive allowed public agencies to deposit a higher share of their savings in private commercial banks (raised from 25 per cent of funds to 50 per cent) in order to create additional funds for credit disbursement. This type of initiative taken by the Central Bank raises questions about the efficacy of the monetary policy to adjust the market situation, particularly in view of the exposure of commercial banks to the capital market. It also exposed the questionable role played by commercial banks in the capital market as institutional investors.

Figure 4.2: Trends of indices of DSEX and DSE30 during January, 2017- March, 2018



Source: Dhaka Stock Exchange (DSE) data.

Note: DSE30 is shown in the right vertical axis. DSEX and DSE30 data for the months of February, 2018 and March, 2018 were taken from the month-end figures as on 28th February, 2018 and 29th March, 2018, respectively.

In 2017, the long-awaited process for completion of demutualisation of the DSE had been revived. As a result, the DSE was able to select its institutional partner who would buy 25 per cent of the shares of its brokers (45 crore shares), and also will make investment for strengthening the market. The DSE has reviewed two proposals – a) Consortium of Shanghai Stock Exchange and Shenzhen Stock Exchange and b) Consortium of National Stock Exchange of India and NASDAQ. The offers made in the two proposals are quite different, particularly in terms of the offer price to purchase shares (Tk. 15 vs. Tk. 22 per share), making investment in improving technologies, requesting to get directorship on the Board, membership in various committees and getting some

of the top management positions etc. Because of better offer price, specific proposal for investment in developing technologies, the DSE selected the proposal submitted by the Chinese Consortium. Following review of the Chinese proposal, the SEC advised to drop its request to be member of different committees. This was important to ensure compliance with related laws of the SEC.

Proposals

Central Bank needs to increase its vigilance in monitoring activities of banks in the capital market

The Central Bank needs to be more proactive and vigilant in monitoring activities of Banks in the stock market. Introduction of daily reporting system of banks' transactions in the stock market, instead of weekly reporting system has made the reporting system more transparent. The Central Banks need to respond quickly to identify market irregularities and to take action against the irregularities on an urgent basis. On the contrary, delaying enforcement of orders, particularly those related to market irregularities, give a wrong signal about the enforcement capacity of the Central Bank. It is important to investigate whether banks are playing their assigned role as institutional investors, in case of buying and selling of shares, particularly at the time of bullish and bearish trends in the market during 2017 and also afterwards.

SEC and Central Bank should work together to prepare a code for institutional investors

Banks, as institutional investors, have a major role to play to stabilise the stock market and also to create confidence among the minority shareholders. Banks should behave responsively in the market, particularly at the time of bullish and bearish trends, and the attendant volatility in the market. The recent behaviour of banks, both at the time of bullish and bearish situations, have raised questions about their role in the market. In this backdrop, SEC and Bangladesh Bank may jointly prepare a code of conduct for institutional investors in the stock market. This type of code is available in other matured markets such as Malaysia and India.

Regular review and monitoring of the activities of the institutional partner of DSE will be required

Working with a reputed international stock exchange as institutional partner will be a new experience for the DSE. The rules and practices followed by DSE is likely to be different from those of the institutional partner. For example, the Shanghai Stock Exchange is governed under a controlled/centralised governance system and is not demutualised. Hence, the Shanghai Stock Exchange needs to accommodate rules, regulations and practices of the demutualised DSE. Hence, review and monitoring of the activities of the institutional partner would help streamline their activities and support smooth operation of DSE. Moreover, it is also important to ensure timely implementation of the various commitments made by the institutional partner, particularly with regard to investment in technologies and human resource development etc. Given the weak infrastructural facility and emergent needs of the market, DSE will be required to invest in new technologies for setting up the derivatives market, bond market, market maker and central clearing company etc.

SECTION V. INCENTIVES FOR EXPORT-ORIENTED SECTORS: RECOMMENDATIONS FOR FY2019 BUDGET

One of the core targets of the Seventh Five Year Plan (7FYP) is to promote industrialisation through favourable trade policy regime. Government envisaged to raise export earnings to USD 60 billion by FY2021. Even if the annual target of USD 37.5 billion (8.2 per cent growth) set for FY2018 is realised to the fullest extent, export earnings will need to grow at about 17 per cent annually over the next three years to attain the target set for FY2021. This will indeed be a herculean task. The challenge is exacerbated by rising uncertainties in the global market (Brexit, growing protectionism which could lead to a trade war between USA and China with consequent adverse implications for global trade), growing domestic costs of production (possibility of upward revision in administrative prices of energy and revision of the minimum wages), heightened competition (including re-emergence of India with additional policy support). In this backdrop, energetic and innovative steps will need to be taken if the pace of export growth is to be accelerated. It is from this perspective that there is a need to revision the fiscal incentives provided to the export-oriented sectors in Bangladesh to raise their efficacy to provide strategic support to export-oriented industries and activities.

Current state and policy space

A review of fiscal incentives in Bangladesh indicate that historically the larger part of fiscal incentives has gone to the RMG sector. This is not surprising. RMG accounts for, by far, the largest share in Bangladesh's exports. While its share in total export was 78.1 per cent in FY2012, the corresponding figure stood at 80.8 per cent at the end of FY2017. A number of new items (non-traditional) has emerged over the recent past; whilst the share in total export has not been significant, in terms of value and pace of growth, their performance must be taken cognisant of (Table 5.1). This reinforces the argument to recalibrate the fiscal incentive package in view of emerging demands.

Table 5.1: Growth of major export-oriented sectors in Bangladesh over last five years

Products	FY12	FY17	FY17 Share	Ratio FY17/FY12	CAGR
	in mln USD				
RMG Sector	19,090	28,150	80.8	1.47	8.1
Knitwear	9,486	13,757	39.5	1.45	7.7
Woven Garments	9,603	14,393	41.3	1.50	8.4
Non-RMG sectors	5,212	6,685	19.2	1.28	5.1
Leather & Leather products (41-43 & 6403)	664	1,234	3.5	1.86	13.2
Footwear (Chapter 64) Excluding 6403	102	241	0.7	2.37	18.9
Jute & Jute goods (Chapter 53, 6305)	967	962	2.8	0.99	-0.1
Engineering products (Chapter 71-88)	375	689	2.0	1.83	12.9
Agriculture products (Chapter 06-24)	403	553	1.6	1.37	6.6
Shrimps	472	446	1.3	0.95	-1.1
Headgear	53	187	0.5	3.51	28.6
Computer services	71	179	0.5	2.53	20.4
Pharmaceuticals	48	89	0.3	1.85	13.1
Plastic products (Chapter 39)	89	117	0.3	1.32	5.7
Paper & Paper products (chapter 48)	28	57	0.2	2.05	15.4
Ships, boats and floating structures (Chapter 89)	46	66	0.2	1.43	7.4
Furniture	27	53	0.2	1.94	14.1
Rubber (Chapter 40)	16	28	0.1	1.75	11.9
Other non-RMG products	1,868	1,812	5.2	0.97	-0.6
Total export	24,302	34,835	100.0	1.43	7.5

Source: CPD calculation based on EPB data.

The Ministry of Commerce (MoC) periodically formulates Bangladesh's Export Policy, from medium term (3-year period) perspective with a view to incentivise export-oriented activities in the economy and remove anti-export bias in the policies (or at least to mitigate/compensate for the anti-export bias). The Export Policy 2015-18 had identified a number of non-traditional exports which had significant export potentials. These included software and IT enable services (ITES), footwear and leather products, ship and ocean-going vehicles, jute goods, agro-based products, pharmaceuticals, furniture and a number of labour-intensive products with export potentials. The Policy also identified a number of thrust sectors which were earmarked for special support in view of their potential to contribute to the export basket of the country. These included electronic products, light engineering, frozen fish, printing and packaging, rubber, silk products, handicrafts and handloom industries.

To support exporters and export-oriented entrepreneurs and help them remain competitive in the global market, successive governments in Bangladesh have put in place an array of fiscal instruments. These were in the form of export subsidy (cash incentives)¹², bonded warehouse and duty drawback facilities (through selectively issuance of bond license), tax rebate, soft and concessional short-term commercial loans, support from export development fund (EDF) and export promotion fund (EPF), export retention quota, special income tax rate, reduced tax rate and a host of other support measures. Some of the incentives are export-product specific; others product-neutral. Some measures are instrumental and aimed at achieving important 7FYP objectives relating to product and market diversification and growth of exports, through allocations for skills upgradation, improvement of technology infusion, and development of trade facilitation.

The need to revisit the incentive structure and resources allocated for incentives is also called for in view of recent policy changes by some of Bangladesh's competitors in the global market. Box 1 presents some information about incentives for export-oriented industries provided by India in recent times particularly in view of offsetting some of the negative implications of introduction of the goods and services tax (GST) in 2017.

Box 1: Export Incentives in Indian Budgets: FY2017-FY2019

FY2017 (1 April 2016-31 March 2017)

- Rs. 6,000 crore special package for the textile and apparel sector
 - Rs. 5,500 crore is for an additional 5 per cent duty drawback for garments
 - The remaining Rs. 500 crore is for additional incentives under amended Technology Upgradation Funds (TUF) scheme
- These initiatives are expected to increase exports by USD 30 billion and help attract investment worth Rs. 74,000 crore in next three years
- Government will bear the entire employer's contribution of 12 per cent under the Employers Provident Fund (EPF) scheme – additional cost of Rs. 1,170 (early provision was 8.33 per cent)

FY2018 (1 April 2017-31 March 2018)

- Rs. 6,000 crore package for employment generation and promotion of textile exports
- A set of reforms are envisaged including simplified labour laws

¹² It is to be noted that such cash incentives are provided only to those exporters who do not avail of the bonded warehousing facility or the duty drawback facility.

- Steps for technology upgradation

Mid Term Review of Foreign Trade Policy 2015-2020 (December 2017)

- Additional fiscal incentives of around Rs. 8,500 crore under Merchandise Exports from India Scheme (MEIS) and Services Exports from India Scheme (SEIS)
- Incentive rates for the garments and made ups have been enhanced to 4 per cent of value of exports from 2 per cent to offset the negative effect of GST since 1 July 2017 (will incur additional annual incentive of Rs. 2,743 crore)
- 2 per cent additional incentive for other MSMEs and labour-intensive industries (additional annual incentive of Rs. 4,567 crore)
- For reducing lead time: (i) testing of samples for drawback purpose (ii) introduction of e-sealing facility

FY2019 (1 April 2018-31 March 2019)

- A comprehensive textile sector package for apparel and made-ups to the tune of Rs. 7,148 crore
- Government will continue to contribute 12 per cent of the wages of the new employees in the EPF
- Increased the funds allocated under the TUF scheme from Rs. 2,013 crore in FY2018 to Rs. 2,300 crore for FY2019
- Reduced income tax rate of 25 per cent for MSMEs (with turnover upto Rs. 250 crore in FY2017)

Review of major incentive tools

Special bonded warehouse facilities (SBW)

Bonded warehouse facilities, a special license scheme issued by Customs Bond Commissionerate (CBC), can be availed of by 100 per cent export-oriented industries. The bond facility allows the beneficiaries to get duty-free access when importing raw materials to be used only for exportable products. The facility has traditionally been enjoyed by the RMG exporters and, to some extent, by exporters of leather products. While in theory this facility is supposedly open for all 100 per cent export-oriented industries, real access has been quite limited. Government incurs a significant burden in the form of revenue forgone particularly when import duties on the bond products for the domestic tariff area is high. Realising the potential of the leather sector, the government has recently carried out a study to identify challenges faced by the sector in availing the bonded warehouse facilities. The study has come up with recommendations to remove the bottlenecks and facilitate access. CPD proposes that the aforesaid plan should be implemented on a priority basis in view of the significant export potential of this sector and in the context of the challenges with which the sector is confronted with. In continuation to this effort, government should formulate a medium-term plan for the thrust sectors to benefit from the SBW facilities.

Whilst misuse of bond facilities is a concern, this should be addressed by strengthening both monitoring and enforcement and by bringing the abusers to justice; and not be limiting access to SBW. Indeed, till now the facility has been availed of only by a few exporters outside the RMG sector. Also, a significant part of the issued licenses remained unutilised or inactive. It is felt that harassment by the Bond officials and misuse of bond by the exporters – both concerns need to be addressed expeditiously. In case of RMGs, Bangladesh Garment Manufacturers and Exporters Association (BGMEA) and Bangladesh Knitwear Manufacturers and Exporters Association

(BKMEA) issue the required UD (utilisation declaration) certificate on behalf of the NBR to facilitate imports of duty-free raw materials for exports under the facility. CBC has to depend on these certificates as the organisation does not have technical expertise to issue the certificate. There is widespread allegation about misuse of the facility. Whilst empowering the BGMEA with the authority to issue UD certificate was a right policy step, CBC should have the expertise and willingness to exercise due diligence. At present, the Bond authority has shortage of technical expertise and human resources to carry out its responsibility. Adequate budgetary allocations should be made in FY2019 budget to improve the situation. The Bond Commissionerate needs to be connected with the central customs data automation process (ASYCUDA) to check fabrication of UD certificates and misuse of duty-free import facility by some unscrupulous exporters. The initiatives taken by the NBR to introduce e-UD and e-EXP are welcome steps which need to be prioritised and adequately supported. This will entail coordination among BGMEA/BKMEA, Customs stations, Bond Commissionerate and the Bangladesh Bank. Bond Commissionerate should also regularly update the HS code list to facilitate import of duty-free raw materials (after proper validation) as imports by enterprises are ever changing and imports of new and differentiated raw material inputs ought to be encouraged for product diversification.

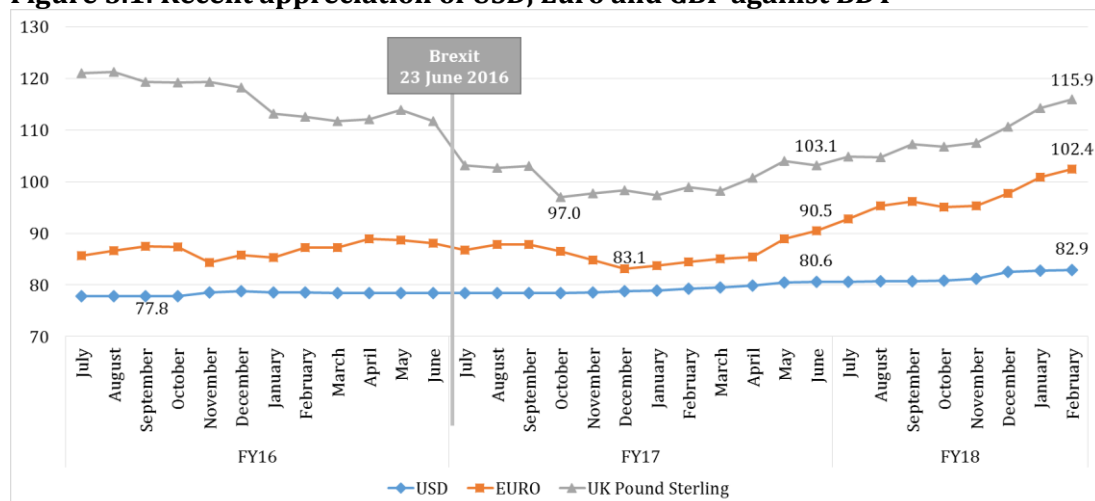
Cash incentives

Government provides significant amount of fiscal support in the form of export subsidies and cash incentives to incentivise exporters of selected sectors with promise and potential. In FY2018, these allocations were to the tune of Tk. 4,500 crore. In FY2017, about Tk. 4,395 crore was disbursed against the same amount of allocation. At present, 27 sectors receive cash incentives in the range of between 2 per cent and 20 per cent based on certain criteria. A large share of the incentives is enjoyed by major export sectors such as RMGs.

The scheme provides incentives to RMG sector and exporters associated with the sector, in various forms. A supplier of raw materials who is a member of Bangladesh Textile Mills Association (BTMA) receives 4 per cent cash incentive calculated on net free on board (fob) of the proportionate value of the export. This incentivises the backward linkages industries and enhances domestic value addition. On the other hand, RMG exporters get additional incentives of 3 per cent for product and market diversification. There are also additional packages for textile SMEs.

Special incentives are also introduced from time to time in view of both challenges and opportunities. RMG exporters to the EU market are currently receiving 2 per cent additional cash incentive (initiated in FY2017). The scheme was introduced in view of sharp depreciation of the Euro and Great Britain Pound (GBP) following the Brexit referendum in June 2016. However, exchange rates of Euro and GBP appreciated against BDT (Figure 5.1). In February 2018, Euro and GBP have appreciated by 21.3 per cent and 17.1 per cent respectively against the corresponding month of 2017. This scheme may be revisited in view of the recent developments.

Figure 5.1: Recent appreciation of USD, Euro and GBP against BDT



Source: Compiled from Bangladesh Bank data.

Among other sectors, government has put emphasis on leather sector as a potential export-oriented industry. Government is planning to continue 15 per cent cash subsidy for leather exports over the next 5 years to reach its export target of USD 5 billion by 2021. Following the recent relocation of major leather industries, the sector is facing a number of challenges which has resulted in a dip in export performance of this promising sector. A comprehensive plan needs to be designed to incentivise leather products export which could ease access to bonded warehouse facilities, support to ensure (environment and labour related) compliance, facilitate supply of skilled workforce. Capacity of Bangladesh Standards and Testing Institution (BSTI) should be developed in the area standard certification. Predictability of incentives should be ensured.

Misuse of export subsidy facility must be addressed with proper enforcement of policies. Recently, the Bangladesh Bank has investigated a number of cases where incentives were misused. Instances included the followings: receiving incentive before getting the export bill; export bill repatriated; channelling export receipt through money exchange houses; miscalculation of value-added part while using local raw materials; claiming incentives while exporting to traditional markets; misuse of bonded warehouse facilities. CPD recommends closer cooperation among involved stakeholders including government agencies, business associations, NBR, dealing banks and Bangladesh Bank. Budgetary allocations should be increased to enhance data access, human resource development and effective vigilance to address the attendant tasks.

Concluding remarks

In view of Bangladesh's graduation from the LDC group by 2024, and the discontinuation of most of the preferential treatment and market access facilities (including the EBA) by 2027, there is an urgent need to revisit the export incentive schemes in place. This is needed by keeping in the purview the LDC-graduated status and with a view to making the incentives more targeted and effective and to check abuse.

The restructured incentive package could include allocation for targeted skills development schemes for workers in export-oriented industries, contribution to employee's contribution fund, redefining non-traditional exports, strengthening of institutions related to enforcing export incentives, calibrating incentives in view of market dynamics, raising efficacy of the bond system and more predictability in the incentive regime.

SECTION VI. SPECIAL ECONOMIC ZONES: PRIORITIES TO SET UP ‘MODEL’ SEZs

In recent years, issues related to establishment of Special Economic Zones (SEZs) have been receiving increased attention from the policymakers, for several reasons. One key reason is the urgency of addressing the ‘infrastructure deficit’. The diverse range of business models and financing arrangements that the SEZs could potentially accommodate is another reason. The scope for providing ‘one stop service’ to potential investors in the SEZs is an added advantage. The interest of policymakers in Bangladesh at the highest level, to go for the SEZs was reflected through the setting up of a separate implementing authority, the Bangladesh Special Economic Zones Authority (BEZA) in 2013. BEZA was mandated with the task of putting in place 100 SEZs by 2030. A variable geometry of combinations with participation of the Government of Bangladesh, the private sector and partner countries were to be involved in developing the SEZs. It was perceived that availability of full-packaged infrastructure facilities will incentivise potential investors to invest in the SEZs once these are ready.

Regrettably, progress in setting up SEZs has been rather slow and behind the targeted timeline. Since the inception of the BEZA, a total of 76 SEZs have been identified, with specific locations. Twenty-two SEZs have been approved by the authority till date (MoF, 2017). Progress of work in the approved SEZs has been uneven. If a continuum of tasks such as undertaking feasibility studies, land development, construction of infrastructure facilities, and allotment of plots to investors are considered, these SEZs are at different stages of development.

Whilst a target was set to develop 20 SEZs by 2018¹³, the progress of work till now leaves much to be desired. Only 10 SEZs have actually been earmarked for completion but no specific timelines have been set with respect to when these could be fully in operation (MoF, 2017). According to the Annual Development Programme for FY2017-18, development work for only two SEZ projects (Jamalpur and Mirsarai) are currently under the purview of the ADP. However, allocation made for these two projects are not adequate for their completion in time. Even with full utilisation of the allocated budget for FY2018 (Tk. 140 crore), only 24.8 per cent of the total work may be completed by the end of the fiscal year. According to SANEM (2017), only four SEZs have completed 75 per cent of their total developmental work. Indeed, the progress in setting up the private SEZs is somewhat encouraging; a number of private SEZs have completed their initial work as regards land development. Some enterprises are at different stages of being established in a few private SEZs. Evidently, the task of getting a sizeable number of SEZs ready for operation ought to be given highest priority by concerned authorities. A few suggestions are being put forward in this connection.

Giving priority to establish few ‘model’ SEZs

BEZA should focus on setting up a few ‘model’ SEZs as a beginning, on a priority basis. This will give investors confidence about the new architecture, its ability to offer the promised facilities and services, and ensure quality of the facilities as per international standards; SEZs should also assure potential investors of its institutional capacity to address the challenges faced by them in such zones. Given mixed experiences at the global level as regards success of SEZs to deliver on what they promise, Model SEZs could serve as a good branding of Bangladesh as an SEZ hub for potential investors. These would also enable the BEZA to assess its strengths and weaknesses and how best to address the attendant challenges. Based on the experience, BEZA would be able to

¹³ As stated by the General Manager of BEZA, Mostaque Hassan [Habib, T. B. (2016, November 25)]

remould and remodel its policies and practices. In this regard, BEZA could draw in the experience of BSCIC (rather discouraging) and BEPZA (many important learning).

Ensuring access on an equal footing

BEZA envisages to develop zones and implement the projects under six different types of ownership and arrangements: a) Government-owned; b) Private-owned; c) Government-to-government (G2G); d) Public Private Partnership (PPP); e) Specialised arrangement and f) Established by corporations. In allocating the plots under its jurisdiction, BEZA should encourage non-traditional and emerging industries (e.g. light engineering industries, accessories industries, food-processing industries, agricultural machineries industries, chemical industries, ICT-based industries and MSMEs) and provide necessary infrastructural facilities and services that cater to their specific needs. In the case of industries with proven track records (e.g. RMG, footwear, leather, Pharmaceuticals, those with high value-added products) should be encouraged. Whilst special incentive packages do provide investors in SEZs with added advantage (besides unencumbered land), prudent management and due diligence must be applied so that incentive packages are not abused and misused. Otherwise, this could create serious disincentive for investors in the domestic tariff areas (DTAs). In this context, due caution must be deployed as regard misuse of tax holiday incentives, land speculation etc.

Provision of adequate ADP allocation

Considering the slow progress of the SEZ project-related work, ADP allocation for the SEZs should commensurate with the planned work. Adequate allocation should be made in the upcoming national budget for FY2018-19 which should align with the SEZ Master Plan for development. In this regard, establishing Model SEZs with provision of full package of infrastructure facilities, services and a supportive regulatory regime should receive priority.

Investment promotion should be carried out by a single authority

Presence of multiple authorities could potentially create confusion, lead to turf wars and delay the effectiveness of the SEZs. Currently, there are several investment promotion authorities in the country which include BEZA, BEPZA, BIDA, PPP Office, BSCIC and Hi-Tech Authority etc. These authorities were established at different points in time of particular sectors and demands of the economy, in order to address specific needs. A review of the activities of these authorities reveal that activities of some of the authorities have significant overlaps e.g. BEZA, BEPZA and PPP Office. Some of the activities could be centralised and others mandated to dedicated wing of the centralised authority. Serious thought should be given towards developing an institutional architecture that best suits the needs of the investors and entrepreneurs, in the multiple types of zones currently in existence in Bangladesh.

SECTION VII. BUDGET FOR SOCIAL SECTOR: IS IT GOOD ENOUGH FOR INCLUSIVE GROWTH?

Introduction

The demand for higher investment in the social sector is understandably very high in countries such as Bangladesh. However, with limited resources and competing priorities, the government faces formidable challenge in allocating adequate resource for the competing sectors. However, what is disquieting is that despite the economic growth and the resultant higher allocative capacity of the government, the share of public expenditure in social sectors, particularly in health and education sectors, has not improved significantly. Consequently, both in terms of quality of education and health and their outcomes Bangladesh is lagging behind. Despite quantitative improvements in the education and health sectors, the quality of education and health service continues to remain a major concern. The government of Bangladesh (GoB) is at present faced with the dual challenge of increasing public spending on health and education, and improving the standard of service and performance of these sectors. In view of government's commitment to attain the SDGs, particularly in areas such as education (SDG 4: Education for all by 2030) and health (SDG 3: Ensuring healthy lives and promote wellbeing for all by 2030), the urgency to address the attendant deficits has risen manifold in the current context. Other SDGs, such as SDG 1 on eradication of poverty, SDG 2 on zero hunger and SDG 10 on reducing inequality are also linked to education and health. This is also important from the perspective of inclusive growth that Bangladesh aspires to achieve. Studies have shown that public spending on health and education can reduce inequality (Hur, 2014; Maitra & Mukhopadhyay, 2012).

In view of the above, allocations for the social sectors demand to be revisited in the upcoming national budget. The following sections provide a narrative on the allocation of resources for the social sector in Bangladesh during the past few years, and present a set of recommendations for the upcoming budget for FY 2019.

Allocation for Health and Education

Whilst Bangladesh has increased budgetary allocations for the social sectors over the past years (Figure 7.1), these not only fall short of the globally recommended targets but are also significantly low compared to the needs of the population. As Bangladesh embarks upon its middle-income journey and steps into LDC graduation process, both expectations and needs for higher allocation, and allocative and use efficiency of resources are emerging as important factors. Table 7.1 presents various targets for health and education sectors and Bangladesh's progress towards achieving those.

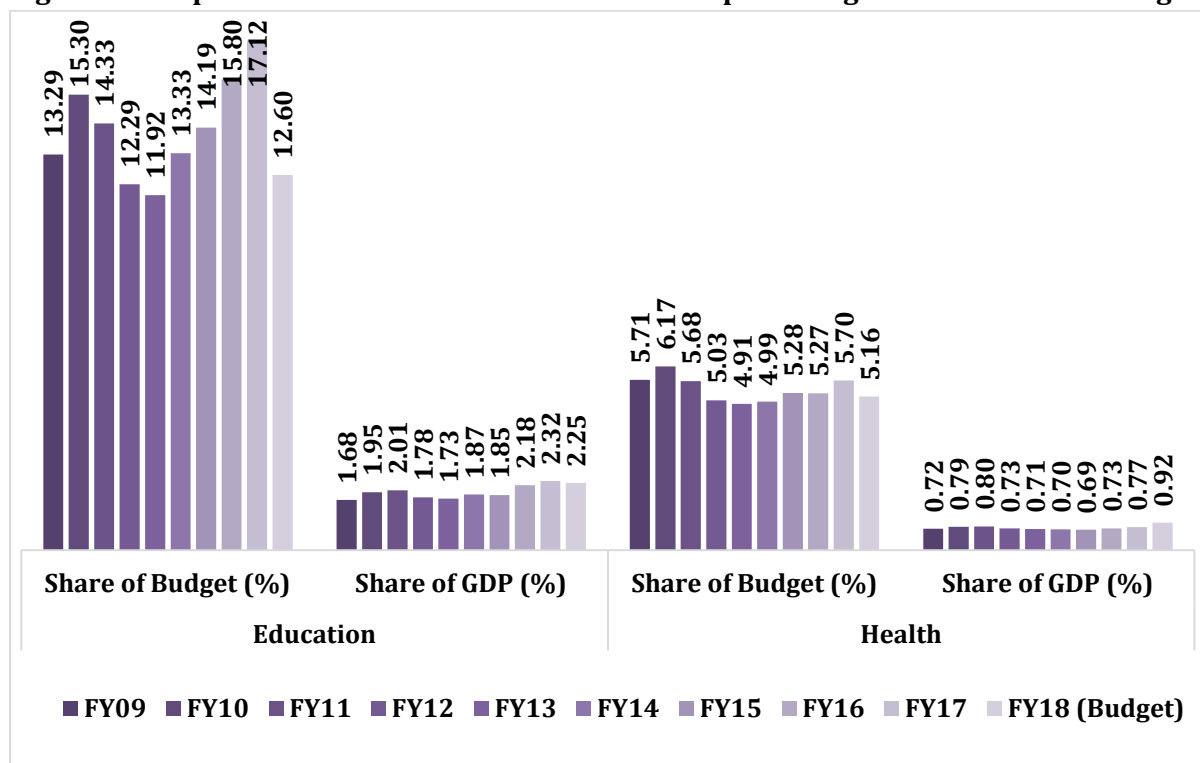
Table 7.1: Target and reality of the social sector

Documents	Targets	Where are we	What is needed
Education			
7FYP, GED (2015)	Expenditure on education to be 3 per cent of GDP (7FYP)	Allocations on education were:	The estimated budget for the education sector should be at least 2.84 per cent of GDP for FY2019, to achieve 3 per cent of GDP by FY2020 as set in 7FYP.
Incheon Declaration, 2015 ¹⁴	The Education 2030 Framework for Action set two benchmarks on domestic financing for education: <ul style="list-style-type: none">➤ 4 -6 per cent of GDP➤ 15 -20 per cent of public expenditure.	<ul style="list-style-type: none">• 2.25 per cent of GDP in FY2018 while actual expenditure was 2.32 per cent in FY2017.• 12.6 per cent of total budget in FY2018, while actual expenditure was 17.1 per cent in FY2017.	
Health			
7FYP, GED (2015)	Expenditure on health to be 1.2 per cent of GDP (7FYP)	Allocations on health were:	Budget for the health sector should be at least 1.12 per cent of GDP in FY2019, to achieve the target of 1.2 per cent of GDP by FY2020 as set in 7FYP.
WHO observation	World Health Organisation (WHO) considers a benchmark of 5 per cent of GDP or GNI of the country.	<ul style="list-style-type: none">• 0.92 per cent of GDP in FY2018 while the actual expenditure was 0.77 per cent in FY2017.• 5.16 per cent of budget in FY2018 while the actual expenditure was 5.7 per cent in FY2018.	

Source: UNESCO et al. (2015); GED (2015); WHO (2003).

¹⁴ UNESCO together with UNICEF, the World Bank, UNFPA, UNDP, UN Women and UNHCR organised the World Education Forum 2015 in Incheon, Republic of Korea, from 19 – 22 May 2015, hosted by the Republic of Korea. Over 1,600 participants from 160 countries adopted the Incheon Declaration for Education 2030, which sets out a new vision for education for the next fifteen years. Retrieved from <http://www.uis.unesco.org/Education/Documents/incheon-framework-for-action-en.pdf>

Figure 7.1: Expenditure on education and health as a percentage of GDP and total budget

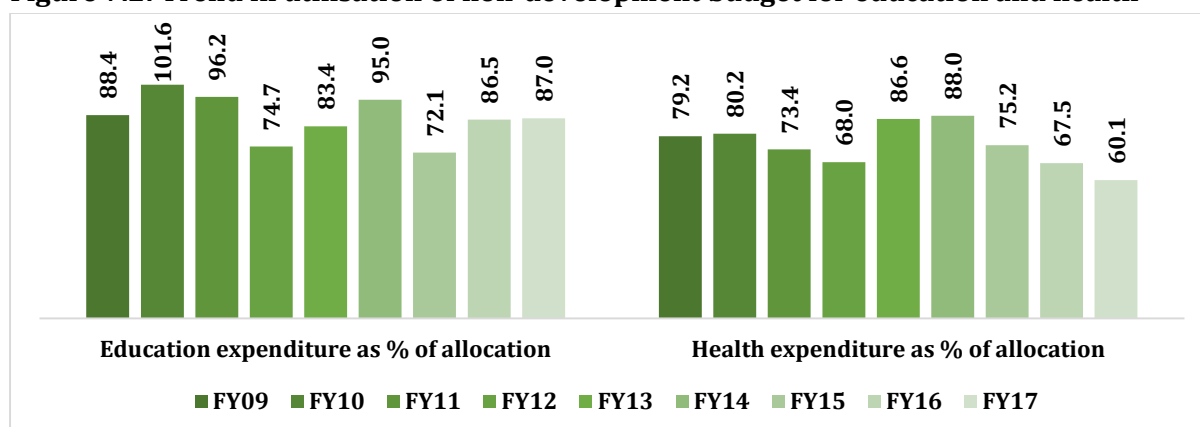


Source: Calculated by authors from various budget documents of MoF; BBS (2018).

Note: Education budget includes figures only from Ministry of Primary and Mass Education, Secondary and Higher Education Division, and Technical and Madrasah Education Division. For Education and Health sectors, figures up to FY17 represent actual expenditure, while for FY18, the figure is for budget allocation.

Utilisation of allocated resources for the social sectors remains a problem. For example, in FY2017, the government was able to spend about 87 per cent of total allocations for education and only about 60 per cent of total allocations for health (Figure 7.2). Indeed, actual expenditure for health in FY2017, as share of sectoral allocations was the lowest in nine years. This clearly indicates the need for a renewed effort to enhance the capacity of concerned institutions to use the funds in an efficient manner.

Figure 7.2: Trend in utilisation of non-development budget for education and health



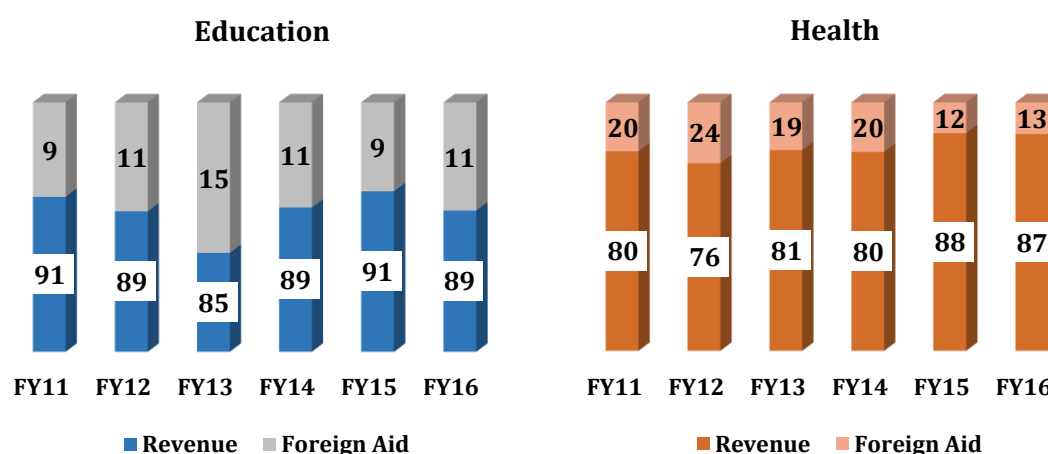
Source: Calculated by authors from Monthly Fiscal Report (various issues), Ministry of Finance (MoF).

Note: Figures represents actual expenditure as percentage of allocation.

It is to be noted that foreign financial resources from foreign sources on account of health sector was lower in FY2016 compared to FY2012 (by 25 per cent), putting strain on domestic resources.

Additionally, both education and health sectors are receiving less resources from the donors in recent years. Figure 7 shows that nearly 90 per cent of the resources had been pooled from domestic sources to finance education and health sectors in FY2016. As Figure 7.3 indicates, shares of foreign assistance in the education and health sectors have declined from the high shares of FY2013 to what these were in FY2016.

Figure 7.3: Major sources of education and healthcare financing (%)



Source: Compiled from data on financial assistance available on ERD, MoF website.

Challenges in the education and health sectors

Several initiatives have been taken by the GoB to improve the performance of education and health sectors of Bangladesh. For example, the Health, Population and Nutrition Sector Development Programme (HPNSDP) Project (2011-17) was the largest health sector programme which was succeeded by HPNSDP 2017-22. In the education sector, the flagship programme is the Third Primary Education Development Programme (PEDP 3) which was to be implemented during 2011-16. PEDP 3 missed its original completion date by more than a year. The programme is now expected to be completed by June 2018. This programme is expected to be followed by PEDP 4 this year. The following section presents some findings as regards the abovementioned programmes on education and health sectors which will provide some indications about the budgetary initiatives needed in this connection.

Education budget in view of emerging needs

Bangladesh's progress in case of gross and net enrolment is satisfactory as these targets have been met (Annex Table 7.1). However, the target for dropout rates has not been achieved in FY2017. The quality of education has become a pressing issue in recent times as learning outcomes leave much to be desired. National School Assessment (NSA) 2015 shows that mean scores in 2015 for Bangla and Mathematics have fallen compared to 2013 across Grade 3 and Grade 5 (Annex Table 7.2). For example, in 2015, the mean scores achieved by Grade 3 and Grade 5 in mathematics were 41 per cent and 10 per cent respectively, while in 2013, Grade 3 students had scored 58 per cent and Grade 5 scored 25 per cent in the two subjects (MoPME, 2017a). This can be explained by a number of factors including high student-teacher ratio (STR) and lack of qualified teachers.

The 7FYP aims for STR of 30:1 by 2018. While this has been achieved, there is significant variation within the country. For example, disaggregated data show that (Table 7.2) Cox's Bazar has the highest (43) STR in government primary schools (GPS). Among the 44 districts mentioned in the

Annual Primary School Census (APSC) 2017, newly nationalised primary schools (NNPS) from 33 districts and GPS from 38 districts have STR above the national target (MoPME, 2017a).

Table 7.2: Districts with the highest and lowest STR

Details	Government Primary Schools (GPS)		Newly Nationalised Primary Schools (NNPS)	
	District	Student-Teacher Ratio (STR)	District	Student-Teacher Ratio (STR)
Highest STR	Cox's Bazar	49	Noakhali	63
	Brahmonbaria	47	Cox's Bazar	60
	Rajbari	47	Narayangonj	57
Lowest STR	Pirojpur	24	Pirojpur	19
	Jhalokathi	24	Jhalokathi	18
	Rangamati	22	Rangamati	17

Source: MoPME (2017a).

Lack of academic staff and qualified teachers has been a perennial problem (MoPME, 2017b). As of March 2016, 27 per cent of the Head Teacher posts and 7 per cent of Assistant Teacher posts under Directorate of Primary Education remained vacant (MoPME, 2017b). Moreover, there is a wide variation in educational qualification among the primary school teachers; in 2016, only 58 per cent of the primary teachers had a Bachelor/Honours or a Masters degree (MoPME, 2017b).

Inadequate budget is also one of the foremost constraints facing Technical and Vocational Education and Training (TVET) stream. Almost 40 per cent of the TVET institutions reported that lack of apparatus, laboratories and trained teachers are major challenges that limit their capacity to impart quality education (BBS, 2016).

Health budget in view of emerging needs

Budgetary allocation for the health sector has remained low. As a result, a significant amount of health expenditure is borne by the consumers of the health service themselves. Over two-thirds of the total health expenditure in Bangladesh is financed by out-of-pocket spending (MoHFW, 2017). Low public spending on health implies that the low-income households are at a disadvantageous situation because of their low disposable income. According to World Development Indicators (WDI), a staggering 4.5 per cent of the population was pushed below the \$1.90 poverty line in 2010 because of out-of-pocket health care expenditure in Bangladesh.

In terms of progress of the HPNSDP, the annual implementation report of the programme revealed that only 11 targets out of the 40 had been achieved by 2014 (MoHFW, 2016). Updated information on six indicators are available from BBS (2017) and MoHFW (2017). These include infant mortality rate, under five mortality rate, maternal mortality ratio, neonatal mortality rate, total fertility rate and contraceptive prevalence rate. The status of the six indicators has been summarised in Table 7.3. As the table shows, targets of only three of the six aforementioned indicators – infant mortality rate, under five mortality rate, and neonatal mortality rate – have been achieved in 2016. From the budgetary perspective, the government will need to put emphasis on indicators where targets remain unattained. Some of these relate to maternal mortality rate, contraceptive prevalence rate and total fertility rate.

Table 7.3: Status of selected indicators

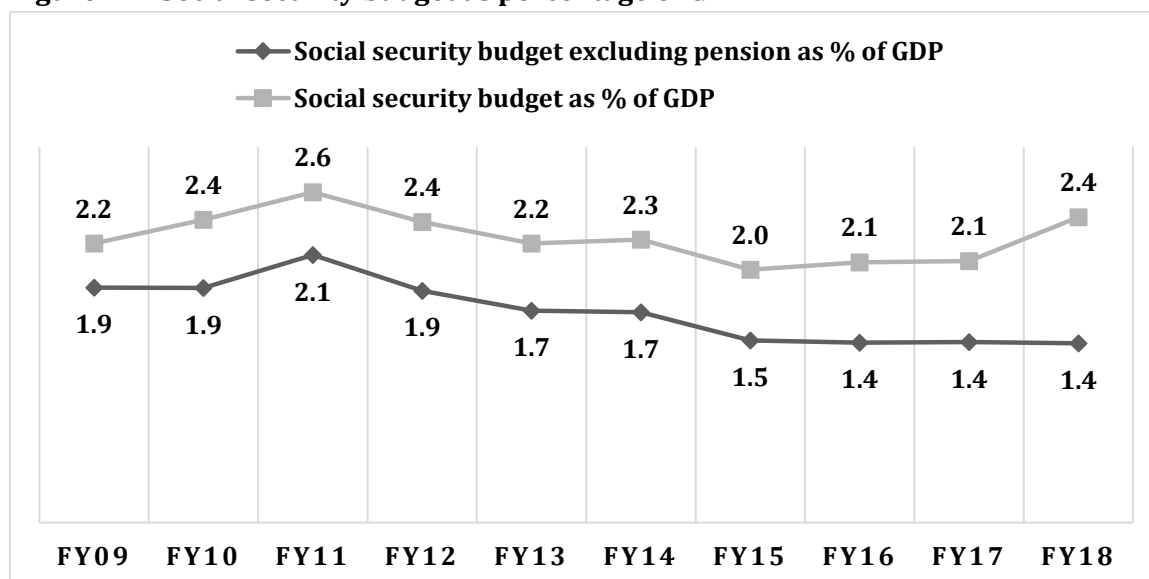
Indicator	Status in 2010 or 2011 or 2012	Target 2016	Progress in 2016	Remarks
Infant mortality rate (IMR)	43	31	28	Achieved
Under 5 mortality rate	53	48	35	Achieved
Maternal mortality ratio per 100000 live births.	194	<143	178	Not achieved
Neonatal mortality rate	32	21	19	Achieved
Total fertility rate (TFR)	2.3	2	2.1	Needs attention
Contraceptive prevalence rate	61.2	72	62.3	Not achieved

Source: MoHFW 2016 and 2012; BBS 2016.

Note: Only the available updated indicators have been included.

Budgetary allocations for social security

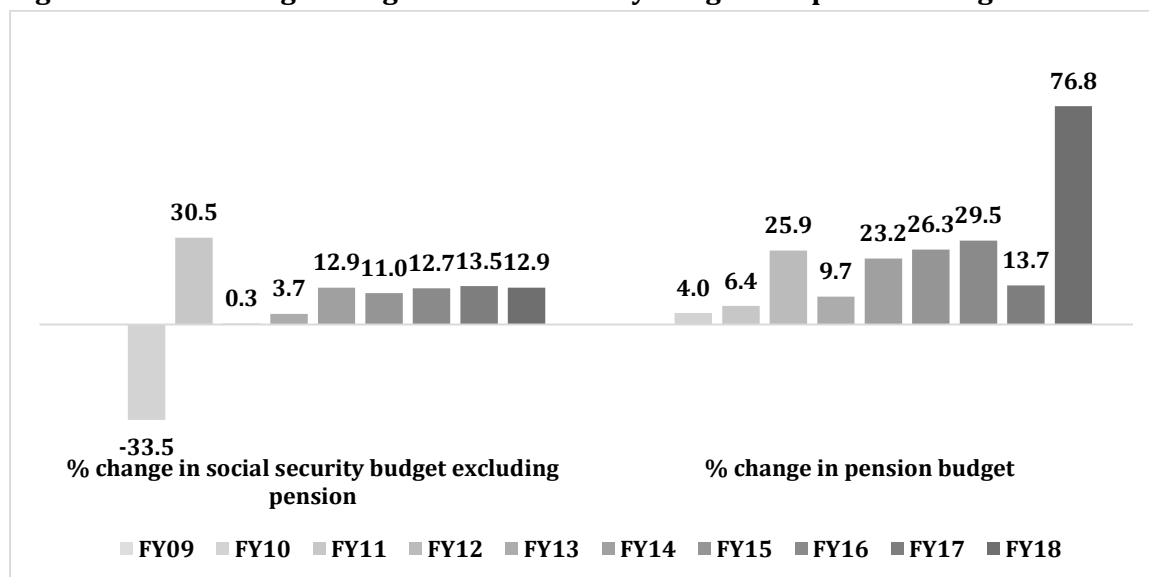
Social security budget has been hovering around 2 per cent of the GDP since FY 2008-09, as illustrated in Figure 7.4. In FY2018, the social security budget was 2.4 per cent of the GDP, which exceeded the target of 2.3 per cent of GDP outlined in the 7FYP. However, a close scrutiny on the allocation for social security indicates that, in FY2018, 41.3 per cent of the budget for social security was allocated for pension of government officials (GED, 2018). In fact, the social security budget excluding pension has been decreasing, from 2.1 per cent of GDP in FY2011 to 1.4 per cent of GDP in FY2018.

Figure 7.4: Social security budget as percentage of GDP

Source: Calculated from Social Security Policy Support (SSPS) Programme data.

Thus, the recent increase in social security budget was mainly due to the increase in the budget for pension. For instance, in FY2018, the social security budget excluding pension increased by 12.9 per cent, whereas the budget for pension increased by 76.8 per cent (Figure 7.5).

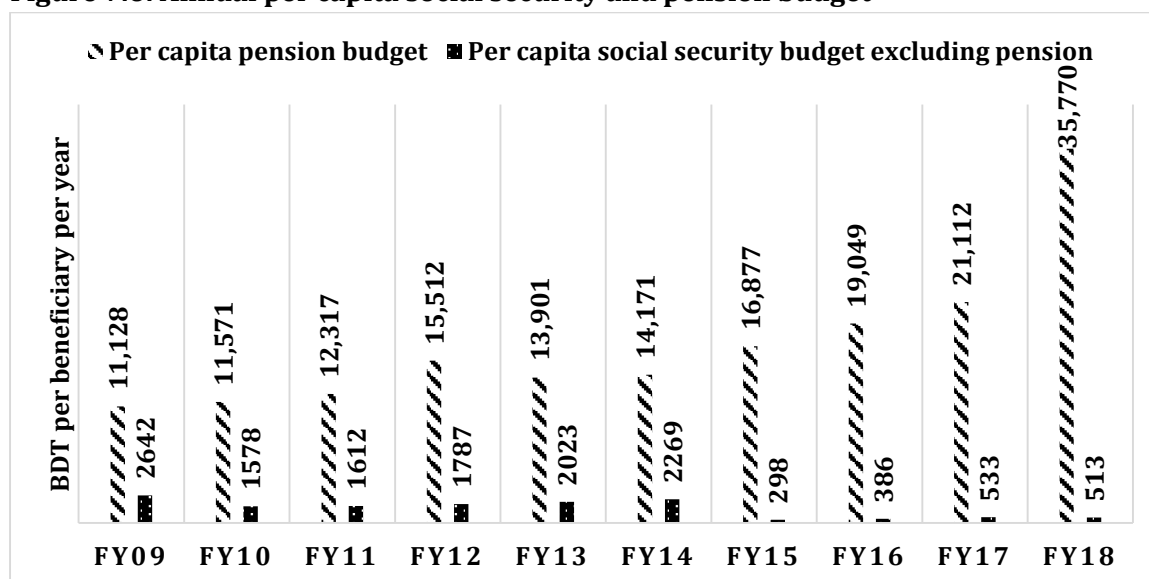
Figure 7.5: Percentage change in social security budget and pension budget



Source: Calculated from Social Security Policy Support (SSPS) Programme data.

Total and per capita budget allocations for pension dwarfs the budget allocations for all other social security programmes. In FY2018, pension received 41.31 per cent of the social security budget, which was equivalent to the budget allocations for the next 23 largest social security programmes combined (GED, 2018). Figure 7.6 shows that since FY2013, per capita budget allocation for pension has been on the rise, whilst at the same time per capita budget allocation for social security excluding pension has been on the decline. In FY2018, per capita budget allocation for pension was BDT 35,770 per beneficiary per year, compared to BDT 513 per beneficiary per year for social security programmes excluding pension. This means that, on average, pension beneficiaries received 69 times more money than beneficiaries of other social security programmes.

Figure 7.6: Annual per capita social security and pension budget



Source: Calculated from Social Security Policy Support (SSPS) Programme data.

The government has prepared a National Social Security Strategy (NSSS) to be implemented during the 7FYP period. The NSSS has broadened the scope of social security from the narrow

safety net concept and included employment policies and social insurance. Operationalisation of such policies would be difficult since majority of the employed people is engaged in the informal sector. Full implementation of the NSSS will also call for deployment of significant resources. The proposed universal pension scheme should receive adequate fund.

Recommendations for National Budget FY 2018-19

In view of the prevailing situation concerning the social sector and safety net programmes, and considering their performance and budgetary allocations, CPD offers the following recommendations for the upcoming budget of FY2018-19:

- Budget for education should be at least 2.84 per cent of GDP in FY2019 to achieve the 7FYP targets. However, the government has to increase the education budget significantly if the relevant SDG targets are to be achieved.
- Increased budgetary allocations should focus on hiring qualified teachers and reducing the student-teacher ratio towards ensuring effective learning outcomes.
- Higher budgetary allocation should be made in order to improve skills of human resources aligned with demands of national and international job markets.
- In view of the low budgetary allocation for health and high out-of-pocket expenditure on this account, budgetary allocations must be significantly increased, and efficiency of resource utilisation enhanced. Budget for health should be at least 1.12 per cent of GDP in FY2019 to meet the target laid out in 7FYP.
- Allocation should be suitably increased for putting in place adequate number of affordable and accessible public healthcare facilities, particularly with a view to reducing out-of-pocket-expenditure of the low-income households.
- Pension for government officials should be separated from social security account. Allocation for social security, excluding pension for government officials, should be raised to 1.6 per cent of GDP from the existing level of 1.4 per cent.
- Bring more clarity on the financing mechanism of the NSSS. Allocate adequate resources in the budget in line with the NSSS. Universal pension scheme should also receive adequate resource.

SECTION VIII. BUDGETARY IMPLICATIONS OF ROHINGYA CRISIS

Bangladesh has been dealing with the influx of estimated 200 thousand *Rohingyas* for several years now. The new influx of *Rohingya* people seeking refuge in Bangladesh since August 2017 has given rise to new challenges for the country, this time of higher magnitude. Since August 2017, nearly 700 thousand *Rohingyas* have sought refuge in Cox's Bazar district of Bangladesh, fleeing from the massacre and violence in the Rakhine state of Myanmar. This has raised the *Rohingya* population in Bangladesh to more than 900 thousand. The *Rohingya* crisis has different dimensions, which range from humanitarian to economic and strategic. As may be recalled, a Memorandum of Understanding (MoU) was signed on 23 November 2017 between Bangladesh and Myanmar for the repatriation of *Rohingyas*. The repatriation process was planned to start from 23 January 2018. However, the process is being delayed due mainly to the reluctance of Myanmar authorities to take back the *Rohingyas*. Complexities in the verification process and uncertainty about their safe return have been delaying the process of repatriation.

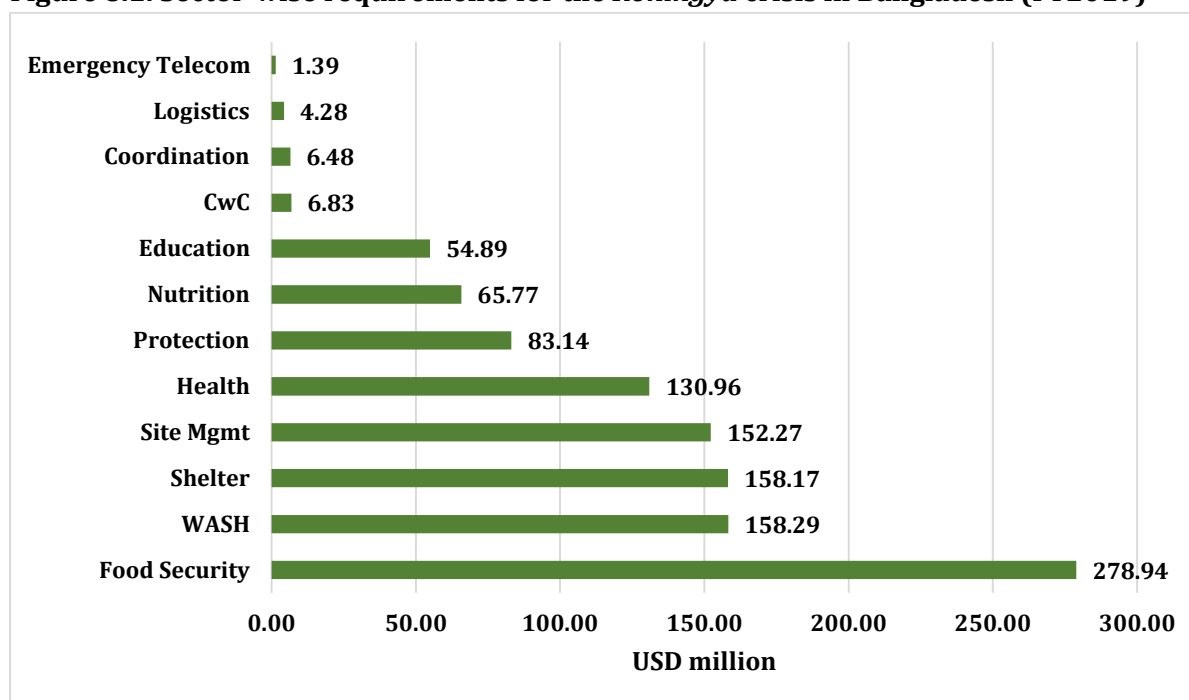
A number of initiatives have been taken till now to mobilise resources in support of the *Rohingyas*. Recently, the UN agencies with International Non-Government Organisation (INGO) partners released the 2018 Joint Response Plan (JRP) in view of the *Rohingya* Humanitarian Crisis. They appealed to the international community for USD 951 million to meet the urgent needs of the nearly 1 million *Rohingyas* and more than 330 thousand local Bangladeshis in the host communities for a period of 10 months, from March 2018 to December 2018. As of 12 April 2018, an amount of only USD 73.4 million has been received which is 2.2 per cent of the total appeal mentioned above.

CPD had earlier undertaken an assessment of the resource requirement for the *Rohingyas*. In its review titled "Implications of *Rohingya* Crisis for Bangladesh" prepared as part of CPD's IRBD report in January 2018, it was mentioned that USD 882.0 million would be required for the period from September 2017 to June 2018 for meeting the needs arising from this crisis (CPD, 2018). It was also estimated that during FY2019 about USD 898 million would be required, assuming 300 *Rohingyas* would be repatriated every day, if population growth and inflation rate remain constant. If population and inflation are taken into consideration, the resource requirement will rise to USD 968 million for FY2019. A set of new estimates, for FY2019, has been presented in the next section.

Costs for the Rohingya Crisis for FY2019

CPD has updated the estimation as regards the requirement for the *Rohingyas*, for FY2019. This is based on the appeal amount of the JRP, noted earlier. CPD's estimation makes the following assumptions: (i) 300 *Rohingyas* will be sent back to Myanmar per day from the month of July 2018; (ii) repatriation process will take place for 25 working days per month; (iii) all costs are equal for each person; and (iv) cost of shelter construction and site management will be the same for all months. The estimates indicate an amount to the tune of USD 1,101.00 million which will be required to underwrite the costs in FY2019. A sector-wise needs of the *Rohingyas* shows that most of the expenditure will have to be incurred on account of food security, WASH, shelter, site management and health (Figure 8.1).

Figure 8.1: Sector-wise requirements for the *Rohingya* crisis in Bangladesh (FY2019)



Source: Estimated by author based on Joint Response Plan, IOM, 2018.

According to the United Nations Office for the Coordination of the Humanitarian Affairs (UNOCHA), support from the GoB was 1 per cent of total requirement of USD 434 million during September 2017 to February 2018 (UNOCHA, 2018¹⁵) period. The sum was sought at the time of the first humanitarian response plan.

Recent Initiatives of the GoB to Provide Humanitarian Support

The GoB has been extending all possible support to the *Rohingyas* as soon as the crisis began. Various ministries of the GoB are engaged in providing humanitarian support to the *Rohingyas*. The Ministry of Health and Family Welfare, Ministry of Public Administration, Ministry of Home Affairs, Ministry of Education, Ministry of Disaster Management and Relief (MoDMR), Ministry of Planning, Ministry of Social Welfare, Ministry of Defence, Bangladesh Water and Power Development Board, Ministry of Environment and Forest, and Local Government Division are actively involved in the humanitarian support process right from the beginning. According to the Refugee Cell of MoDMR, the GoB has received around BDT 1,000 crore from private donations and contributions. Of this, the GoB has directly spent around BDT 200 crore on the *Rohingya* crisis.

The GoB is planning to provide vocational training for adult *Rohingyas* to enhance their skills and carry out the jobs around the camps. Training and work opportunities in camps as barbers, tailors and cleaners could help the unskilled workforce to earn a livelihood. The children are being provided education in English and Burmese.

There is scarcity of land in Cox's Bazar and it will be difficult to relocate additional *Rohingyas* when monsoon sets in. The refugees continue to live under threats of landslides, floods and heavy storms. Around 230 thousand *Rohingyas* (10 thousand families) have been relocated from camps

¹⁵ UNOCHA, 2018. Financial Tracking Service. Available on: https://fts.unocha.org/appeals/628/flows?order=directional_property&sort=asc&f%5B0%5D=sourceOrganizationIdName%3A%222981%3ABangladesh%2C%20Government%20of%22

to safer areas around the camp in view of the approaching monsoon season. But only about 100 thousand *Rohingyas* can be relocated within the camp areas.

Considering the risk of natural disaster and security concerns and taking cognisance of tourism interests in the areas, the GoB has taken an initiative to transfer the camps from Cox's Bazar to Bhashan Char in Noakhali district. Bangladesh Navy is implementing the project costing USD 280 million to construct shelters for *Rohingyas* in the island. About 40 per cent of the construction of 1,440 houses including 120 cyclone shelters has already been completed by the Bangladesh Navy as of 19 March 2018. The National Economic Council of GoB has approved an amount equivalent to USD 280 million for the construction¹⁶. The relocation may begin before the upcoming rainy season depending on the progress of the construction works.

Recommendations

In light of the current situation of the *Rohingya* crisis, following recommendations are put forward in the context of the upcoming national budget for FY2019.

- Given that the requirement for the *Rohingyas* is quite significant and the repatriation process is uncertain, the GoB has to chalk out a comprehensive plan for resource mobilisation.
- Information on the flow of international fund for *Rohingyas* and the usages of these funds should be made readily available. Ministry-wise resource requirement plan for FY2019 would be helpful for informed resource management.
- Transparency in the allocation of budget, at the ministerial level, in view of the *Rohingya* crisis, should be ensured. This will ensure allocative efficiency and resource-use efficacy in connection with the various activities being implemented including particularly in the construction of *Rohingya* shelters at Bhashan Char, setting up of vocational training system for them and provisioning of basic facilities to help sustain livelihoods till the repatriation of the *Rohingyas*.

¹⁶ <http://www.dhakatribune.com/bangladesh/development/2017/11/28/ecnec-bhashan-char-rohingya-relocation/>

SECTION IX. A TRUST FUND FOR SDG DELIVERY

Background

Implementation of the aspirational agendas of the Sustainable Development Goals (SDGs), by 2030, call for multi-stakeholder participation in achieving the 17 goals and 169 targets. Along with government and public organisations, non-state actors such as private sector, Non-Government organisations (NGOs), Civil Society Organisations (CSOs), media, and knowledge community as also development partners are expected to play important role in implementing the diverse areas of activities associated with the SDGs. Significant amount of resources will need to be mobilised and wide-ranging activities carried out if poverty levels are to be brought down to zero, hunger eliminated, decent jobs created and triangulation of economic development, social inclusiveness and environment-friendly development are to be ensured in light of the SDGs.

Since independence, the NGOs/CSOs in Bangladesh are playing a critically important role in the country's socio-economic development. Experience reveal that, alongside the government interventions, NGOs played a crucial role in achieving the Millennium Development Goals (MDGs) in Bangladesh. For instance, non-state actors such as the Grameen Bank, BRAC, and PROSHIKA have made significant contribution to attain the MDGs through micro-credit programmes, skill development and training, and employment generation programmes (Bhuyan, 2006). There is a wide recognition that drawing on their track record and experiences in MDGs implementation, NGOs have the potential to make their mark in view of the SDGs as well. The 2030 Agenda has created an opportunity for the NGOs to get involved in the discourse as regards sustainable development at all levels. NGOs can play a key role in the process of implementing the SDGs through awareness building, mobilisation of stakeholders around the goals, and leveraging government actions. NGOs can prepare shadow reports on SDGs and feed into the Voluntary National Review (VNR) process and carry out advocacy and highlight concerns at the High Level Political Forum (HLPF) and UN Economic and Social Council (ECOSOC) meetings. Other than their own-initiated programmes, NGOs can also collaborate in projects relevant to SDGs implementation undertaken by the local governments, private sector and others. Indeed, SDG17 (promoting new partnerships) spell out the necessity of such collaboration as a key modality to attain the SDGs. NGOs are also very well-positioned to disseminate the knowledge about SDG-related progress and stressing for transparency and accountability in the implementation process and contribute to cost-effective and timely implementation of the attendant tasks. NGOs can also help mobilise global opinion and generate resources in support of SDGs implementation in developing countries such as Bangladesh.

A recognition by the government of the positive role NGOs could play is a sine qua non for the GO-NGO partnership to be successful. Adequate financial endowment of the NGOs is a must for the NGOs to be effective. It is in the context of the second overriding factor that the idea of setting up a SDG Trust Fund in support of the NGOs becomes a relevant proposition.

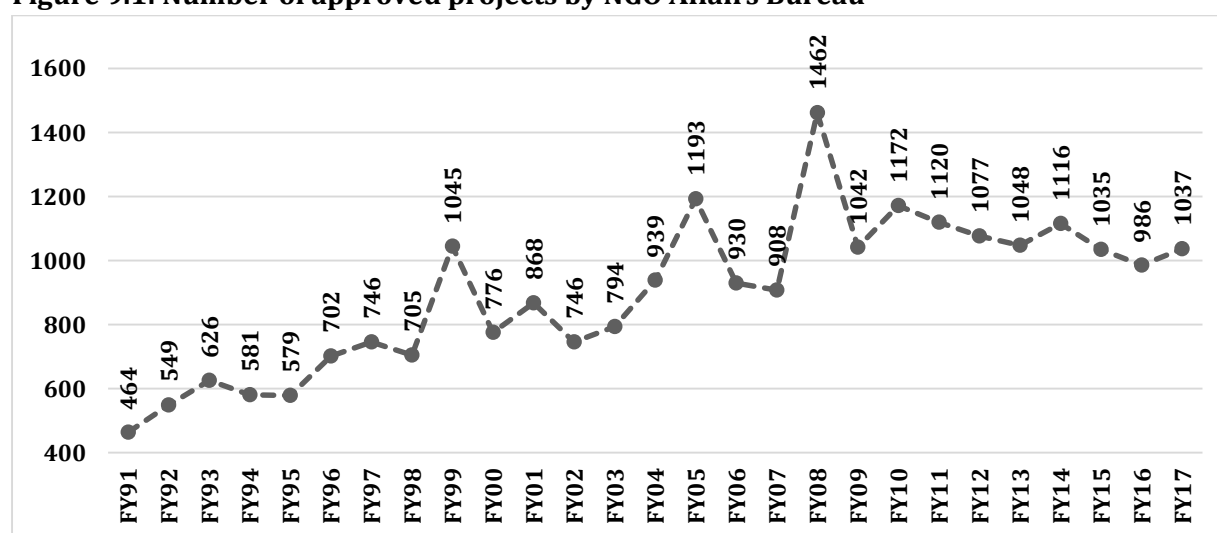
Rationale for SDG Trust Fund

As a country which has embarked upon its middle-income journey, Bangladesh is expected to face increasing challenge in attracting ODA on concessional terms. Aftermath of the global financial crisis of 2008-09 and diversion of resources to address more urgent issues like migration have accentuated the challenge of mobilising aid in support of global cause such as the SDGs, however noble and worthy the cause may be.

Global resource crunch and Bangladesh's middle income and LDC graduation (eligibility) are also going to affect funding of NGOs from global sources. NGOs in low income countries and LDCs are most likely to be prioritised for global support. In 1970, government of many developed countries agreed to devote 0.7 per cent (equivalent) of their national income (GNI) as aid to developing countries of the world (Kamphof, Spitz, & Boonstoppel, 2015). This aid was to be earmarked both for governments and the NGOs. However, only a few developed countries have kept their promise. This had negative implications for fund flow and availability concerning the NGOs. All these will have important implications for the functioning of many NGOs who are dependent on foreign support. They will need alternative sources of funding to carry out their activities. As is well known, financing needs for implementing the SDGs would be significantly higher than the MDGs. A report prepared by the General Economic Division (GED, 2017) estimate that, in order to meet the additional (synchronised) financial needs of implementing the SDGs, Bangladesh will need a total of USD 928.48 billion (of which, USD 796.09 billion is estimated to come from domestic sources and USD 132.39 billion from external sources) at 2015-16 constant prices over the period of FY2017- FY2030 towards the SDGs implementation. The annual average price tag would be about USD 66.32 billion (at constant price) (GED, 2017). The GoB has rightly identified Public-Private Partnership (PPP) as a key strategy to finance SDG implementation. The government has also identified the NGOs as a major player in implementing the SDGs and also as an important source for SDG-related financing and addressing the financing gap in implementing the SDGs. The estimated amount to be financed by the NGOs was expected to be about 5 per cent (on average) of the total additional finance requirement during the FY2017-FY2030 period (GED, 2017).

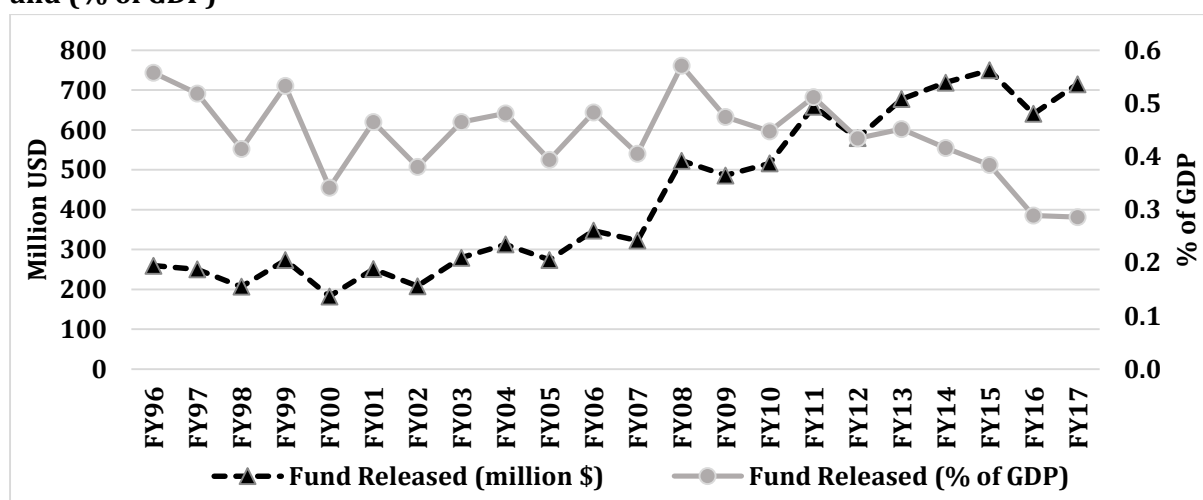
Foreign fund disbursed in favour of NGOs has been about 20.2 per cent of total ODA flow to Bangladesh in FY2017. Number of projects approved by the NGO affairs bureau was about 1037 during the FY2016-17 period (Figure 9.1). Although the flow of foreign grant fund released through the NGO affairs bureau shows an increasing trend, its share in the GDP has been declining (Figure 9.2).

Figure 9.1: Number of approved projects by NGO Affairs Bureau



Source: NGO Affairs Bureau, Prime Minister's Office.

Figure 9.2: Flow of foreign grant fund released through NGO Affairs Bureau (million USD) and (% of GDP)



Source: NGO Affairs Bureau, Prime Minister's Office.

Note: Fund released (% of GDP) is shown in the right vertical axis.

However, the inadequacy of foreign fund earmarked for the NGOs is only one part of the argument. What is reasoned here is that the GoB should consider allocating budgetary support to the NGOs in view of their potential role as an important contributor to SDG implementation in Bangladesh. Enhanced NGO capacity to implement the SDGs where they have comparative advantage and proven track record. This is of particular significance in attaining the SDG aspiration of 'Leave No One Behind'. The NGOs have a natural advantage in reaching the furthest first. This is borne out by a World Bank report which shows that, about 80 per cent of the villages in Bangladesh are covered by NGO programmes or projects (World Bank, 2005 cited in Bhuyan, 2006). Also, it may ensure leveraging government activities through NGO interventions towards overall effectiveness.

It is from the above vantage point that a financing mechanism for NGOs to help them implement the SDGs is being proposed here. The idea is to set up a SDG Trust Fund for the NGOs/CSOs.

Establish a SDGs Trust Fund for the NGOs

The objective of the proposed SDGs Trust Fund is to create a financing window for NGO partnership to implement the 2030 global agenda in Bangladesh. Non-government organisation is used here in broader sense since all non-state actors such as NGOs, CSOs, think tanks and community organisations could be part of such an initiative. The SDG fund is to be operationalised through PPP. Government may consider making budgetary allocations in the national budget to set up this fund to support NGOs/CSOs working in areas relevant to the SDGs and SDG implementation. The recipients will spend the money from the fund by maintaining transparencies and accountability in accordance with an identified structure and framework of operation.

Proposed Framework

The following is a proposed framework for the SDGs Trust Fund. This framework is prepared based on a review of the legal and governance structures of different Environmental Trust Funds (EFs) established in developing countries.

Formation and governance. A government approved legal framework will be developed to establish the SDGs Trust Fund. There will be a Memorandum of Understanding (MoU) or other types of agreements between the national government and the Trust Fund according to the PPP law/guideline. According to the PPP law 2015, the government can contribute via financial participation in five forms: Technical Assistance Financing, Viability Gap Financing, Financing against Equity and Loan, Financing against Linked Component, and financing against such other activities as may be planned by the PPP authority (PPPA,2016). Procurement Guidelines for PPP Projects 2018 stimulates that in order to deliver the PPP Projects, selection of a Private Partner is to be done in four phases (PPPA, 2018). These include: Identification Phase, Development Phase, Bidding Phase, Approval and Award Phase.

A select number of “Trustees/Board Members”, will be responsible for putting in place, structuring, and governing of the fund. They will also process the decisions of the fund. Apart from this, there could be advisory committee, internal audit section, monitoring and evaluation section and other administrative sections to run the fund, as deemed necessary. Operational plans in the areas of implementation, fundraising, resource mobilisation, communications, and evaluation etc. will need to be developed.

The fund is expected to work independently and be tax exempted.

Amount. As was noted earlier, according to GED (2017), about 5 per cent of total additional financing requirement for SDGs in Bangladesh will need to be financed by the NGOs, on an annual basis. This implies that NGOs are envisaged to contribute to SDGs implementation to the tune of about Tk. 14,000 crore to meet the financing gap. If the total foreign fund channelled through NGOs in FY2017 (USD 715 million or about Tk. 6,000 crore) are considered, there may be a gap of about Tk. 8,000 crore. The idea is not to look for funds to bridge this significant gap as the government’s resource constraints and limitations are well-known. The idea is to help the NGOs to draw synergies, and leverage other initiatives in areas where NGOs are best placed in terms of implementing the SDGs. Government allocation to NGOs could play a catalytic role in helping the NGOs to make more effective use of funds available to them and also take up additional work. This will also help bridge the aforesaid gap as regards NGO contribution to SDGs implementation particularly taking cognisance the fact that a significant part of the national budgetary allocation often remains underutilised on a regular basis. Since, the proposed SDG Trust Fund is a new concept, the government may like to start with a token allocation of Tk. 500 crore. This may be further raised in phases considering demand, resource availability, and utilisation efficacy.

Sources of fund and utilisation. It is envisaged that the major part of the envisaged fund will come from the national government through budgetary allocation in the ADP. Utilisation of the fund will also have the flexibility to blend finances from multilateral and bilateral aid, NGOs, foundations, lotteries, philanthropic bodies, and innovative sources.

- Foreign and other potential donors may also be invited to contribute to this fund.
- Private sector may also put in corporate social responsibility (CSR) money.

The fund money will be allocated to eligible implementing agencies such as NGOs, CSOs, community-based organisations, and private sector entities. The implementing agencies will be selected based on the strength of respective proposals submitted against relevant calls on different SDG themes. All selection and allocation will be through a competitive process to be supervised by competent bodies to be set up by the SDG Trust Fund Board. The fund will also help relevant capacity building of the implementing agencies based on need assessments.

Monitoring and evaluation. A dedicated monitoring and evaluation section of the Fund will be primarily responsible for this task. It will monitor use of fund and examine grantee reports. Staff from the section will visit fields where implementation of activities underwritten by the Fund would be taking place, on a regular basis. It is advisable that maintain a score card for the implementing agencies which will scale quality of implementation under different relevant indicators/criteria. Evaluation will include assessment of the project implementation outcomes according to the objectives set out in the proposal, implementing organisations' performance, and efficacy of the use of the fund disbursed. Annual progress report and other assessment tools will be used to decide on continuity of support and relevant actions to ensure best use of the grant by the recipient NGOs and CSOs.

Risk factors

As may be recalled here, Bangladesh has created Bangladesh Climate Change Trust Fund (BCCTF) and Bangladesh Climate Change Resilient Fund (BCCRF) in 2010 with the purpose to help communities recover, mitigate, adjust and harness capacities, and also develop resilience in view of climate change impacts. The other objective was to make use of the fund to leverage financial assistance from development partners. However, lessons from operationalising these funds should be appropriately drawn to run the proposed SDG Trust Fund. A TIB study found a number of problems that inform functioning of the two funds including lack of transparency, political influence in selection of the NGOs, poor quality of work, and poor state of accountability in the funds' overall operations (Haque, Rouf, & Khan, 2013). Consequently, the proposed SDGs Trust Fund should take cognisance of the possible risks and be planned accordingly.

Some of the risks that need to be considered are as follows:

- Autonomy of the implementing NGOs may be compromised due to overdependence on the trust fund
- Slow disbursement of funds due to poor management
- Political influence over decisions as regards grants allocation and selection of implementing NGOs
- Government agencies controlling tendency may impede the independent functioning of the fund
- Lack of organisational/technical capacities impeding the effective implementation of the projects
- Variability and inflation of administrative costs, and/or lack of delivery, due to poor design
- Failure to coordinate with stakeholders in implementation and monitoring and evaluation¹⁷
- Political instability, lack of policy continuity, change in governments could undermine effective functioning of the fund
- Fraudulent practices by particular NGOs

Risks will need to be mitigated and addressed through appropriate up-front steps and downstream oversight.

It is hoped that, new funding source will help the NGO to scale up mobilisation and collaboration.¹⁸ The fund will also help the GoB to align its priorities in terms of implementing the

¹⁷ <http://www.undp.org/content/sdfinance/en/home/solutions/environmental-trust-funds.html>

¹⁸ <http://www.undp.org/content/sdfinance/en/home/solutions/environmental-trust-funds.html>

SDGs and thus help synergise the activities of key stakeholder towards successful implementations of the 2030 Agenda. On the other hand, as mentioned earlier, NGOs have the advantage of working at the grass-root and with the grassroots and have the ability to reach the marginalised at low cost by leveraging their existing activities and initiatives. Thus, the proposed SDG Trust Fund could be a win-win proposition for both the government and the NGOs.

SECTION X. CONCLUDING REMARKS: RECOMMENDATIONS FOR NATIONAL BUDGET FY2019

The overarching macroeconomic stance of the national budget for FY2019 should be maintaining macroeconomic stability with greater emphasis on inclusive development. Admittedly, in spite of the formidable challenges in a number of areas, the Bangladesh economy is benefitting from a number of advantages. The provisional national accounts estimates for ongoing fiscal year indicated a sustained acceleration of economic growth while employment generation figures for the previous year also showed some promise. However, as the present review suggests, in FY2017 average real labour income had declined; and at the same time, unemployment rates for youth and relatively more skilled labour force had increased considerably. Apparently, the jobs created during FY2017 were generally of low productive in nature.

Analysis of the macroeconomic correlates presented in the preceding sections reveals a number of stress points which are contributing towards the weaknesses emerging in Bangladesh's overall economic management. These include failure to mobilise resources from domestic sources at the needed level; delays, cost overrun and institutional weakness in development project implementation; financing of fiscal deficit from relatively expensive sources such as net sales of NSD certificates; gradual increase in inflation fuelled by rising food prices; disarray in the banking sector; increasing interest rate; depressed balance of payment scenario in the backdrop of spurt in import growth despite recovery in export earnings and remittance inflow along with better disbursement of foreign aid; and volatility in the exchange rate market.

In view of the emergent scenario, the need for a significant improvement in the quality of macroeconomic management cannot be overemphasised. In this backdrop, the present document puts forward the following set of recommendations in the context of the forthcoming national budget for FY2019. As may be recalled, CPD, over the past several years, has been repeatedly urging for initiating reforms in a number of critical areas. Evidently, in the run up to the forthcoming national election in December 2018, the government has little appetite for implementing the much-needed reform agenda. Acknowledging this reality from a political economy perspective, it is, however, critical that the reform issues inform the debate and discourse in the course of the electoral campaign so that the issues are kept alive and concrete measures toward implementation are taken by the new government after the national elections.

Macroeconomic policy stance and fiscal budgetary recommendations for FY2019

The budget for FY2019 along with supportive macroeconomic policies will need to address the disquieting trends in the macroeconomic correlates. CPD, as it has recommended earlier in January, 2018, in its first reading of the IRBD, continues to maintain its position in favour of a conservative macroeconomic stance and stringent macroeconomic management. The macroeconomic and fiscal-budgetary policies need to be informed by the following recommended measures.

- Bangladesh Bank must pursue a cautious monetary policy in the coming months in view of rising inflation and easing the pressure on the BoP situation. Policy consistency should be exercised in view of the Monetary Policy Statement. In this context, independence and authority of Bangladesh Bank must be maintained. Influence of vested interest groups needs to be restrained while formulating national economic policies. Role of the commercial banks and other institutional investors should be put under scrutiny in view of strengthening the capital market.

- Budgetary allocation for the state-owned commercial banks in the form of recapitalisation, carried out repeatedly in recent years, is morally unacceptable and economically unjustifiable. Public money should be distributed to banks only in exceptional cases and only under stringent terms and conditions in order to ensure proper utilisation of taxpayers' money. At the same time, alternative avenues such as using revenue to increase capital, exploring private investors to buy bank shares, or mergers with other banks should be explored. Under the present circumstances, these measures should particularly be applicable in case of the struggling private commercial banks.
- The fast-rising import payments have become a major concern due to the adverse implications for the balance of payments, exchange rate stability and foreign exchange reserve accumulation. Since, a significant part of the import payments (particularly those associated with majority of the large public investment programmes) is underwritten by foreign resources, the pressure on current account is somewhat eased by the surplus in the financial account. However, the financial account surplus has not been adequate enough to arrest the deficit in the overall BoP. The demand for foreign exchange may continue in view of higher import requirement in future, and the creeping global commodity prices. The central bank should consider discouraging imports of consumer and luxurious commodities by raising L/C margins for import and reducing the time for L/C repayment. Since the beginning of FY2018 there has been depreciation of BDT to the tune of about 3 per cent. Foreign exchange management should aim at maintaining stability in the exchange rate of the BDT against USD. For the time being the foreign exchange reserves should be able to cover the pressure in the BoP. However, the central bank should remain vigilant against volatility in the domestic foreign exchange market as has been experienced in recent times.
- Historically, trade mispricing and capital flight are found to be more extensive during the election years. It may be recalled that CPD (2018) in January 2018 also raised this concern in view of recourse to overinvoicing in import payments in case of some items. Curbing such illicit financial flows will require coordinated efforts by several policy actors including the Bangladesh Bank and the NBR. The long overdue data integration process (e.g. NBR data centre) should be established to reduce trade mispricing and revenue leakages through analysis of the quality of disaggregated trade data. NBR's transfer pricing cell should be adequately endowed and vested with the required capacity to enable it to carry out its responsibilities in an effective manner.
- The forthcoming national budget must focus on raising revenue from niche areas including speedy realisation of disputed revenue claims through the Alternative Dispute Resolution (ADR). Immediate steps need to be taken in order to recover the large amount of due taxes from the state-owned enterprises.
- As was mentioned, the rate of inflation has been gradually on the rise, contributed by rising food-inflation. On the other hand, the data from the Labour Force Survey 2016-17 evince that average monthly real wage of individuals has been decreasing since 2013. These have combined to put pressure on the disposable income of lower-middle and middle-income households. The budget for FY2019 should consider raising the tax-free income ceiling to Tk. 3 lakhs in order to provide respite to lower middle income households.¹⁹ The budget may also

¹⁹ In the budget for FY2016, personal income tax (PIT) exemption threshold, at the general level, was increased to Tk. 2.5 lakhs from the previous ceiling of Tk. 2.2 lakhs in FY2015 (13.6 per cent increase). This

consider reducing the personal income tax rate for the first slab to 7.5 per cent from the prevailing rate of 10.0 per cent. Resultant boost in disposable income and the consequent multiplier effect on the economy should provide opportunities for the government to make up for the forgone income through additional revenue earnings.

- The budget should take a view to assess tax incentive and exemption packages based on economic returns. The budget document should clearly mention the fiscal policy changes (in the areas of tax incentives, exemptions, rebates, surcharges etc.) which are being proposed and their impacts on different sectors/segments of the economy including revenue forgone from the point of attaining fiscal targets and ensuring transparency. More efforts will be required to expand the prevailing incentives for export-oriented sectors beyond the RMG and some of the other thrust sectors. However, institutional strengthening through enhancement of capacity of oversight agencies and enforcement of relevant laws must be ensured before taking such steps, to deter misuse of such incentives.
- The budget should refrain from reducing corporate tax rates on an ad-hoc basis, in a hasty manner and without a rigorous analysis. Adjustments of corporate tax rates, if required, should be done in a staggered way over the medium term in order to absorb any revenue shock and provide investors predictability as regards investment decisions.
- Budgetary allocations for social sectors must be coherent with the overall development needs of the economy, particularly in view of SDG targets. According to World Bank and IMF data, Bangladesh was ranked among the bottom countries with regard to education (85 out of 90 countries), health (197 out of 197 countries) and social protection expenditure (36 out of 47 countries). In view of the budgetary targets for social sectors set by 7FYP, resource allocations for education, health and social security need to be enhanced to 2.84 per cent, 1.12 per cent and 1.6 per cent of GDP respectively in FY2019. The government also needs to take concrete steps to implement the NSSS. CPD also recommends to create a SDG Trust Fund in the upcoming budget (with Tk. 500 crore) which can be utilised by the NGOs with a view to attain the objective of 'leaving no one behind'.
- While placing the fiscal-budgetary proposals before the parliament, budgetary implications for Rohingya management should be mentioned in a transparent manner. In view of the resource requirements for the *Rohingyas* and their repatriation process remaining uncertain, the government in this connection should have a clear plan.
- It may be tempting for a political government to consider development projects in the run up to the election by pursuing a populist approach. However, for the sake of prudent macroeconomic management, the budget for FY2019 should avoid all conspicuous public spending.
- Delayed implementation is a major reason that drive cost escalation of the ADP projects. Timely implementation should be prioritised, particularly for the large projects. This is particularly important to encourage crowding-in of the private investment. To this end, the implementing agencies should accelerate the pace of implementing the 'model' SEZ projects while the Finance Division will need to ensure adequate budgetary allocations. These SEZ facilities should be seen as tools for augmenting new private investment and be awarded in a

threshold has been maintained ever since. At the same time, general CPI has experienced a 16.9 per cent increase between July 2015 and March 2018.

competitive manner while measures should be there to check any likely misuse of tax incentives by entities in the SEZs.

Recommendations in the run-up to the election

To sustainably improve economic management, continued efforts are needed to strengthen legal and institutional system. Regrettably, the economic management of Bangladesh is plagued with low quality, non-performing and inadequate number of institutions. While some of the shortcomings stem from long-standing systemic issues, others might be corrected through prudent short to medium term policies and appropriate strategies. Independent and rigorous economy wide analyses should be conducted for all types of reforms. Indeed, the economic reform agenda should be at the forefront of the forthcoming election debates and should find place in the election manifestos of major political parties.

Both revenue-GDP and tax-GDP ratio in Bangladesh remained significantly low compared to South Asian neighbours and other emerging Asian economies. According to data from World Development Indicators, out of 105 countries (for which data was available), Bangladesh ranked 102 and 98 respectively with regard to revenue-GDP and tax-GDP ratio. The government is currently considering devising a Medium-Term Revenue Strategy (MTRS). To this end, it is critical to emphasise timely implementation of VAT and SD Act 2012. The implementation plan ought to be informed by the prevailing concerns. Implementation of online VAT registration and filing system and digitisation of VAT process and bringing in more businesses under the system should be given priority. Efforts should be made to finalise the draft Direct Tax Act at an early date; it should be placed in the public domain to seek opinion of relevant stakeholders and interested groups. Besides, the government needs to rationalise and modernise the Customs Act on an urgent basis. This should correspond with the current industrial and export policies (including export diversification strategies). The medium-term strategy should seek to identify innovative areas for resource mobilisation including assessing feasibility of introducing taxation of agricultural income, a comprehensive property tax and inheritance tax in line with international practices. It is also possible to gain efficiency through broader use of technology including introduction of electronic tax deduction at source (e-TDS) with issuance of tax certificates by the NBR against an e-TIN linked to each TDS collection. This will improve the state of regulating and managing the process. Indeed, the NBR should improve and utilise its tax database towards better enforcement of its policies.

Establishing a Public Expenditure Review Commission for ensuring accuracy of cost estimation of public investment projects and for raising overall effectiveness of public spending should be seen as priorities in the economic reform agenda. At the same time, it is strongly reckoned that the next government should consider establishment of a permanent Local Government (Finance) Commission towards effective devolution of power and introduction of appropriate financing modalities for local government. This initiative will help to ensure that public expenditure has greater impact at grassroots levels

The government is currently considering introduction of a universal pension scheme and a national health insurance scheme. These will be major steps towards a more inclusive society. Both these initiatives will require legal and institutional reforms. The background technical work should be expedited so that national election debates in this context are well-informed. The budgetary implications of such steps should be captured appropriately and funding modalities need to be properly identified in preparation of implementing the schemes.

Inflation, particularly that of food items, must be checked given its negative impact on the welfare of marginalised section of the society. It is also critical that incentive prices for the producers are ensured. To this end, the government should consider setting up an Agriculture Costs & Prices Commission (ACPC). This Commission should be mandated to provide strategic guidelines to ensure food security in Bangladesh, recommend incentive structure for the producers, provide guidelines for price signals in the market and for procurement, reduce the disparity between farm-gate and retail prices of agricultural products, balance consumer-producer interests and ensure fair prices for farmers.

In the backdrop of the disarray in the banking sector, CPD reiterates its earlier proposal to establish an Independent Financial Sector Reform Commission (IFSRC). This commission will evaluate the needs of customers and the economy, identify the weaknesses, scrutinise governance structure, security system, incentives, and risk management system in the banking sector. Furthermore, the commission will provide guidelines for NPL management and recapitalisation of banks, rescheduling of bad debt. The non-bank financial institutions could also be included within the remit of commission's scrutiny.

Quality and timely data is central to designing plans and strategies in the area of economic policymaking. In recent times, there has been growing concern as regards quality of data and coherence and credibility of various estimations. From this perspective, the new government may consider setting up an independent Statistical Commission to examine the quality of data pertaining to key macroeconomic correlates and come up with suggestions to improve data quality and ensure autonomy of statistical organisations. This will contribute to ensuring data integrity and enhancing transparency.

The two priorities of pursuing a conservative macroeconomic policy to stabilise the economy over the short term and designing a medium-term reform agenda, should inform macroeconomic management and preparation of fiscal-budgetary proposals in the context of the forthcoming national budget for FY2019.

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ANNEX

Annex Table 7.1: PEDP III selected priority indicators with benchmarks and targets

Indicators	2010 (baseline)	Target 2017	Status in 2017	Target 2018	Comments/others
Results Area 1: Learning Outcomes					
Gross enrolment rate, primary education (boys and girls) [EFA 5] (%)	107.7	105	111.7		Achieved
Net enrolment rate, primary education (boys and girls) [EFA 6] (%)	94.8	98	97.97		Achieved
Results Area 3.2: Effectiveness					
Dropout rate by grade (%)	39.8	15.0	18.85		Not Achieved
Boys (%)	40.3	17.0			Needs attention
Girls (%)	39.3	13.0			Needs attention
– Grade 1	8.5		1.5		
– Grade 2	3		3.0		
– Grade 3	7.7		3.9		
– Grade 4	12.2		8.0		
– Grade 5	9.5		2.5		
Coefficient of efficiency [EFA 14]					
Ideal as % of actual	62.2		85.0	85.0	Needs attention
Number of input years per graduate	8.0		6.1	6.0	Needs attention

Source: MoPME (2017a).

Annex Table 7.2: Assessment of learning as per national school assessments

Key Performance Indicators	2011	2013	2015	Target 2018
Mean scores Grade 3 Bangla (%)	67	74	65	75
Mean scores Grade 3 Math (%)	50	58	41	60
Mean scores Grade 5 Bangla (%)	25	25	23	35
Mean scores Grade 5 Math (%)	33	25	10	40

Source: MoPME (2017a).