



বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

# **State of the Bangladesh Economy in FY2016-17**

## *Second Reading*

## **CPD's Budget Recommendations**

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*The CPD IRBD 2017 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.*

# State of the Bangladesh Economy in FY2016-17

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## *Second Reading*

### **CPD's Budget Recommendations**

## **SECTION I. INTRODUCTION**

The CPD budget proposals for FY2018 is the second reading of the State of the Economy report prepared under the *Independent Review of Bangladesh Development (IRBD)*, which follows the first reading presented in January 2017. The first reading focused on some of the key trends in the Bangladesh economy at the halfway juncture of FY2017. The current report presents CPD's perspectives in the context of the upcoming FY2018 budget by taking the current dynamics of macroeconomic performance as the reference points.

The focus of this report is on four areas: (a) taking cognisance of the macroeconomic stances in terms of sustainable growth acceleration and enhanced employment generation; (b) enhancing resources for the budget; (c) supporting the private investment; and (d) strengthening social security and provision of human resources development for the marginalised and the vulnerable groups. The report uses the most recent data from available official sources. Most of the recommendations on the upcoming budget have been derived from earlier in-depth analytical works undertaken by CPD.

This report will be followed by a comprehensive analysis of the Bangladesh economy covering FY2017, to be released prior to the presentation of FY2018 budget. The final instalment of this year's IRBD will come up with CPD's reactions to the FY2018 budget once it is presented in June 2017.

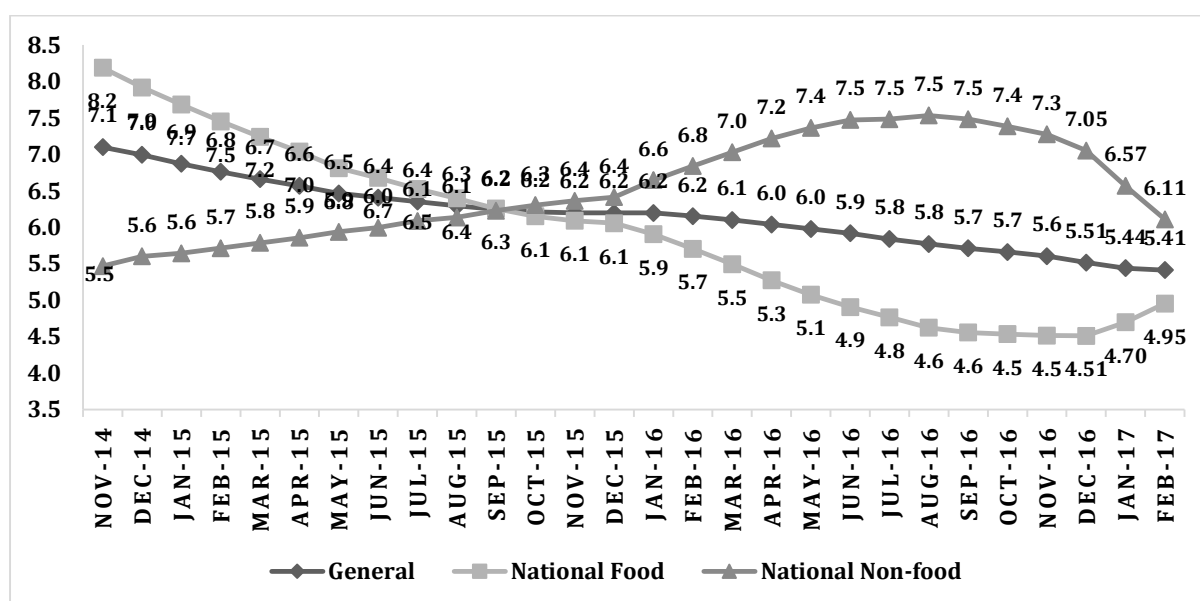
## SECTION II. MACROECONOMIC BACKDROP IN THE RUN-UP TO THE NATIONAL BUDGET FOR FY2018

Designing of national budget for FY2018 ought to take into cognisance the context in which the exercise is being carried out. Hence, it is important to review Bangladesh's current macroeconomic trends which will inform the fiscal-budgetary allocations, measures and incentives to be proposed in the budget. With this in the backdrop, the present section reviews performance of key macroeconomic indicators in the ongoing fiscal year, and sets the benchmark for the upcoming national budget.

### 2.1 Macroeconomic correlates in positive trend

*Headline inflation continued to decline albeit with some rise in food inflation.* Consumer Price Index (CPI) inflation in Bangladesh has maintained the declining trend in FY2017, till February 2017 (Figure 2.1). Annual average inflation was 5.41 per cent in February FY2017 which was well within Bangladesh Bank's Monetary Policy Statement (MPS) target of 5.3-5.6 per cent for FY2017. However, this declining trend is primarily driven by declining non-food inflation, although the rate was higher compared to food inflation. Within non-food inflation, inflation of medical care and transport expenses have seen some slow down. On the contrary, inflation of rent, fuel and lighting is showing upward trend in recent months. In view of this, the government's decision to further increase gas and electricity price may exacerbate the inflation situation over the coming months. At the same time, the decision to keep administered retail prices of kerosene and diesel unchanged in the domestic market deprived the consumers and producers of Bangladesh to get some relief on account of the lower oil price in the global market. Indeed, it may be noted here that, price of kerosene, which is the primary source of energy for the poor in Bangladesh, is currently about 1.8 times higher than that of Kolkata, India.

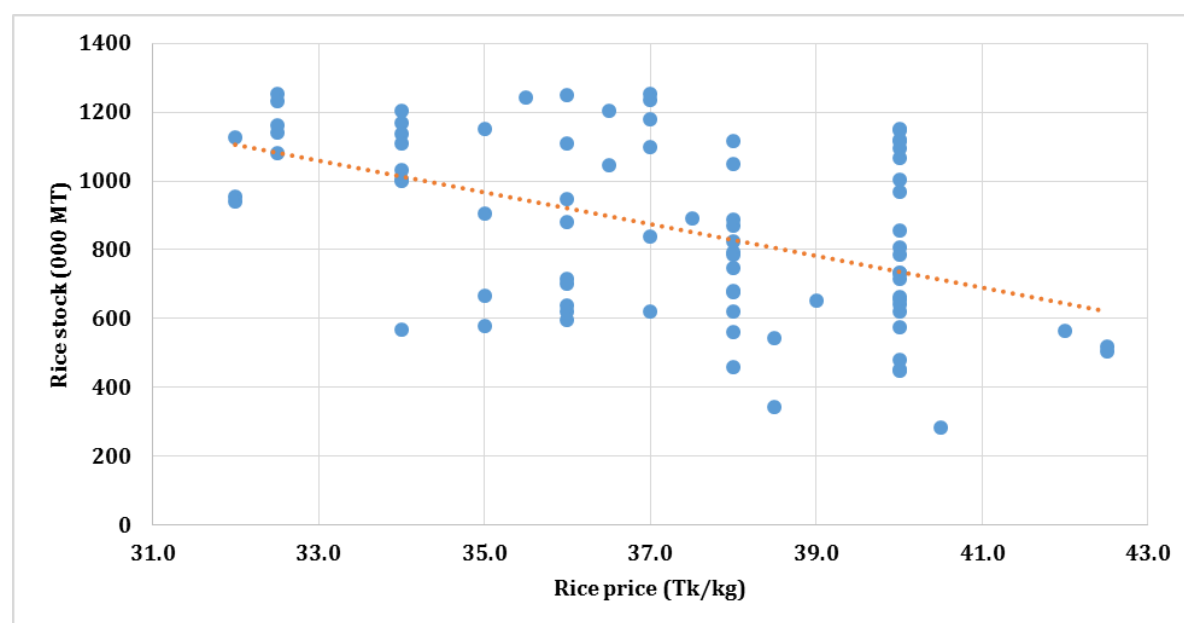
**Figure 2.1: Annual Average Inflation Rate (%)**



Source: Bangladesh Bank data.

At the same time, the rising food inflation since January 2017 needs to be closely monitored in view of its adverse effect on the poorer households. Rising rice price in recent months in the backdrop of declining public stock appears to be the major cause that is pushing food inflation upward. At present, coarse rice price is about 24 per cent higher than a year ago. Also, average rice price in Bangladesh is about 27.9 per cent higher than that of India<sup>1</sup>. Observation of recent data suggests a negative correlation between rice stock and rice price (Figure 2.2). It needs to be noted with due seriousness that, FY2017 marks the lowest level of rice stock in March since FY2012. Also, Aman procurement (till the end of March 2017) to the tune of 444 thousand MT, fell somewhat short when compared against the target of 500 thousand MT. It will, thus, be advisable that the policymakers take a closer look at the stock situation and calibrate the targets for Boro season procurement accordingly.

**Figure 2.2: Relationship between Public Stock of Rice and Retail Price of Rice**

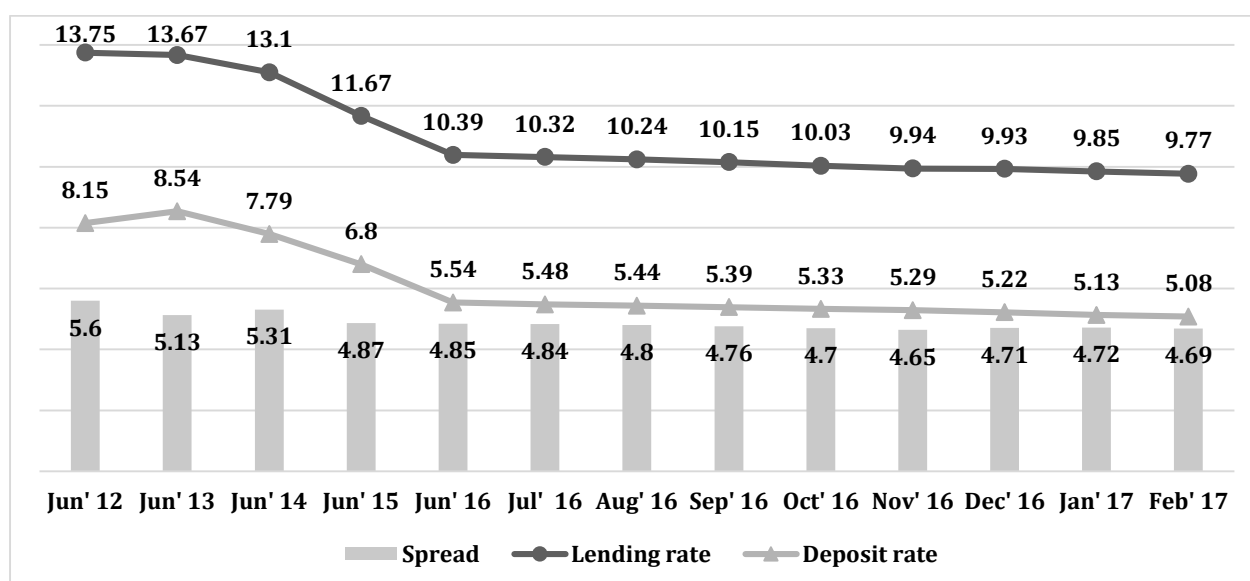


Source: Calculated from Bangladesh Bank and FPMU data.

*Interest rate continued to fall with sticky spread.* Interest rates for both lending and deposit continued to decline throughout the FY2017, in line with the declining trends experienced in FY2016. Curiously, both of the rates have been decreasing by maintaining a similar trend with the result that the spread has been hovering around 4.7 per cent (Figure 2.3). It needs to be closely monitored to what extent the weak state of the corresponding banking sector parameters including non-performing loans (NPL) and CAMELS indicators (see below), is contributing to a situation where the spread are not coming down. Indeed, without significant improvement in corporate governance and operational efficiency in the banking sector, further reduction of the spread will be difficult. As is the case, Bangladesh Bank's directives to the commercial banks to raise efficiency has not produced any visible success.

<sup>1</sup> Prices of medium quality Aman rice and 5% parboiled rice were considered for Bangladesh and India respectively. Data collected from Food Planning and Monitoring Unit (FPMU), Ministry of Food, Bangladesh.

**Figure 2.3: Interest Rate Spread (%)**

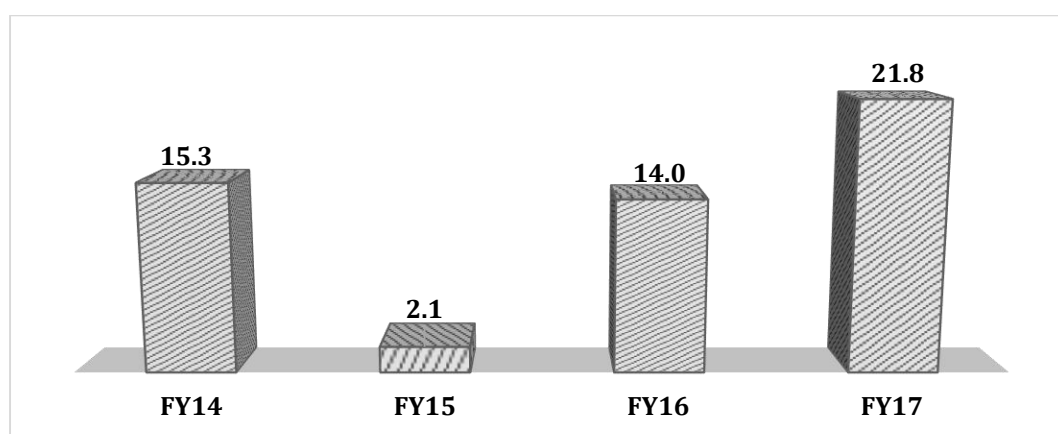


Source: Bangladesh Bank data.

*Proxy indicators for private investment show promising signs.* FY2016 ended with an upturn in private investment-GDP ratio. During July-February of FY2017, capital machinery import, which has important investment implications, registered an impressive growth of nearly 24.0 per cent.<sup>2</sup> However, this investment was concentrated in one particular area, the power sector (CPD, 2017). This uptake is reflected in the private sector credit which increased by 15.9 per cent by the end of February 2017 compared to the corresponding period of FY2016. During July-February of FY2017, net foreign direct investment (FDI) inflow also increased by 17.4 per cent.

Agriculture credit disbursement registered 21.8 per cent growth during July-February of FY17, which was 14 per cent during corresponding period of FY16. It is to be noted that, this is the highest attained growth since FY2014 (Figure 2.4). Non-farm rural credit also rose by 28.6 per cent during the aforesaid period. Additionally, loan disbursement to small and medium enterprises rose by 21.7 per cent during July-December of FY2017.

**Figure 2.4: Agricultural Credit Disbursement Growth (July-February, %)**



Source: Bangladesh Bank data.

<sup>2</sup> During the same period, L/C opening for capital machinery also increased by 13.4 per cent.



On the flipside, Industrial term loan disbursement recorded only 6.9 per cent growth during July-December of FY2017, which was (-) 3.0 per cent over the matched period of FY2016. As can be seen from Table 2.1, during the January-June period of both FY2015 and FY2016, growth rate of industrial term loan disbursement was significantly high. Replicating similar growth in FY2017 has proved to be difficult.

**Table 2.1: Industrial Term Loan Disbursement Growth (%)**

Period	FY14	FY15	FY16	FY17
Jul-Dec	-1.8	45.9	-3.0	6.9
Jan-Jun	0.8	36.6	23.6	

Source: Source: Bangladesh Bank data.

To be able to reap the benefits from the prevailing scenario, it is important to deliver infrastructure and policy support in a timely fashion. Of particular importance in this connection is ensuring the availability of gas and electricity and raising efficiency of port facilities on a priority basis (discussed in detail in Section IV).

*Balance of payment situation is still at a comfortable zone.* Up to February of FY2017, the overall balance of payments was positive (USD 2.5 billion) while current account balance fell into the deficit terrain.<sup>3</sup> Higher trade deficit alongside the falling remittance inflow have contributed to this. During July-February of FY2017, taka has appreciated against Euro, Chinese Yuan and GBP and depreciated against USD and Indian Rupee. Foreign exchange reserves stood at USD 32.2 billion at the end of March 2017 – indicating nearly a USD 2.2 billion increase from July 2016. The Government of Bangladesh is considering to utilise the growing forex reserve for infrastructure development through a sovereign wealth fund. CPD (2017) argued that independent institutional mechanism, moderate interest rate, feasible maturity period and appropriate monitoring and governance should be the key concerns in the aforementioned context. It is also to be noted that whilst the reserves do provide a cushion in terms of months of import that it can sustain, growing debt servicing and other obligations in terms of foreign exchange payments should inform any policy decision in this context.

*NBR revenue collection growth improved.* FY2017 set an ambitious NBR revenue growth target of 38.9 per cent compared to the actual collection in FY2016. Against this the attained growth has been 20.6 per cent up to October of FY2017<sup>4</sup> when compared with the corresponding period of the previous fiscal year. The comparable periods for FY2015 and FY2016 registered a much lower growth of 8.0 and 10.9 per cent respectively (Table 2.2). However, the required growth of NBR revenue for the remainder of FY2017 is 45.8 per cent which is not likely to be achieved. It is likely that a significant revision of revenue mobilisation target will be made while preparing for the budget for FY2018. It may be recalled that, CPD (2017) expressed its apprehension that the revenue mobilisation by the end of fiscal year was likely to be about Tk. 38,000 crore lower than the target set for FY2017. In view of this, further efforts towards domestic resource mobilisation along with exploration of new avenues ought to be one of the key priorities that should inform the forthcoming budget for FY2018 (discussed in details in Section III).

<sup>3</sup> (-) USD 1.1 billion which was USD 2.9 billion during the corresponding period of FY2016

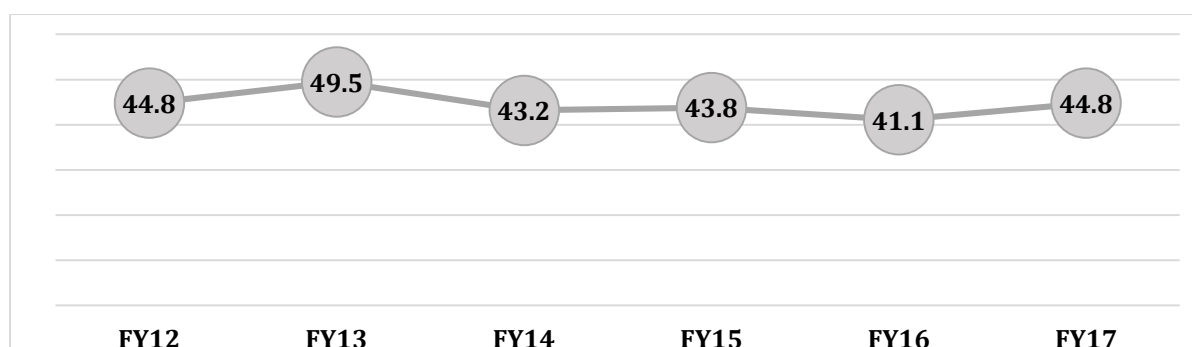
<sup>4</sup> According to Bangladesh Bank data, during July-December of FY2017, NBR revenue growth was 17.9 per cent.

**Table 2.2: Revenue Growth Target and Achievement (%)**

Source of Revenue	Actual FY15 (Up to Oct)	Actual FY16 (Up to Oct)	Budget FY17	Actual FY17 (Up to Oct)	Required Nov-Jun FY17
Tax Revenue (a+b)	7.9	11.5	38.5	19.7	45.6
a. NBR	8.0	10.9	38.9	20.6	45.8
b. Non-NBR	5.9	28.1	28.4	-0.4	41.9
c. Non-tax Revenue	-36.5	6.9	65.7	3.2	107.2
Total Revenue (a+b+c)	-3.2	10.8	41.6	17.1	51.5

Source: Authors' calculation from MoF data.

*ADP implementation pace recovered somewhat:* ADP implementation was 44.8 per cent during July-March of FY2017. This is an improvement over similar timeline of FY2016 (41.1 per cent) and the second highest after FY2013 (Figure 2.5). It may be said that ADP implementation has recovered from its earlier slump in July-March of FY2016 and returned to trend performance pace. However, this recovery is primary anchored on higher expenditure of local resources. Utilisation of foreign funding is lowest in last five years. Besides, pace of implementation of the fast track projects have been mostly unsatisfactory. Up to February, 2017 implementation rates in FY2017 for the Padma Multipurpose Bridge and Padma Bridge Rail Link were 30 per cent and 14 per cent respectively against respective allocations for FY2017.<sup>5</sup> Similarly, up to January, allocations for FY2017 for the Dhaka Mass Rapid Transit Development Project (Metro Rail) and Rooppur Nuclear Power Plant Projects have been used to the tune of only 4.4 per cent and 25.5 per cent respectively. Implementation of deep sea port projects at both Paira and Sonadia appears to be stalled. Slow progress of these projects is reflected in the low demand for funds. It may be recalled that, revised ADP (RADP) allocation for Padma Multipurpose Bridge was 48.5 per cent of the original allocation in FY2016. One should caution that the slow pace of progress of these mega projects will likely result in higher cost. Also this will create uncertainty among the private investors as regards timely delivery of the needed infrastructure contingent upon which investment decisions are made.

**Figure 2.5: ADP Implementation (July-March, %)**

Source: Authors' calculation from IMED data.

<sup>5</sup> However, for construction of Single Line Dual Gauge Track from Dohazari-Ramu-Cox's Bazar and Ramu to Ghundum near Myanmar Border the corresponding figure was 67 per cent.

## 2.2 Macroeconomic indicators with disquieting trends

*Overreliance on NSD sale for deficit financing continued.* Government of Bangladesh has been increasingly reliant on the sales of National Savings Directorate (NSD) certificates for budget deficit financing. Net sales of NSD certificates stood at Tk. 28,894.15 crore during July-January of FY2017 which is 74.0 per cent higher than that of the corresponding period of FY2016. It should be noted that the target for net sales of NSD is Tk. 19,610 crore for the entire FY2017. Accordingly, the sales up to the month of January was already an astounding 47 per cent higher than the annual target. As is known, NSD instruments entail payment of higher interest rates; consequently, higher amount of resources will be required for debt servicing. This could put under jeopardy the country's relatively comfortable debt sustainability track record and credentials (CPD, 2017). Hence, a downward revision of NSD rates, as also maximum ceiling on purchase, may be considered recognising the fall in the deposit interest rates in commercial banks and in view of the medium to long term implications of accumulating debt servicing liabilities of the government.

*Weak banking sector performance persisted.* NPL in the banking sector continued its usual cyclical pattern but remained higher than previous years' levels. As can be observed from Table 2.3, over the last few years NPL as a share of total outstanding loan tends to come down in December but then registers a rise afterwards. A possible reason could be restructuring and rescheduling of loans that takes place at the end of December every year (CPD, 2017). While state owned commercial banks (SCB), specialised banks (SB), and private commercial banks (PCB) evinced mixed trends over the last four quarters, foreign commercial banks (FCB) exhibited upward trends with respect to the NPL. It should be mentioned that the Government of Bangladesh injected a total amount of Tk. 9,655 crore over the last five years (between FY2012 and FY2016) in order to recapitalise the SCBs plagued with NPL. In FY2017 there was a Tk. 2,000 crore budgetary allocation for this. At the same time, the commercial banks have significant amount of excess liquidity in the face of lack of domestic demand and in view of the tendency of large investors to borrow from abroad.

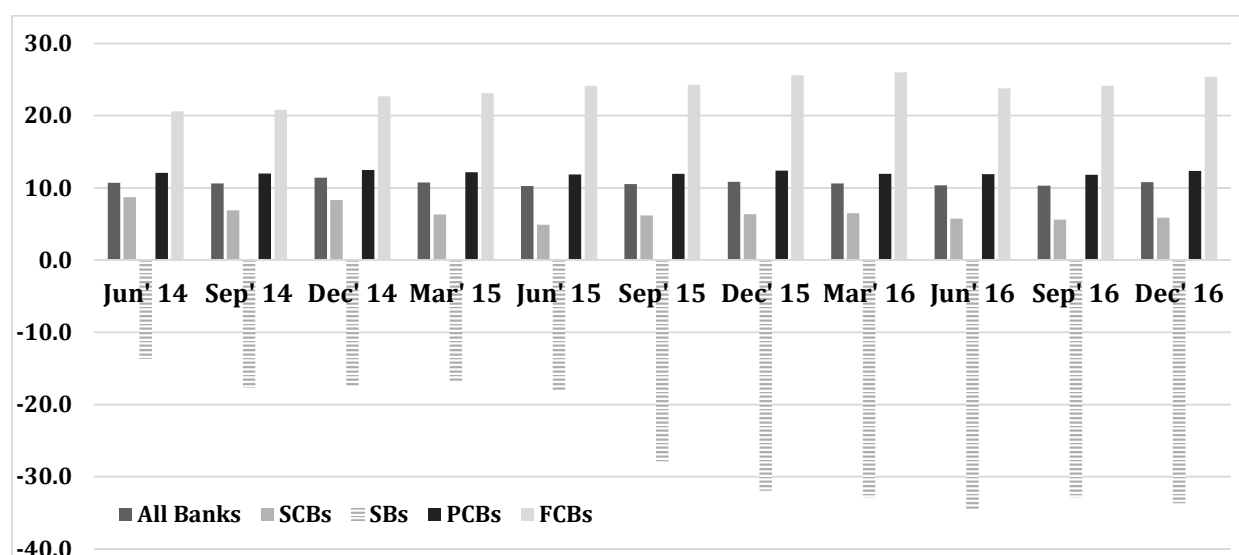
**Table 2.3: NPL (Gross) as Percentage of Total Outstanding Loan**

Month	SCBs	SBs	PCBs	FCBs	Total
Mar, 2013	27.05	27.17	6.23	4.60	11.90
Jun, 2013	26.44	26.19	6.62	4.66	11.91
Sep, 2013	28.76	29.39	7.30	6.02	12.79
<b>Dec, 2013</b>	<b>19.76</b>	<b>26.78</b>	<b>4.54</b>	<b>5.46</b>	<b>8.93</b>
Mar, 2014	21.98	30.93	5.77	5.32	10.45
Jun, 2014	23.23	33.12	5.70	6.19	10.75
Sep, 2014	23.92	37.84	6.34	7.01	11.60
<b>Dec, 2014</b>	<b>22.23</b>	<b>32.81</b>	<b>4.98</b>	<b>7.30</b>	<b>9.69</b>
Mar, 2015	22.49	33.46	6.03	8.25	10.47
Jun, 2015	21.89	25.47	5.67	8.25	9.67
Sep, 2015	21.82	24.68	6.09	8.79	9.89
<b>Dec, 2015</b>	<b>21.46</b>	<b>23.24</b>	<b>4.85</b>	<b>7.77</b>	<b>8.79</b>
Mar, 2016	24.27	23.24	5.75	7.51	9.92
Jun, 2016	25.74	26.14	5.44	8.33	10.06
Sep, 2016	25.16	26.14	5.9	8.85	10.34
<b>Dec, 2016</b>	<b>25.05</b>	<b>26.02</b>	<b>4.58</b>	<b>9.56</b>	<b>9.23</b>

Source: Bangladesh Bank data.

Bangladesh is to fully implement BASEL III from January 2020. As a core requirement, between 2015 and 2019, the commercial banks need to maintain a capital adequacy ratio (CAR) to the tune of 10.625 per cent in 2016. In December 2016, neither the SCBs nor the SBs could maintain the minimum requirement. Although PCBs and FCBs maintained CAR above the minimum requirement, underperformance of SCBs and SBs brought down the total share below the minimum requirement (Figure 2.6). This state of affairs calls for adequate policy attention since the required CAR for 2017 has been set at 11.25 per cent.

**Figure 2.6: Capital Adequacy Ratio (%)**



Source: Bangladesh Bank data.

Of the profitability indicators for banks, both Return on Asset (ROA) and Return on Equity (ROE) have come down from 0.77 per cent and 10.51 per cent respectively at the end of December 2015 to 0.71 per cent and 9.92 per cent during the corresponding period of 2016. The ROA for SCBs, SBs and FCBs deteriorated from (-) 0.04, (-) 1.15 and 2.92 per cent respectively in December 2015 to (-) 0.16, (-) 1.40 and 2.56 per cent respectively in December 2016. On the other hand, ROA for PCBs remained nearly unchanged at 1.03 per cent. From December 2015 to December 2016, the ROE for SCBs, SBs and FCBs deteriorated from (-) 1.47, (-) 5.79 and 14.59 per cent respectively to (-) 6.02, (-) 6.94 and 13.09 per cent respectively. The ROE for PCBs has somewhat improved from 10.75 percent in December 2015 to 11.09 percent in December 2016.

*Lower growth in export earnings has emerged as a concern.* During the first nine months of FY2017, export earnings have remained below the annual target (Figure 2.7). According to Export Promotion Bureau (EPB) data, export earnings rose by 4.0 per cent during July-March period of FY2017 against the annual growth target of 8.0 per cent. Export growth of RMG products (2.4 per cent) was below the target (8.1 per cent). Knit RMG items attained 4.9 per cent growth during July-March of FY2017 against the annual target of 6.1 per cent. Over the same timeframe, woven RMG items recorded a lowly 0.2 per cent growth as opposed to the target of 10.0 per cent. On the contrary, non-RMG products registered 11.1 per cent growth against the annual target of 7.4 per cent. The better performance of non-RMG products was underpinned by leather products and footwear, jute and jute goods, and engineering equipments.

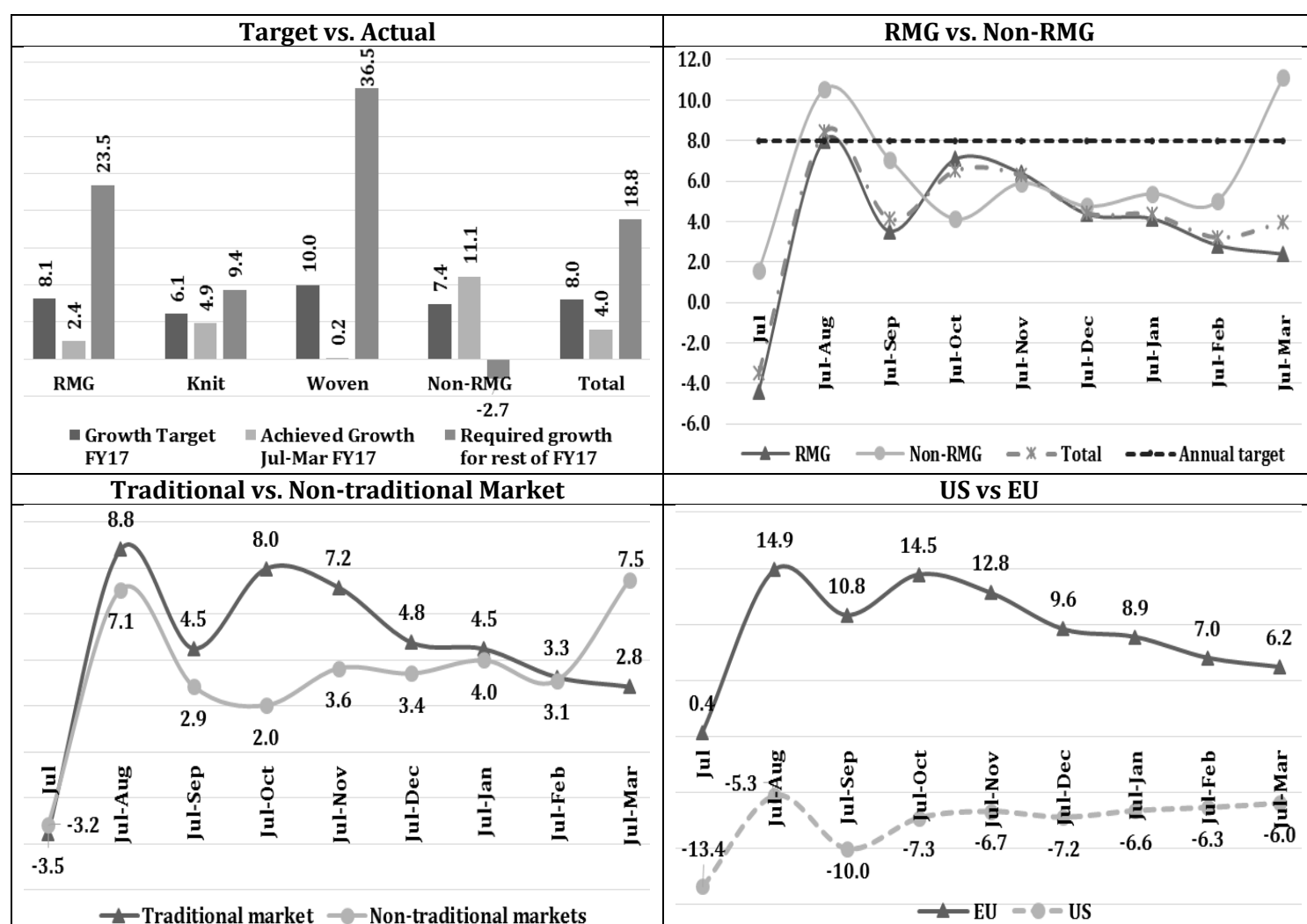
Export growth in the non-traditional markets (7.5 per cent) outstripped the export growth in the traditional markets (2.8 per cent) (Figure 2.7). The boost in non-traditional markets was mostly attained via impressive performance of non-RMG products in Australia, Chile, China, India, and

Russia. RMG products achieved significant growth in non-traditional markets such as Chile, China, and Russia.

Export performance in the US market was rather subdued in FY2017 although it is showing some signs of improvement in recent months (Figure 2.7). Both knit and woven RMG exports have posted low growth. Performance in the EU is has experienced a gradually declining trend. This is particularly so in case of the woven exports.

The sluggish performance of Bangladesh's export originate from depressed global demand, relative strengthening of BDT compared to some of the competitors, and relatively high cost of doing business in Bangladesh. Exchange rate of BDT against other currencies has emerged as a concern, more so against the USD. Although the nominal exchange rate has remained fairly stable in recent times, real effective exchange rate (REER) has seen some appreciation leading to erosion of Bangladesh's export competitiveness (CPD, 2017).

**Figure 2.7: Current Scenario of Export (July-March of FY2017)**

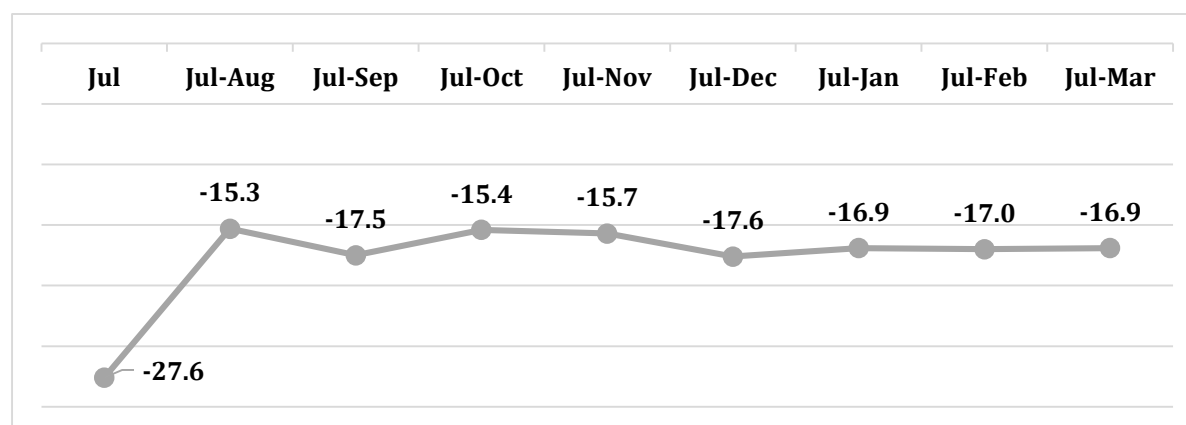


Source: Authors' calculation from EPB data.

*Remittance inflow continued to experience decline.* The case of remittance inflow to Bangladesh is rather intriguing. Thus far, for all the months in FY2017 remittance inflow has declined compared to the corresponding months of FY2016. This has been happening at a time when monthly outward migration flow has seen a robust rise. During the July-March period of FY2017,

remittance inflow declined by (-) 16.9 per cent (Figure 2.8) while outward migration rose by 30.9 per cent. While depressed economic situation in petro-dollar earning Middle-East countries, and the consequent downward pressure on salaries and wages are a cause, greater flow through informal channels has also been cited as reasons. Higher flow through money transfer agencies of various types and higher cost of sending are also reasons. A more indepth study of the possible reasons is called for to identify appropriate policy interventions in this regard.

**Figure 2.8: Remittance Inflow Growth (%)**



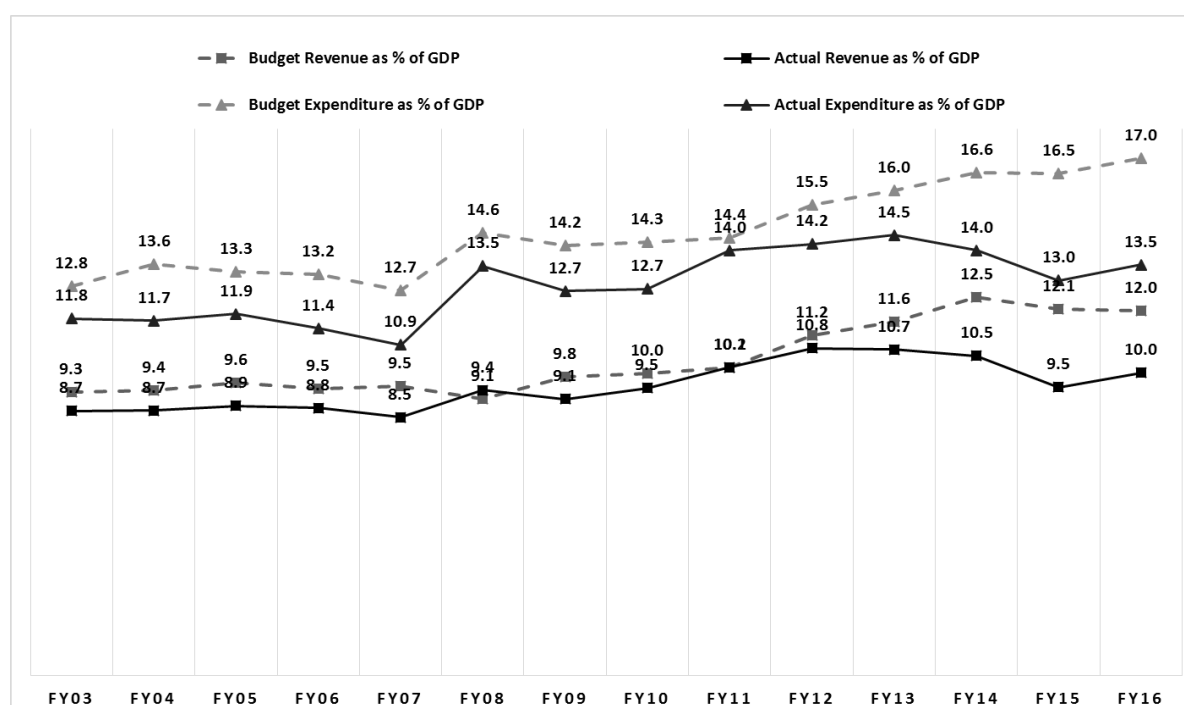
Source: Calculated from Bangladesh Bank data.

## 2.3 Recommendations for the budget

The recent trends in major macroeconomic correlates presented above demonstrate a number of strengths on which the national budget for FY2018 can draw upon. The prevailing macroeconomic stability attributed to restrained budget deficit, sliding inflation amid low level of global commodity prices, declining interest rate, positive balance of payment and stable exchange rate provides a unique opportunity for the government to calibrate its fiscal policy in accordance with its developmental objectives. In this backdrop, the government may like to opt for an expansionary fiscal policy in the context of the upcoming national budget to serve its development aspirations as well as to support private investment uptake and accelerate the economic growth momentum. Indeed, Bangladesh economy is well-positioned for such a policy push also thanks to the comfortable debt situation of the country (Bhattacharya and Ashraf, 2017).

Since FY2010, the government has formulated national budget in a way that raises public expenditure to GDP ratio. As can be seen from Figure 2.9, planned public expenditure in FY2016 was 17.0 per cent of GDP which was 14.3 per cent in FY2010. Regrettably, actual public expenditure (i.e. realised budget) declined to 13.5 per cent in FY2016 from 14.0 per cent in FY2010. Similarly, planned revenue-GDP ratio was increased from 10.0 per cent in FY2010 to 12.0 per cent in FY2016. However, actual revenue-GDP ratio was 10.0 per cent in FY2016, a rise from the 9.5 per cent posted in FY2010. Indeed, the gap between planned and realised public expenditure has widened over the years (3.5 percentage points in FY2016) compared to that between planned and realised revenue mobilisation levels (2.0 percentage points in FY2016). This implies that either the institutional capacity of the government could not keep pace with the plan laid out in the consecutive national budgets, or the design of national budget allocations was faulty.

**Figure 2.9: Revenue and Total Expenditure as % of GDP: Budget Target vs Actual**

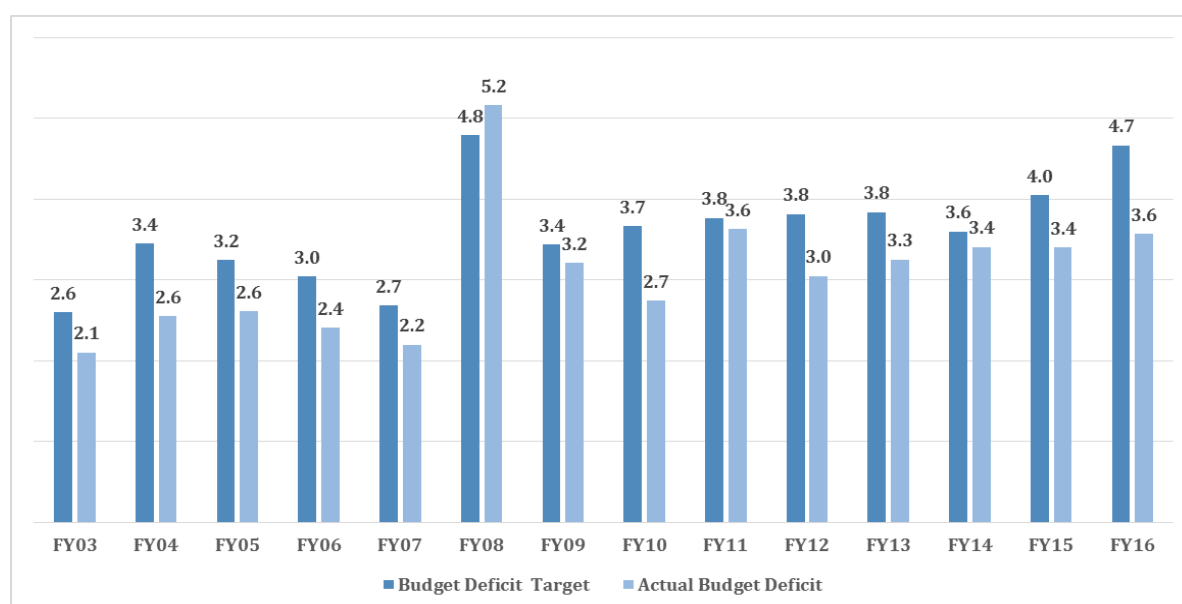


Source: Authors' calculation from MoF and BBS data.

Indeed, a number of planned reform agendas remained unimplemented and this has severely constrained the capacity of the government to raise the budget implementation rate. Successive delays in implementing the VAT and SD Act, 2012 had also held back several other revenue mobilisation reform agendas (including new Acts on Direct Tax and Customs) which constrained the revenue mobilisation efforts. As is known, the government had planned a number of reforms geared to raise the ADP implementation capacity. These included policy on the Project Preparatory Fund (PPF), appointing project directors through direct interviews by the line ministries and divisions, assigning a dedicated official in each government agency for monitoring and evaluating respective projects, and delisting the longstanding 'non-operational' projects from the ADP (CPD, 2016a). Regrettably, these have not been adequately followed up. Implementation Monitoring and Evaluation Division (IMED) also comes up with recommendations in the annual progress report based on the challenges faced during the project cycle on a regular basis. Again, these are often not adequately followed up with concrete measures. In this backdrop, it is also observed that large amount of allocations made against the 'mega projects' have remained underutilised in successive years. In addition to the above, while the prevailing low level of global commodity prices has indeed contributed to macroeconomic stability, this may have, at the same time, constrained realisation of revenue mobilisation targets.

One may also argue that public spending is affected by government's willingness to pursue a policy of 'fiscal discipline' in the backdrop of weak revenue mobilisation capacity. In Bangladesh, over the last decade no national budget has aimed for a budget deficit that is higher than the threshold of '5 per cent of GDP'. Besides, as can be seen from Figure 2.10, actual budget deficit never surpassed the corresponding target levels. Indeed, over the last five years, budget deficit hovered around 3.5 per cent of the GDP.

**Figure 2.10: Budget Deficit as % of GDP: Budget Target vs Actual**



Source: Authors' calculation from MoF data.

As a matter of fact, budget implementation capacity has become a major concern from the perspective of macroeconomic management in Bangladesh. This issue has been highlighted in several CPD studies of recent years on budget analysis (see CPD, 2014, 2015, 2016b). Indeed, compared to other developing countries, budget implementation rate (in the areas of both revenue mobilisation and public expenditure, including development expenditure) in Bangladesh is quite low (Table 2.4).

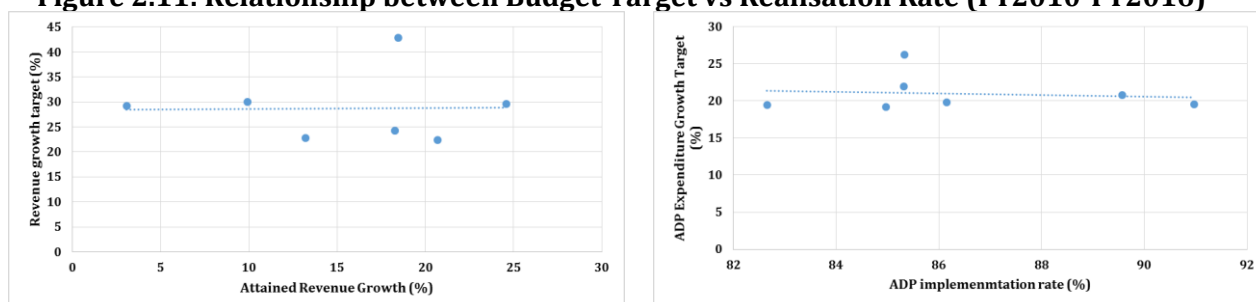
**Table 2.4: Budget Implementation Rate (% of Planned) in Various Countries**

Budget implementation (%)	2015				2016			
	India	Vietnam	Uganda	Bangladesh	India	Vietnam	Uganda	Bangladesh
Revenue	92.6	101.8	99.7	<b>78.7</b>	104.7	102.4	98.1	<b>83.0</b>
Development expenditure	80.5	104.2	87.2	<b>73.0</b>	155.8	102.4	83.0	<b>74.7</b>
Total expenditure	92.7	101.1	89.3	<b>78.8</b>	100.7	101.8	90.3	<b>79.4</b>

Source: Authors' calculation from data collected from Ministries of Finance of aforesaid countries.

It is often argued that opting for an ambitious target may also raise higher realisation rate. However, the following scatter diagram (Figure 2.11) shows that such relationships are very weak for both revenue and the ADP. In view of this, it is critical to ensure discipline in formulating budgetary targets.

**Figure 2.11: Relationship between Budget Target vs Realisation Rate (FY2010-FY2016)**

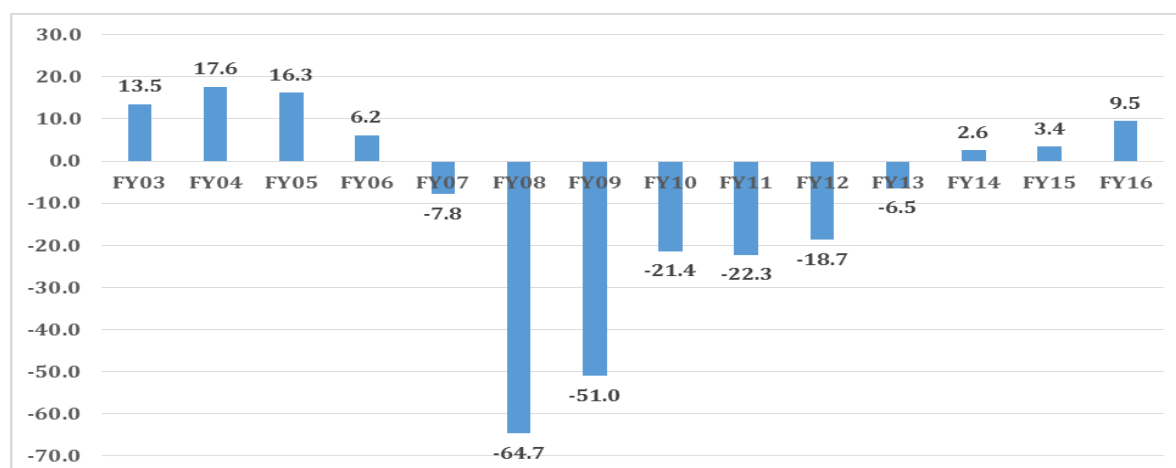


Source: Authors' calculation from MoF data.



One of the positive developments in the area of national budget implementation is that, over the last three years (FY2014-2016) at least some part of the ADP financing could be serviced by the revenue surplus (total revenue minus all other public expenditures including amortisation payment for foreign aid) (Figure 2.12). Indeed, in view of the lower global petroleum prices, required public money for 'loans and advances' in favour of SoEs was rather low which provided the additional fiscal space.

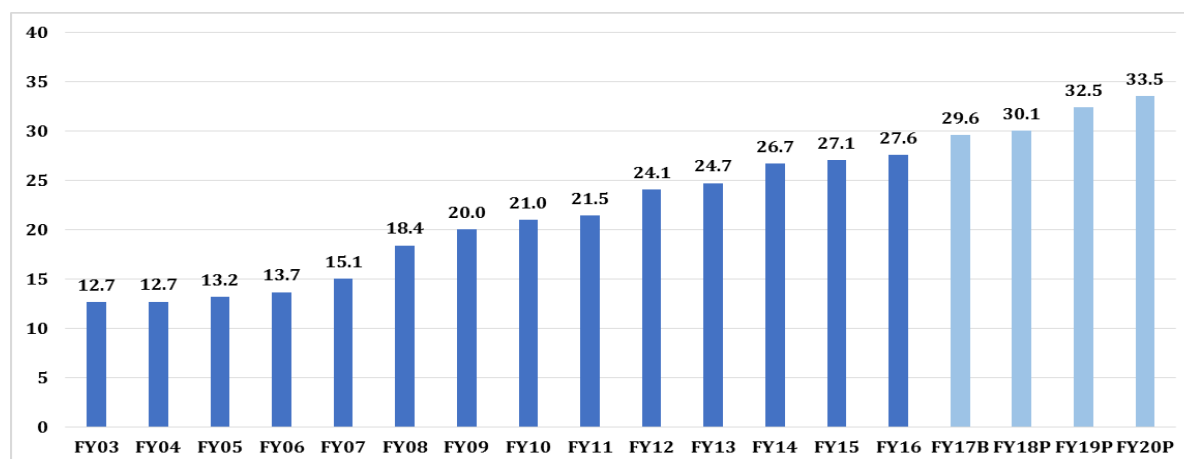
**Figure 2.12: Contribution of Revenue Surplus to ADP Financing (%)**



Source: Authors' calculation from MoF data.

Maintaining this trend will require significant improvements in revenue mobilisation efforts. The 7th Five Year Plan (7FYP) aims to raise revenue-GDP ratio to 16.1 per cent in FY2020 from the 10.0 per cent in FY2016. Considering the shortfall predicted for FY2017 based on CPD projection, over the next three years, annually, on an average, 31 per cent growth will be required to attain the target. It is well understood that the revenue mobilisation plan for FY2018 will largely rely on a successful implementation of the VAT and SD Act 2012. However, without making a similar effort towards augmenting earnings from the income tax, it is highly unlikely that the aforesaid medium term target will be achieved. Indeed, 7FYP also aims to raise the share of income tax in total revenue to 33.5 per cent in FY2020 from 27.6 per cent in FY2016. In order to attain this, over the next three years income tax mobilisation, on an average, needs to increase by 43 per cent annually.

**Figure 2.13: Share of Income Tax in Total Revenue (%)**



Source: Authors' calculation from MoF and 7FYP data.

Note: B denotes budget and P denotes planned.

In view of above, while an expansionary fiscal policy for FY2018 is called for, the government will need to address the structural weaknesses in budget implementation by undertaking the required reforms. Besides, taking the disquieting trends in the macroeconomic scenario into cognisance, it is also important to pursue a set of economic policies including, but not limited to, fiscal-budgetary measures on an urgent basis.

*First*, in view of depleting growth of export earnings and sliding remittance inflow, the government should continue with devaluation of the BDT over the short term. While it is understandable that the central bank needs to consider several factors to this end, including increase in import costs leading to higher cost of production and inflationary pressure for consumers. However, this is critically important for maintaining export competitiveness and ensuring adequate resource flow to the rural economy in the form of remittance inflow.

*Second*, the government must reduce the administered prices of kerosene and diesel. The continuous windfall gains by the BPC at the expense of consumers and producers is not well-justified. It may be recalled that a CPD study found the reduction in petroleum prices to have positive impact on economic growth, private investment and employment (CPD 2015). Moreover, the forthcoming national budget should inform how the windfall gain has changed BPC's bottom line and how this has been made use of the BPC till date i.e. how much of this profit was used to adjust accumulated losses and repay earlier debts. Transparency in this regard can help appropriate policymaking in the areas of proposed price adjustments as also allocation of relative benefits to be enjoyed by key stakeholders and sectors (e.g. farmers, transport users, producers, exporters and consumers).

*Third*, the government needs to adjust both the interest rates and purchasing ceiling with respect to NSD certificates. This is important from both debt servicing liability and fiscal discipline perspective. This may also help restore interest of depositors in saving with the commercial banks.

*Fourth*, in view of rising rice price in the domestic market, the government will need to exercise caution and vigilance. If required, the government should go for import of rice after the Boro procurement in line with its public food distribution programme for FY2018. Given the observed volatility in prices of agricultural commodities, the government is well advised to set up an Agriculture Price Commission on an urgent basis to ensure incentivised price for the producers while maintaining market stability.

*Fifth*, the government needs to be prudent in allocating taxpayers' money to SCBs for recapitalisation. It may be recalled that CPD has earlier proposed setting up an Independent Financial Sector Reform Commission (IFSRC) to come up with appropriate recommendations to address the formidable fault lines in Bangladesh's financial sector. This Commission can undertake an in-depth review and assessment of the health and performance of the financial sector of the country and come up with concrete guidelines to deal with NPL, recapitalisation of banks and rescheduling of bad debt. This has now emerged as an urgency particularly in view of the need for a smooth transition to the BASEL III regime.

## SECTION III. ENHANCING RESOURCES FOR THE NATIONAL BUDGET

Revenue collection has gained momentum in the recent past. In FY2016, the revenue collection growth was 19.1 per cent when compared to FY2015. However, Bangladesh's revenue-to-GDP ratio, which was only 9.9 per cent in FY2016, remained significantly low when compared with other lower-middle income countries (LMICs) and South Asian neighbours. NBR sourced tax revenue accounted for about 85 per cent of total revenue income, while the ratio between direct and indirect tax was 35:65.

Over the years, domestic resource mobilisation in Bangladesh has faced multifaceted challenges including low tax base and low tax compliance, multiplicity of taxes, significant amount of foregone revenue in the form of tax incentives and exemptions which have not resulted in expected results, capital flight, weak administration and technological backwardness, delays in implementing necessary administrative and legal reform. As is known, the NBR remains the key agency to raise resources for budget implementation through augmenting tax revenue. Over the last few years, a number of reform agendas in the areas of tax collection have been planned by the NBR. Regrettably, implementation of these plans has failed repeatedly to meet the respective timelines. Consequently, over the last five years the gap between revenue mobilisation target and corresponding realisation figures have continued to widen. Effective implementation of these reforms and programmes are critically important to adequately improve the institutional capacity of the NBR to achieve the ambitious targets of revenue collection set out in the national budget to finance the developmental needs of Bangladesh.

### 3.1 Ongoing reforms for resource mobilisation

In 2011, GoB adopted a comprehensive NBR Modernization Plan (2011-2016) with a view to achieving higher revenue. Tax policy reforms (modernisation of income tax, VAT and customs laws), integration of revenue management process, modernisation of revenue collection procedures, development of strategic communication with taxpayers, redefining and restructuring of the status, function and regulatory powers of the NBR, development of institutional and administrative capacity (human resource development, infrastructure development and enforcement improvement program) – these were some of the major reform agenda. Although the projected timelines for the involved measures and initiatives are already way past their stipulated targets, many of the planned actions are still to be fully implemented.

#### *VAT reform*

In the backdrop of two years' delay in going into operation, the new VAT and SD Act 2012 is set to come into force from 1 July 2017. The 'VAT Online' project is currently being implemented by the NBR with the aim to automate VAT registration and e-filing of the returns. The new Integrated VAT Administration System (IVAS) requires all business entities to digitally comply to VAT system with a fresh VAT registration and a new 9-digit e-BIN.<sup>6</sup> Besides, installation of electronic cash register (ECR) in the VAT-eligible business entities is also being promoted. The NBR has organised several training and discussion sessions with the business community to familiarise the involved parties with the requirements of the newly introduced systems. However, concerns

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<sup>6</sup> Businesses which are entitled to pay VAT or turnover tax.

remain in terms of operationalisation, issues relating to preparedness and training of the VAT administration, technical aspects, adequacy of awareness building campaign and enforcement strategies. As will be appreciated, adequate preparedness of the tax administration is a key informing for efficient management of revenue collection. The administrative and management capacity of the taxpayer remains a major determinant in deciding the success of any new and automated system, not to speak of such a complex system as the VAT. Awareness building campaign in the form of training, conference, sector wise group consultation for business entities which are also critically important determinants have also remained inadequate till now. This is particularly important to make the end users at the periphery areas more comfortable about the new system. The strategy in the areas of regulation and monitoring as regards technical issues concerning the new VAT system is, however, not clear. NBR needs to integrate a number of government and autonomous agencies in the system for information sharing, but their capacity to comply with the system remains a concern.<sup>7</sup> Taking cue from the concerns raised during preparation of the enforcement of the law, NBR should frame a comprehensive enforcement plan on an urgent basis, and make a public announcement of this plan prior to enforcement of the VAT law as of 1 July 2017. This will provide all relevant stakeholders including producers and consumers with clear information and guidelines about enforcement of the law.

Business entities (which are vested with the responsibility of collecting the VAT from consumers) have voiced their opposition to the uniform VAT rate of 15 per cent on the ground that this was on the high side. They have urged for a reduced VAT rate. A review of global VAT rates suggests that the 15 per cent rate is perhaps the global median rate. However, in South and East Asia and among the LMICs, the median rate appears to be 12.0 per cent (Table 3.1). It is reckoned that, Bangladesh's proposed uniform VAT rate was on the high side when compared to her neighbouring LMICs in South and East Asia. In view of this, if it is inevitable that the uniform 15 per cent VAT rate will be operationalised as of 1 July 2017, it is recommended that the rate be reduced to 12 per cent in a staggered manner over the medium term. It is hoped that as the uniform VAT of 15 per cent gets applied, revenue expansion will enable the government to lower the VAT rate without adverse earnings consequences.

**Table 3.1: Global VAT Rate (%) in 2013**

Countries/ regions	Simple average rate	Median rate
South Asia (India, Pakistan and Sri Lanka)	10.7	12.0
East Asian LMICs (11 countries)	10.7	12.0
South and East Asian LMICs (14 countries)	10.7	12.0
All available LMICs (55 countries)	14.0	15.0
World (190 countries)	13.8	15.0

Source: Collecting Taxes Database. Retrieved from: <https://www.usaid.gov/data/dataset/cdeb8a1b-3440-4e88-b6cb-81b2428f8cea> (accessed on 5 April 2017)

A key concern regarding the enforcement of the new VAT law is that except for some necessary items, all products and services, at local and domestic stages, are subject to pay the 15 per cent uniform VAT. This implies that the present truncated rates will no longer be applicable. In case of particular commodities of essential nature, a one shot adjustment of VAT rates may have significant negative repercussions. Particularly, stakeholders are concerned as regards the likely

<sup>7</sup> The NBR needs to integrate the system with at least four agencies namely, Office of the Registrar of Joint Stock Companies and Firms (RJSC), Bangladesh Election Commission, Bangladesh Bank and Bangladesh Customs

rise of VAT rates on utility services (e.g. electricity consumption at household levels for which present rate of VAT is 5 per cent). As GoB is considering another round of price adjustment for various types of utility services, uniform VAT on electricity services may impose a significant burden on the common people. CPD, thus, recommends to consider the price adjustments and VAT rates on the utility services in a coordinated manner and to implement the price adjustments and VAT rise in a staggered way in consideration of likely negative impact on both consumption and private investment.

#### *Income tax reform*

The issue of income tax reform is an agenda which has been on the table for many years. Due to the complexity and inconsistencies in the earlier draft of the income tax code, NBR had decided to frame a new draft of income tax act considering the country's current socioeconomic context. It is expected that the proposed Income Tax Act will be easier to understand, both for the taxpayers as also for the tax officials. In view of preparing the draft, NBR has constituted a number of advisory, monitoring and drafting implementation committees. The new draft was planned to be completed by the end of December 2016; a committee was supposed to be formed with experts to evaluate and examine the draft. Speedy completion of the draft and its disclosure in the public domain to seek suggestions from the relevant stakeholders and interested groups, is highly recommended. Indeed, it is to be noted that the forthcoming law is expected to be implemented from 1 July 2018. Hence the urgency.

#### *Reforms for modernisation of customs*

In view of modernising the customs, a strategic action plan (2014-2017) has been prepared. The plan has identified 10 key programme areas (including strategic planning and management; modernisation and reform; human resource management and training; infrastructure development; legislation, policy, and procedures; information and communication technology; external communication and partnerships; good governance and integrity; trade and travel facilitation; and revenue collection). Several medium to high priority projects are also being implemented and these are at different stages of completion. In an attempt to raise revenue generation at customs points, several projects have received high priority such as development and implementation of a compliance improvement programme which include the followings: measures to identify leakage and enhance revenue collection; strengthen the capacity of the valuation department in line with WTO requirements; review the current valuation database to ensure that concerned staffs have access to all relevant open and closed sources of information; augment revenue collection through implementation of Post Clearance Audit (PCA). It is to be noted that, an automated bonded warehouse management system utilising the ASYCUDA World module is already in place. Though the majority of the projects that are designed to improve trade facilitation have received 'high' priority as regards completion, there are several customs infrastructural development projects that (which may have higher spillover effects in terms of raising the volume of trade) have been given 'medium' priority. Development of custom infrastructure ought to be seen as a vehicle to improve trade facilitation; indeed, this will contribute to increasing the volume of trade, and thereby raise the scope of higher revenue generation.

#### *Effective operationalisation of transfer pricing cell*

In 2014, the transfer pricing cell (TPC) was set up to address incidences of tax evasion by multinational companies through 'transfer mispricing'. In the following year (2015), seven

transfer pricing officials were appointed to examine and audit the statements of international transactions of the 175 multinational companies operating in Bangladesh. The NBR also developed a prescribed form for the MNCs to submit details of their international transactions with respective company tax returns. At the same time, the NBR also prescribed rules according to which MNCs international transactions were to be monitored and assessed by a group of tax experts. The cell officials were to determine the price and send a report to the circle office to complete assessment on the basis of decision by the officials concerned. NBR has recently signed an MOU with the Organisation of Economic Cooperation and Development (OECD). According to the MoU, experts from the OECD will share technical knowledge and provide training to the transfer pricing officials (TPO) over the next two years with a view to improve their capacity and efficiency. However, more will need to be done if the transfer pricing cell to perform the responsibilities it has been vested with. The cell will need to be provided with adequate logistic support, infrastructure, access to data and data sharing and data storage facilities to raise its capacity to undertake rigorous analysis, forensic investigations and perform intelligence tasks.

### **3.2 Priority issues that need to be addressed**

#### *Personal income tax (PIT)*

Personal income tax (PIT) exemption threshold was raised to Tk. 2.5 lac in the budget for FY2016<sup>8</sup>. In view of the general CPI having experienced a rise of about 11.2 per cent<sup>9</sup> over the last two years, a relief for the taxpayers appears to be logical. At the same time, implementation of the new VAT law will likely put pressure on consumers. To provide some relief to taxpayers, it is proposed that the first slab of PIT rate be reduced from the current 10 per cent to 7.5 per cent. It is expected that, the measure will increase disposable income of the taxpayers and the consequent multiplier impact on the economy will create opportunities for the government to compensate for revenue losses through additional revenue earnings.

It may be recalled that, earlier, CPD has recommended introduction of e-TIN provisions for the foreign nationals working in Bangladesh.

#### *Corporate income tax (CIT)*

High growth in income tax collection in the recent past has largely hinged on revenue collected under the corporate income tax (CIT) head. NBR annual report 2013-14 showed that, contribution of corporate tax in the income tax collection jumped to 72.5 per cent in FY2014 which was about 55 per cent in FY2013. Corporate tax rates has remained unchanged in the last budget. The current rates are in line with global comparative figures. Median CIT for 56 LMICs was found to be 25 per cent in 2013, which is equal to the rate in Bangladesh for listed companies. India has CIT at the range of 29-30 per cent with additional surcharges and cess for education.

At present, cigarette manufacturing companies, both, listed and non-listed, are paying tax at the rate of 45 per cent. FY2018 Budget may consider raising the rate for non-listed cigarette manufacturers which is likely to generate higher tax revenue and also will induce these companies to go for listing in the capital market. Getting listed will also improve transparency in their bookkeeping process. This will also be helpful from the public health point of view.

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<sup>8</sup> The threshold was raised by about 13.6 per cent (which was Tk. 2.2 lac in FY2015) considering required inflationary adjustment.

<sup>9</sup> CPI has increased by 11.2 per cent between July 2015 and February 2017.

### *Tax deducted at source (TDS)*

As is observed from table 3.2, 'tax deducted at source' has emerged as a relatively more effective mode of collecting income tax. Due to informal nature of the labour market<sup>10</sup>, and the large share of non-compliant firms, TDS should be seen as a preferred avenue for generating income tax in the particular context of Bangladesh. Introduction of electronic version of TDS (e-TDS) is more likely to improve the system significantly and make it easier, interlinked and efficient.

**Table 3.2: Various Types of Income Tax Collection in FY2014**

Forms of collection	Share (%)	Incremental share (%)
Tax deducted at source (TDS)	57.6	79.1
64 Advance income tax (AIT)	25.6	-4.1
74 Returned income tax (RIT)	7.5	-8.8
Private ltd company (without TDS)	2.6	1.5
Company (without TDS)	1.4	0.6
Salary (without TDS)	1.3	5.2
Public Limited Company (without TDS)	0.7	4.1
Others	3.2	22.5
Total	100.0	100.0

Source: NBR Annual Report 2013-14.

In the above situation, CPD recommends to introduce and promote e-TDS (the electronic and automation process of TDS). In this connection, maintaining a list of TDS collecting authorities is being suggested. CPD has also earlier recommended, in view of Budget for FY2017, introduction of a progressive TDS for higher income earners.<sup>11</sup> These measures are expected to generate additional revenue, in short term (without broadening the tax net). Additionally, if NBR issues tax certificates against an e-TIN linked to each TDS collection, this will improve the state of regulating and managing the process.

### *Property tax*

In absence of well-crafted land/property tax, incentives to invest in productive sectors could be easily distorted in favour of investing in land holdings and real estate. While the government may continue with the existing wealth surcharge system for next few years, as a forward looking strategy it should consider introduction of a land/property tax. At the same time, government should focus on training of officials (to improve their capacity) who will be responsible for valuation of land/property in order to levy appropriate amount of taxes.

## **3.3 Recommendations for the budget for FY2018**

In view of the above discussion, it is proposed that a number of steps be taken to facilitate revenue generation for financing the budget. Some of the steps need to be initiated on an urgent basis although these will have medium-term implications from the point of view of mobilisation of resources. Some of the priority issues that needs immediate actions are listed below:

<sup>10</sup> The 2013 Bangladesh Labour Force Survey showed that roughly 50.5 million (87 per cent) of the 58.1 million employed persons aged 15 and above were informal workers. In comparison, only about 10 per cent labour are informal in OECD countries.

<sup>11</sup> Tax collected through these measures will be adjusted when a taxpayer/entity submit his return. Therefore, these measures would not pose any significant burden on taxpayers under the tax net.

### *Fiscal measures that call for immediate actions*

- Reduce the first slab of PIT rate from 10 per cent to 7.5 per cent.
- Introduce e-TIN provisions for the foreign nationals working in Bangladesh.
- Consider raising the corporate tax rate for non-listed cigarette manufacturers.
- Take initiative to enlist all TDS collecting entities with the NBR; tax certificate should be issued by NBR for each e-TIN against all TDS collection.
- Introduce e-TDS as an alternative effective income tax collection source.
- Adjust VAT rate on utility services in a staggered manner (e.g. electricity and gas). All adjustments, including price adjustment, should be made in a way that the combined effect does not create serious burden for the consumers.
- Design and disclose (before 1 July 2017) the VAT enforcement plan.
- Gradually reduce the uniform 15 per cent VAT rate to 12 per cent to safeguard the interest of consumers.
- Assess tax incentive and exemption packages based on economic returns. Budget speech should clearly mention the fiscal policy changes (in the areas of tax incentives, exemptions, rebates, surcharges etc.) being proposed and their impacts on different sectors/segments of the economy from the point of attaining fiscal targets.
- Take immediate steps to recover the large amount of taxes that are due to SoEs including BPC and Petrobangla.

### *Institutional reforms*

- Automate VAT collection process by ensuring increased use of ECR/POS and take prudent monitoring and enforcement strategy to reduce revenue leakages.
- Conduct mass awareness raising campaigns to make businesses (collection agents) comply with the requirement of registration (or enlistment) with the IVAS and to go for online VAT return submission.
- Implement customs modernisation projects in accordance with the timelines mentioned in the Customs Strategic Action Plan (2014-2017).
- Establish the long overdue data integration process (e.g. NBR data centre) towards better policy analysis and policy directions. For instance, analysis of quality and disaggregated trade data will help to reduce trade mispricing and revenue leakages.
- Vest the TPC with the required capacity to enable it to carry out its responsibilities in an effective manner. Raise its power to access global platform and databases to enhance its capacity to deal with illicit financial flow (IFF).

### *Legal reforms*

- Finalise the draft Income Tax Act and place it in the public domain to seek opinion of relevant stakeholders and interested groups. To introduce a system of modern direct tax, enforce the Act by 1 July 2018.
- Rationalise and modernise Customs Act on an urgent basis. This should correspond with the current industrial and export policies (including export diversification strategies).
- Constitute the long awaited Financial Council to operationalise Financial Reporting Act 2015 (FRA) without delay.
- Establish an independent fiscal policy authority and separate the existing unit from revenue collection authority.



## **SECTION IV. PROMOTING PRIVATE INVESTMENT: HOW TO STRENGTHEN POLICY INSTRUMENTS?**

### **4.1 Background**

Over the last several years, private investment has been struggling to maintain growth momentum which had been observed in earlier years. As discussed elsewhere, private investment in both domestic market-oriented and export-oriented industries has been slowed down due to number of internal and external reasons. Moreover, operating costs in the manufacturing sector are likely to rise in the coming days because of upward adjustment of tariff rate of gas, rise in price of coarse rice which would put pressure to rise in workers' wages and slow adjustment of exchange rate of BDT against US\$ etc. In this backdrop incentivizing private investment is highly critical but is a daunting task.

The fiscal-budgetary measures undertaken by the government in order to promote trade, industry and investment are often found to less 'effective'. A number of global surveys reveal that private investment is only partially influenced by such policy measures; indeed the efficacy of the influence of such measures tended to vary between only 6 and 33 per cent (Table 4.1). Interestingly, a significant share of the involved entrepreneurs felt that such policies suffered from both lack of targeting as also their appropriateness in terms of meeting the actual demands of the investors (James, n.d.). The following table provides important insights, from cross-country studies, into how entrepreneurs themselves perceive the efficacy of policy tools, in this case fiscal policies, in influencing their investment behavior. There are important lessons to learn from these perception surveys to draw appropriate lessons for Bangladesh at a time when the country is preparing the budget for FY2018. These lessons include whether incentives offered for promoting private investment in Bangladesh have contributed differently than what was observed in other developing countries.

**Table 4.1: Results of Various Surveys on Incentives Offered for Promoting Private Investment**

Author	Focus of Survey	Conclusion		Did incentives influence the Investment level? (% saying yes)
Investment Climate Advisory (FIAS)—investor motivation surveys	Malaysia (2014)	Redundancy ratio for incentives (would have invested even if Incentives were not provided)	81%	33%
	Guinea (2012)		92%	6%
	Jordan (2009)		70%	28%
	Kenya (2012)		61%	11%
	El Salvador (2013)		37%	13%
	Nicaragua (2009)		15% (51% for non-exporting firms outside free zones)	17%
	Serbia (2009)		71%	6%
	Tanzania (2011)		91%	8%
	Tunisia (2012)		58%	25%
FIAS	Vietnam (2004)		85%	-
FIAS	Thailand (1999)		81%	-
Nathan Associates	Mozambique (2009)		78%	13%
Guisinger and Associates (1985)	Investment incentives and performance requirements for export-oriented firms		33%	
Reuber (1973)	FDI and market orientation		52% for export oriented firms	

Source: J. Weiss, n.d.

## 4.2 Trends of private investment in Bangladesh: A brief overview

As is known, Bangladesh has been pursuing a policy of private sector led industrialisation for a prolonged period of time. However, performance of the industrial sector has not been able to achieve targets set in terms of sectoral composition, spatial distribution, sectoral efficiency and productivity, market orientation and development of vertical linkages. According to Table 4.1, a large part of private investment, in majority of cases underwritten by debt financing, is overwhelmingly dominated by 'large scale enterprises' (over 75 per cent of total disbursed term loan in FY6) with relatively very low share of 'medium' and 'small' scale enterprises (15.5 per cent and 10.6 per cent respectively). Thanks to a number of targeted measures, share of 'small' scale enterprises in terms of disbursed term loans has experienced some increase but this has been at the cost of declining share of 'medium' scale enterprises. In other words, there is a tendency to emerge 'missing middle' in the composition of private investment.

**Table 4.2: Disbursement of Term Loan: Share of LSI, MSI, SSI**

Quarter	Disbursement (% of total)			
	LSI	MSI	SSCI	Total
FY09	73.43	22.67	3.90	100.00
FY10	73.42	21.27	5.31	100.00
FY11	68.27	24.75	6.98	100.00
FY12	62.13	31.09	6.78	100.00
FY13	65.73	27.21	7.05	100.00
FY14	68.65	22.66	8.70	100.00
FY15	76.06	16.21	7.74	100.00
FY16	75.15	14.27	10.58	100.00
FY17 (Jul-Dec, 2016)	73.89	15.47	10.64	100.00

Source: Bangladesh Bank.

The significantly large private investments relate to a small number of large enterprises which are only 0.07 per cent of total establishments. And these investments are concentrated in limited number economic activities.<sup>12</sup> The above observations are also equally applicable in case of the FDIs. Despite the various efforts to attract FDI, the realized rate of FDI is still at a low level. Bangladesh's FDI-GDP ratio is lower than that of average ratio for lower middle income country and is lower than its major competing countries including India, Vietnam, China and Thailand (Table 4.3).

**Table 4.3: FDI-GDP Ratio: Bangladesh and Selected Countries**

Country	Foreign direct investment, net inflows (% of GDP)		
	2005	2010	2015
Bangladesh	1.1	1.07	1.73
India	0.87	1.65	2.1
China	4.55	3.99	2.27
Vietnam	3.39	6.9	6.1
Thailand	4.34	4.33	2.28
LMIC	2.36	2.14	2.26
UMIC	3.34	3.29	2.52

Source: WDI database.

While there is no denying that the causal relationship between policies and private sector investment patterns call for more rigorous and in-depth analysis, there are also other factors including infrastructure, overall business environment and regulatory regime which have important impact on entrepreneurs' investment decisions. However, the need for better targeting and better deployment of policy tools in countries such as Bangladesh cannot be over-emphasized. In the next section an attempt has been made to examine the efficacy of fiscal tools deployed to promote investment in the context of some selected sectors.

<sup>12</sup> Major economic activities (in terms of establishments) are concentrated in weaving and finishing of textiles, manufacturing of wearing apparels, manufacture of knitted apparels, manufacture of luggage and handbag, foot wear, printing, plastic products, metal products, treatment of metals, metal furniture, packaging materials and jewelry etc.

### 4.3 Policy intervention through fiscal measures and their likely implications for selected industries

CPD has carried out an exercise which cover five selected sectors which received benefits through successive national budgets, between FY2010 and FY2015, in the form of fiscal measures such as imposition/changes of supplementary duties (SDs) on related finished products. These sectors are electrical appliances, motor vehicles, plastic, footwear and tiles and ceramics. The objective of this exercise was to understand whether changes in SDs have had any impact in terms of achieving the target of discouraging imports and providing protection to domestic market-oriented, import-substituting industries.<sup>13</sup>

CPD exercise found that imposition and/or changes in the SDs did not necessarily generate the expected results (Table 4.4). Out of 13 product categories (at HS Code 4 digit level), 7 experienced slowdown or decline in import during the post-change period while rest 6 experienced rise in import during the same period. For example, import of finished plastic products did slowed down after the imposition of the SDs. Footwear sector, on the other hand, did not experience a similar trend following the imposition of duty on finished leather products. In order to facilitate local tiles industry, the government had raised SD on finished tiles and ceramic products. The policy met the objectives partially. Import of electrical appliances slowed down after the imposition of duty; on the other hand, automobiles sector showed some mixed results after the changes in the SD structure.

No doubt, the pattern of correlations cited above should be interpreted with due care, since there are many other factors that tend to influence the import behavior, including relative (domestic/imported) prices, level and pattern of demand, change in consumer choices etc. However, what continues to remain true is that, and this has been well-established in relevant global literature, if fiscal policies are not appropriately designed and are not supported by other reinforcing policies and measures, there is a high possibility that these will fail to attain the declared objectives.

**Table 4.4: Imposition/Changes/Withdrawal of SDs in Selected Products**

Industry (finished products)	Product H.S. code	Product name	Type of SD applied	Yearly Growth (period considered)		Likely Effect
Plastic	3917	Tubes, pipes and hoses, and fittings therefor, e.g. joints, elbows, flanges, of plastics	newly imposed	26.82 (2010-12)	22.22 (2013-15)	import slowed down
	3926	Articles of plastics and articles of other materials of heading 3901 to 3914	rate increased and decreased	116.47 (2010-13)	20.52 (2014-15)	import slowed down
Leather foot wear	6406	Parts of footwear, incl. uppers whether or not attached to soles other than outer soles	newly imposed	26.84 (2010-11)	28.98 (2012-15)	import increased

<sup>13</sup> While the SDs may also have served revenue mobilization purpose of the budgets, the primary objective cited in the budgets was for this fiscal measure to give protection to domestic industries.

Industry (finished products)	Product H.S. code	Product name	Type of SD applied	Yearly Growth (period considered)		Likely Effect
Tiles and ceramics	6907	Unglazed ceramic flags and paving, hearth or wall tiles; unglazed ceramic mosaic cubes and	rate increased	21.3 (2010- 12)	12.26 (2013- 15)	import slowed down
	6908	Glazed ceramic flags and paving, hearth or wall tiles; glazed ceramic mosaic cubes and the ...	rate increased	115.03 (2010- 12)	(-)3.7 (2013- 15)	import decreased
	6910	Ceramic sinks, washbasins, washbasin pedestals, baths, bidets, water closet pans, flushing .	rate increased	(-)4.89 (2010- 12)	60.44 (2013- 15)	import increased
	6911	Tableware, kitchenware, other household articles and toilet articles, of porcelain or china ...	rate increased	0.92 (2010- 12)	204.82 (2013- 15)	import increased
	6912	Tableware, kitchenware, other household articles and toilet articles, of ceramics other than ...	rate increased	(-)25.71 (2010- 12)	591.81 (2013- 15)	import increased
	6913	Statuettes and other ornamental ceramic articles, n.e.s.	rate increased	171.9 (2010- 12)	1099.7 (2013- 15)	import increased
	6914	Ceramic articles, n.e.s.	rate increased	779.76 (2010- 12)	24.56 (2013- 15)	import slowed down
	8415	Air conditioning machines comprising a motor-driven fan and elements for changing the temperature ...	newly imposed	13.11 (2010- 12)	9.76 (2013- 15)	import slowed down
Automobiles	8704	Motor vehicles for the transport of goods, incl. chassis with engine and cab	newly imposed	3.37 (2010- 11)	9.77 (2012- 15)	import increased
	8711	Motorcycles, incl. mopeds, and cycles fitted with an auxiliary motor, with or without side-cars; ...	rate increased	16.45 (2010- 11)	11.85 (2012- 15)	import slowed down

Source: Authors' estimates based on various published data.

The logic of fixing the rates for the SDs for different products belonging to different industries remains unclear, if not arbitrary. One common practice is for the rates of the SDs to be the same for all products under the same HS product category at 8 digit level, with some exceptions. However, one finds wide variations in this regard. Indeed, four tiers (of rates) are in existence for the 34 plastic products for which SDs are there at present, 10 per cent on 5 products, 20 per

cent on 11 products, 30 per cent on 8 products and 45 per cent on 10 products. Moreover, SDs have been imposed on a number of products where import is not mentionable. For example, while one of the ceramic products (i.e. 6912) had SD of 45 per cent between 2010 and 2012 when total import was only several thousand US\$; the rate of SD was raised in 2012 from 45 per cent to 60 per cent when total import was only US\$40 thousand. There was an imposition of duty of 20 per cent on another ceramic product (6906) where import ranged between 0 to US\$33 thousand during the period under scrutiny. Table 4.5 has tried to capture the various rates of SDs in FY2015 for selected industries with shares of respective import value for these products in total with a view to understand if there was a rationale behind setting the rates based on the level of import. One fails to discern any logic in the pattern of the SDs that are imposed.

From this vantage point, it will be interesting to investigate how business bodies/business groups/individuals tend to influence the budgetary process in fixation of SDs and thereby use fiscal instruments to their respective advantage. The issue of fixing SDs calls for a more in-depth look and there is a need to demand greater transparency from the NBR in this context.

**Table 4.5: Share of Import vis-à-vis Rates of SDs**

Various SD Rates	Share of total import in 2015 (import data available at 4 digit HS code)				
	39	64	69	84	87
SD rates					
Single rates (at 8 digit level)					
15				46.6	
20	38.5		7.28		33.4
30	5.3	45.2			3.15
45		54.8		34.0	
60	10.9		92.7		
Multiple rates (at 8 digit level)					
20-45	40.2				
20-60	5.2				
20-100				19.4	
30-250					36.6
45-500					26.9
Total	100	100	100	100	100

Source: Authors' estimate based on Trademap database.

An examination of growth and performance of the selected manufacturing industries when juxtaposed to different public policy instrument is thus, an exercise that is worth undertaking. A preliminary investigation carried out as part of this analysis fails to establish any association in this connection (Table 4.6). Plastic and footwear, two of the priority sectors identified by policymakers are seen to experience consistent growth between 2006 and 2012 in terms of number of establishments, number of workers and amount of assets per unit. In contrast, the growth of the other two industries, electrical appliances and motor vehicles, is found to be different. While the number of enterprises belonging to electrical appliances sector has significantly increased, number of workers and amount of assets per unit have declined. The case for the motor vehicles is somewhat similar. Given the differences in the period of comparison of fiscal measures with changing composition of selected sectors, it is difficult to discern direct causal relationship between the two. However, it is clear that growth of industries is not overwhelmingly influenced by the fiscal measures offered through the national budget.

**Table 4.6: Changes in the Composition of Selected Manufacturing Industries: 2006 and 2012**

Sectors	% change in establishments	% change in no of workers per unit	% change in amount of assets per unit
Plastic	38.74	44.65	116.2
Footwear	37.66	39.45	121.58
Electrical Appliance	311.55	-19.35	-77.62
Motor Vehicles	87.67	-48.08	27.24

Source: Survey of Manufacturing Industries, 2006 and 2012

#### 4.4 Strengthening the policy instruments

In view of the apparent weaknesses of fiscal and other instruments to attain the target of incentivising industrial development and industrial diversification, there is a need to explore alternative approaches to stimulate private investment in the desired direction.<sup>14</sup> The focus of the alternate approach is not on sectors alone but on activities as well which will encourage innovation and ensure long term productivity growth.<sup>15</sup> In this backdrop, government should put due consideration on following issues in the upcoming national budget for FY2018.

- a) ***There should have proper assessment of fiscal incentives:*** As discussed, fiscal incentives provided to different sectors did not necessarily ensure achieving targeted objectives in selected sectors (i.e. electrical appliances, motor vehicle and plastic industry). At present fiscal incentives for industrial activities are largely sector-specific and partly location specific. A number of these sectors have been identified as 'priority/high priority' sectors under different policies (e.g. Industrial Policy, Export Policy and SME Policy). Given the limitations of these measures towards achieving the required goal, a proper assessment of those measures is highly important with a view to appreciate their contribution in terms of enhancing investment, production and employment generation in targeted activities.
- b) ***Fiscal incentives should be time bound and terminated after a pre-specific period:*** The current structure of fiscal incentives particularly in the form of tax holiday, depreciation allowance, cash incentives and supplementary duties etc. are mostly 'open-ended' in nature. There is often no time line after which those benefit will be terminated. This lack of predictability affects the businesses to undertake target-oriented investment measures. Moreover government faces the difficulty to stop those benefits once started because of the pressure from the businessmen for lack of preparation owing to no prior announcement about the timeline. In this backdrop, all kinds of fiscal benefits should be made 'time-bound'.
- c) ***Fiscal incentives should be 'well targeted' and performance oriented:*** The policy support should not be specific to sectors only but also specific to activities (such as producing high

<sup>14</sup> In the backdrop of the various types of market failures and the incomplete and missing links in the markets, 'strategic industrial policy' prepared by Hausmann and Rodrik (2005) offers an alternative to the traditional mode of public policies which merits closer consideration in the context of Bangladesh.

<sup>15</sup> To facilitate this, various types of interventions are to be deployed which are categorised as 'horizontal' and 'vertical' policy interventions.<sup>15</sup> Hausmann and Rodrik (2005) proposed that interventions should be more of 'horizontal' and less of 'vertical' in nature. More importantly, what they propose is that the various support measures ought to be 'conditional' on the performance of the involved enterprises and should be time-bound i.e., 'terminated' after a pre-specific period and supporting activities should be not so distant in terms of existing specialization.

value products/services, investing on R&D, setting up high-tech machineries, and producing raw materials which significantly enhances domestic capacity). Besides, there should have 'performance requirement' criteria with a view to ensure proper use of the facility by the entrepreneurs. The criteria should include various performance indicators such as level of productivity, efficiency, employment generation and social compliance etc.). In order to carry out the exercises such as identification of industries and assessing the performance of industries, the existing database available to NBR and Tariff Commission need to be strengthened.

For example, use of SD in the name of promoting domestic industries needs to be streamlined because of their limited impact on targeted industry as discussed earlier. Moreover, the proposed rates of changes in SD should be well-justified both within and between sectors. In this case, there should have a prior assessment in case of implementing any kind of change (imposition/change/withdrawal) in SD.

- d) *A well-functioning institutional set-up for assessment and monitoring of policy instruments:*** There should have a proper institutional mechanism for assessment and monitoring of policy instruments used to provide support to industries. In this case, NBR should play the key role by taking support from other relevant public offices such as Customs and Tariff Commission. Based on the ex-ante assessment, the national budget once announce the benefits in the national budget should disclose amount of 'revenue forgone' for undertaking those tax expenditures. Under the institutional arrangement, the performance of the beneficiaries should be monitored a regular basis. At the end of the specified period, an ex-post assessment has to be made with a view to appreciate how much the targeted goals have been achieved through undertaking those measures.



## **SECTION V. MOVING BEYOND A STATUS QUO BUDGET FOR THE SOCIAL SECTOR**

### **5.1 Introduction**

Social sector, in particular health, education and social security, has to receive special focus in the national budget through higher budgetary allocation and relevant fiscal measures. Public spending on health and education has the potential to reduce inequality and contribute to GDP and inclusive growth (Hur, 2014; Maitra and Mukhopadhyay, 2012). Expenditure on social protection can play a role in achieving social inclusion through providing gainful employment and reducing income inequality (Bukuluki and Mubiru, 2014; European Commission, 2004; Gangopadhyay and Bhattacharyay, 2015; García and Gruat, 2003; UN, 2012). In Bangladesh, social sector deserves increased attention of the policy makers as the country aspires to move forward with greater economic momentum. The sphere social safety net has to be broadened as well in order to reduce poverty and inequality in the society.

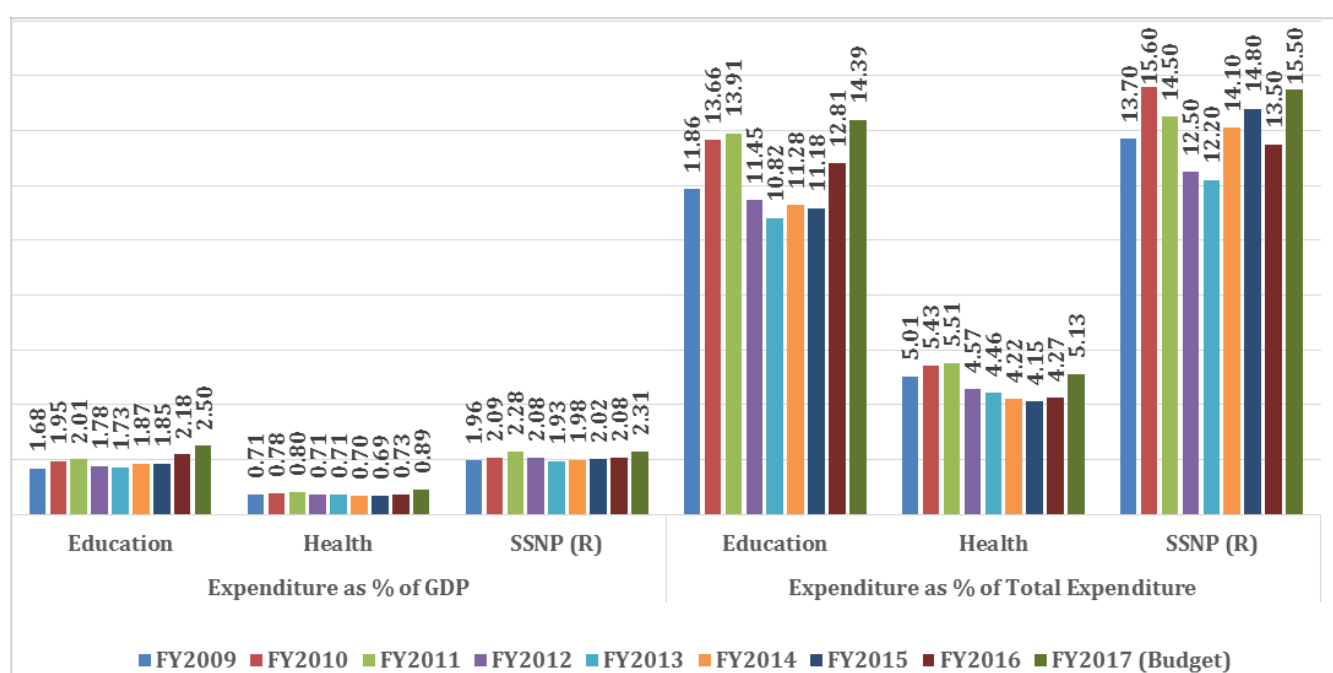
### **5.2 Allocation for health, education and safety net**

Expenditure on education and health as percentage of GDP and budget has increased to some extent in recent years. However, the pace of increase in case of allocation and expenditure is not the same as planned in the budget. For example, allocation for health was 0.74 per cent of actual GDP both in FY2015 and FY2016 while expenditure for the sector was 0.69 per cent and 0.73 per cent respectively. Resources for Social Safety Net Programmes (SSNP) is hovering around 2 per cent of GDP (for example, 2.08 per cent in FY2016) (Figure 5.1). The planned expenditure was 3 per cent of GDP in the Sixth Five Year plan (6FYP), which was revised downward to 2.3 per cent of GDP in the Seventh Five year Plan (7FYP). According to Mid Term Budgetary Framework (MTBF) and 7FYP, allocation for six ministries<sup>16</sup>, related to social welfare has improved in FY2017 though a declining trend during FY2014-19 is observed (Figure 5.2). The need for a boost in expenditure for these ministries is obvious.

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<sup>16</sup> These include Ministry of Education; Ministry of Primary and Mass Education; Ministry of Health and Family Welfare; Ministry of Social Welfare; Ministry of Women and Child Affairs; and Ministry of Disaster and Relief.

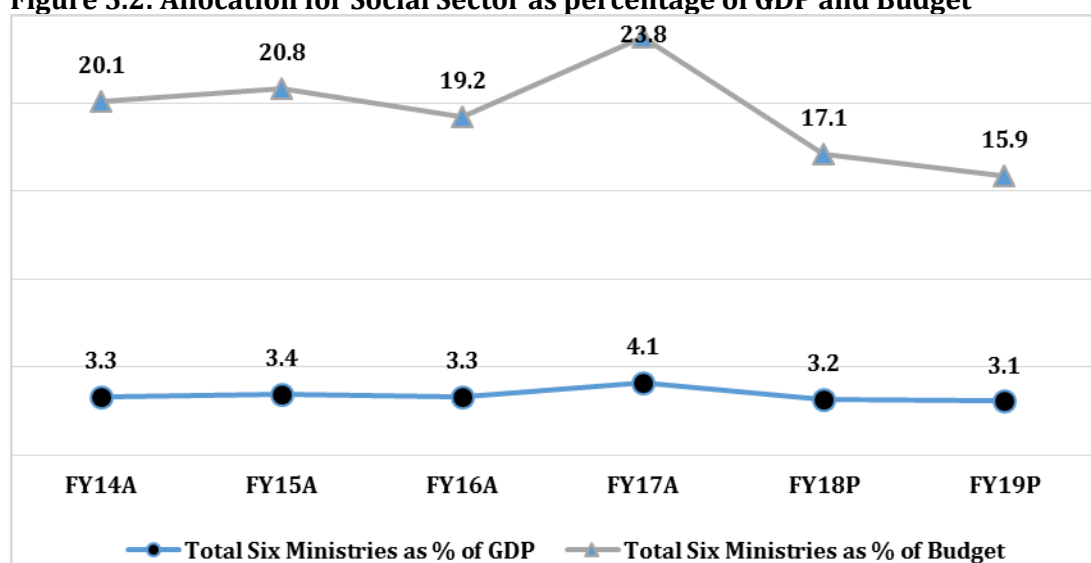
**Figure 5.1: Education, Health and SSNP as percentage of GDP and Total Budget**



Source: Calculated by authors from Monthly Fiscal Report (various issues), MoF; Budget documents (various years, statement 2) MoF; Gross Domestic Product (GDP), BBS (2015-16).

Note: For Education and Health sectors' figures upto FY2016 are actual expenditure, while for FY2017 the figure is for budget. For SSNP figures upto FY2016 are for revised budget and for FY2017 the figure is for budget.

**Figure 5.2: Allocation for Social Sector as percentage of GDP and Budget**



Source: Calculated from MTBF (various years), Ministry of Finance (MoF) and 7FYP, GED (2015).  
Note: 'A' stands for Budget allocation and 'P' stands for MTBF projection.

When compared against various national and international targets, expenditure on social sector in Bangladesh seems very low (Table 5.1). CPD has carried out estimation to understand how much resources will be required in FY2018 to achieve the targets of 7FYP by FY2020. This exercise shows that budget for the education sector should be at least 2.7 per cent of GDP in FY2018 to achieve the target of increasing the allocation for education to 3 per cent of GDP as set in 7FYP. Similarly, budget for the health sector should be equivalent to at least 1 per cent of GDP in FY2018 to achieve the target of reaching 1.2 per cent of GDP as set in 7FYP. It may be noted

that Bangladesh's out of pocket health expenditure is one of the highest in the world. Bangladesh occupied 6<sup>th</sup> highest position in terms of out-of-pocket expenditure in the world in 2014. This was also highest in the SAARC region. With a very high spending out of pocket expenditure and a low budget allocation, the country has a long way to achieve universal health coverage. In case of social safety net, allocation includes pension for government employees which occupies 0.86 per cent of GDP (total SSN 2.31 per cent of GDP in FY2017).

**Table 5.1: Target and Reality of Social Sector Expenditure**

Documents	Targets	Where are we	What is needed
<b>Education</b>			
7FYP, GED (2015)	Increase spending on education 3% of GDP (page 86, 7FYP)	Allocation on education was 2.5% of GDP in FY2017 while expenditure was 2.2% in FY2016. Allocation was 14.4% of total budget in FY2017, expenditure was 12.8% in FY2016.	Education and health budget should be increased in line with GDP and total budget considering the national and international standard.
Incheon Declaration, 2015 <sup>17</sup>	The Education 2030 Framework for Action set two benchmarks on domestic financing for education: <ul style="list-style-type: none"> <li>➤ 4 -6% of GDP</li> <li>➤ 15 -20% of public expenditure</li> </ul>		The estimated budget for the education sector should be at least 2.7% of GDP for the FY2018, to achieve 3% of GDP, as set in 7FYP.
<b>Health</b>			
7FYP, GED (2015)	Increase spending on health 1.2% of GDP (7FYP)	The allocation on health was 0.9% of GDP in FY2017 while the actual expenditure was 0.7% in FY2016.	Budget for the health sector should be at least 1% of GDP in FY2018, to achieve the target of 1.2% of GDP as set in 7FYP
WHO's observation	World Health Organization (WHO) sometimes observe country expenditure on a benchmark of 5% of GDP or GNI		
<b>Social Safety Net</b>			
7FYP, GED (2015)	Spending on social protection as a share of GDP to be increased to 2.3% of GDP (7FYP)	The allocation on SSN was 2.3% of GDP. But when government pension is excluded it amounts to only 1.4%, of GDP in FY2017.  The revised expenditure was 2.1% in FY2016 and 2.0% in FY2015	Budget for SSN should be excluded from government pension and allocation for SSN excluding government pension should be 2.3% of GDP.

Source: Incheon Declaration (2015); 7FYP, GED (2015); WHO (2003).

<sup>17</sup> UNESCO together with UNICEF, the World Bank, UNFPA, UNDP, UN Women and UNHCR organized 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>

### 5.3 Progress in health, education and social security

The largest programme on primary education titled 'Primary Education Development Programme (PEDPIII)' is going to end December 2017 while the programme on health titled 'Health, Population and Nutrition Sector Development Programme (HPNSDP)' was to be closed in June 2016. Given the large size of these programmes, a review of the outcome of these is necessary.

The third PEDP, successor of PEDPI (1997-2003) and PEDPII (2004-2011), covers grades I-V and one year of pre-primary education, originally had to be implemented during July 2011 – June 2016. This was later extended till December 2017. Key Performance Indicators (KPIs) of PEDPIII's each of six results areas, measure progress towards achieving those outcomes. An assessment of these indicators during the project period reveals not so encouraging outcome. Some key features are summarized below (details Annex 1, based on Ministry of Primary and Mass Education).

- Overall, Bangladesh has been performing well in enrolment and reducing differences between households and between genders in primary education. However, drop of school and out of school still continue to be high. Quality of primary education, is another major concern.
- 'Learning outcomes' measured as 'mean score in Bangla and Mathematics' for both grade III and grade V have declined in 2016 than that of 2011.
- In case of 'Universal Access and Participation' measured as 'number of children out of school (boys and girls) 6-10 years old (%)' has increased by 2.9 percentage point between 2010 and 2014. However, number of out of school children (boys and girls), aged from 11 to 14 years (%) has been reduced by 7.6 percentage point between 2010 and 2014.
- "Reducing Disparities" outcome is on track to achieve the target of 2017. But here the disparity should fully disappear. Composite performance indicator over the period 2011-2016 has been declined and is far away from 2017 target.

Health, Population and Nutrition Sector Development Programme (HPNSDP) 2011-16 has 40 priority indicators along with a number of targets to be achieved by 2016. The estimated fund for this programme was USD 6.6 billion<sup>18</sup> for 2011-16, of which GOB and development partners contributions were 78 per cent and 22 per cent respectively (MoHFW, 2016).

The Annual Programme Implementation Report (APIR) of the programme 2016 shows that only 11 targets out of 40 (27.5 per cent) have been achieved by 2014<sup>19</sup>. If it progresses at the same pace, other things remaining unchanged, it will take additional 5 years after June 2017 to implement the remaining 72.5% targets of the programme. It is appreciable that the fourth HPNSDP 2017-21 involving Tk 1.15 lakh crore received ECNEC's approval in March 2017.

The government has developed a National Social Security Strategy (NSSS) to be implemented gradually during the 7FYP starting from FY2015-16. NSSS revisits social security system by combining tax-funded SSNPs with contributory social insurance and employment regulations. This is a promising initiative which has broadened the scope of social security from the narrow safety net concept and included employment policies and social insurance. This mechanism would not work if the majority of the employed people is in the informal sector. However, initiatives to formulate the provident fund for informal labour is a laudable beginning towards achieving the objectives of broader social security. Implementation of this strategy will be a major

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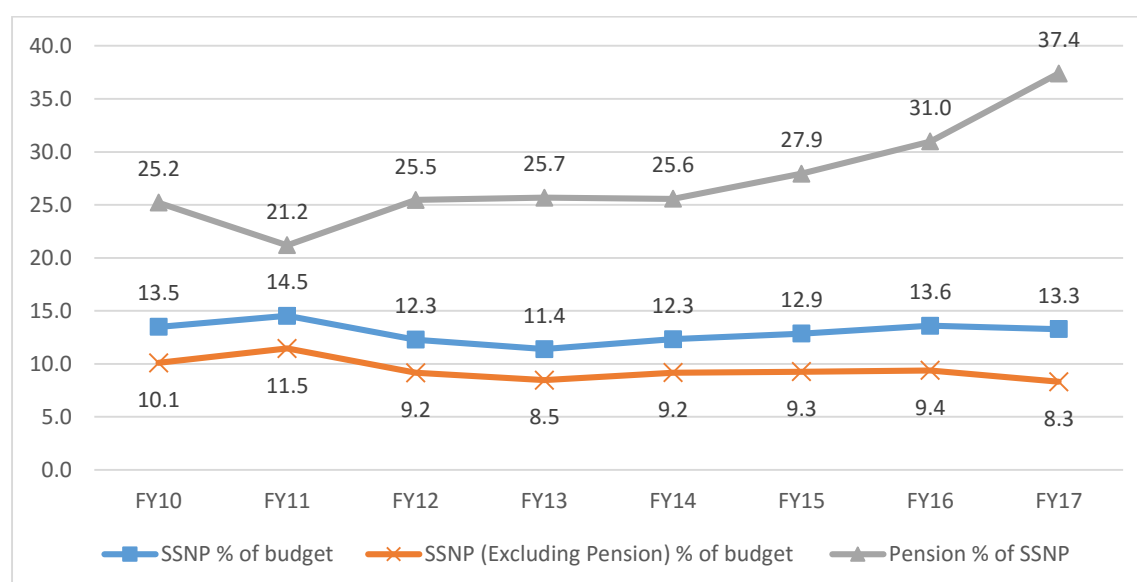
<sup>18</sup> Later extended to up to December 2016

<sup>19</sup> Data after 2014 are not available

task of the 7FYP. This comprehensive NSSS and the way programmes under NSSS are designed, directed and implemented will largely influence the success of achieving social inclusion. Implementation of NSSS will require adequate resources and policy coordination among various ministries and departments of the government. Challenges also remain for the time being because until the full implementation of the NSSS, the current amount of SSN allocation is not adequate to support the people who lag behind. Overall, the proposed financing source of broader social security seems rather vague.

Since the inception of the NSSS in FY2015-16, only the allocation for government pension has drastically increased (Figure 5.3). Pension is 31 per cent in revised budget of 2015-16 and 37.4 per cent in 2016-17 budget, while this was 27.9 per cent in 2014-15 before the inception of NSSS (Figure 5.4). On the other hand, other core life cycle programmes receive much lower allocation in SSN. Old age allowance received only 71.6 per cent of NSSS target in FY2016 and only 53.5 per cent of NSSS target in FY2017. Similar situation is observed in case of child school benefit and allowances for vulnerable women.

**Figure 5.3: Total SSNP Expenditure over the Time**



Source: Calculated by authors from Monthly Fiscal Report (various issues), MoF; Budget documents (various years, statement 2) MoF; Gross Domestic Product (GDP), BBS (2015-16).

Note: Except FY17, revised budgets for all other years are used for calculation.

## 5.4 Recommendations for the upcoming budget

In view of the above discussion on allocation and performance of social sector and social safety net programmes, a number of recommendations can be made for the upcoming budget for FY2018.

- Increase budget for education and health sectors substantially to reach at least the national expenditure targets during the 7FYP; make yearly resource requirement estimation for fulfilling the SDG targets.
- Budget for the education sector will have to be at least 2.67 per cent of GDP in FY2018 to achieve the target of increasing the allocation for education to 3 per cent of GDP as set in 7FYP. However, given such low ambition for the sector in 7FYP, the government should increase allocation to 3 per cent in FY2018 itself rather than by 2020.

- Health sector needs utmost priority as allocation has been measurably low. Improved public health facilities and reduction of out pocket expenditure will require substantive allocation. Budget for the health sector has to be equivalent to at least 1 per cent of GDP in FY2018 to achieve the target of reaching 1.2 per cent of GDP as set in 7FYP.
- Separate government pension for retired government employees and their families from SSN budget; allocate the full amount (i.e. 2.3% of GDP) for the SSN excluding pension for the poor during the 7FYP. Government pension should be part of the broader social security plan that will include people beyond government employees.

## SECTION VI. CONCLUDING REMARKS

The overarching macroeconomic objective of the national budget for FY2018 should be sustainable acceleration of economic growth momentum with enhanced employment opportunities. The apparent macroeconomic stability provides the government additional space to formulate an expansionary fiscal policy to serve this objective. Arguably, this macroeconomic stance will also test the delivery capacity of the government in view of the recent melancholic experience. In this context, the present document puts forward the following core recommendations on behalf of CPD for the forthcoming national budget.

*First*, it is observed that the planned size of the total budget (both expenditure and revenue mobilisation components) has increased over time – both in nominal terms as well as in relative terms (as a share of GDP). In contrast, actual implementation of the national budget as share of GDP did not improve over the last six years by discernible margin. For example, public expenditure remained stagnant at 13.5-14.0 per cent of GDP. It is high time to turn this so called ‘big budget’ myth into reality.

*Second*, the quality of budgetary framework has been weakening over time. A part of it may be explained by the weaknesses manifested in the budget accounting (i.e. target setting). Moreover, budget data from various sources needs to be harmonised to do away with the current divergences.<sup>20</sup> Besides, decisions of allocative priorities will also need to be guided by the assessment of implementation capacity of the concerned ministry or agency. Transparency is key for raising the quality of budgetary planning. It may be recalled in this connection that last year, CPD, in its proposal for the national budget FY2017, CPD urged for transparency in several budget-related areas including disclosure of financial accounts of state-owned enterprises, government’s asset acquisition, defence budget, local government financing, NGO financing and in South-South transactions. Indeed, better transparency in fiscal and budgetary processes should be one of the key areas of the government’s reform agenda.

*Third*, budget implementation capacity of a number of key government agencies will need to be enhanced - in both quantitative and qualitative terms. Indeed, IMED should rush to constitute a performance-based project evaluation system to provide figures on value for taxpayers’ money. It is observed that there are signs of improvement in the area of revenue mobilisation capacity, while such improvements are not visible in case of public expenditure, particularly in delivering ADP in a time-efficient and cost-effective manner. Further, the marginal improvement one observes in case of ADP expenditure is exclusively driven by the spending of local resources, a part of which has been financed by revenue surplus; while capacity to utilise foreign aid remains deficient as ever.

*Fourth*, it is apprehended that in FY2018, cost of production in almost all sectors may experience upward trend. This concern is pertinent to promotion of private investment. The rise in cost of production is expected to originate from implementation of new VAT and SD Act, possible depreciation of exchange rate, rise of rice price which is the major wage-goods and another round of upward adjustment of the tariffs for electricity and gas. Rational downward adjustment of

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<sup>20</sup> CPD (2017), the first reading of the state of the economy in FY2017, discussed this issue in details, analysing data on revenue collection by the NBR, ADP expenditure, and budget deficit and financing.

kerosene and diesel prices can provide some relief to the investors as well as the consumers by raising their disposal income, particularly those with lower level of income. It may be recalled that with declining remittance inflow and planned increase of indirect tax coverage, the consumers will also have lower disposable income. Besides, as has been proposed by this report, a reduction in income tax rate for the lowest level of threshold can also help raising disposable income for boosting domestic consumption. More importantly, the national budget for FY2018 will need to promote domestic-market-oriented industries. To this end, needed strategic protection to these sectors will be critical. Also, effective delivery of quality infrastructure to the manufacturing sector is of critical importance.

*Fifth*, it needs to be taken into cognisance that the rise in cost of production is expected to be accompanied by a decline in external earnings from exports and remittances. To this end, CPD recommends to depreciate BDT to provide exporters some relief. The government must also continue to provide cash subsidies to export of non-traditional products and for non-traditional markets.

*Sixth*, budgetary allocations for education and health sectors need to be coherent with the overall development needs of the economy. Targets of the 7FYP are very conservative compared to the requirement. Indeed, the recent rise in allocation is particularly attributed to the government salary scale adjustment. The government may opt for an early attainment of 7FYP allocation targets for education and health sectors (3.0 per cent and 1.2 per cent by 2020 respectively). However, such an effort is less restrained by fiscal constraint. Rather, developing a delivery mechanism (e.g. ADP projects) and ensuring an efficient implementation would be more challenging to this end. In this context, the forthcoming large projects for education and health sectors should be designed to achieve the aspired targets of 7FYP and SDGs. It is thus important to ensure how an incremental allocation can be used to service the development needs. The government also needs to make a sincere effort to implement the NSSS; financial resource constraint should not be an excuse.

Finally, the budget should come with a set of associated reform agenda which would require high policy attention. CPD in earlier sections has urged for two commissions – an Independent Financial Sector Reform Commission (IFSRC) and an Agriculture Price Commission. Along with these two, setting up an independent Public Expenditure Review Commission (PERC) with the mandate to provide medium term policy guidelines to the government and formulate a concrete set of strategies in order to improve the current level of efficiency in budget delivery, is also called for.



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## ANNEX

**Annex Table 5.1: PEDP III Priority Indicators with Benchmarks and Targets**

KPI Sl.	Indicators	2010 (baseline)	Status in 2011	Current status 2016	Year interval	Achievement	Target 2017	Comments/others
<b>Results Area 1: Learning Outcomes</b>								
1.	Grade III: mean score (boys and girls): in Bangla (%)		67	65 (2015) 74 (2013)	4	-2	75	Need attention
	Boys (%)		66	73 (2013)				
	Girls (%)		68	75 (2013)				
	Grade III: mean score (boys and girls): in Mathematics (%)		50	41 (2015) 58 (2013)	4	-9	60	Need attention
	Boys (%)		51	59 (2013)				
	Girls (%)		49	57 (2013)				
2.	Grade V: mean score (boys and girls): in Bangla (%)		25	23 (2015) 25 (2013)	4	-2	35	Need attention
	Boys (%)		25	24 (2013)				
	Girls (%)		26	25 (2013)				
	Grade V: mean score (boys and girls) : in Mathematics (%)		33	10 (2015) 25 (2013)	4	-23	40	Need attention
	Boys (%)		33	25 (2013)				
	Girls (%)		32	25 (2013)				
3.	Grade V terminal examination pass rate (boys and girls) (%)		97.3	98.52 (2015)	4	+1.22	95	Achieved
	Boys (%)		97.5	98.45 (2015)			95	Achieved
	Girls (%)		97.1	98.58 (2015)			95	Achieved
<b>Results Area 2.1: Universal Access and Participation</b>								
4.	Number of children out of school (boys and girls): 6-10 years old (%)	15		17.9 (2014)	4	-2.9		Need attention
	Boys (%)	17		18.9 (2014)		-1.9		
	Girls (%)	13		17.4 (2014)		-4.4		
	Number of children out of school (boys and girls): 11-14 years old (%)	22		14.4 (2014)	4	+7.6		Need progress
	Boys (%)	28		19.4 (2014)				Need progress
	Girls (%)	17		9 (2014)				Need progress
5.	Gross enrolment rate, primary education (boys and girls) [EFA 5] (%)	107.7	101.5	112.1	5	+10.6	105	Achieved
	Boys (%)	103.2	97.5	109.3	5	+12.8		Achieved
	Girls (%)	112.4	105.6	115	5	+6.6		Achieved
6.	Net enrolment rate, primary education (boys and girls) [EFA 6] (%)	94.8	94.9	97.96	5	+3.06	98	Achieved

KPI Sl.	Indicators	2010 (baseline)	Status in 2011	Current status 2016	Year interval	Achievement	Target 2017	Comments/others
	Boys (%)	92.2	92.7	97.11	5	+4.41	97	Achieved
	Girls (%)	97.6	97.3	98.83	5	+1.53	99	Achieved
<b>Results Area 2.2: Reducing Disparities</b>								
7.	[Participation] Gender parity index of gross enrolment rate	1.09	1.08	1.05			1.03	Need progress
8.	[Participation] Net enrolment rate –top 20% of households by consumption quintile (%)	88		88 (2014)	4	0	90	Inconclusive
	[Participation] Net enrolment rate – bottom 20% of households by consumption quintile (%)	77		80 (2014)	4	+3	82	Inconclusive
	Difference between Top20% and bottom20% of HHs by consumption/wealth quintile (%)	11		8 (2014)	4	+3	8	Achieved
9.	Upazila level composite performance indicator: Annual improvement of 20 percent lowest performing upazilas	1.26	1.31	1.17 (2015)	4	-0.14	1.56	Need attention
	Upazila level composite performance indicator: top 10% of upazila	2.36	2.23	2.00 (2015)	4	-.23	2.5	Need attention
	Upazila level composite performance indicator: bottom 10% of upazila	1.04	1.15	1.04 (2015)	5	-0.11	1.5	Need attention
	Range between average value of index for top 10% and bottom 10% of upazilas	1.2	1.10	0.96 (2015)			1	On track
<b>Results Area 3.1: Decentralization</b>								
10.	Percentage of AOP budget allocation for unconditional block grants (SLIPs and UPEPs) (%)	5.1	6.9	7.01 (2015)			10	
	% of AOP budget allocation for unconditional block grants (UPEPs for upazilas) (%)	0.1	6.9	0.005 (2015)			10	
	% of AOP budget allocation for unconditional block grants (SLIPs for Schools) (%)	5.2	0	7 (2015)			10	
11.	Expenditure of unconditional block	95	99.7	100 (2015)			95	

KPI Sl.	Indicators	2010 (baseline)	Status in 2011	Current status 2016	Year interval	Achievement	Target 2017	Comments/others
	grants (UPEPs and SLIPs) by Upazilas and schools (%)							
	Expenditure of unconditional block grants (UPEPs) by upazilas (%)	5	99.98	100 (2015)			95	
	Expenditure of unconditional block grants (SLIPs) by schools (%)	96		100 (2015)			95	
<b>Results Area 3.2: Effectiveness</b>								
12.	Completion rate, primary education (boys and girls) (%)	60.2	70.3	80.8	5	+10.5	85	Need attention
	Boys (%)	59.7	67.6	77.7			83	Need attention
	Girls (%)	60.7	73.0	83.9			87	Need attention
13.	Dropout rate by grade (%)	39.8	29.7	19.2	5	+10.5	15	Need attention
	Boys (%)	40.3	32.4	23.9 (2015)			17	Need attention
	Girls (%)	39.3	27.0	17 (2015)			13	Need attention
	Grade 1	8.5		0.7				
	Grade 2	3		2.9				
	Grade 3	7.7		4.2				
	Grade 4	12.2		9.8				
	Grade 5	9.5		1.5				
14.	Coefficient of efficiency [EFA 14]							
	Ideal as % of actual	62.2	69.1	80.1 (2015)	4	11.0		Need attention
	Boys		67.7	77.8 (2015)				
	Girls		70.5	82.3 (2015)				
	Number of input years per graduate	8	7.2	6.2 (2015) 6.1	5	+1.1		Need attention
	Boys		7.4	6.4 (2015)				
	Girls		7.1	6.1 (2015)				
15.	Percentage of schools that meet composite school-level quality indicators (%)	17	24	29.3 (2015)	4	+5.3	35	Need attention

Source: Annual Primary School Census 2016, Ministry of Primary and Mass Education (2016); and Bangladesh Primary Education Annual Sector Performance Report – 2016, Ministry of Primary and Mass Education (2016).

**Annex Table 5.2: Key Performance Indicators of HPNSDP 2011-16**

Indicator	Status in 2010 or 2011 or 2012	Update 2016 (based on 2014 data)	Change 2011-14	Target 2016	Gap= Target - 2014 data	Achieved	Proportion done each year	Required years
Infant mortality rate (IMR)	43	38	-5	31	7	No	-1.7	4.2
Under 5 mortality rate	53	46		48		Yes		
Neonatal mortality rate	32	28	-4	21	7	No	-1.33	5.25
Maternal mortality ratio per 100000 live births.	194	170	-24	<143	27	No	-8	3.38
Total fertility rate (TFR)	2.3	2.3	0	2	0.3	No	0	
Prevalence of stunting among children under 5	41.3%	36.1%	-5.2	38%		Yes		
Prevalence of underweight among children under 5 years	36.4%	32.6%	-3.8	33%	0.4	Yes		
Prevalence of HIV in MARP	<1% (0.7%)	0.7%,		<1%		Yes		
Percentage of delivery by skilled birth attendant	31.7%	42.1%	10.4	50%	7.9	No	3.5	2.3
Antenatal care coverage (at least 4 visits)	25.5%	31.2%	5.7	50%	18.8	No	1.9	9.9
Postnatal care within 48 hours (at least 1 visit)	27.1%	33.9%	6.8	50%	16.1	No	2.3	7.1
Contraceptive prevalence rate	61.2%	62.4%	1.2	72%	9.6	No	0.2	8
Unmet need for family planning	11.7%	12%	0.3	9.00%	3	No	0.1	*30.0
Measles Immunization Coverage by 12 months	87.5%	86.6%,	-0.9	90%	3.4	No	-0.3	*11.3
Percentage of children (0-59 months) with pneumonia receiving antibiotics	71.4%	34.2%	37.2	50%	15.8	No	12.4	*1.3
Percentage of children (6-59 months) receiving Vitamin A, last 6 months	59.5%	62.1%	2.6	90%	27.9	No	2.6	10
TB case detection rate	70.5%	53%	-17.5	75%	22	No	-5.8	*3.8
Proportion of births in health facilities by wealth quintiles	Q1:Q5 = 9.9:59.8	1:4.6		Q1:Q5 = <1:4	.6	No		
Use of modern contraceptives in low performing areas	Sylhet: 35.2% Chit: 44.5%	S: 40.9 Ch: 47.2	S: 5.7 Ch: 2.7	Sylhet & Chit: 50%	9.1 2.8	No.	1.9 0.9	4.8 3.1 0.9
No of Upazilas with women targeted by improved voucher scheme	53	53	0	70	17	No		

Indicator	Status in 2010 or 2011 or 2012	Update 2016 (based on 2014 data)	Change 2011-14	Target 2016	Gap= Target - 2014 data	Achieved	Proportion done each year	Required years
Rate of exclusive breastfeeding in infants up to 6 months	64%	55.3%	-8.7	50%		Yes		
No of children 6-23 months fed with appropriate Infant and Young Child Feeding (IYCF) practices	20.9%	22.8%	1.9	52%	27.2	No	0.6	42.9
No of Community Clinics (CC) with increasing number of service contacts over time	NA	13006		13,500	494	No		
Percentage of upgraded union-level facilities able to provide basic EmOC services	4.3%,	47.2%,	42.9	50%	2.8	No	14.3	0.2
Percentage of MOHFW budget allocated to Upazila level or below	47%, 2008/2009	47%, 2008/2009	0	60%	13	No	0	
Percentage of annual work plans with budgets submitted by LDs by defined time period	100%,	100%,		100% (achieved by 2013)		Yes		
MIS reports on service delivery published and disseminated annually	Published but not disseminated	Published and disseminated		100%		Yes		
Performance report of OPs reviewed with policy makers, MOHFW, Directorates and DPs, six monthly and annually	100%,	100%,		100% (achieved by 2013)		Yes		
Proportion of service provider positions functionally vacant at Upazila/District level and below, by category	Physicians: 46.1%, Nurses: 19.59%, FWV/SA CMO/MA: 21.2%,	Physicians: 37.8%, Nurses: 19.3%, FWV/SA CMO/MA: 9.0%,	-23.30 -4.59 -16.20	Physicians: 22.8% Nurses: 15% FWV/SA CMO/MA: 8.5%	Phy: 15 Nurses: 4.3 FWV: 0.5	No	-7.77 -1.53 -5.40	1.93 2.81 0.74
No. of additional providers trained in midwifery at Upazila health facilities	115	2025	1910	3,000	975	No	636.7	1.5
No. of comprehensive EmOC facilities with functional 24/7 services covering all districts	85	164	79	204	40	No	14.7	1.52
Case fatality rate among admitted children with pneumonia in Upazila health complex	8%, Year 2009	0.31%,		<1.0%		Yes		

Indicator	Status in 2010 or 2011 or 2012	Update 2016 (based on 2014 data)	Change 2011-14	Target 2016	Gap= Target - 2014 data	Achieved	Proportion done each year	Required years
Percentage of health facilities, by type, without stock-outs of essential medicines at a given point in time	74%,	78.7%,		75%		Yes		
Percentage of facilities without stock-outs of contraceptives at a given point in time	55.1%,	54.3%,	-0.8	70%	15.7	No	-0.3	*58.9
% of facilities (excluding CCs) having separate, improved toilets for female clients	44.5%,	47.6%,	3.1	75%	27.4	No	1.0	26.5
Regulatory framework for accreditation of health facilities including hospitals (both in the public and private sectors) reviewed and updated		Accreditation document finalised by HEU		Accreditation document with an Action Plan developed		Yes		
Number of non-pool DPs submitting quarterly expenditure reports	1 out of 15 (only USAID)	88% (14 out of 16 DPs)		100%	12	No		
Utilization rate of Reimbursable Project Aid (RPA) against RADP	85.0%,	66%	-19	100%	34	No	-6.3	5.4
% of Operational Plans (OPs) with spending > 80% of ADP allocation	N/A in	34%		100% (by 2013)	66	No		
% of serious audit objections settled within the last 12 months	7%, Year 2007/8	68%	61	>80%	12	No		0.6
<p><b>Average required years after 2014 to fulfill the targets= 7.11</b>  <b>Average required years after June 2017 to fulfill the targets: 7.11-2.5 =4.61 or it can be considered as 5 years</b>  <b>**N= 20</b>  * Average is made of excluding the indicators those showed inverse trend in between the years 2011-14.  ** No. of observations are 20 categories from 17 indicators</p>								

Source: MoHFW 2016 and 2012.