

Bangladesh Economy in FY2016-17

*Interim Review of
Macroeconomic Performance*

Prepared under CPD's programme on



June 2017

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Macroeconomic Performance*

Independent Review of
iRBD
Bangladesh's Development



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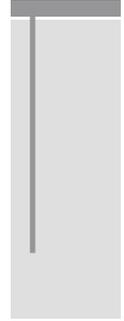
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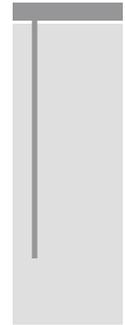
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The CPD IRBD 2017 Team alone remains responsible for the analyses, interpretations and conclusions presented in this publication.

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Acronyms

ADP	Annual Development Programme
AIT	Advance Income Tax
ANC	Antenatal Care
AOP	Annual Operational Plan
APIR	Annual Programme Implementation Report
ASYCUDA	Automated System for Customs Data
BBS	Bangladesh Bureau of Statistics
BC	Bills for Collection
BDT	Bangladeshi Taka
BIN	Business Identification Number
BO	Beneficiary Owner (Account)
BOP	Balance of Payments
BPC	Bangladesh Petroleum Corporation
BSE	Bombay Stock Exchange (India)
(B)SEC	(Bangladesh) Securities and Exchange Commission
BSTI	Bangladesh Standards and Testing Institution
CA	Chartered Accountant
CAMELS	Capital Adequacy; Assets; Management Capability; Earnings; Liquidity; Sensitivity
CAR	Capital Adequacy Ratio
CC	Community Clinic
CCB	Capital Conservation Buffer
CDBL	Central Depository Bangladesh Ltd.
CIT	Corporate Income Tax
CPD	Centre for Policy Dialogue
CPI	Consumer Price Index
CPR	Contraceptive Prevalence Rate
CRC	Credit Rating Company
CSE	Chittagong Stock Exchange
CSEX	CSE Broad Index
CSR	Corporate Social Responsibility
DAE	Department of Agricultural Extension
DFI	Development Financial Institution
DMD	Deputy Managing Director
DPP	Development Project Proposal
DSE	Dhaka Stock Exchange
DSEX	DSE Broad Index
ECNEC	Executive Committee of National Economic Council
ECR	Electronic Cash Register

EFA	Education for All
EMH	Efficient Market Hypothesis
EPB	Export Promotion Bureau
EPS	Earnings per Share
EU	European Union
EVP	Executive Vice President
EmOC	Emergency Obstetric Care
FCB	Foreign Commercial Bank
FDI	Foreign Direct Investment
FIAS	Facility for Investment Climate Advisory Services
FPMU	Food Planning and Monitoring Unit
FRA	Financial Reporting Act
FRC	Financial Reporting Council
FWV	Family Welfare Visitor
GBP	British Pound
GDP	Gross Domestic Product
GNI	Gross National Income
GoB	Government of Bangladesh
HEU	Health Economics Unit (MoHFW)
HIV	Human Immunodeficiency Virus
HPNSDP	Health, Population and Nutrition Sector Development Programme
HS	Harmonized Commodity Description and Coding System
IBBL	Islami Bank Bangladesh Limited
ICOR	Incremental Capital-Output Ratio
ICT	Information and Communication Technology
IDB	Islamic Development Bank
IDRA	Insurance Development Regulatory Authority
IFF	Illicit Financial Flow
IFSRC	Independent Financial Sector Reform Commission
IMED	Implementation Monitoring and Evaluation Division
IMF	International Monetary Fund
IMR	Infant Mortality Rate
INR	Indian Rupee
IPO	Initial Public Offering
IRBD	Independent Review of Bangladesh's Development
IVAS	Integrated VAT Administration System
KPI	Key Performance Indicator
LDC	Least Developed Country
LFS	Labour Force Survey
LGD	Local Government Division
LMIC	Lower Middle-Income Country
LSI	Large-scale Industry
LoC	Line of Credit
L/C	Letter of Credit
MARP	Most at Risk Population
MIS	Management Information System
MLT	Medium and Long-Term
MNC	Multinational Company
MPS	Monetary Policy Statement
MRA	Microcredit Regulatory Authority
MRP	Maximum Retail Price
MSI	Medium-scale Industry
MT	Metric Ton
MTBF	Medium-Term Budgetary Framework
MoF	Ministry of Finance

MoHFW	Ministry of Health and Family Welfare
MoPME	Ministry of Primary and Mass Education
MoU	Memorandum of Understanding
M2	Money Supply
NBFI	Non-Banking Financial Institution
NBR	National Board of Revenue
NER	Nominal Exchange Rate
NGO	Non-Government Organisation
NID	National Identity (Card)
NPA	Non-Performing Asset
NPL	Non-Performing Loan
NSD	National Savings Directorate
NSSS	National Social Security Strategy
OECD	Organisation for Economic Co-operation and Development
OMS	Open Market Sales
PCA	Post Clearance Audit
PCB	Private Commercial Bank
PD	Project Director
PEDP	Primary Education Development Programme
PERC	Public Expenditure Review Commission
PIT	Personal Income Tax
PNC	Postnatal Care
POL	Petroleum, Oil and Lubricants
POS	Point of Sale
PPF	Project Preparatory Fund
P/E	Price-Earning
QIP	Quantum Index of Production
RADP	Revised ADP
REER	Real Effective Exchange Rate
RIT	Returned Income Tax
RJSC	Registrar of Joint Stock Companies and Firms
RMG	Readymade Garments
ROA	Return on Assets
ROE	Return on Equity
RoO	Rules of Origin
R&D	Research and Development
SAARC	South Asian Association for Regional Cooperation
SACMO	Sub-Assistant Community Medical Officer
SB	Specialised Bank
SCB	State-Owned Commercial Bank
SD	Supplementary Duty
SDG	Sustainable Development Goal
SFYP	Sixth Five Year Plan
SIBL	Social Islami Bank Ltd.
SLIP	School Learning Improvement Plan
SME	Small and Medium Enterprise
SSCI	Small-scale and Cottage Industry
SSN	Social Safety Net
SSNP	Social Safety Net Programme
SoE	State-Owned Enterprise
TB	Tuberculosis
TDS	Tax Deducted at Source
TFR	Total Fertility Rate
TIN	Taxpayer Identification Number
TPC	Transfer Pricing Cell

TPO	Transfer Pricing Officer
ToR	Terms of Reference
ToT	Terms of Trade
UAE	United Arab Emirates
UMIC	Upper Middle-Income Country
UNDP	United Nations Development Programme
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Population Fund
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations Children's Fund
UPEP	Upazila Primary Education Plan
US	United States
USAID	United States Agency for International Development
USD	United States Dollar
USITC	United States International Trade Commission
U5MR	Under-5 Mortality Rate
VAT	Value Added Tax
WHO	World Health Organization
WTO	World Trade Organization
7FYP	Seventh Five Year Plan

Chapter 1

State of the Bangladesh Economy in FY2016-17 *(Third Reading)*

1.1 INTRODUCTION

This chapter is prepared as the third interim report of the State of the Bangladesh Economy in FY2016-17. It has been prepared under CPD's flagship programme titled *Independent Review of Bangladesh's Development (IRBD)*. The objective of this report is to track trends of major macroeconomic correlates and present an assessment of the performance of key sectors of the Bangladesh economy during FY2016-17 in the run-up to the national budget for FY2017-18. As part of its traditional exercise involving a review of the performance of the economy during a particular fiscal year and analysis of key emerging developments, CPD closely monitors the economy throughout a fiscal year. The IRBD exercise to be carried out in the ongoing fiscal year will also include an immediate assessment of the upcoming national budget for FY2017-18, to be released on 2 June 2017, the day after the national budget is set to be presented at the National Parliament.

This report has picked up three major issues of the economy from the perspective of investment and employment generation. These broad areas are: (i) growth and structural transformation; (ii) external sector with focus on exports and remittances; and (iii) sources of finance by looking into banking sector and capital market. These issues are discussed in four sections which are titled as follows:

1. Whither Macroeconomic Management
2. Emerging Global Scenario and Challenges for External Sector Management
3. Banking Sector: A Growing Malignancy in the Economy
4. Capital Market at Bay

The report concludes with depicting the outlook for the economy and highlighting a number of urgent measures to be pursued by policymakers in view of the emergent challenges. The report considers latest available data and information from domestic and international sources, as well as insights gleaned from key informants. It needs to be mentioned here that in preparation of this report, CPD confronted more than usual data constraint. Annex Table 1.1 depicts how availability of data within the reference time period has declined compared to the preceding fiscal year.

1.2 WHITHER MACROECONOMIC MANAGEMENT

CPD's earlier review of the state of the Bangladesh economy highlighted the prevailing macroeconomic stability attributed to restrained budget deficit, sliding inflation in the backdrop of low level of global commodity prices, declining interest rate and positive balance of payments (BOP). This emerging scenario provides a unique opportunity to the government to calibrate an expansionary fiscal policy in accordance with its developmental objectives that is geared to supporting private investment uptake and accelerating economic growth momentum. The review also cautioned that while an expansionary fiscal policy for FY2017-18 is called for, the government will need to address the structural weaknesses in budget implementation by undertaking the required reforms. In this context, the present section revisits the macroeconomic trends of the economy in the run-up to the forthcoming national budget for FY2017-18.

1.2.1 Strong Economic Growth Projected by BBS

As stated in the provisional estimate by the Bangladesh Bureau of Statistics (BBS), the growth rate of gross domestic product (GDP) is expected to reach 7.24 per cent in FY2016-17, which was 7.11 per cent in FY2015-16. This will be the third time in the country's history over the last two decades (since FY2006-07) that the GDP growth would cross the 7 per cent mark. At the same time, for FY2016-17, Bangladesh's per capita gross national income (GNI) has been projected to be about USD 1,602, which is USD 138 higher than the preceding year of FY2015-16. Even though GNI recorded a growth of 9 per cent in FY2016-17, it must be noted that the previous growth figure of GNI was 11.3 per cent. As regards per capita GDP, this too has been estimated to rise to USD 1,538 in FY2016-17 from the previous level of USD 1,385 in FY2015-16,

registering an increase of USD 153 (11 per cent growth). Lower growth of GNI compared to GDP is attributed to the falling inflow of remittances (resulting current account deficit) along with marginal depreciation of Bangladeshi Taka (BDT) against the United States Dollar (USD), both a departure from recent trends.

Of the estimated growth rate of 7.24 per cent for the current FY2016-17, from Table 1.1 it can be discerned that agriculture sector's contribution will be to the tune of 0.5 per cent (0.43 per cent in FY2015-16), contribution of industry sector about 3.18 per cent (3.24 in FY2015-16), and that of the services sector about 3.31 per cent (3.21 per cent in FY2015-16). As is observed, industry sector's contribution is underpinned by the manufacturing sector, despite lower growth of export earnings. Services sector's contribution is mainly enhanced by growth of public administration and defence, education, health and social works, and wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods. The abovementioned sectors account for 50.2 per cent of the estimated 3.31 per cent growth on account of the services sector. Indeed, if this year's elevated growth figure is considered, it can be observed that additional growth has been driven by services sector, while somewhat declined contribution of industry sector has been compensated by that of the agriculture sector.

Table 1.1**Contribution to GDP Growth in Last Seven Years***(in Per cent)*

Industrial Origin Sector	FY11	FY12	FY13	FY14	FY15	FY16	FY17 (P)
Agriculture	0.78	0.52	0.41	0.70	0.53	0.43	0.50
<i>Crops and horticulture</i>	<i>0.40</i>	<i>0.18</i>	<i>0.06</i>	<i>0.34</i>	<i>0.16</i>	<i>0.07</i>	<i>0.14</i>
Industry	2.31	2.47	2.59	2.27	2.74	3.24	3.18
<i>Manufacturing</i>	<i>1.64</i>	<i>1.69</i>	<i>1.80</i>	<i>1.60</i>	<i>1.93</i>	<i>2.26</i>	<i>2.21</i>
Services	3.25	3.43	2.88	2.92	3.00	3.21	3.31
<i>Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods</i>	<i>0.89</i>	<i>0.90</i>	<i>0.83</i>	<i>0.90</i>	<i>0.86</i>	<i>0.88</i>	<i>0.92</i>
<i>Public administration and defence</i>	<i>0.27</i>	<i>0.24</i>	<i>0.21</i>	<i>0.22</i>	<i>0.32</i>	<i>0.38</i>	<i>0.34</i>
<i>Education</i>	<i>0.12</i>	<i>0.16</i>	<i>0.13</i>	<i>0.16</i>	<i>0.17</i>	<i>0.26</i>	<i>0.26</i>
<i>Health and social works</i>	<i>0.12</i>	<i>0.07</i>	<i>0.09</i>	<i>0.09</i>	<i>0.09</i>	<i>0.13</i>	<i>0.13</i>
Tax less subsidy	0.12	0.10	0.13	0.16	0.28	0.24	0.25
GDP growth	6.46	6.52	6.01	6.06	6.55	7.11	7.24

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

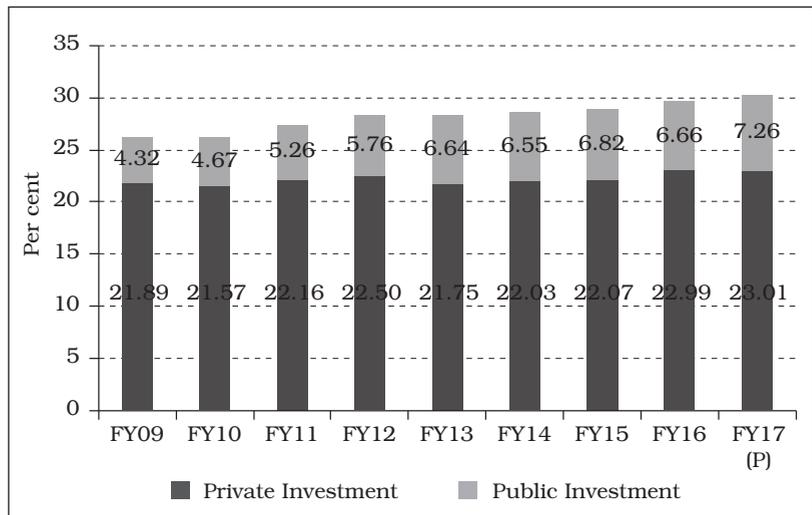
Note: Throughout the chapter, 'P' denotes provisional estimates.

As reported by the BBS, investment as per cent of GDP is expected to rise by 0.6 percentage points to 30.27 per cent in FY2016-17, thanks primarily to a spurt in the public investment levels (Figure 1.1). However, the investment-GDP ratio figure is still 0.63 percentage points lower than the Seventh Five Year Plan's (7FYP) projection of 30.9 per cent. According to the 7FYP, by the end of FY2019-20, investment-GDP ratio is expected to be 34.4 per cent. Private investment as per cent of GDP is projected to be only 0.02 percentage points higher in FY2016-17, though during the preceding year the recorded change was 0.92 percentage points. For public investment as per cent of GDP, the BBS projection expected a rise by 0.59 percentage points. It should be noted here that in FY2016-17, incremental capital-output ratio (ICOR) is also expected to be almost unchanged.

Domestic savings-GDP ratio is expected to rise by about 1.1 percentage points to 26.1 per cent in FY2016-17 (Figure 1.2). On the contrary, national savings-GDP ratio is projected to decline by 0.5 percentage

Figure 1.1

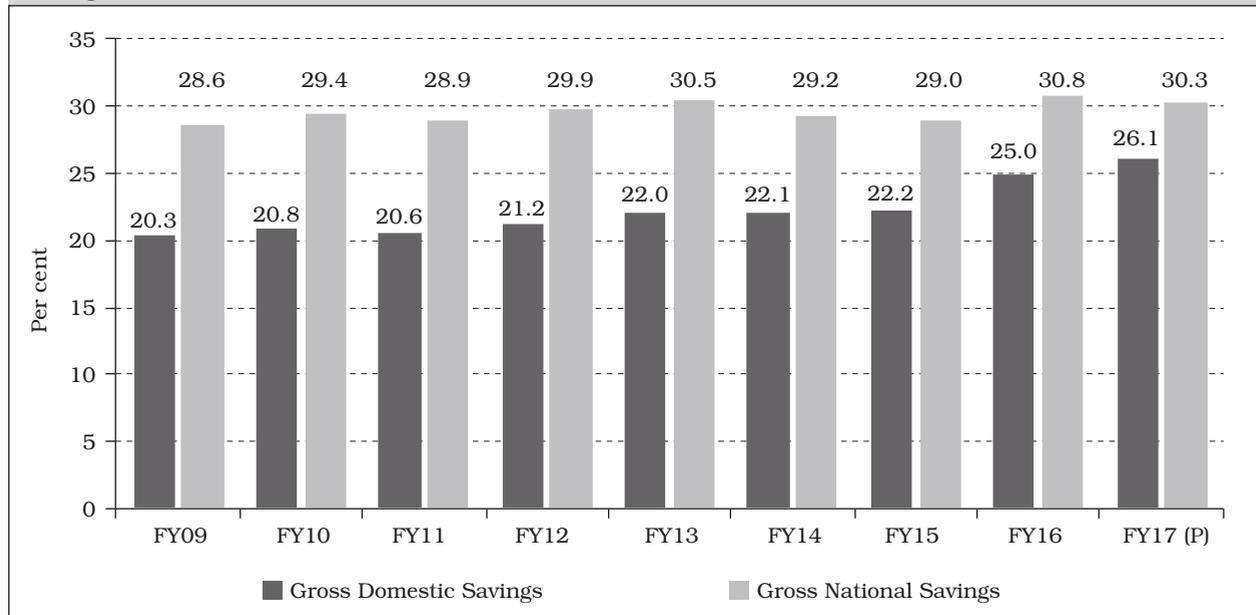
Investment Scenario: FY2008-09 to FY2016-17



Source: Bangladesh Bureau of Statistics (BBS).

Figure 1.2

Savings Scenario: FY2010-11 to FY2016-17



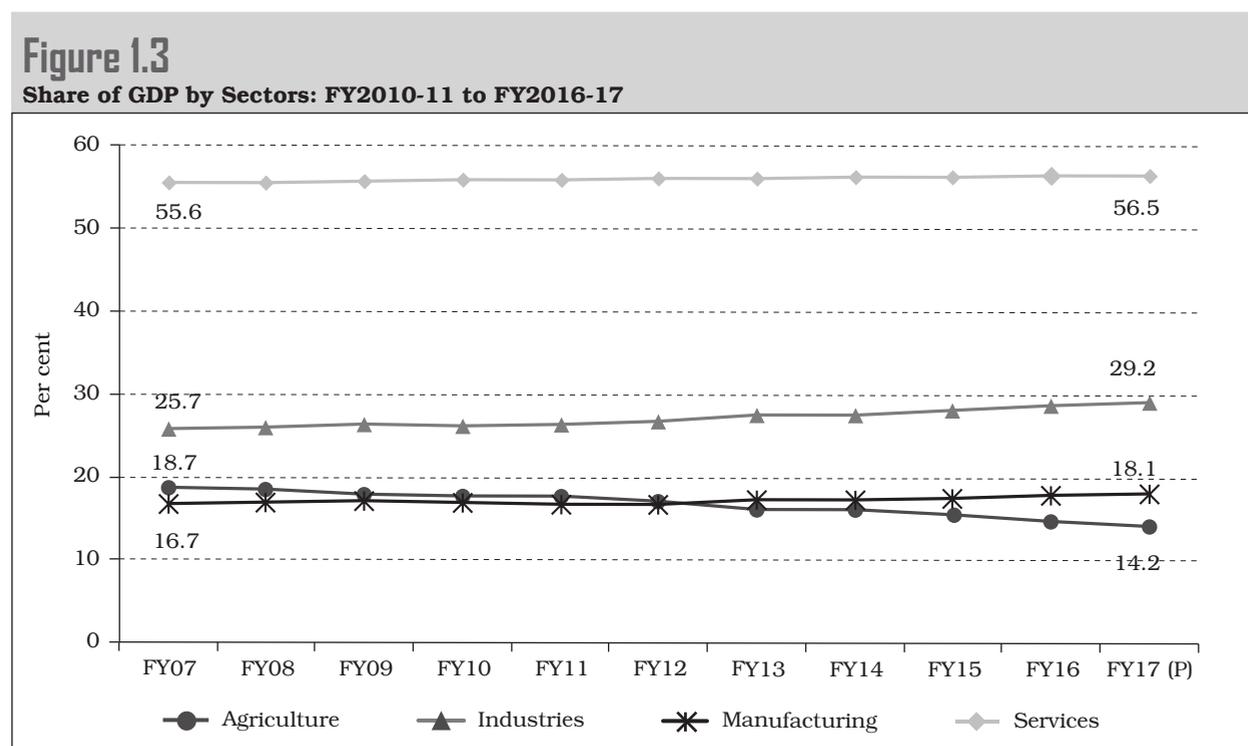
Source: Bangladesh Bureau of Statistics (BBS).

points to 30.3 per cent in FY2016-17 in the backdrop of the large current account deficit. Indeed, this may be the first time in the recent history of Bangladesh when national savings and total investment (as a share of GDP) have come this close.

It needs to be considered that the provisional estimate of GDP has been prepared with the limited available information and did not consider more recent trends in key macroeconomic correlates. For example, the provisional estimate of BBS has predicted a strong growth of agriculture sector (3.4 per cent in FY2016-17 which was 2.79 per cent in FY2015-16). This accelerated growth is predicted to be driven by strong performance of crops and horticulture sector, which, in all possibility, had not considered the loss of Boro output. Besides, the value addition of manufacturing sector has been estimated with first 5-6 months of data which could not capture the falling growth rate of export earnings in the latter months. Also, the estimates have been prepared with an assumption that the entire government budget earmarked

for FY2016-17 will be implemented. When the final figures of budget implementation will be available, the associated GDP figures may also need to be significantly revised. Nevertheless, even if the provisional figures are perhaps overestimated, the GDP growth outcome for FY2016-17 may still be recognised as quite respectable, particularly when compared to global developments.

As is known, in Bangladesh, significant emphasis is given to the discourse on GDP growth rate. However, it is critically important to examine both structure of the GDP growth and its distributional impact. Indeed, these two aspects are also interrelated. Structure of economic growth in an economy like Bangladesh can be assessed from the vantage points of structural transformation and employment generation. In case of Bangladesh, the gradual shift in the economy, from agriculture to industry and services, is clearly discernible (Figure 1.3). On a welcome note, between FY2006-07 and FY2016-17, share of agriculture sector in GDP declined by (-) 4.5 percentage points, while industry and services sectors gained 3.5 percentage points and 1 percentage point respectively. As employment figures are not available, it is difficult to assess employment generation impact of this particular pattern of economic growth structure. More importantly, from the perspective of broader development objectives, economic growth in Bangladesh must accompany decent job creation. It may be noted that the BBS took up an initiative to prepare quarterly Labour Force Survey (LFS) data, but release of this data has now been discontinued. It is expected that the quarterly data will be released soon for full fiscal year (FY2015-16). It may be observed that the GDP growth as projected for FY2016-17 is driven by strong growth in manufacturing output. However, it is reckoned that a significant part of this growth has been capital-intensive in nature. This trend is particularly becoming visible in the readymade garments (RMG) sector in view of the post-Rana Plaza tragedy reforms. Hence, the incremental benefit from this type of growth may accrue to the rich capitalist class rather than the poor working class.



Source: Bangladesh Bureau of Statistics (BBS).

1.2.2 Revenue Mobilisation by NBR is Strong, but Needs to Keep Momentum

Revenue mobilisation target for FY2016-17 was ambitious to start with, and CPD (2017) predicted a possible shortfall to the tune of Tk. 38,000 crore. Despite of the strong growth performance recorded by the National Board of Revenue (NBR), the revised budget was likely to reduce the revenue mobilisation target by about

Tk. 32,000 crore. Against the annual target, according to the NBR sources, the attained growth rate during July-February period of FY2016-17 was 19.6 per cent, which was 14.4 per cent in FY2015-16. Interestingly, income tax collection growth has almost doubled, from 9.7 per cent in July-February FY2015-16 to 18.1 per cent in FY2016-17. This is indeed a positive sign. All other components, apart from 'turnover tax' posted growth rates which were higher than the preceding years. Regrettably, revenue collection from non-NBR sources was rather disquieting according to the data available for first four months only.

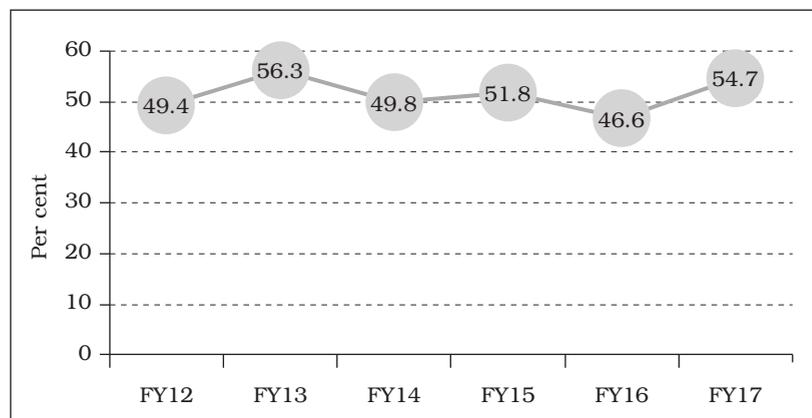
For FY2017-18, the revenue collection growth target may be fixed at about 34 per cent over the revised target. The annual growth target for FY2017-18 may rise further as the actual revenue mobilisation could fall short of the revised target for FY2016-17. In this connection, further efforts towards domestic resource mobilisation along with exploration of new avenues ought to be one of the key priorities that should inform the forthcoming budget for FY2017-18. It must be acknowledged that for the upcoming FY2017-18, Government of Bangladesh (GoB) will implement the much discussed VAT and SD Act 2012, perhaps with a uniform rate that would be lower than the previously set 15 per cent. However, as mentioned earlier in CPD (2017), in order to implement the abovementioned act in a realistic and staggered manner, an action agenda needs to be developed. Furthermore, to facilitate a higher revenue collection growth, CPD (2016) had proposed several reform measures which include changes to the current advance income tax (AIT) collection system through making tax deducted at source (TDS) online, introduction of the Benami Property Bill, and strengthening the Transfer Pricing Cell (TPC) to curb illicit financial flows. Moreover, the government should expedite preparation of a new Direct Tax Act and an amended Customs Act as these reforms are key to raising revenue mobilisation in a sustainable and realistic manner.

1.2.3 ADP Implementation Pace Recovered as Local Resource Utilisation Improved

According to the Implementation Monitoring and Evaluation Division (IMED) data, during July-April of FY2016-17, about 54.7 per cent of total Annual Development Programme (ADP) allocation has been spent. Over similar timeframe in the preceding year, implementation rate was recorded at 46.6 per cent. This is an improvement and also the second highest implementation rate, after FY2012-13 (Figure 1.4). It may be noted that ADP implementation has recovered from its earlier slump which was recorded in July-April of FY2015-16, and has now returned to the trend performance pace.

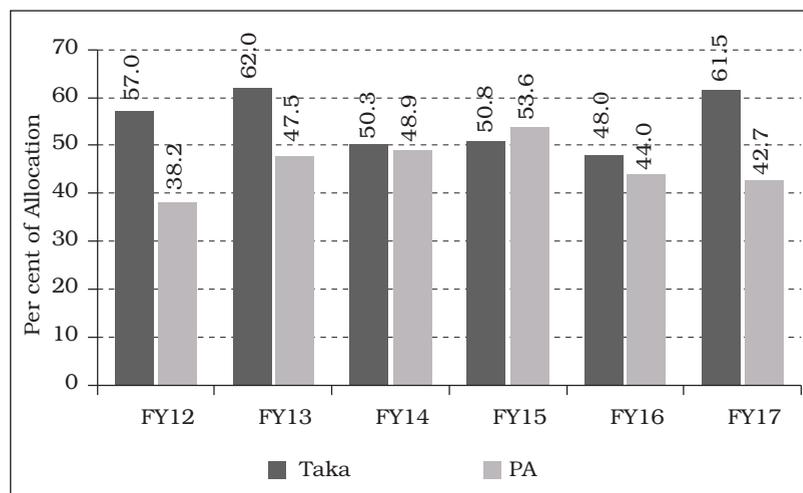
Indeed, this recovery is primary attributable to higher utilisation of local resources (Taka). In contrast, utilisation of foreign funding (42.7 per cent) is also the lowest in last five years (Figure 1.5). Besides, the pace of implementation for the fast track projects have remained mostly unsatisfactory due to majority of the projects being stalled for long period of time. Despite slow progress in ADP expenditure, the revised allocation for ADP has been kept unchanged in FY2016-17.

Figure 1.4
ADP Implementation (July-April)



Source: Author's calculation based on the Implementation Monitoring and Evaluation Division (IMED) data.

Figure 1.5
Taka and Project Aid
Implementation (July-April)



Source: Author's calculation based on the Implementation Monitoring and Evaluation Division (IMED) data.

Up to February 2017, implementation rates for the period of FY2016-17 for the Padma Multipurpose Bridge and Padma Bridge Rail Link were calculated to be 29.8 per cent (38.4 per cent as per the Revised ADP (RADP) FY2016-17) and 13.8 per cent (11.8 per cent as RADP FY2016-17) respectively against allocations for FY2016-17. Similarly, up to February, allocations for FY2016-17 for the Dhaka Mass Rapid Transit Development Project (Metro Rail) and Rampal Power Plant have been used to the tune of only 7.4 per cent and 2.4 per cent respectively, while as per cent of RADP these stood at 13.9 per cent and 1.2 per cent respectively. The Dohazari-Ramu-Cox's Bazar-Myanmar Railway was initially projected to start in 2010, but it appeared to have stalled for large part of this period. However, implementation rate in FY2016-17 has been 130.3 per cent of the approved ADP FY2016-17, whilst 79.8 per cent of the RADP FY2016-17. Matarbari Coal Plant's implementation rate was recorded at 11.6 per cent of ADP FY2016-17, whilst it was 52.8 per cent of RADP FY2016-17. Implementation of deep seaport projects at both Paira and Sonadia appear to have stalled, even though there had been allocations in FY2016-17. Slow progress of the mega projects is reflected in the low demand for funds. Slow implementation pace of these projects may translate into higher cost as is evident for a large number of development projects which were completed way behind their respective deadlines. This pattern of slow pace of implementation may result in uncertainty among private investors as regards timely delivery of the needed infrastructure contingent, upon which they would make investment decisions.

Top 10 ministries/divisions account for 72.9 per cent of the total ADP allocation for FY2016-17. Performance for implementation for particularly four ministries/divisions, viz. Power Division (83.9 per cent), Local Government Division (LGD) (71.7 per cent), Road Transport and Highways Division (71.6 per cent) and Energy and Mineral Resources Division (46.1 per cent) have been the highest in the last four years. In contrast, the rest of the six ministries achieved an implementation rate lower than preceding years (Table 1.2). Government has been active in trying to improve the power situation in the country which is reflected

Table 1.2
Implementation of Top 10 Ministries (July-April)

<i>(in Per cent)</i>				
Ministry/Division	FY14	FY15	FY16	FY17
LGD (incl. block allocation)	66.3	66.6	61.3	71.7
Power Division	47.3	51.6	57.7	83.9
Bridges Division	7.5	39.7	28.3	26.8

(Table 1.2 contd.)

(Table 1.2 contd.)

Ministry/Division	FY14	FY15	FY16	FY17
Road Transport and Highways Division	55.0	56.6	58.3	71.6
M/o Railway	56.5	49.6	36.6	39.0
M/o Health and Family Welfare	53.9	42.8	37.7	36.8
M/o Primary and Mass Education	61.5	51.0	56.7	44.7
M/o Education	50.3	52.4	49.5	46.5
M/o Water Resources	51.9	31.5	41.4	40.9
Energy and Mineral Resources Division	20.4	39.9	36.1	46.1
Top 10 Ministries/Divisions	48.2	51.5	50.1	56.0
Grand Total	49.8	51.8	46.6	54.7

Source: Author's calculation based on the Implementation Monitoring and Evaluation Division (IMED) data.

in the implementation rate recorded by the division. In the proposed ADP for FY2017-18, LGD will receive the highest allocation of Tk. 21,465 crore, followed by Power Division with an allocation of Tk. 18,845 crore, and the Road Transport and Highway Division will receive Tk. 16,820 crore. Indeed, 90 new projects have been added to the ADP, but the completion of the remaining existing projects must be accounted for as well.

1.2.4 Utilisation of Indian LoCs: Lessons from the Past Experience

In 2010, India extended a line of credit (LoC) for the first time worth USD 1 billion to Bangladesh with a view to strengthening economic cooperation between the two countries. Later, a number of welcome adjustments were made with respect to the original amount of loan commitment, including USD 200 million being converted into grants and increase of the rest credit amount to USD 862 million from USD 800 million in 2015. In addition, annual interest rate was also fixed at 1 per cent which was lower than the originally proposed 1.75 per cent, with a 20-year repayment term, including a 5-year moratorium. However, concerns remained as regards conditionalities in the form of tied part of the loan. It is often argued that under the first Indian LoC, 75 per cent loan amount was tied in nature. In addition, concern lies as regards implementation of the projects under the first Indian LoC. According to official sources, till May 2017, out of 15 projects only eight have been completed and seven are still ongoing. With regard to the disbursement, only 52.2 per cent of LoC amount was disbursed including USD 200 million grant, which was utilised for the Padma Bridge project. Excluding the grant amount, this accounts for only 41.1 per cent of the revised loan commitment. Meanwhile, India has extended two more LoCs to Bangladesh to the tune of USD 2 billion in 2016 and USD 4.5 billion in 2017. Although it is encouraging that India was forthcoming with additional LoCs despite slow progress of the projects under the first LoC, it is perhaps pertinent to understand the implementation challenges for improved utilisation of the second and third Indian LoCs.

Among the 15 projects approved under the first Indian LoC, 13 were directly linked to the development of Bangladesh Railway. Besides, two projects were undertaken to modernise and strengthen Bangladesh Standards and Testing Institution (BSTI) and procurement of dredgers, ancillary crafts and accessories for Mongla Port. It may be noted that the first LoC was used predominantly to improve domestic connectivity and standard of Bangladesh Railways bearing in mind the possible multi-modal regional connectivity. Of these, nine projects were related to procurement only, and three projects each were for construction and modernisation or institutional strengthening. It is important to note that, as of now, all the eight projects being completed under the first Indian LoC were procurement projects. Among the other seven ongoing projects, only three have utilised more than 50 per cent of estimated project cost, while two are at the inception level. As informed by official sources, major impediments afflicting project implementation include problems associated with land acquisition, review and approval of Development Project Proposal (DPP), lack of conformity among and between different agencies, and limited competitive bidding process for procurement. For example, because of land acquisition-related challenges, the USD 308.9 million worth construction of the Khulna-Mongla Port rail line project waited for about 42 months from the date of

awarding of the contract. It is also important to realise that time overrun has pushed up the overall cost of the project. Hence, the additional cost will need to be financed by GoB's own resources.

Under the second Indian LoC, 14 projects were identified, of which 11 has received approval from the EXIM Bank. Among the identified projects, four are under roads and highways, three under railways, two projects each under education sector and information technology, and one each under power sector, inland shipping port development and establishment of economic zones. Unlike the first LoC, only three projects are directly related to procurement, while six projects are directly related to construction of roads, railway lines and buildings. Besides, rest of the five projects are linked to establishment of economic zones, establishment of power transmission channels, and modernisation and upgradation of existing institutions and infrastructures. No change has been made regarding interest rate and repayment period. However, for the civil construction works, conditional (or tied) portion of procurement was brought down to 65 per cent (from 75 per cent) in the agreement. The provision for further reduction of procurement under conditional (or tied) arrangement remained open in cases of unavailability of supplies from the Indian counterpart.

Nevertheless, implementing the projects under the second and third LoCs will be even more challenging as they include a significantly higher number of construction projects (eight out of 11 and 15 out of 17 respectively) compared to the first LoC. It is also important to recognise that there is a shift in project identification and approval process under the second and third LoCs when compared to the first Indian LoC. A large number of construction projects are linked to infrastructure development in view of Bangladesh-India bilateral multimodal transport connectivity. Upon completion, these will also contribute to India's transit facility through Bangladesh. As Bangladesh aims to implement these projects in a timely manner, the government will need to seek scope for negotiating a reduced part of sourcing requirement and a more competitive bidding process for procurements. It is also important to improve coordination among different agencies involved in the implementation process in order to reduce the time and cost overrun. It is also time for Bangladesh to initiate required complementary/matching projects that are needed to reap the benefits of ongoing large-scale projects being implemented under the Indian LoCs.

1.2.5 Need for Adjusting Interest Rate of NSD Certificates Acknowledged

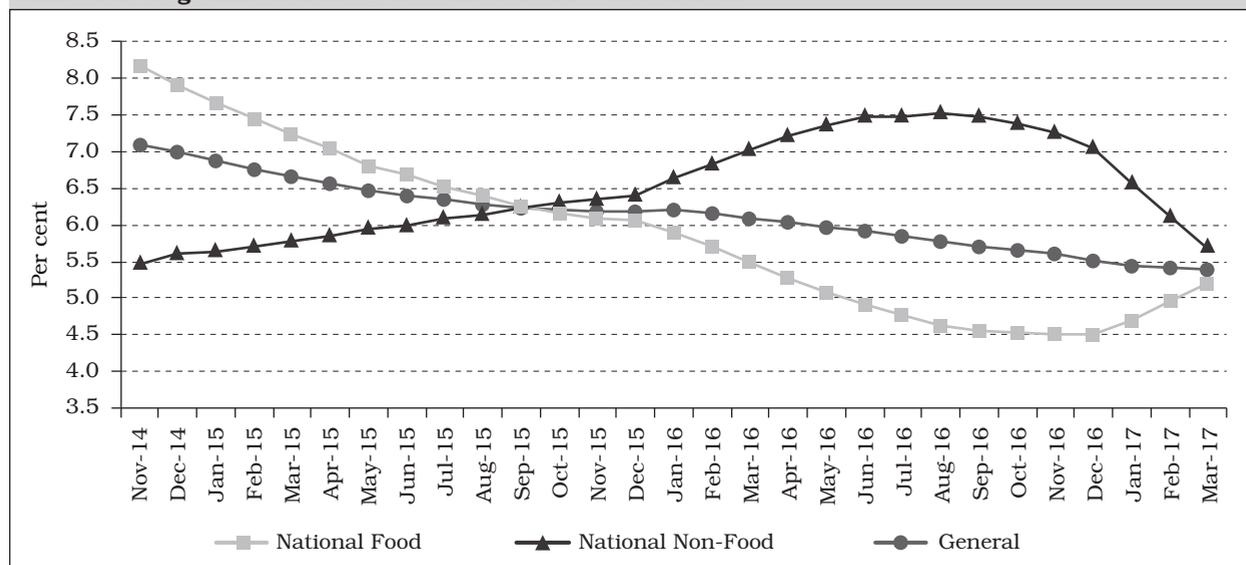
Overreliance on National Savings Directorate (NSD) sales for deficit financing continued all through the year. Net sales of NSD certificates stood at Tk. 33,283 crore during July-February of FY2016-17 which is 67.3 per cent higher than that of the corresponding period of FY2015-16. Besides, sales during the first eight months was already an astounding 69.7 per cent higher than the annual target of Tk. 19,610 crore. As NSD instruments entail payment of higher interest rates, and hence, higher debt servicing liability, CPD (2017) recommended a downward revision of the NSD rates, as also as regards the maximum ceiling on purchase, in view of the fall in the deposit interest rates in commercial banks, and also considering the medium- to long-term implications of accumulating debt servicing liabilities of the government. It is encouraging to find that the government has also acknowledged the need.

1.2.6 Rising Rice Price Fuelling Inflation

The Consumer Price Index (CPI) inflation in Bangladesh has witnessed a declining trend in FY2016-17 (Figure 1.6). The general (annual average) inflation rate was 5.39 per cent in March 2017 which is within the Bangladesh Bank's Monetary Policy Statement (MPS) target of 5.3-5.6 per cent. This decreasing inflation rate is primarily due to the contribution of a declining trend in non-food inflation. All components of non-food inflation have experienced a slowdown, except for the 'national recreation, entertainment, education and cultural services', which has been on the rise. Contrary to the abovementioned situation, food inflation has been on an increasing trend since January 2017, and was 5.2 per cent in March 2017, up by 0.3 per cent over the previous month. One could identify a gradual convergence between food and non-food

Figure 1.6

Annual Average Inflation Rate: November 2014 – March 2017



Source: Bangladesh Bureau of Statistics (BBS).

inflation. Indeed, there is no scope to be complacent with the current inflationary trends and it is important to put under scrutiny the rising trend in food inflation.

Rising price of rice is driving the food inflation at present. It may be noted that, rice accounts for a lion's share in the commodity basket of the CPI. Currently coarse rice is being traded at Tk. 45-46 per kg (in May 2017), which is about 42.2 per cent higher than the price of a year ago which was Tk. 30-38 per kg (in May 2016). Prices of other varieties of rice are also about 15-18 per cent higher. This shows that with the current structure of rising food inflation, it is the poorer consumers who are most affected since (coarse) rice is the single most important commodity in their consumption basket.

In FY2016-17, the target of Boro rice production was about 19 million metric tonnes (MT). Possibility of meeting this target is rather unlikely as production has suffered from early flash-floods in the *haor* wetlands and 'blast' pest attacks on paddy crops. Fifty-seven unions of nine districts (Sunamganj, Sylhet, Moulvibazar, Habiganj, Brahmanbaria, Kishoreganj, Netrokona, Comilla and Natore) have suffered from early flash-floods. According to the Department of Agricultural Extension (DAE), about 433 thousand hectares of Boro fields were submerged in the latest flash-floods in these nine districts. In the aforementioned nine districts, three-year average (FY2013-14 to FY2015-16) cultivated land under Boro crop was about 1,086 thousand hectares. It is revealed that about 40 per cent of total cultivated land under Boro crop suffered in these areas. Besides, in these nine districts, three-year average yield rate was 3.8 MT per hectare which was marginally lower than the national average yield rate of 4 MT per hectare. Assuming no change in the yield rate in FY2016-17, it is estimated that due to early flash-flood in *haor* wetlands, there may be a loss to the tune of 1.6 million MT Boro rice production, i.e. about 8.5 per cent of national Boro rice production. According to a media report, the corresponding official figure was 1.2 million MT. However, anecdotal information and estimates using unofficial sources suggest that the loss of Boro rice production may be double in FY2016-17 than what had been estimated earlier.

The loss of Boro rice production may further accentuate as 'blast' pest attack has been found in 2,500 to 3,000 hectares of land in 34 districts including the highly productive regions such as Rangpur, Bogra, Rajshahi, Naogaon, Joypurhat, Kushtia and Jessore. Assuming four MT per hectare yield rate and 50 per

cent of rice production loss per hectare due to 'blast' pest attack, it is estimated that an additional 6,000 MT loss in Boro rice production.

The rising rice price in recent months in the backdrop of the declining public stock appears to be the major cause that is pushing food inflation upward (CPD, 2017). The public foodgrains stock was estimated to be 561.5 thousand MT, of which only 245.6 thousand MT was rice during the month of May (FPMU, 2017). It may be mentioned in this connection that, Aman procurement fell short of the target by 56 thousand MT. Boro procurement started from the beginning of May 2017 and is expected to continue till the end of August 2017. The targets for procurement of paddy, parboiled rice and white rice have been set at 700 thousand MT, 700 thousand MT and 100 thousand MT respectively. Prices have also been set at Tk. 24 per kg for paddy, Tk. 34 per kg for parboiled rice, and Tk. 33 per kg for white rice to be procured from the domestic markets.

Success of the procurement process remains uncertain due to higher prices existing in the domestic market. Government should be aware of the emergent scenario and be ready to import rice. Removal of the existing 25 per cent tariff on rice imports also needs to be considered. While rural farmers may have surplus rice for consumption at this moment, rice distribution programmes, in the forms of open market sales (OMS) and others, for the urban poor and flood-affected people, need to be initiated without delay.

1.3 EMERGING GLOBAL SCENARIO AND CHALLENGES FOR EXTERNAL SECTOR MANAGEMENT

1.3.1 External Sector Management: Crack in the Wall

Traditionally, Bangladesh's external sector has served as a bedrock of the economy. With robust export growth, high inflow of remittance, comfortable current account balance, and the consequent rising reserves and stable exchange rate, Bangladesh's external sector has been a star performer. However, in a departure from the recent past years, in the course of the ongoing FY2016-17, the Bangladesh economy has come under some pressure in terms of the external sector dynamics and performance. The signals stemming from the sector are rather mixed.

Export growth has underperformed in view of the targets set for the major contributing sectors. Thus, with the fall in export growth and some rise in growth of imports, current account experienced significant pressure. Current account balance has shown negative sign for the first time over the last five fiscal years and stood at USD (-) 1.38 billion at the end of March 2017 as against USD 3.36 billion in March 2016. Besides muted export performance and rise in import payments, the negative sign is also attributed to the significant fall in remittance. Remittance earning growth has been in the negative terrain for the first 10 months of this fiscal year. BDT's exchange rate against USD has witnessed some volatility in recent times with sharp depreciation in the secondary market, which called for central bank intervention.

Import payments recorded period-on-period growth of 11.1 per cent in the first nine months of FY2016-17. Foreign exchange reserves stood at a robust USD 32.2 billion, although, its fast rise appears to have been halted. Overall BOP stood at a positive USD 2.6 billion at the end of July-March FY2016-17, which, however, was lower than that of the previous fiscal.

The good sign is that the overall global economic outlook appears to be positive as per the World Bank and International Monetary Fund (IMF)¹ reports – growth in the advanced economies (Bangladesh's major markets) is set to gain some momentum in 2017 and 2018. However, projections of major retailers are not encouraging and a large part of the growth will come from high-tech sectors. On the other hand, the projections are that petroleum prices will continue to remain low, with only some rise expected. According

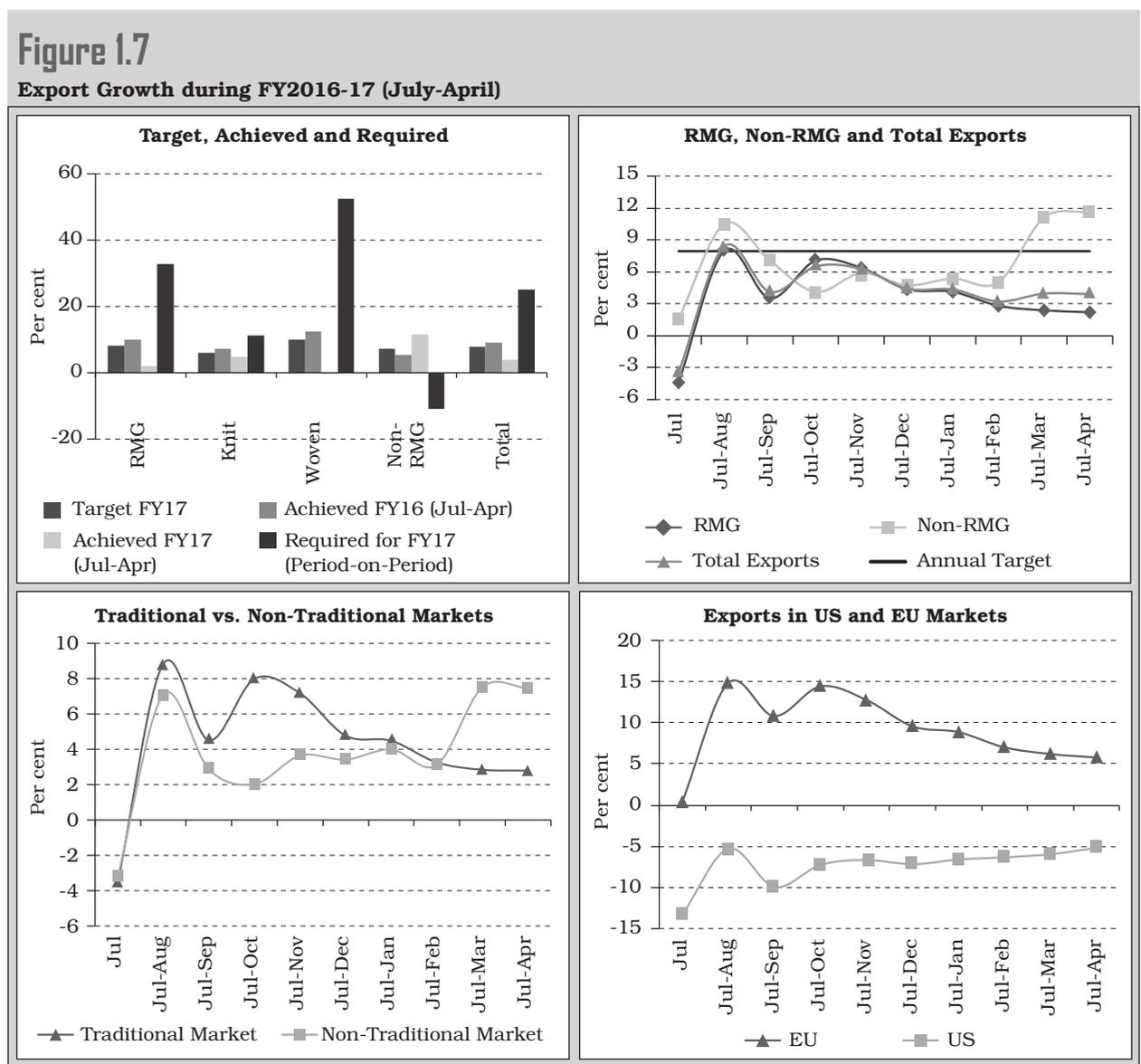
¹World growth is expected to rise from 3.1 per cent in 2016 to 3.5 per cent in 2017, and 3.6 per cent in 2018.

to the projections made by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), the price growth of Bangladesh's exportables was likely to decline in 2017 to 3.8 per cent from 4.2 per cent in 2016; if export is to grow this will need to be through growth in export volumes.²

While there is a debate as regards flow of remittance (formal and informal flow), the fact remains that, overall, external sector of the country is transmitting mixed signals and policymakers should take due notice of this.

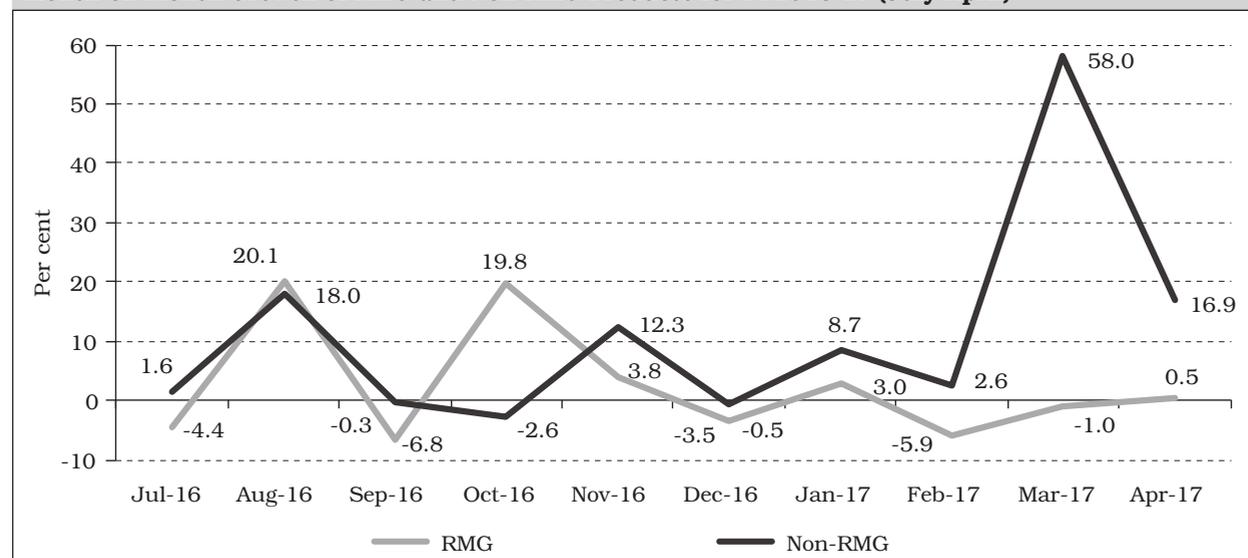
1.3.2 Export Sector Performance

Export earnings during the first 10 months of FY2016-17 (July-April) have shown considerable volatility on a month-on-month basis. Export growth has been half of what was targeted. The growth in the first ten months was (-) 3.9 per cent as against annual target of 8 per cent set out for FY2016-17 (Figure 1.7). Exports have experienced a general declining growth in the second and third quarters.



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

²<http://www.unescap.org/sites/default/files/aptir-2016-ch1.pdf>

Figure 1.8**Month-on-Month Growth of RMG and Non-RMG Products for FY2016-17 (July-April)**

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

The weak trend was mainly attributable to the fall in the RMG³ export earnings. On the other hand, the slight recovery noted in the March-April period has been for the rise in non-RMG export earnings. Since RMG exports are the major contributor of the total export earning of Bangladesh (80.6 per cent for July-April FY2016-17⁴), the 11.7 per cent period-on-period growth for July-April FY2016-17 for the non-RMG export earning was unable to raise total export growth significantly (Figure 1.7). Non-RMG export growth (month-on-month) has been higher than RMG exports growth for the last two quarters of the current fiscal year, starting from October 2016 (Figure 1.8). The performance in non-RMG exports has been higher than what was targeted, achieved growth for July-April FY2016-17 was 11.7 per cent as against targeted growth of 7.4 per cent (Figure 1.7).

It is observed that achieved growth has fallen short of target for RMG (2.2 per cent in the face of a target growth of 8.1 per cent). This was also evident at a more disaggregated level, for both knit and woven RMG. Intra-RMG growth composition shows that woven export earnings have incurred negative growth in July-April FY2016-17 period when compared with earnings of July-April FY2015-16, when this was 12.7 per cent (Figure 1.7). Relative performance in traditional markets (2.8 per cent growth) and non-traditional markets (7.5 per cent growth) is to be noted. While encouraging, the muted performance in Bangladesh's traditional markets is rather disquieting (Figure 1.7).

Exports to the United States (US) market has remained in the negative terrain and recorded a growth of (-) 5.2 per cent for the period of July-April FY2015-16 (Figure 1.7). In the month of April, export growth to US was 2.5 per cent, positive performance after two successive quarters. During the July-April period, RMG and non-RMG exports to US recorded growth of (-) 6.8 per cent⁵ and 9.9 per cent respectively. Export earnings from the European Union (EU) market has also been falling for the last two quarters (since October 2016). Export to EU recorded a growth of 5.8 per cent in July-April FY2016-17 (over July-April FY2015-16). This growth was influenced by the 5.9 per cent growth in RMG export earnings (6.9 per cent

³From here on, figures for RMG exports or imports constitute of the total figure of knit (HS 61) and woven (HS 62).

⁴Non-RMG exports have contributed 19.4 per cent of export earnings of Bangladesh for July-April FY2016-17.

⁵Both knit and woven apparels recorded negative growth of (-) 7.1 and (-) 6.7 per cent for the period of July-April FY2016-17 relative to same period in previous fiscal year.

growth in knit and 4.6 per cent growth in woven export earnings). Growth in non-RMG exports earnings was 4.6 per cent. It emerges from further analysis that the fall in growth of exports to the EU market was mainly price-driven. Relative appreciation of BDT against Euro and depreciation of Euro against USD is likely to have contributed to this.⁶

Performance as regards RMG imports (in terms of import value) by the US and the EU (Table 1.3) shows that in the US market RMG imports have fallen secularly in recent years. In 2016, annual growth was (-) 5.3 per cent in the US market. However, it is to be noted that imports from Bangladesh has fallen to a lesser extent of (-) 1.7 per cent. Vietnam is the only country from which US imports of RMG has increased in 2016 (growth rate 2.5 per cent). Vietnam's export performance in the US market has been consistently better than Bangladesh as also in comparison to other countries through all the observed years (Table 1.3). Growth of RMG imports by the EU has fallen drastically from 10 per cent in 2015 to 0.1 per cent in 2016, with China and Vietnam being the hardest hit. Bangladesh performed better than the world average with growth of imports from Bangladesh being 8.2 per cent. However, Cambodia has been the frontrunner in the EU market with growth of 14 per cent in 2016. As may be recalled, in the EU market, export performance of Bangladesh received a boost in 2012 due to the relaxation of rules of origin (RoO) requirement from two-stage to single-stage processing. Whilst the initial boost this has given Bangladesh has gradually tapered off, she appears to be benefitting from the comparative advantage originating from the favourable RoO for woven RMG items. It appears that it is Vietnam in the US market and Cambodia in the EU market which have been able to take best advantage of the emergent situation.

Table 1.3**Annual Growth of RMG Imports of the US and the EU***(in Per cent)*

Source	US Market				EU Market			
	2012	2014	2015	2016	2012	2014	2015	2016
World	7.4	6.4	3.4	-5.3	5.8	8.6	10.0	0.1
Bangladesh	12.9	8.8	10.4	-1.7	43.3	24.3	23.6	8.2
Cambodia	13.9	-0.8	-1.1	-13.1	109.5	53.0	31.5	14.0
China	3.1	2.6	1.4	-8.6	-4.0	1.4	5.5	-7.6
Vietnam	21.7	31.0	13.3	2.5	29.4	25.7	25.6	6.7

Source: Computed from the United States International Trade Commission (USITC) and EuroStat data.

Further in-depth analysis reveals that price dynamics are in play behind the falling growth of import values in the US and the EU markets. Table 1.4 shows the price dynamics of RMG products in the US and the EU markets imported from Bangladesh and its competitors.

Table 1.4 shows that, in US, average price of the major export item, woven apparels, has experienced increase in the 2010-2014 period, and then has experienced a secular decline. Similarly, in the EU, the trend has been the same for the dominant knitwear item. Volume-driven nature of export earnings performance (as against a price-driven one) becomes apparent from the above.

⁶Euro has been highly volatile against USD over the past 10 months in FY2016-17 due to several reasons including Brexit, French elections, etc.; Euro was down to its minimum exchange rate of (EUR/USD) at 1.04 on 20 December 2016.

Table 1.4**Country-wise and Year-wise Comparison of Per Unit Price of Woven and Knit Items in the US and EU Markets**

<i>US Market (Price in USD)</i>						
Product	Year	Bangladesh	Cambodia	China	India	Vietnam
Knit (HS code 61)	2010	10.4	14.9	15.8	15.5	16.8
	2012	13.4	17.0	17.8	19.8	19.1
	2014	14.0	17.5	17.0	19.7	19.3
	2016	13.4	16.6	15.1	18.2	18.1
Woven (HS code 62)	2010	12.9	14.4	16.1	25.5	17.0
	2012	17.0	17.0	19.0	30.9	21.2
	2014	17.4	18.6	18.9	31.4	22.2
	2016	16.6	18.0	17.1	29.7	22.5
<i>EU Market (Price in Euro)</i>						
Product	Year	Bangladesh	Cambodia	China	India	Vietnam
Knit (HS code 61)	2010	10.8	14.1	12.1	14.2	12.5
	2012	22.8	26.5	24.3	28.5	24.8
	2014	23.1	26.9	23.0	27.7	28.5
	2016	19.4	21.9	17.3	19.8	26.3
Woven (HS code 62)	2010	9.4	13.0	13.7	22.1	17.2
	2012	19.1	26.1	26.4	42.7	32.9
	2014	19.6	26.8	26.8	40.2	34.4
	2016	15.2	20.8	21.1	31.0	28.7

Source: Computed from the United States International Trade Commission (USITC) and EuroStat data.

Note: HS: Harmonized Commodity Description and Coding System.

1.3.3 Import Performance

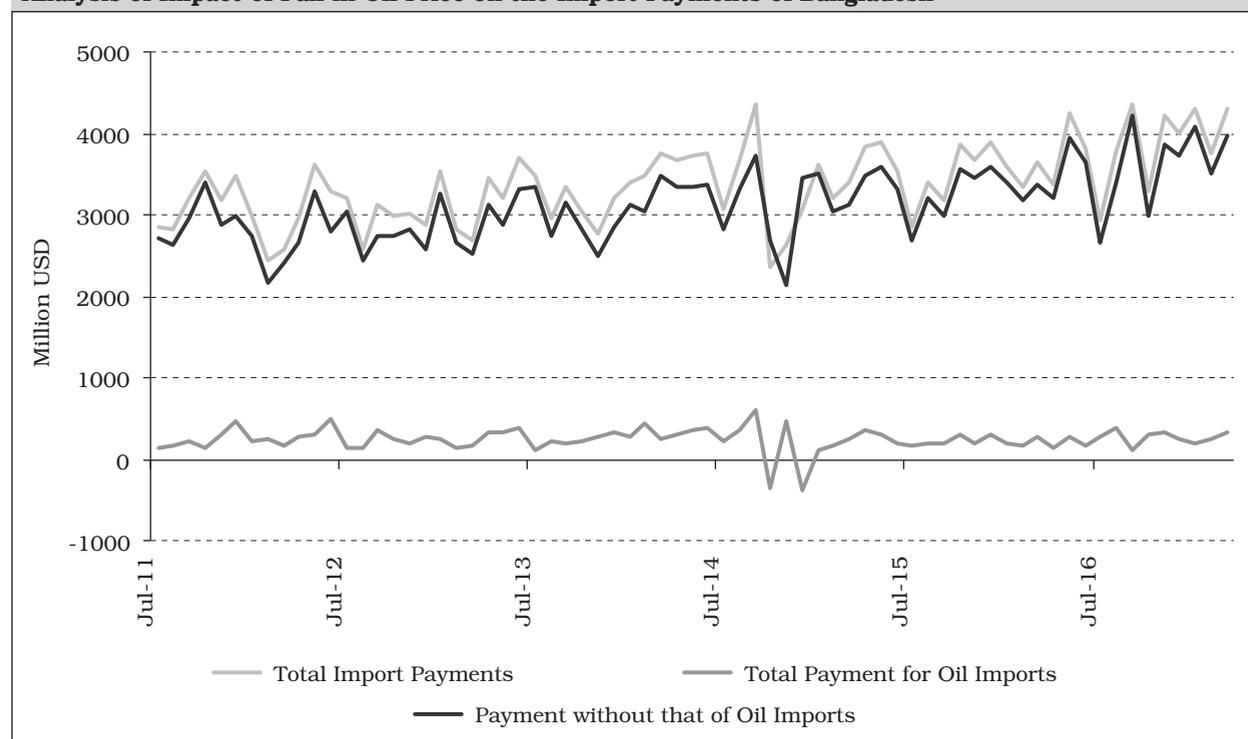
Bangladesh's import payments has seen a gradual rise in recent months. Growth was 8.2 per cent and 11.1 per cent at the end of the second and third quarters, albeit below the 17.3 per cent growth experienced in the first quarter. Among the major 23 items, nine product categories show growth rate higher than the 11.1 per cent growth for all imports during the period July-March FY2016-17⁷; six of the rest (interestingly, five of which are intermediate goods) recorded negative period-on-period growth.⁸ Import growth of wheat (31.9 per cent) and consumer goods (24.1 per cent) have risen noticeably – analysis shows that these were mostly volume-driven. Imports of intermediate goods and capital goods have respectively contributed to 54.1 per cent and 23.8 per cent of total imports during the period July-March FY2016-17.⁹

An analysis of structure of import over the last five years do not evince any major shift. However, share of capital goods has been on the rise – from 20 per cent in total imports in FY2012-13 to 23.8 per cent in FY2016-17 (July-March). Share of capital machineries has also seen some rise – from 6 per cent to 8.3 per cent over the corresponding period. Share of crude petroleum, and petroleum, oil and lubricants (POL)

⁷Top five imported products with highest growth rates were: pulses (50.5 per cent), sugar (35 per cent), spices (32 per cent), wheat (31.9 per cent) and petroleum products (25.6 per cent).

⁸These six import items are: rice ((-) 64.3 per cent), fertiliser ((-) 38.4 per cent), oilseeds ((-) 30.9 per cent), yarn ((-) 0.8 per cent), textile and articles thereof ((-) 2 per cent) and staple fibre ((-) 0.6 per cent). The later three of these are raw materials for RMG and textile industries, which depict less prominent negative growth rates. The fall in fertiliser import payment was due to increase in price in the third quarter of FY2016-17.

⁹More specifically, import payments of intermediate goods of textile and articles industry and iron, steel and base metals industry and capital machinery contributed respectively to 12.7 per cent, 8.3 per cent and 8.3 per cent of the total import payments.

Figure 1.9**Analysis of Impact of Fall in Oil Price on the Import Payments of Bangladesh**

Source: Author's compilation based on the data from National Board of Revenue (NBR) and the World Bank Pink Sheet.

items has seen a fall from 8.3 per cent to 7.3 per cent in the backdrop of fall in prices. Interestingly, share of consumer's goods has fallen from 12.3 per cent to 7.7 per cent of the corresponding period.

As is known, oil price has been falling since July 2014. It is observed that the overall movement in import payments excluding oil import payments is not significantly different than that with oil import payments (Figure 1.9).

Analysis of incremental growth shows that capital goods contributed the most (38 per cent) to the incremental growth in import payments, which includes contribution of payments of capital machinery (17.2 per cent). Intermediate goods contributed to 26.2 per cent of the incremental growth, lower than that of last fiscal year; key contributors were on account of payments for iron, steel and base metals (16.5 per cent)¹⁰ and petroleum products (12.5 per cent).¹¹

For July-March FY2016-17, total letter of credit (L/C) opening and settlement have shown a positive growth of 13 per cent and 11.3 per cent respectively, compared to matched period in FY2015-16.¹² The compositional share of consumer goods (12.5 per cent), intermediate goods (8.5 per cent), industrial raw materials (37.3 per cent), petroleum products (5.4 per cent) and capital machineries (11 per cent) in the total amount of L/C opening for the period under discussion are analogous to those of the last fiscal year. L/C opening for petroleum products has experienced positive growth of 19.2 per cent which is quite high.¹³ On the other

¹⁰This is supposedly the effect of increase in the price of iron ore, which recorded month-on-month increase of 97 per cent in December 2016, remained high in January-March 2017 period (World Bank Pink Sheet).

¹¹In the last fiscal year, intermediate goods contributed the most (53.9 per cent) to the incremental growth in import payments, propelled by payments for petroleum products (23.2 per cent), and textile articles (20.1 per cent).

¹²The growth of L/C opening for July-March FY2015-16 was 2.29 per cent lower than that of corresponding period in FY2013-14.

¹³Though L/C settlement has shown negative growth of (-) 1.74 per cent.

hand, growth in L/C opening for industrial raw materials was only 4.4 per cent over the corresponding period of discussion. Similarly, back-to-back L/C opening for RMG raw materials stood at USD 5.9 billion with the growth being 3.6 per cent. Thus, L/C opening figures of production-related items do not augur any significant acceleration in production in near-term future.

On the other hand, imports of capital machineries in terms of L/C settlement depicted a growth of 52.8 per cent, and L/C opening for capital machineries showed a growth of 17.3 per cent¹⁴ for the period July-March FY2016-17 compared to the corresponding period of the last fiscal year. This rise in imports of capital machineries has been largely on account of implementation of various large-scale infrastructure development projects and power plant projects. Noteworthy growth of 32.1 per cent has been observed in the growth of L/C opening for energy/power industry (which stood at USD 0.66 billion); the corresponding L/C settlement figure is USD 1.2 billion (220.4 per cent higher than the figure of USD 376 million observed for July-March FY2015-16). Likewise, notable growth has been observed in L/C opening of machineries for telecom industry (14 per cent), garment industry (12.6 per cent) and textile (5.2 per cent). Robust growth of these important items will likely have positive impact on investment, albeit with some time lags.

1.3.4 Terms of Trade

Bangladesh's terms of trade (ToT) has been showing a secularly declining trend since the new base was established (FY2005-06). The increase in import price index and the fall in ToT despite the 52.1 per cent decrease in the price of crude oil¹⁵, one of the major import components, indicate that given its export and import structure, Bangladesh was not able to reap the benefits of falling global commodity prices. As can be seen from price movement of Bangladesh's key export, RMG, overall average export-weighted prices of Bangladesh could not keep up with average import-weighted price of Bangladesh (in spite of fall in fuel price import), leading to decline in ToT.¹⁶

Table 1.5

Terms of Trade of Bangladesh

Fiscal Year	Export Price Index	Import Price Index	Commodity Terms of Trade (Base: FY06 =100)	Calendar Year	Change in Oil Price	
					Yearly	Compared to Peak (2012)
FY07	104.9	103.6	101.2	2007	4.2	-21.8
FY08	116.3	131.4	88.5	2008	26.6	-1.0
FY09	125.1	140.4	89.2	2009	-32.1	-32.8
FY10	132.6	148.3	89.4	2010	23.5	-17.1
FY11	146.4	166.5	87.9	2011	18.6	-1.7
FY12	151.7	176.4	86.0	2012	1.7	0.0
FY13	163.0	189.6	86.0	2013	-0.5	-0.5
FY14	172.1	200.4	85.9	2014	-6.1	-6.5
FY15	182.3	212.4	85.9	2015	-41.6	-45.4
FY16	196.0	228.2	85.9	2016	-12.2	-52.1

Source: Bangladesh Bank and World Bank.¹⁷

¹⁴The period-on-period growth in FY2015-16 was 13.9 per cent and in FY2014-15 was 5.7 per cent.

¹⁵In the period of 2004-2016, oil price was at its peak in 2012 at the rate of USD 95.3 per barrel. Then there was a fall in oil price in the following years as shown in Table 1.5.

¹⁶Considering the US market for instance, the prices of knit and woven products decreased by x and y per cent respectively in the year 2016.

¹⁷<https://www.bb.org.bd/pub/annual/anreport/ar1516/chap11.pdf>

1.3.5 Exchange Rate

In recent years, Bangladesh Bank's exchange rate policy with its open market operations has kept BDT stable in terms of major currencies. However, nominal exchange rate (NER) was allowed to slide a bit and BDT depreciated by 1.2 per cent in the third quarter of FY2016-17, with USD/BDT rate reaching its maximum value of 80.6 on 17 May 2016.¹⁸ The year 2016 ended with an upward trend in the NER; on the other hand, real effective exchange rate (REER) experienced some appreciation and was 150.1 in December 2016.¹⁹ Foreign exchange reserves stood at USD 32.4 billion at the end of the July-March period of FY2016-17.²⁰

In the recent period, exchange rate experienced some volatility. Average rate of USD/BDT for import payments between 11 April 2017 and 27 April 2017. The Bills for Collection (BC) selling rate was the highest for most banks on 25 April 2017. The average USD/BDT rate for import payments varied from BDT 80.3 to BDT 84.8 on 25 April 2017, and from BDT 80.3 to 84.95 on 26 April 2015 for different banks. On 26 April 2017, Bangladesh Bank had to intervene in the currency market and introduced a bar of BDT 2 on deviation of the average BC selling rate from the inter-bank exchange rate. This calmed the market and consequently the rates came down to level off with the headline exchange rate by 2 May 2017. In the period of 23-27 April 2017 the USD/BDT rate for importers increased by the maximum extent of BDT 4.77. Table 1.6 shows the number of banks with the extent of dispersion between the average exchange rate for import payments and the inter-bank exchange rate on 25 April 2017 (and 26 April 2017).

Table 1.6

Number of Banks as per the Deviation of Headline Exchange Rate and Average BC Selling Rate

Extent of Deviation	All Banks		FCBs		PCBs		SCBs	
	25 Apr	26 Apr	25 Apr	26 Apr	25 Apr	26 Apr	25 Apr	26 Apr
Deviation \geq 4.0	5	9	3	2	2	7	0	0
3.5 \geq Deviation < 4.0	14	10	2	2	12	8	0	0
3.0 \geq Deviation < 3.5	8	8	0	1	8	7	0	0
2.5 \geq Deviation < 3.0	8	4	0	0	6	2	2	2
2.0 \geq Deviation < 2.5	3	5	0	0	1	3	2	2

Source: Author's calculation based on data collected from the Bangladesh Bank.

Note: FCB: Foreign commercial bank; PCB: Private commercial bank; SCB: State-owned commercial bank.

This sudden volatility was attributed to the cumulative pressure originating from the rise in L/C settlement, higher demand for foreign loan payments and declining remittance flow through the banking channels. Some analysts have also not ruled out market manipulation and alluded to lack of proper oversight by the central bank. Steps should be put in place to guard against the situation which gave rise to the market volatility.

1.3.6 Remittance

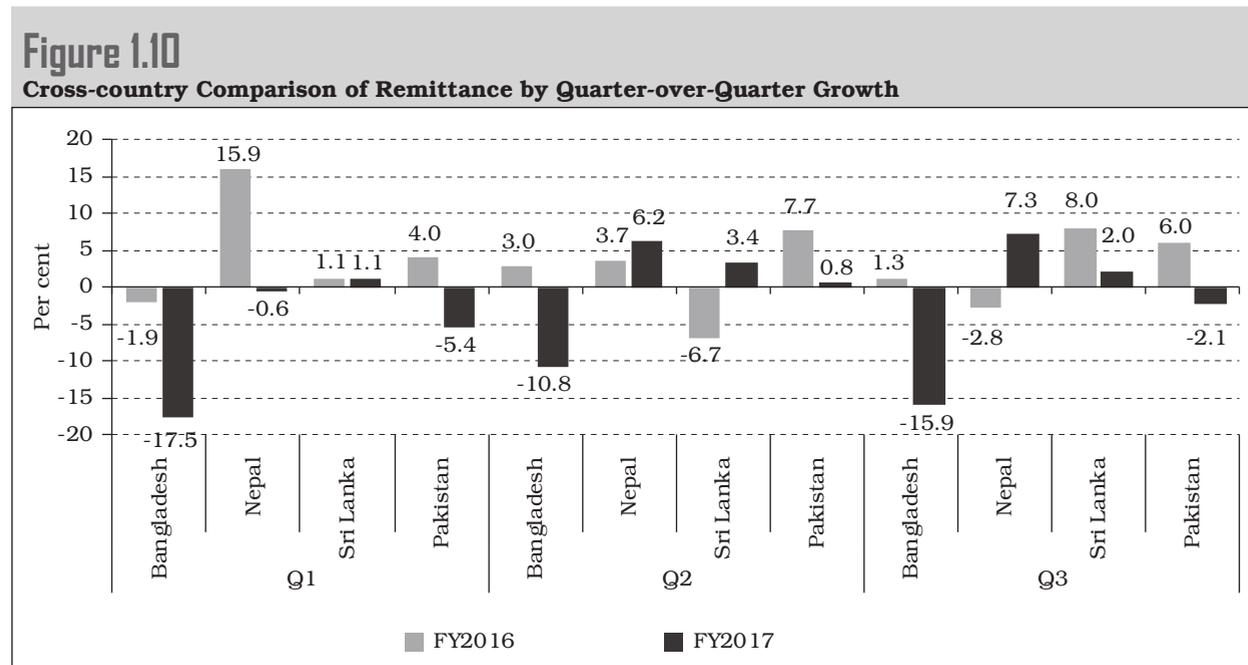
Month-on-month remittance flow has been in the negative terrain all through FY2016-17. At the end of July-April FY2016-17, remittance was 16 per cent lower than that of July-April FY2015-16.²¹ Structure of remittance flow shows that 58.1 per cent of the remittance earning came from the Gulf countries, with

¹⁸The USD/BDT rate started this fiscal year (FY2016-17) with the value of 78.4, and first increase was encountered on 27 October 2016.

¹⁹REER has been appreciating since FY2010-11, more recently being 114.4 in FY2013-14 and 130.6 in FY2014-15 (base: FY2010-11 and considering 10 currency baskets; Source: Annual Report of the Bangladesh Bank).

²⁰14.2 per cent lower than that of the analogous period in FY2015-16.

²¹The period-on-period growth was (-) 2.1 per cent for July-April FY2015-16.



Source: World Bank Migration and Remittances Data.

17.5 per cent coming from the United Arab Emirates (UAE) and 16.8 per cent from Saudi Arab. Among the non-Gulf countries, the US (12.8 per cent), the United Kingdom (9.6 per cent) and Malaysia (7.3 per cent) were the largest sources of remittances. This gloomy picture, true for all major markets²² was attributable to several factors including slowdown of economic growth in Bangladesh's traditional source economies. Similar trend is observed in the global scenario. The yearly growth of global remittance inflow has been low in recent years, and has moved to the negative terrain in 2015 ((-) 2.37 per cent) and 2016 ((-) 1.24 per cent). A cross-country comparison of quarter-over-quarter growth rates is shown in Figure 1.10, it reveals that the fall in remittance has been pervasive for almost all countries except for Nepal. However, as the figure shows, the depth and consistency in the fall in remittance have been particularly telling for Bangladesh when compared to other countries such as Pakistan and Sri Lanka.

On the contrary, migration outflow data has shown robust growth with a period-on-period growth of 34.2 per cent. Migration outflow in FY2016-17 was mostly contributed by Gulf countries having the major compositional share of 83 per cent, attributed by that of Saudi Arab (40 per cent), Oman (16 per cent) and Qatar (12 per cent).

Remittances have come down in spite of more than 5 lakh workers going abroad over the first nine months of the current fiscal. Since no reliable figure is available for returnee migrants, there is hardly any doubt that growth of net migration has also been quite robust. That about a fourth of the new migrants were women, with low-paying jobs, does not fully explain the narrative of falling remittances. Bangladesh Bank had indeed carried out field investigation to identify the reasons.²³ Discussion with key informant and anecdotal information indicate that a large part of the fall in remittance flow may be explained by substitution taking place between formal and informal channels of money transfer, particularly from Middle East, Singapore and Malaysia. Many migrant workers are sending money through intermediaries who are taking advantage of mobile platforms and various software applications (apps). Some of the reasons driving

²² Only Qatar, Italy, Germany and South Korea have shown positive period-on-period growth of 34.3 per cent, 45.9 per cent, 14.1 per cent and 27.7 per cent respectively for July-April FY2016-17.

²³ Report published on 8 May 2017.

this trend (in substitution of formal channels by informal channels) are higher exchange rate margin, shorter transaction processing times²⁴, quick delivery of money to the beneficiaries, easy access, and lower service fees compared to the banks in host countries. All these lead to lower costs of sending remittance back to Bangladesh. To make the situation worse, because of higher vigilance on account of terrorist financing, and the attendant cost rise, banks in important corridors are charging higher transaction fees. CPD has earlier argued for waiving these additional charges for those who send remittance below a certain amount. Table 1.7 below shows a comparison of the costs borne by remitters in some of the major host countries. It is seen that for most of the country corridors (except for Singapore) rates of sending remittance were higher than the Sustainable Development Goal (SDG) target of 3 per cent. Proposals have been floated to make remittance-sending process free-of-cost for remitters.²⁵ Some steps in this direction will encourage remitters to use formal channels. In view of the attendant situation, steps should be taken on two fronts: at the domestic front, by discouraging use of illegal platform and by taking measures to accelerate transfer of remittance through formal channels. Energetic steps should also be taken through global negotiations to bring down banking fees that are charged on small amounts of remittances sent through key corridors.

Table 1.7**Cost of Sending Remittance to Bangladesh (% Fee Required to Send USD 200 Equivalent)**

Source Country	FY16 Q2	FY16 Q3	FY16 Q4	FY17 Q1	FY17 Q2	FY17 Q3*
UK	3.5	4.0	4.0	4.6	4.7	5.0
Saudi Arab	4.2	4.8	4.3	5.1	4.8	5.0
KSA	3.3	3.7	4.3	3.8	3.6	3.9
Malaysia	4.4	3.9	3.9	3.6	3.3	3.9
Singapore	1.6	2.3	2.3	2.3	2.2	2.6

Source: World Bank Remittance Prices Database.

Note: *The world average for this period is 7.45 per cent for every USD 200 sent.

The growth of number of female migrant workers has risen in the past three years²⁶ with yearly growth of 34.8 per cent, 36.5 per cent and 13.9 per cent. In view of this increasing trend, safety and security has become a major concern. Since some of the key host and sending countries are all signatories of the Colombo Process, initiatives should be taken towards further strengthening of the measures taken under this Process.

1.3.7 Balance of Payments

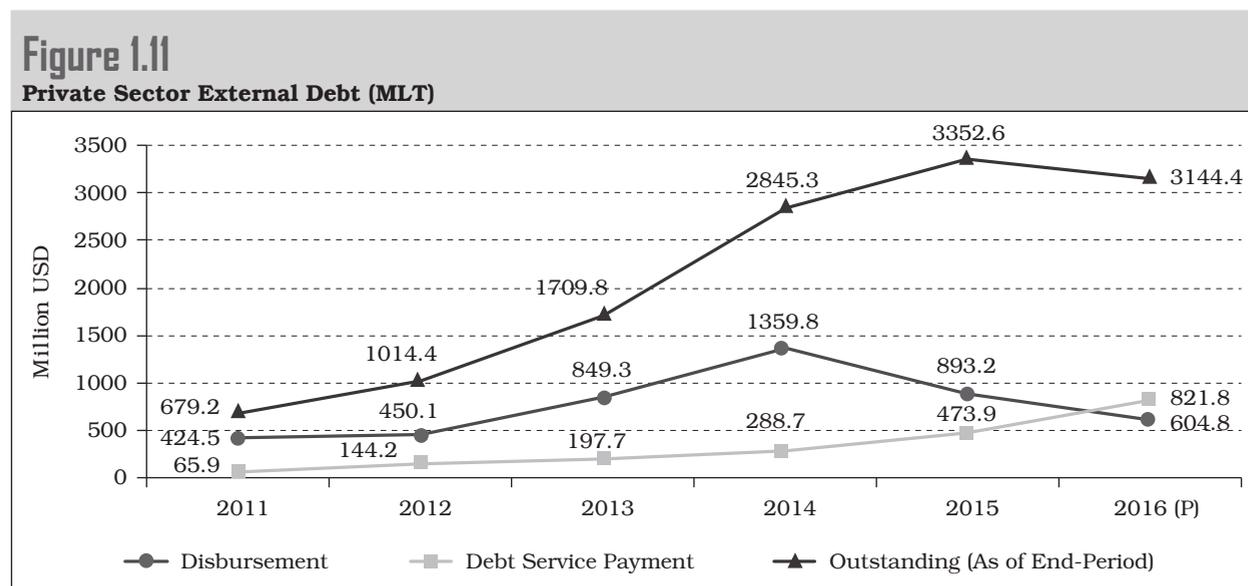
Current account balance was negative for July-March period of FY2016-17. The balance amount came down to USD 1.38 billion for July-March FY2016-17 compared to the corresponding figure of USD 3.36 billion for FY2015-16.²⁷ This downward pull was mainly driven by the negative trade balance of USD 7.04 billion and the fall in remittance flow that was equivalent to USD 1.83 billion. However, the overall balance could be maintained at a positive amount of USD 2.6 billion (though lower than USD 3.5 billion of corresponding period in FY2015-16). A 20.3 per cent period-on-period growth of foreign direct investment (FDI) and 7.72 per cent growth of MLT (medium and long-term) foreign loans contributed to this. Foreign loans to private sector has risen significantly since 2011. Debt service payment has also been on the rise (Figure 1.11) with repayment obligations maturing. Further data analysis shows that major share of the loans, of value of USD 0.95 billion, has maturity period of between five to seven years; USD 1.61 billion worth of loans

²⁴Five to 10 minutes in case of full digitalised processes with apps and mobile banking.

²⁵As reported in The Daily Star on 14 May 2017.

²⁶In the years 2014, 2015 and 2016.

²⁷Current account balance was (-) USD 1.1 billion for July-February FY2016-17.



Source: Statistics Department, Bangladesh Bank.

has interest rates between 4 to 6 per cent. Total foreign aid received by Bangladesh during July-February FY2016-17 was USD 1.38 billion, which was 2.9 per cent lower than that of the corresponding period of the last fiscal year.

1.3.8 Concluding Remarks

With export growth registering only half of what was projected for FY2016-17, with remittance falling significantly and with a deteriorating ToT, Bangladesh's external sector is witnessing a turning point. This is manifested in the significant fall of about USD 3 billion in the current account balance which has gone into negative territory. The prospect of graduating out of the least developed country (LDC) group and the fact of having graduation to middle-income status are likely to bring in more near-term challenges (shift from low interest to blended financing, preference erosion as international support measures get phased out gradually). In this backdrop, a rethinking of external sector management will be called for.

The exchange rate of BDT has depreciated, albeit to a small extent, and it is reckoned that there is further scope for this in view of the falling current account balance, exchange rate movement of competitors, open market exchange rate movements, and for providing incentives to exporters and remitters.

Forex reserves, whilst robust, could come under pressure in view of export and remittance performance, and debt servicing liabilities of various types. Bangladesh Bank should closely monitor liabilities originating from loans taken by the country's private sector, particularly from the point of view of currency and maturity mismatch and movement of LIBOR. In this backdrop, a careful and conservative approach should be pursued in view of demands for partial capital account convertibility to allow Bangladeshi investors to invest abroad.

While global remittance flow has seen some decline in recent times, comparative record of key receiving countries indicate that in case of Bangladesh, this, at least to some extent, can be explained on account of substitution of remittance inflow from formal channels to informal channels. Whilst legal actions against illegal platforms will be necessary, parallel initiatives to facilitate speedy and cost-effective remittance transfer, through appropriate domestic as well as regional- and global-levels initiatives will be called for. To secure the interests of the increasing number of female migrant workers, labour wings of Bangladesh

embassies in key host countries should be further strengthened and adequate safeguard measures be undertaken, both at pre- and post-migration stages. Bangladesh will also need to take best advantage of the Colombo Process on migration.

To conclude, business-as-usual in external sector management will not do. Some of the fault lines in the edifice, flagged in the preceding discussion, is already transmitting cautionary signals. Issues of enhancing competitive strength through skill augmentation and productivity gains, product and market diversification of exports, prudent reserves and exchange rate management in view of the evolving demand-supply situation – all these will call for renewed thinking in managing the external sector in these challenging times.

1.4 BANKING SECTOR: A GROWING MALIGNANCY IN THE ECONOMY

1.4.1 Introduction

A sound financial sector is key to a sustained economic development for any country as it facilitates the financial mechanisms between borrowers and lenders, helps expedite capital accumulation, and makes use of resources into productive sectors. In Bangladesh, the contribution of the financial sector has increased over the years. In FY2010-11, financial sector's share in GDP was 2.99 per cent at constant price, which has increased to 3.41 per cent in FY2016-17 (BBS, 2017). Commercial banks play the dominant role, possessing almost 80 per cent of the financial sector. In FY2016-17 the share of banking sector in GDP was 2.91 per cent. The contribution of other financial institutions including non-banking financial institutions (NBFIs) and insurances was only 0.5 per cent of GDP.

Despite significant growth, the sector is currently faced with a number of serious challenges. Overall performance of banks, particularly of state-owned commercial banks (SCBs), is far from satisfactory. The sector is struggling to recover from the setbacks of large financial scams in a number of state-owned and private commercial banks, unearthed in recent years. Most indicators reveal a poor health and lack of discipline in several banks.

CPD has been following the development in the banking sector closely and writing on the sector in its IRBD reports. Given the emergent concerns of various sorts, the present interim report also highlights some of the challenges of the sector, and makes recommendations to move forward. More specifically, the issue of non-performing loans (NPLs), recapitalisation and governance issues are the focus of this section.

1.4.2 Trepid Growth of Deposit and Credit

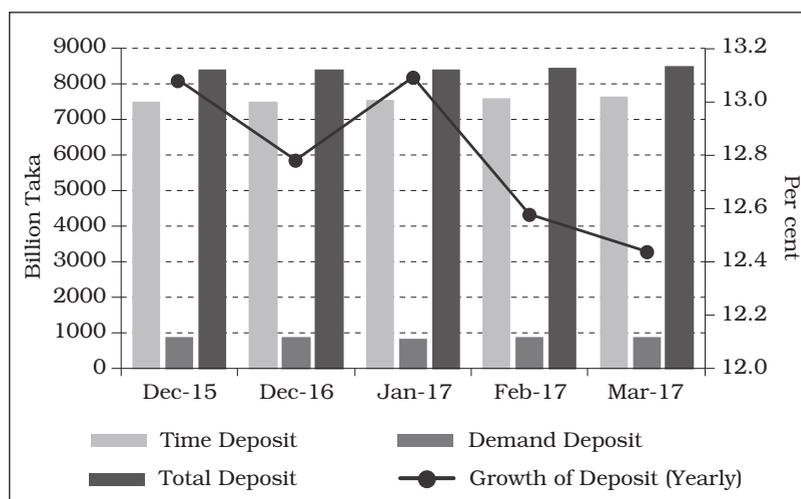
Total deposit of the sector in 2015 stood at 46 per cent of GDP that increased from 38 per cent in 2005. However, it has declined compared to that of 2010 (49 per cent). On the whole, three indicators of financial depth, i.e. ratios of – money supply (M2) to GDP, total deposits to GDP, and total domestic credit to GDP – have increased over the years (Table 1.8).

Table 1.8
Financial Depth of Bangladesh

Indicator	2005	2010	2015
M2/GDP	0.41	0.52	0.51
Deposit/GDP	0.38	0.49	0.46
Credit/GDP	0.32	0.39	0.49

Source: Bangladesh Bank and Bangladesh Bureau of Statistics (BBS).

Figure 1.12
Types of Deposits and Deposit
Growth Rate



Source: Statistics Department, Bangladesh Bank.

More recent data indicates that although the total amount of deposit has increased in the month of March FY2016-17, the growth rate of deposit has declined (Figure 1.12). Lower deposit rate may have affected the growth of deposit. The amount of time deposit and demand deposit both have increased from previous two months. Deposit growth has decreased to 12.4 per cent in March 2017 from previous March which was 13.04 per cent.

Growth of domestic credit increased slightly to 12.2 per cent in March 2017 compared to 11.4 per cent in March 2016 (Table 1.9). The target of credit growth is 16.4 per cent as spelt out in the MPS of Bangladesh Bank, published in January 2017. Though growth of credit to the private sector was 16.1 per cent in March 2017, close to Bangladesh Bank's target of 16.5 per cent (Table 1.9 and Figure 1.13), credit to the public sector has been negative (-) 9.5 per cent (Table 1.9). The reason behind low demand for bank credit by the public sector is government's reliance on NSD (details in Section 1.2). Due to lower demand for credit, liquidity in the banking system is high. Total liquid asset amounted to Tk. 2,67,508.6 crore in March FY2016-17, while the minimum requirement was Tk. 1,60,319.4 crore.

In an effort to attract investment, emphasis has all along been put on lowering bank rates. In November FY2015-16, the lending rate was downsized to single digit. High lending rate has been attached to high deposit rate. Bangladesh Bank desires that commercial banks should keep their interest rate spread within

Table 1.9
Growth of Monetary Indicators (Outstanding as of March 2017)

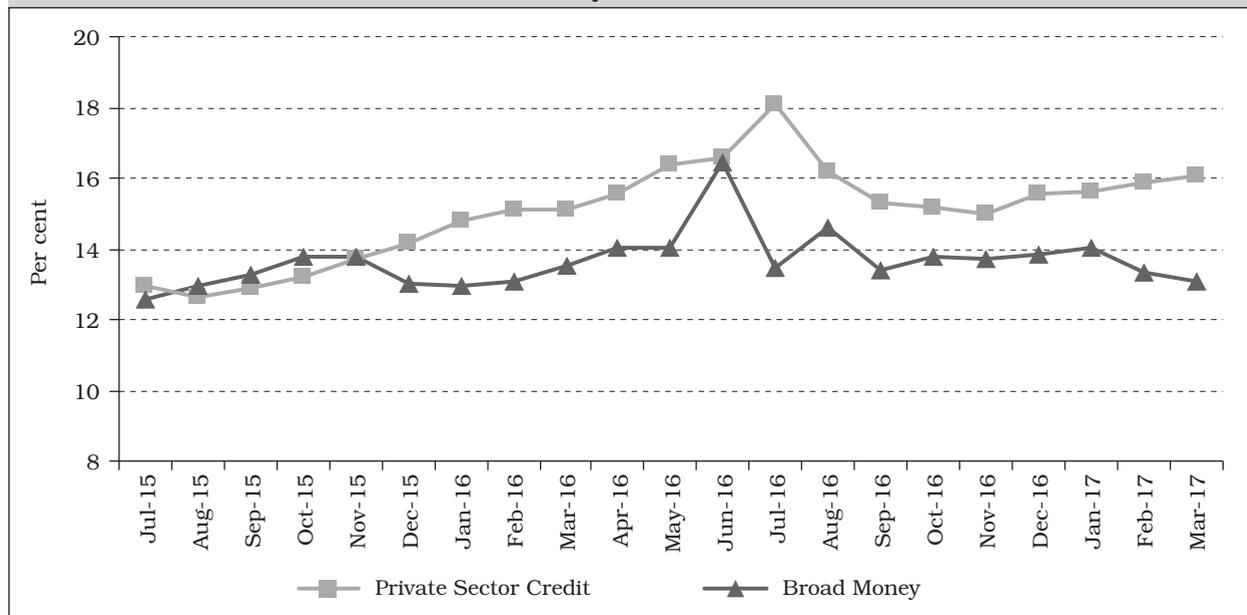
(in Per cent)

Indicator	Actual (Jun 2016)	Actual (Mar 2016)	Actual (Mar 2017)	Jun 17 (Jan 17 MPS Prog.)
Net foreign assets	23.2	24.1	15.3	10.1
Net domestic assets	3.6	10.3	12.3	17.3
Domestic credit	14.2	11.4	12.2	16.4
Credit to the public sector (incl. govt.)	3.6	-5.6	-9.5	16.1
Credit to the private sector	16.8	15.2	16.1	16.5
Broad money	16.3	13.5	13.1	15.5
Reserve money	30.1	15.8	19.0	14.0

Source: Bangladesh Bank.

Figure 1.13

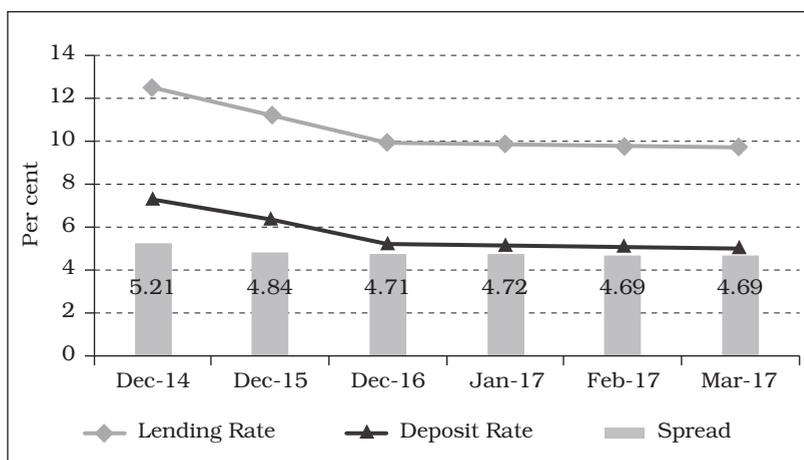
Growth of Private Sector Credit and Broad Money



Source: Bangladesh Bank.

Figure 1.14

Interest Spread and Deposit Status



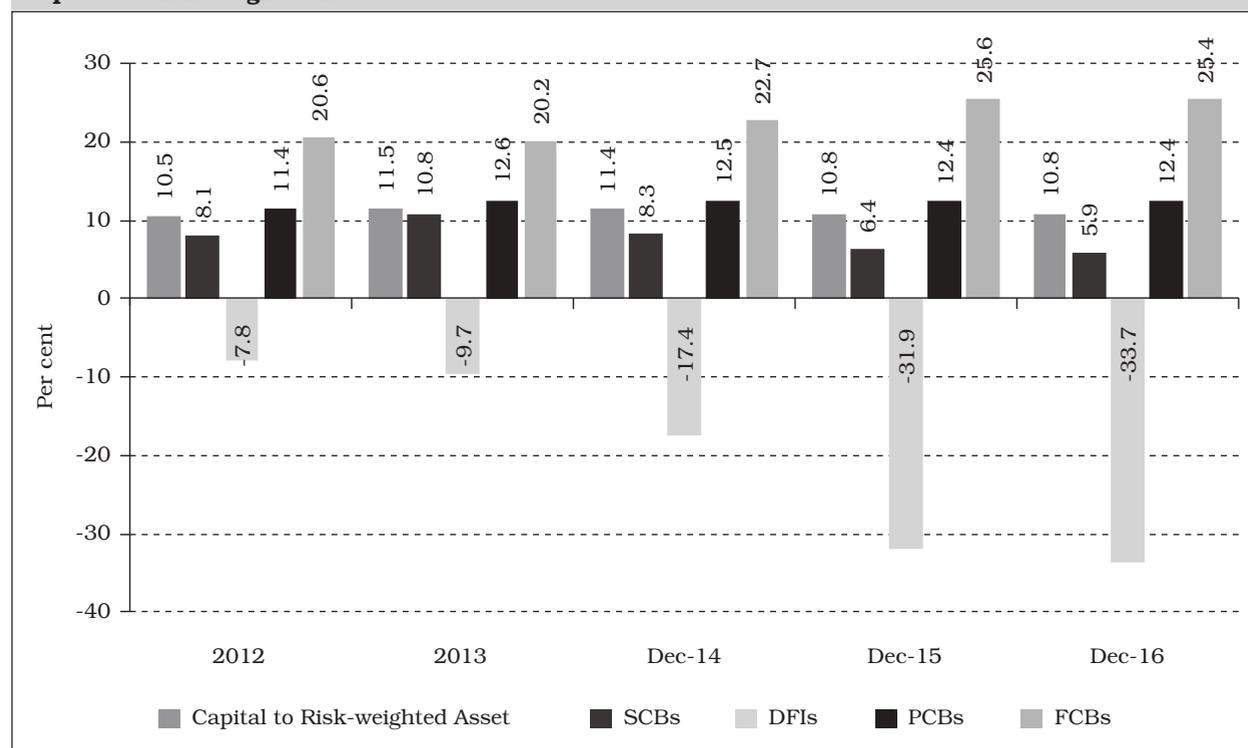
Source: Monthly Major Economic Indicator (various issues), Bangladesh Bank.

5 per cent. In recent period there is a downward trend of both lending and deposit rates. The interest spread for the month of March FY2016-17 is 4.69 per cent, which has decreased from the previous year (Figure 1.14).

1.4.3 Capital Adequacy is below BASEL III Requirements

High NPL and low profitability have resulted in low capital adequacy in the banking sector. Bangladesh is in the process of full implementation of a global regulatory guidelines such as Basel III for capital adequacy from January 2020. The process of Capital Conservation Buffer (CCB) requirement for banks has started from early 2016, and will be fully implemented by 2019 in line with the Basel III framework.²⁸ At end of December 2016, the risk-weighted capital adequacy ratio (CAR) in the banking sector was 10.8 per

²⁸ Basel III is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector.

Figure 1.15**Capital to Risk-weighted Asset**

Source: Bangladesh Bank.

cent (Figure 1.15) which was slightly higher than the minimum requirement of 10 per cent and 50 basis points higher than the ratio recorded during September 2016. SCBs and development financial institutions (DFIs) could not maintain the minimum CAR requirement, indicating vulnerability of these banks. Private commercial banks (PCBs) and foreign commercial banks (FCBs) maintained their CAR above the minimum requirement. DFIs' situation has worsened in December 2016 quarter from previous quarter June 2016 (Bangladesh Bank).

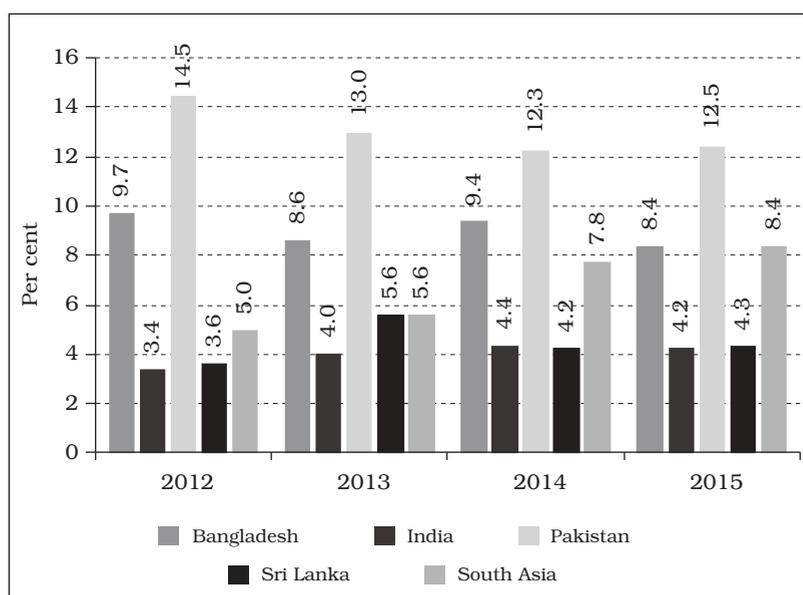
1.4.4 No Respite from NPLs

The central bank has made some effort to ensure an effective banking system and to bring SCBs and DFIs under strict monitoring and control mechanism. The introduction of the Bank Company (Amended) Act 2013, formation of risk management committee, implementation of credit and risk management training, spelling out the terms of reference (ToRs) and responsibilities of the board of directors, and a number of reform measures at the administrative level are among those.

Despite various initiatives taken by the central bank, the amount of NPLs has piled up. During January-March FY2016-17 period it rose to Tk. 73,409 crore from Tk. 62,170 crore in the preceding quarter.²⁹ NPL in the banking sector has a general pattern observed during the last few years which shows that towards December of each year, NPL comes down, but starts to rise afterwards. This is due to banks' effort to clean up their balance sheets at the end of the year. In December 2016, the NPL was 9.2 per cent and within the next three months it rose to 10.5 per cent. During January-March 2017 period, the total amount of NPLs in six SCBs went up to Tk. 35,717 crore from Tk. 31,026 crore in the previous quarter. Regional comparison

²⁹ Reported on Financial Express; available from: <http://www.thefinancialexpressbd.com/2017/05/17/70594/Q1-non-performing-loans-leaps-to-Tk-734.09-billion/print>

Figure 1.16
Share of NPL to Total Gross
Loans in South Asia



Source: World Bank.

Table 1.10

Banking Sector Performance

Indicator	Bangladesh			India	Pakistan
	2005	2010	2015	2015	2015
Capital to Risk-weighted Assets (%)	5.60	9.30	10.80	13.94	20.10
NPL to Total Loans (%)*	13.60	7.30	8.80	3.81	1.89
Expenditure-Income Ratio	92.10	70.80	76.30	49.13	
Return on Asset (%)	0.60	1.80	0.80	0.46	2.50
Return on Equity (%)	12.40	21.00	10.50	7.74	25.80

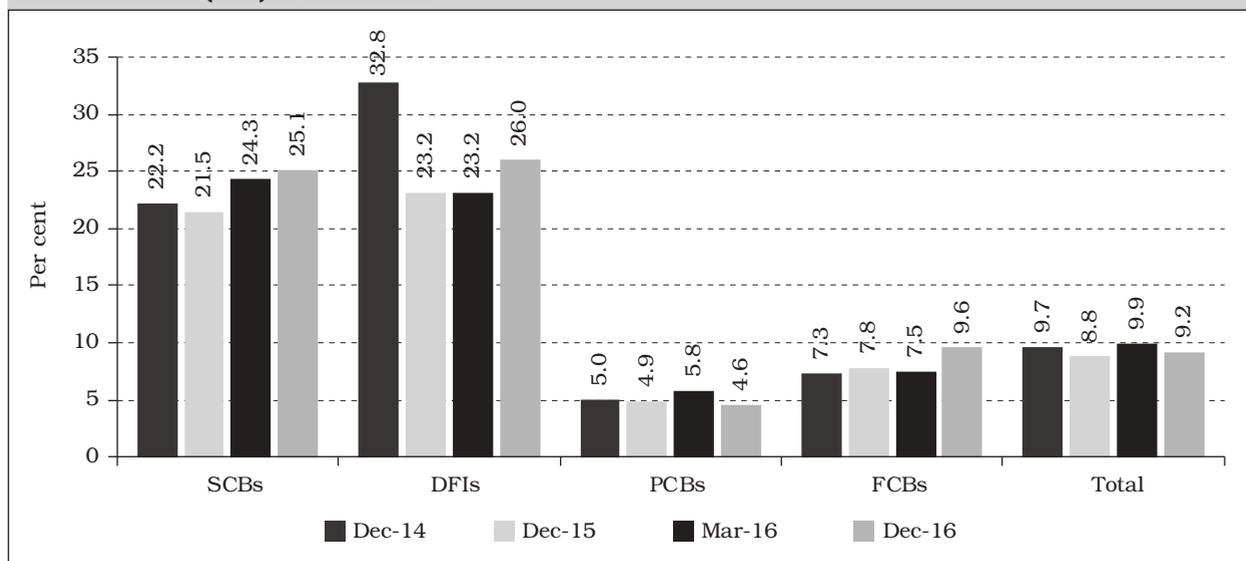
Source: Annual Reports, Bangladesh Bank; Annual and Quarterly Reports, State Banks of India and Pakistan.

Note: *For India and Pakistan, net non-performing assets (NPA) to net advances ratio has been reported.

shows that Sri Lanka and India have much lower NPL than Bangladesh, though Pakistan shows a poorer performance in case of NPL (Figure 1.16 and Table 1.10). Though Bangladesh Bank adopted a flexible loan rescheduling policy in December 2013, it did not bring positive outcome as intended (Figure 1.17). Among the SCBs, Janata Bank tops the list of loan default, followed by Agrani, Sonali and Rupali Banks. Bangladesh Bank introduced a separate loan restructuring policy for big defaulters worth Tk. 500 crore or more in 2015. So far 11 corporate groups have availed the facilities. Of them, seven are clients of Janata Bank. Three groups which made a total loan of more than Tk. 2,300 crore regularised by various banks have failed to continue their payment of installments. Under the central bank's restructuring policy, different banks have restructured over Tk. 4,800 crore of loans of one company. Increased NPL in Bangladesh is the result of relaxed recovery effort, financial fraudulences, political influence and lack of governance.

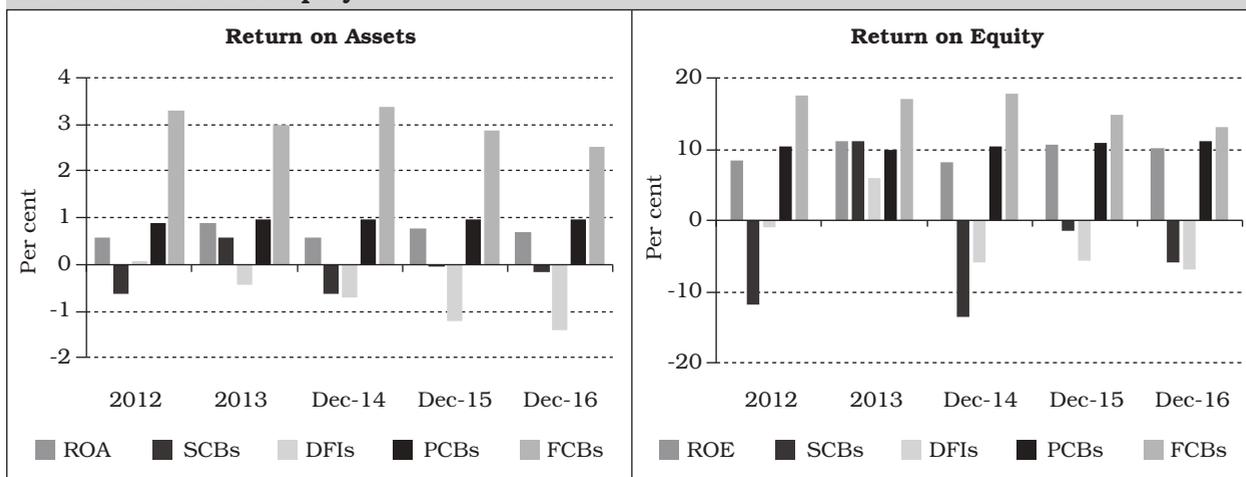
Increased NPL and lower credit to the domestic sector have hit the profitability of banks though it increased in December 2016 compared to June 2016. This increase is lower than that of December 2015. Profitability indicators such as Return on Assets (ROA) and Return on Equity (ROE) show that in December 2016, ROA increased to 0.7 per cent from 0.44 per cent in June 2016, while ROE increased to 9.9 per cent in December 2016 from 7.13 per cent in June 2016 (Figure 1.18). These increases are led by FCBs, followed by PCBs.

Figure 1.17
Classified Loan (NPL) to Total Loan



Source: Bangladesh Bank Quarterly reports.

Figure 1.18
Return on Assets and Equity



Source: Bangladesh Bank.

1.4.5 Cost of Recapitalisation is High

The government has been providing generous support to SCBs in order to improve their balance sheet. In recent years, certain amount is earmarked in the national budget to make for the losses of the SCBs. In the budget of FY2016-17, the government had allocated a recapitalisation fund equivalent to Tk. 2,000 crore in order to meet the capital shortage of banks created by loan defaults. But the default loan situation of the SCBs has not improved. For the last three consecutive years, i.e. FY2013-14, FY2014-15 and FY2015-16, the allocated budget funds to meet the capital shortfalls was about Tk. 5,000 crore for each fiscal year. Such recapitalisation funds were not much of a help since they could only improve the balance sheet of the ailing banks, but not the overall loan default situation. The actual expenditure for recapitalisation was highest in FY2013-14.

Among the receiving banks, Sonali Bank received the highest amount, Tk. 2,794.8 crore of recapitalisation budget fund, followed by BASIC Bank (Tk. 2,390 crore). The financial condition of the two SCBs deteriorated due to massive loan anomalies and malpractices. Among the other fund-receiving banks, Agrani Bank received Tk. 1,081 crore, Janata Bank Tk. 814 crore, Rupali Bank Tk. 272.5 crore, Bangladesh Krishi Bank Tk. 789.7 crore, and Rajshahi Krishi Unnayan Bank received Tk. 318 crore as recapitalisation fund.³⁰

In a resource-constraint country the opportunity cost of such a large amount is high. CPD has estimated the share of recapitalisation fund in incremental revenue income of Bangladesh to understand the magnitude of resources that is misused (Table 1.11). This resource could otherwise be utilised for the social sector where budget allocation falls short of the requirement. Table 1.12 shows that if the recapitalisation fund was used for education and health sector, it would improve the share of these sectors' budget in GDP.

Table 1.11**Recapitalisation as Percentage of Incremental Revenue Income**

Year	Total Revenue (Crore Tk.)	Incremental Revenue (Crore Tk.)	Amount of Recapitalisation (Actual) (Crore Tk.)	Recapitalisation as % of Incremental Revenue
FY2009	64285			
FY2010	75559	11274	1000	8.9
FY2011	92993	17434	1050	6.0
FY2012	113786	20793	341	1.6
FY2013	128823	15037	420	2.8
FY2014	140369	11546	4477	38.8
FY2015	144009	3640	2617	71.9
FY2016	172910	28901	1800	6.2
Total (FY10-FY16)	868449	108625	11705	10.8

Source: Monthly Fiscal Frameworks (various issues), Budget Brief (Statement IV, various issues).

Table 1.12**Share of Education and Health Budget if Recapitalisation Fund is Included**

Year	Education Budget (Actual Expenditure) (Crore Tk.)	Health Budget (Actual Expenditure) (Crore Tk.)	Amount of Recapitalisation (Actual) (Crore Tk.)	Education as % of GDP (Actual Expenditure)	Share of Education Budget in GDP if Recapitalisation Amount is Included (%)	Health as % of GDP (Actual Expenditure)	Share of Health Budget in GDP if Recapitalisation Amount is Included (%)
FY2010	15550	6183	1000	1.95	2.10	0.78	0.90
FY2011	18383	7286	1050	2.01	2.10	0.80	0.91
FY2012	18737	7476	341	1.78	1.80	0.71	0.74
FY2013	20748	8545	420	1.73	1.80	0.71	0.75
FY2014	25089	9384	4477	1.87	2.20	0.70	1.03
FY2015	28001	10394	2617	1.85	2.00	0.69	0.86
FY2016	37811	12600	1800	2.20	2.30	0.73	0.84

Source: Author's calculation based on budget documents.

³⁰Reported on Dhaka Tribune; available from: <http://www.dhakatribune.com/business/banks/2017/03/25/state-banks-fail-improve-bad-loan-situation/>

1.4.6 Amendment to the Banking Company Act is a Regressive Measure

The government has approved amendments to three provisions of the Bank Company Act on 8 May 2017. First, increasing the tenure of the board of directors of a private bank will be increased from six to nine years. Second, the elected chairman, directors and the managing director of a private bank will require the consent of Bangladesh Bank prior to assuming office. In the current law, they have to seek permission from Bangladesh Bank before participating in the election. Third, up to four members of a family may be appointed as board of directors for a bank, while the law currently permits only two members from one family.

The Banking Companies Act has been subject to several amendments on a regular basis. In 2003, an amendment significantly improved corporate banking governance as it established the requirement to form an audit committee and introduced independent directors. Other such amendments have been successful, such as in 2009 the amendment pushed for the mainstreaming of corporate social responsibility (CSR) in financial institutions and achieved increased investments in CSR.

Bangladesh's banking sector is dominated by family members. Such dominance often means that there is resistance to adopting corporate regulations. There is also a tendency for important decisions to be made at family gatherings rather than at corporate meetings. In view of this the Banking Companies Act was amended in 2013 to curb such activities. This amendment had allowed banks to have a maximum of 20 members on the board, of whom three directors must be independent. This allowed a maximum of two family members to hold directorial posts. This law was enforced in 2014.

In Bangladesh's banking sector, it is not uncommon to observe owner-management collusion to perform irregularities. Owner interference in the management of PCBs also led to various malpractices in these banks. This most recent amendment is regressive in nature since it will be taking a step back from the previous changes made to the Act. This law will mean that family ownership will have greater control in banks with the possibility of erosion of corporate governance.

1.4.7 Orderly Transition to End Islami Bank Crisis

Islami Bank Bangladesh Limited (IBBL), established in 1983, was facing allegations of being involved in terrorist financing and funding political violence for the last few years. In view of demands from various corners, investigation was launched against the bank's activities and its connection with the anti-liberation groups. In order to protect the public interest and the depositors, Bangladesh Bank imposed special control on any appointment at the senior management level of IBBL in December 2015.

The newly created management committee is now charged with managing the bank. However, a number of developments have created concerns about the smooth functioning as well as the future of the bank. Amidst major changes in the management of the bank, the concentration of shares has shifted towards a single owner-borrower. In view of the ongoing turmoil and uncertainty in IBBL, an orderly transition is urgently required. The situation demands a statement from Bangladesh Bank. In the interest of common depositors and borrowers and in order to improve its governance, the central bank has to play a strong role at this critical moment. Some of the developments regarding IBBL are presented in Box 1.1.

Box 1.1

Chronology of Developments on Islami Bank Bangladesh Limited³¹

17 July 2012

- U.S. Senate Permanent Subcommittee on Investigation in its report titled “U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case History,” disclosed that two Bangladesh-based banks, IBBL and Social Islami Bank Limited (SIBL) were involved in terror financing.

2 April 2016

- Bank declared 10 per cent dividend against a net profit of Tk. 450 crore.

8 May 2016

- Taskforce to strengthen action against militancy financing has asked the authorities of IBBL to submit statement of dividends provided to its non-profit depositors since the inception of the bank.

5 January 2017

- IBBL Chairman was replaced by a former Secretary of the GoB.
- New managing director and chief executive officer were appointed.

10 January 2017

- Four executive vice presidents (EVPs) of the IBBL were promoted to deputy managing directors (DMDs).

23 May 2017

- Islamic Development Bank (IDB), one of the founding members of IBBL, declared it would sell 8.7 crore shares out of its total holding of 12.08 crore shares in the bank at the current market price.

25 May 2017

- Two independent directors of IBBL resigned from the board, two days after they were removed from their executive posts.

1.4.8 Looking Ahead

The banking sector has burgeoned over the years in terms of the number of banks, amount of asset and contribution to the economy. CPD, in its previous reports has consistently been emphasising on the need for improved governance through strong monitoring and supervision, use of technology and ensuring independence of the regulatory authorities. The need for an Independent Financial Sector Reform Commission (IFSRC) has also been reiterated time and again, which will look into the challenges of the sector and make recommendations for an accountable and strong banking system. If the current trend of mammoth NPL, inefficient management and lack of governance continues, the banking sector can cripple a flourishing economy instead of contributing towards its advancement.

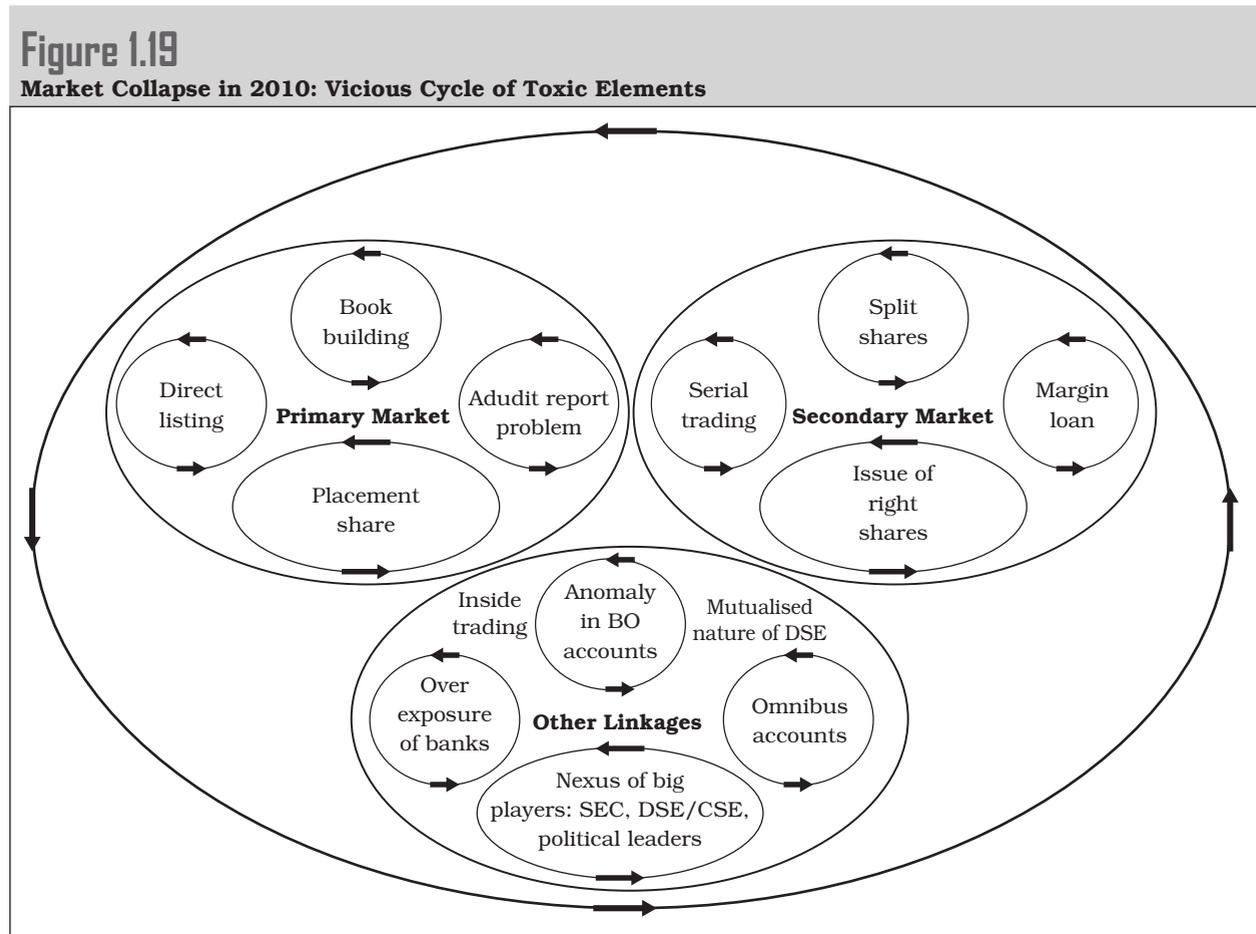
1.5 CAPITAL MARKET AT BAY

1.5.1 Introduction

It has been more than six years since the share market debacle of December 2010. Following the bubble and bust, a number of official investigations had been put in place; a number of academic studies have tried to identify the causes of the scam, attendant weakness in restoring confidence in the market. CPD has also conducted several studies in this regard (CPD, 2011; Moazzem and Rahman, 2012). These have identified 17 different types of problems which include the followings: (a) Lack of transparency in beneficiary owner

³¹<http://www.dhakatribune.com/business/banks/2017/05/26/whats-going-islami-bank/>
<http://www.thedailystar.net/frontpage/islami-bank-crisis-deepens-two-directors-quit-1411177>
<https://businessnews-bd.net/ibbl-four-evps-promoted-to-dmds/>
<http://www.newagebd.net/article/6551/articlelist/323/Cartoon>
<http://www.eurasiareview.com/12112012-bangladesh-banking-for-terror-analysis/>

(BO) accounts; (b) Presence of bull cartels; (c) Weak monitoring of book building system; (d) Rampant use of placement shares; (e) Frequent recourse of the malpractice of serial trading; (f) Insider trading; (g) Faulty audit reports of many listed companies; (h) Faulty operations of merchant banks that are too many in number; (i) Retailer-like behaviour of institutional investors; (j) Role of commercial banks; (k) Weak oversight of the Bangladesh Bank; (l) Participation of small investors in 'Keynesian Beauty Contest'; (m) Faulty operations at Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE); (n) Weak and ineffective role of the Securities and Exchange Commission (SEC) as a regulator; (o) Weak institutional capacity of the SEC; (p) Lack of enforcement of rules and regulations; and (q) Lack of coordination among the various regulatory bodies. Presence of these 'toxic elements' had created a 'vicious cycle' in the capital market of Bangladesh (Figure 1.19) that resulted in market manipulation, and these need to be addressed through appropriate restructuring and reform measures.



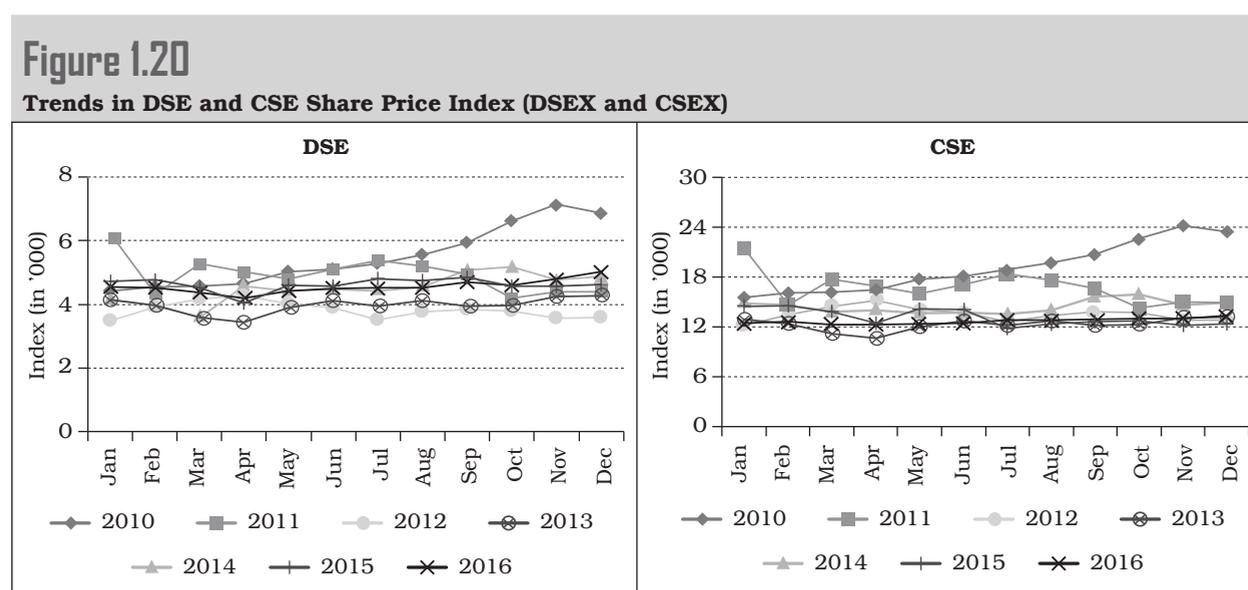
Source: Moazzem and Rahman (2012).

In response to the market collapse, SEC announced a medium- to long-term plan to restructure the capital market and undertook a diverse range of measures accordingly. Various regulatory and operational measures undertaken in the context of the problems were identified by CPD studies. A large part of such measures are regulatory in nature. These were particularly related to transparency in BO accounts, book building system, reduction in the use of placement shares, introduction of better auditing practices, efficient operation of merchant banks, better management and operation of the SEC and demutualisation of stock exchanges, etc. At the same time, a number of operational measures were also undertaken. These measures have been well-appreciated by stakeholders (Shah, 2016). However, the important issue at hand is to assess whether these measures were able to ensure market efficiency, and hence build confidence among the involved stakeholders.

In this backdrop, this section examines the level of efficiency of the capital market in order to appreciate the effectiveness of various reform measures introduced over the past six years. Based on the analysis, the paper examines major weaknesses that continue to persist in the market. The study makes an attempt to capture their implications on market performance and efficiency. Finally, the paper puts forward a set of suggestions for improved operational efficiency in the market.

1.5.2 Overview of the Capital Market: Examining Market Level Efficiency

Over the last six years, the majority of the capital market indicators has experienced significant levels of correction. Major market-related indicators such as DSE Broad Index (DSEX), CSE Broad Index (CSEX) and price-earning (P/E) ratios have experienced downward revision between January 2011 and April 2017: by about (-) 12.8 per cent, (-) 52.7 per cent and (-) 44 per cent respectively. DSEX and CSEX have stabilised at around 5,000 and 12,000 marks respectively (Figure 1.20). Consequently, market capitalisation has undergone significant reduction over the past years. Number of companies enlisted in the capital market has come down (on average nine companies per year), though number of applications submitted for enlistment was significantly high.³²



Source: Prepared by the author based on the data extracted from the Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE) websites.

1.5.3 Examining the 'Efficient Market Hypothesis'

This study has examined the efficient market hypothesis (EMH) in relation to the DSE by using the 'Random Walk Model' (Table 1.13). Sample data comprises of the daily index value of DS30 and DSEX for the period of 1 January 2015 to 22 May 2017 which include a total of 583 observations for both these indicators. It is observed from the test that z values of both the indices are significantly higher than the normal limit ((-1.645 to (+)1.645), and corresponding p-values are also zero, which indicates that the consequent price changes did not move in an independent manner, and returns of DS30 and DSEX did not follow the random walk theory. This would indicate that DSE's level of efficiency is weak.

Another way to test randomness is to examine the serial correlation of the index values. Lo and MacKinlay (1988) developed a variance ratio test to check the EMH. The test implies that if the natural logarithm of a

³² More importantly, new listing of companies has decreased significantly in recent years (four companies in 2015, eight companies in 2016, and three companies thus far in 2017).

Table 1.13**Testing Market Efficiency: Dhaka Stock Exchange**

Index	Number of Positive Returns	Number of Negative Returns	Total Run	z-value	p-value
DS30 Index	291	292	35	-21.35	0.00
DSEX Index	291	292	17	-22.84	0.00

Source: Estimated by the author.

time series Y_t is a pure random walk, the variance of its q -differences rises proportionally with the difference of q .³³ To test the EMH for the DSE, the autocorrelation tests with 20 lags were performed for DS30 and DSEX. The result of these tests showed that, in case of DS30, the null hypothesis is rejected for all lags at 5 per cent level of significance, except for lags 1, 3, 5 and 14. While in the case of DSEX, the null hypothesis is rejected for all lags at 1 per cent level of significance. The study further tests the joint hypothesis of autocorrelation coefficients up to 20 lags applying Ljung-Box Q statistics. The result of Q -statistics reveals that the autocorrelation coefficients up to 20 lags are jointly significant for DS30 and DSEX at 5 per cent and 1 per cent levels of significance respectively. This implies that the returns of DS30 and DSEX did not follow the Random Walk Model. This would indicate that DSE was afflicted by weak form of efficiency.

1.5.4 Analysis of Market-related Indicators of Newly Listed Companies since 2011

Performance of capital market since the collapse in 2010 may be examined based on different market-related indicators. This study considers information on the newly listed companies since January 2011. Of the 73 enlisted companies, data was available for 54 companies. Of the approved initial public offerings (IPOs) in different years, highest number of companies belonged to textiles (23), followed by engineering (12), fuel and power (9) and pharmaceuticals (6). Highest number of companies were listed in the years 2014 (17), 2013 (14) and 2015 (13); however, the number of enlisted companies has come down in 2016.

Share price of a traded company generally indicates company's current performance as also its possible future performance. The share price of the newly listed companies did not maintain a consistent trend over the past six years. In majority of the cases, changes in share prices of the same company has varied widely over the years. In most of the years, changes in average price of most of the companies were found to be negative.

Moreover, changes in share prices are not always consistent with other company-level indicators such as earnings per share (EPS), P/E ratio, net asset and net profit after tax (Table 1.14). It was observed that in most cases, share prices of the newly listed companies have suffered losses immediately after their trading was initiated in the market. Analysis of 54 companies reveals that share price of almost two-thirds of the newly listed companies decreased in the second day, and that the trend continued in the following days (Table 1.15). Till the seventh day, majority of companies had experienced a fall in share prices. This indicates inconsistency in the price set for trading; this also indicates inherent weaknesses in the listing process.

More importantly, changes in the values of key company performance indicators of newly listed companies are not consistent with one another (Figure 1.21). Analysis reveals that changes in values of key indicators (between 2011 and 2016) i.e. EPS, P/E ratio, profit after tax and net asset value of different companies in many cases were found to be difficult to explain.

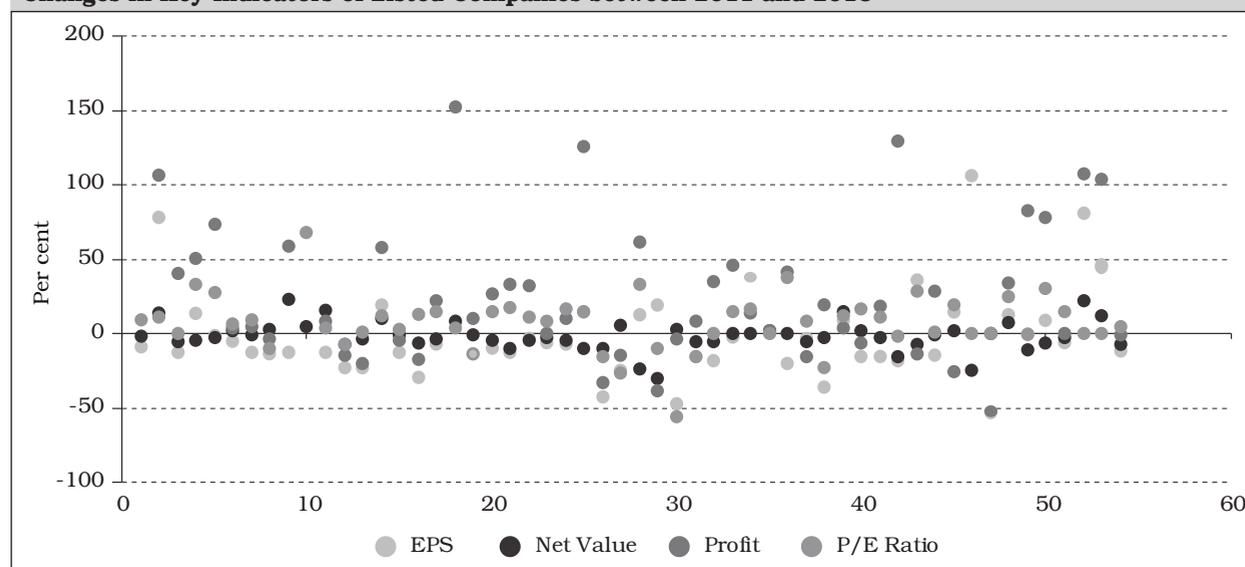
³³ In other words, if a series follows a random walk process, the variance of its q period should be q times the variance of the one period difference.

Table 1.14**Changes in Key Indicators^a of Newly Listed Companies between 2011 and 2016**

Indicator	Number of Listed Companies since 2011	Per cent of Total Companies
No change in key indicators	3	5.56
Only one indicator is positive	16	29.63
Only two indicators are positive	18	33.33
Three indicators are positive	11	20.37
Four indicators are positive	6	11.11
Total	54	100.00

Source: Author's estimates based on collected data.**Note:** ^aFour key indicators are: EPS, P/E Ratio, Net Asset, and Net Profit after Tax.**Table 1.15****Changes in Share Price of Newly Listed Companies during the First Week of Transaction**

Price Change	Day 2	Day 3	Day 4	Day 5	Day 6	Day 7
Price decreased	50	42	47	44	45	43
Price increased	21	31	26	29	25	28
Price unchanged	3	1	1	1	4	3
<i>in Per cent</i>						
Price decreased	67.57	56.76	63.51	59.46	60.81	58.11
Price increased	28.38	41.89	35.14	39.19	33.78	37.84
Price unchanged	4.05	1.35	1.35	1.35	5.41	4.05

Source: Author's estimate based on collected data.**Figure 1.21****Changes in Key Indicators of Listed Companies between 2011 and 2016****Source:** Author's estimate based on collected data.

Additionally, such a trend in company performance is difficult to explain when this is compared with sectorial performance. It is found that the majority of sectors related to the listed companies have performed

Table 1.16
Changes in GIP of Selected Medium and Large Industries

Year	Manufacture of Food Products	Manufacture of Textiles	Manufacture of Leather and related Products	Manufacture of Paper and Paper Products	Manufacture of Chemical and Chemicals Products	Manufacture of Pharmaceuticals	Manufacture of Medicinal Chemicals	Manufacture of other Non-Metallic Mineral Products	Manufacture of Basic Metals	Manufacture of Fabricated Metals Products	Manufacture of Electrical Equipment	Manufacture of Machinery and Equipment
2010-11	138.7	139.5	129.0	169.7	70.8	165.0	134.6	111.5	137.7	122.5	173.0	173.0
2011-12	161.3	139.4	132.3	171.3	80.8	169.8	138.2	114.3	138.8	125.2	178.3	178.3
2012-13	219.1	142.4	139.8	160.4	84.6	178.8	139.5	136.4	149.0	128.5	155.9	155.9
2013-14	241.5	139.7	147.8	152.0	80.4	230.6	144.2	150.2	164.3	132.1	172.7	172.7
2014-15	333.1	122.8	140.5	174.7	77.5	291.0	182.8	187.1	182.3	164.6	204.9	204.9
Change in Per cent												
2011-12	16.4	-0.1	2.6	1.0	14.1	2.9	2.7	2.5	0.8	2.3	3.1	3.1
2012-13	35.8	2.1	5.6	-6.4	4.8	5.3	0.9	19.4	7.4	2.6	-12.6	-12.6
2013-14	10.2	-1.9	5.8	-5.3	-5.0	29.0	3.4	10.1	10.3	2.8	10.8	10.8
2014-15	37.9	-12.1	-5.0	15.0	-3.6	26.2	26.8	24.6	10.9	24.6	18.7	18.7

Source: BBS (2017).

relatively well during the concerned period (2011-2015) (Table 1.16). Overall, relationship between sectorial performance of various industries (reflected in the Quantum Index of Production (QIP)) and company-level performance of listed companies was not found to be aligned.

Analysis of performance of listed companies since 2011 raises a number of questions as regards functional efficiency of the market, particularly with regard to consistency of the data on performance-related indicators for the listed companies, quality of financial reporting of the listed companies, trading behaviour of investors in the secondary market, quality of financial audits, enlistment process for new companies, performance of issue managers, and role of DSE/CSE and regulatory role of the SEC.

1.5.5 Major Concerns with regard to the Capital Market

Quality of Financial Reporting of Listed Companies

Performance indicators of listed companies indicate that financial reports prepared by the companies often do not show the 'actual' performance of the companies. It happens in spite of several regulatory and operational measures having been undertaken by the SEC with a view to improve financial reporting standards of the listed companies. The measures included selection of listed audit firms for reporting, rotation of listed audit firms every three years, and options for re-audit. It is important to examine whether SEC has actually monitored the compliance requirements to be followed by listed companies, whether SEC took the needed measures for re-auditing, and if so, what kinds of penalty were imposed on listed companies in case of failure to comply with the required standard. According to Table 1.17, SEC did take certain steps against the complaints lodged.³⁴ However, most of the complaints were related to non-payment or delays in payment of dividend, transfer of shares and refund warrants, etc.³⁵ Such complaints did not concern quality of financial report and quality of auditing.

Table 1.17

Complaints against Listed Companies in 2011 and 2015

Complaint	2011			2015		
	NCR	UP	CR	NCR	UP	CR
Overall	173	22	133	52	27	25
Resolved (%)	76.87			48.07		
<i>in Per cent</i>						
Non-payment or delay in payment of dividend	8.09	18.18	8.27	30.70	29.60	32.00
Non-payment of debenture instalment	0.58	4.55	0.00	0.00	0.00	0.00
Regarding transfer of shares	4.62	13.64	3.76	7.69	11.10	4.00
Non-receipt of letter of rights share offering	56.65	18.18	63.91	0.00	0.00	0.00
Non-receipt of annual report	6.36	0.00	7.52	3.85	0.00	8.00
Refund warrant	0.58	4.55	0.00	0.00	0.00	0.00
Non-demat of shares	23.12	0.00	0.75	0.00	0.00	0.00
Miscellaneous	0.00	40.90	15.8	57.6	59.20	56.00

Source: Author's estimate based on collected data.

Note: NCR: Number of complaints received; UP: Under process; CR: Case resolved.

³⁴However, both numbers of lodged complaints and resolved complaints have declined in recent years – 76 per cent of complaints were resolved in 2011, which reduced to 48.1 per cent in 2015.

³⁵There are a large number of complaints under miscellaneous category.

Due Diligence Applied for Enlistment of Companies

During 2011 and 2017, a total of 131 companies submitted prospectus to the SEC for enlistment; of these 73 companies received approval, and were subsequently enlisted. This would mean that about 44 per cent of applications did not get the necessary approval. A number of regulatory and operational changes have been put in place in relation to submission of applications, particularly under book building method and collection of funds drawn through IPO process. The average number of times companies were required to resubmit their applications has declined – from 2.57 in 2011 to 1.4 in 2017.

Interestingly, the average number of resubmission is relatively higher in case of companies which had applied under the category of fuel and power (4.4), followed by textiles (3.7) and engineering (3.1). Out of the 131 companies, there are 42 cases where companies resubmitted their applications only once. It is important to examine whether IPO applications are scrutinised properly and in case of resubmission whether compliance process has been duly followed. There were procedural delays in case of approval of IPO proposals due to incomplete/improper submission of applications by issue managers. In such cases submission requirements increase and approval process gets delayed. Generally it takes about 10 months to get approval from the SEC. This was significantly higher than that of the Bombay Stock Exchange (BSE) (two and a half months).

Enlistment of IPOs

Enlistment of IPOs has reduced significantly since the boom and bust of 2010, more specifically after 2013. This may have been the case particularly due to introduction of additional compliance requirements through amendment of IPO rules in 2015-16 leading to the shift from 'merit-based' to 'disclosure-based' method of scrutinising IPO applications. Under the new system, companies need to comply with additional information requirements such as cash flow and EPS-related information for the preceding two years. Besides, the process of exercising due diligence has improved with introduction of the requirement of physical inspection, use of auditors from panel of auditors selected by the SEC, and also introduction of better corporate governance at the company level. These changes made the process of getting approval of IPOs more stringent. In case of book building system as well, a number of changes have been introduced. Despite these welcome measures, below par performance of many of the companies listed through the IPO process gives rise to concerns as regards efficacy of the newly enacted measures.

Performance of Merchant Banks and Brokerage Houses

There is a concern that the number of merchant banks and brokerage houses is higher than the volume of trade taking place in the capital market. A large number of these entities is not involved in financially viable operations; most importantly, many of these have dearth of adequate capital. Moreover, operation of some of the merchant banks and brokerage houses has not been above question. While the problem concerning margin loans appears to have receded to the background in recent years, the issue persists. It is important to see whether margin limit of these companies has been properly maintained. Additionally, the number of market intermediaries currently in operation appears to be rather high – as many as 450 intermediaries (236 in DSE and 148 in CSE) have received license to operate in these markets. Moreover, these intermediaries operate through branches all across the country. Investors often complain about the quality of operation and services rendered by the branches of these intermediaries. There are allegations about lack of transparency in operating the individual BO accounts by these companies. In view of the significantly large number of financial intermediaries and their branches, regularity of inspection by the SEC has suffered. Even in case of those which were inspected by the SEC and referred to the enforcement department for some action, speedy measures could not be undertaken (Table 1.18). Indeed, with the limited human resource, at its disposal, it is difficult for the SEC to perform its task. A thorough examination of operation of merchant banks and brokerage houses is thus called for.

Table 1.18**SEC Inspection of Stock Brokers, Stock Dealers and Merchant Banks**

Year	Number of Inspections	Referred to Enforcement Department for Action	Under Process	Resolved
2011	37	18	5	14
2012	71	6	44	21
2013	113	38	71	4
2014	65	23	39	3
2015	12	2	8	2
Total	298	87	167	44

Source: Bangladesh Securities and Exchange Commission (BSEC) Quarterly Review.

Transparency in BO Accounts

At present a total of 2.9 million BO accounts are registered with the capital market. The number has varied over the years – from as low as 2.6 million in June 2013 to as high as 3.6 million in May 2015. Highest number of accountholders belong to the individual category – these account for over 60 per cent of total BO accounts. This is followed by joint-holders (37 per cent). On the other hand, number of omnibus accounts has come down over time.³⁶ Concern has been raised as regards transparency with which BO accounts of individual/joint accountholders has been maintained. A proper alignment of personal information of BO accountholders with other relevant organisations will significantly reduce illegal practices in the capital market. This will also make tracking of transactions and deals by individual accountholders easier.

Demutualisation

Although the process of demutualisation was initiated in November 2013, this is yet to be completed. As per the timeline, this process should be over by June 2017. Identification of strategic investors and selling of 25 per cent of total paid up capital to strategic partners are still in progress. All these activities were planned to be completed by June 2017. Once this is done, DSE will need to be self-listed. However, the 250 brokers of the DSE (of which 36 brokers are active) are yet to arrive at a consensus about selection of strategic partners as prospective investors' offered price for purchasing brokers' shares appears to the latter as low.

Following initiation of the process of demutualisation in 2013, the boards of DSE and CSE have been restructured – out of 12 directors only four are brokers' representatives, while the rest of the directors including the chairman are 'independent' members. Hence, the chairman and independent directors have a critically important role to play in decision making in the newly formed board. In this context, chairman and other board members will have to be technically sound in stock market-related issues and they should be able to take decisions that are in the greater interest of the capital market. There is much room for improvement in this regard.

DSE/CSE

Level of due diligence required from DSE/CSE to ensure good compliance of the listed companies in connection with financial reporting appears to be weak. Following the amendment of rules with regard to process of reporting of financial statement of listed companies, DSE/CSE need to put comments on the submitted reports. In view of the poor quality of many of the financial reports, it is important to examine whether DSE/CSE have been able to pursue due diligence as rigorously as they should.

³⁶However, the number of principal accounts has increased very little.

Insider Problem

Despite introduction of guidelines as regards good corporate governance practices, capital market has often remained hostage to the insider problem. It has been alleged that directors of some companies did not have the minimum required shares. It is important to examine whether this actually is the case. It has also been observed that some directors often get involved in day-to-day management operations of listed companies.

Trading Behaviour of Investors in the Secondary Market

A number of initiatives have been undertaken to better educate and to raise awareness of investors about trading and investing in the capital market. However, trading behaviour of 'retail' and 'institutional' investors do not conform to the best practices. Access to information through automation of DSE/CSE should have been helpful to the investors. They mostly look for short-term gains with scant confidence as regards medium- to long-term business prospects of the companies. Moreover, shallowness of the capital market remains a challenge where the large number of willing investors do not have adequate opportunities for investment.

Bangladesh Bank

There is an Inter-regulatory Coordination Committee which includes representatives from the Bangladesh Bank, SEC, Insurance Development Regulatory Authority (IDRA), Microcredit Regulatory Authority (MRA) and cooperatives. In view of the overexposure of some of the commercial banks with poor assets, Bangladesh Bank has asked the commercial banks to adjust their exposure to the capital market in a timebound manner. As may be recalled, the Bangladesh Bank has allowed the credit taken by merchant banks from their mother banks not to be considered as 'bank's exposure' to the capital market. Considering these adjustments, individual bank's exposure to the capital market has to be maintained at the required level. Bangladesh Bank should now closely examine whether all banks have exposure within the stipulated limit. As per the new guidelines, all banks must have independent directors in order to comply with SEC guidelines. This requirement also needs to be examined and enforced.

Operation of SEC

Following the various regulatory reform measures, volume of activities on the part of the SEC was expected to rise which would have ensured better compliance in the operation of the capital market. However, till now, a proactive stance remains to be seen and SEC's role is more reactive than proactive, focusing more on addressing complaints lodged. As per the available information, SEC has taken various measures in view of complaints made against listed companies, market intermediaries, brokerage houses and issuer companies. However, the number of such complaints is also not very high. More importantly the process of resolving disputes and complaints also appears to be rather slow.

1.5.6 Suggestions for Strengthening the Institutional and Operational Structure of the Capital Market

Transparency in BO Accounts

Transactions under the different types of BO accounts, particularly of individuals and joint accounts, need to be made transparent. It is alleged that many individuals and joint accountholders tend to maintain multiple BO accounts which is more than the stipulated number. There are 'ghost' accounts which are maintained illegally by avoiding compliance requirements. In this context, information pertaining to the accountholders needs to be aligned with other sources of information such as national identity (NID) card,

information preserved at the NBR and with the Bangladesh Bank. SEC should take an initiative to undertake the needed changes in the Central Depository Bangladesh Ltd. (CDBL) system to include appropriate codes for NID, business identification number (BIN) (if required), and bank account numbers in order to identify BO accountholders with other national databases.

Improvement in Quality of Auditing

Financial auditing system for the listed companies needs to be significantly improved. Although a number of measures have been undertaken in order to improve the auditing practices, quality of many of the financial reports continues to be doubtful. In this context, SEC needs to take a proactive stance. It should ask for 're-auditing' of firms on a random basis. In this context, delays in operationalisation of Financial Reporting Council (FRC) under the recently enacted 'Financial Reporting Act' (FRA) has emerged as a major concern. Thus, establishment of the FRC with appointment of competent chairman and members, and its coming into force are urgently called for.

Proper Review of IPOs

Although the IPO review process has improved with changes in reporting system and requirement of various documents, the process needs to be further strengthened. A review of share prices of newly traded companies in the first week of trading indicates that share price of most of the companies has declined from the second day of trading. In other words, the companies perhaps are not properly assessed before allowing them to go for trading. Unless appropriately assessed with physical inspection, 'paper-based' information about health of the companies remains doubtful. In this backdrop, SEC and DSE/CSE need to strengthen their assessment process with proper physical inspection to examine viability of companies and their actual intention to go for enlistment. Process of assessment should be accelerated so that companies may have a predictable timeframe.

Proper Monitoring of Merchant Banks and Brokerage Houses

Inspection of activities of stock brokers, stock dealers and merchant banks need to be more frequent. Given the significantly high number of financial intermediaries and their branches, frequency of inspection at present appears to be very low. A large number of cases has been referred to the DSE/CSE involving complaints against financial intermediaries. These need to be speedily resolved. Out of 282 cases referred to DSE/CSE, only 169 cases (about 60 per cent) have been resolved till now. In other words, about 40 per cent cases remain unresolved. It is important to know the reasons behind the delays from the part of DSE/CSE to settle the complaints. Settling such cases, speedily and in a transparent manner, will transmit a positive signal to the market. In a good number of cases, SEC had penalised some of the intermediaries for various illegal activities (Table 1.19). It is important to know the amount of money which has been collected by penalising companies, and also amount of money that is yet to be collected.

Table 1.19

Enforcement of Legal Measures

Against	2011		2012		2013		2014		2015	
	Warning	Penalty								
Total	176	105	107	98	54	36	80	72	76	52
<i>in Per cent</i>										
Company	88.6	42.9	46.7	57.1	29.6	38.9	56.3	20.8	17.1	34.6
CA firm	1.1	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	3.8

(Table 1.19 contd.)

(Table 1.19 contd.)

Against	2011		2012		2013		2014		2015	
	Warning	Penalty								
Broker/ dealer	4.0	45.7	43.9	29.6	48.1	41.7	35.0	48.6	65.8	36.5
CRC	0.6	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Merchant bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.2	6.6	11.5
Issue manager	1.1	1.9	0.9	0.0	1.9	2.8	0.0	1.4	0.0	7.7
Others	4.5	9.5	6.5	13.3	20.4	16.7	8.8	25.0	10.5	5.8

Source: Bangladesh Securities and Exchange Commission (BSEC) Quarterly Review.

Note: CA: Chartered Accountant; CRC: Credit rating company.

Strengthening the Boards of DSE/CSE

The boards of the DSE/CSE need to be strengthened with appointment of competent and honest persons as independent directors. The chairman and the board members need to have strong background on the capital market, and should be able to take decisions without influence of any vested quarters. The decision-making process needs to be more transparent, and these decisions should be enforced quickly. For example, weak review process concerning IPO applications, slow progress in undertaking actions in view of complaints against financial intermediaries and lack of initiative to self-review the applications indicate that the boards need more power to provide proper directives to the DSE/CSE administration to operate transparently and efficiently. On the other hand, brokers should be represented in the board by new members with a view to provide new and dynamic thinking to make the stock exchange more forward-looking and strategic.

Completion of Demutualisation Process

It is important to complete the identification and selection process of institutional investors without delay. As the stipulated date for completion of the demutualisation process draws near (June 2017), it is needed to identify appropriate investors for investment in the capital market. It is expected that the selected institutional investors will be of high repute at global level, and will facilitate development of the capital market by maintaining high level standards. Following this, the self-listing of DSE/CSE needs to be completed.

Rules related to Special Tribunal Need to be Amended

Although the setting up of the special tribunal is a welcome measure, its pace of activity has been rather slow. At this moment, the tribunal is handling only 21 cases. A major drawback which afflict the special tribunal is that it only handles those cases which are transferred from other courts/tribunals (25 (B) under the SEC Act 1969). Neither SEC nor any other authority is empowered to lodge any petition directly to the tribunal. In view of the above, the tribunal has not been able to meet the expectations and deliver. Hence, necessary amendments of relevant clauses in the SEC Act is needed for the SEC to be able to lodge cases directly in the special tribunal.

Improving Trading Behaviour of Institutional Investors

It is important to introduce appropriate guidelines for trading by institutional investors in the capital market (e.g. as in India). Such guidelines are necessary to streamline trading behaviour of institutional investors in the backdrop of the many complaints as regards market behaviour of many such entities.

Strengthening of the SEC

With putting in place of the various rules, regulations and guidelines, the responsibilities of the SEC have increased significantly, and it has been further empowered. SEC now needs to change its focus in the areas of monitoring and enforcement from a 'complaint-based' mode to 'proactive review and assessment' mode. With the existing workforce of 173, it is difficult for the SEC to undertake the rising and diverse range of activities. As per plan, SEC needs a workforce of 800, of which an additional 205 staff is currently being recruited. Most importantly, SEC needs more human resources to scrutinise the various relevant documents including financial documents provided by the listed companies. Frequent and randomly conducted special audits of companies should be SEC's regular practice. Additional workforce will be required for speedy resolution of the various complaints lodged. This will improve confidence in the market. Moreover, additional workforce need to be deployed for day-to-day monitoring of activities in order to identify anomalies, and for taking speedy measures in view of those.

Initiatives for Increasing the Depth of the Capital Market

Appropriate initiatives are needed to enhance the depth of the capital market. Firstly, given the potential opportunities of bond financing for infrastructure projects, it is important to develop a well-structured bond market in the country. Secondly, SEC should take measures to create greater opportunities so that small- and medium-scale companies are able to raise funds from the capital market. In this context, SEC should set annual targets for enlistment of small and medium enterprise (SME) firms in the capital market. Thirdly, state-owned enterprises (SoEs) which had earlier decided to offload a part of their shares, should be encouraged, through the Ministry of Finance (MoF) and other concerned institutions, to offload at least a part of the shares in the capital market.

1.6 CONCLUDING REMARKS

From the perspective of macroeconomic management, it is important to consolidate the strengths and devise appropriate policies to address the emerging challenges in the Bangladesh economy. The current macroeconomic trends indicate a number of disquieting signals including increasing public debt burden, persisting weakness in the banking sector performance, sluggish capital market, lower growth in export earnings, and decline in remittance inflow. At the same time, it is also apprehended that in FY2017-18, cost of production in almost all sectors may experience an upward trend in view of implementation of new VAT and SD Act, possible depreciation of exchange rate, rise of the cost of wage good (rice price), and yet another round of upward adjustment of the tariffs for electricity and gas. Addressing these challenges calls for a proactively responsive macroeconomic management as a major policy stance in the upcoming national budget.

It may be noted that CPD has already elaborated this aspect in its April 2017 proposal for the national budget (CPD, 2017). In the following paragraphs we build on the forgoing analysis in this report as well as on the recommendations for national budget for FY2017-18 presented earlier (Chapter 2 of the present volume).

Improve the Quality of the Budgetary Framework

It has become critical for the government to improve quality of budgetary framework and turn the so called 'big budget' myth into reality. As has been established elsewhere, declared size of the budget (as a share of GDP) – from both revenue mobilisation and public expenditure point of view – has increased over the years. But in reality (after implementation) it did not improve by any discernible way (if not declined). For example, programmed total expenditure in FY2015-16 was 17 per cent of GDP as against 14.3 per cent in

FY2009-10. However, actual public expenditure was only 13.5 per cent of GDP in FY2015-16, a decline from 14 per cent in FY2009-10. Concurrently, target for revenue-GDP ratio was 10 per cent of GDP in FY2009-10, which was programmed to increase to 12 per cent in FY2015-16. However, actual revenue-GDP ratio could only be enhanced to 10 per cent in FY2015-16 from the 9.5 per cent posted in FY2009-10. Thus, budget implementation capacity of the government agencies needs to be enhanced by a significant margin in order to have improved impact of public resource flows in the economy.

Strengthen Quality of Public Investment

Government pledged to implement a number of reforms with a view to raising the ADP implementation rate. These included introduction of a Project Preparatory Fund (PPF), appointing project directors (PDs) through direct interviews by the line government agencies, 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, 2016). IMED also came up on a regular basis with recommendations in the annual progress report based on the challenges faced during the project cycle. Regrettably, these have not been adequately followed up with concrete policy actions. Time and cost overrun, with high opportunity cost, have become a persistent problem in public sector project implementation. It is also observed that project costs in Bangladesh are substantially higher than those in other comparable countries. For example, construction cost of one kilometre road in India costs about Tk. 12.5-15 crore, while in Bangladesh, such cost is about three to four times higher. This is true for almost all types of projects, particularly those in the construction sector. Thus, even though Bangladesh is investing a large amount of resources in public infrastructure, such investments are yet to make an impact through delivery of services. Indeed, effective rate of return from such public investments has become very obscure. It is time for setting up a Public Expenditure Review Commission (PERC) to ensure quality of public investments underwritten by scarce domestic revenue.

Augmenting Resource Mobilisation

A number of planned reform agendas has remained unimplemented and this has severely constrained the capacity of the government to deliver budgetary programme. 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. For the forthcoming budget, implementation of the VAT and SD Act, 2012 will be of critical importance. CPD (2017) has made a number of proposals for smooth implementation of the new provisions of value added tax (VAT). In South and East Asia and among the lower middle-income countries (LMICs), the median VAT rate appears to be 12 per cent, and hence, this can be an acceptable VAT rate for Bangladesh. It was also recommended that for the electricity, VAT rate should not be increased at one shot in view of its likely negative impact on both consumption and private investment. In this context, government may fix the maximum retail price (MRP) of electricity inclusive of VAT. Hence, the government will also need to be ready to provide adequate subsidy to the sector which may be later withdrawn in a phased manner. While implementing the new VAT Act, it is important to keep provision for supplementary duties (SDs) to protect the interest of the domestic-market-oriented industries. To this end, needed strategic protection to these sectors will be critical, particularly in view of the need to augment aggregate demand in the context of slowdown in export growth and fall in remittances. A longer, well-thought-out list of SDs may also help the government compensating for a reduced VAT rate.

It may be mentioned that, while the government is assessing the scope for a reduced VAT rate, according to several media reports, increase in SD rates for fuel, cement and telecom are also being considered. If implemented, this will be counter-productive. An increase in SD rate for fuel import may mobilise resources for NBR, but it will also create burden for the Bangladesh Petroleum Corporation (BPC). While producers

and consumers of Bangladesh could not fully enjoy the benefit of decline in global prices of petroleum, it is time that the administered prices of kerosene and diesel are reduced to provide relief to the concerned groups. Similarly, cement is one of the most critical investment commodities in Bangladesh, imposing SD on which would mean taxing both public and private investment. SD on telephone use is also regressive in nature, and hence, should not be imposed.

In view of possible rise in cost of living, to provide some relief to taxpayers, CPD also proposed a reduction of income tax rate from the current 10 per cent to 7.5 per cent for the first slab. Such a measure will help increasing 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 creating scope for additional revenue earnings.

Enhance Allocation to Social Sectors

Budgetary allocations for education and health sectors need to be enhanced significantly. It may be recalled that Bangladesh's education and health budgets as a share of GDP are among the lowest in the world. In view of ambitious SDG targets, it is time for Bangladesh to amend the situation. The forthcoming national budget also needs to make adequate provisioning for implementing the National Social Security Strategy (NSSS).

Financing Budget Deficit

Implementation of forthcoming national budget must also bring discipline in the area of budget deficit financing. In view of declined interest rates of bank deposits and rising debt servicing burden, the interest rates on NSD certificates along with the purchasing ceilings need to be rationalised.

On the other hand, more effective steps will need to be taken for utilisation of the foreign aid in the pipeline. This aspect will be of defining importance for FY2017-18 as the off-take of project aid experienced a decline in the outgoing fiscal year.

Incurring Efficiency of the Public Food Distribution System

The government needs to be vigilant in view of the recent rise in rice price in the domestic market in the midst of harvesting season. The government will need to prepare a strategy to import rice as the Boro procurement may not reach its target. Import duty on rice may be reduced if private import is also required. In view of the 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 and protecting consumer interests.

The forthcoming budget should also review the subsidy package for agriculture. The present structure of agricultural subsidy is heavily Boro-biased. In view of the loss of the Boro season, the farmers should be incentivised to cultivate in the forthcoming Aus season. Besides, it has also become critical to provide adequate incentives to diversify crop sector, and also promote poultry, livestock and fisheries sectors.

Public food distribution programme needs to be used in strategic way to protect the affected people in the *haor* and *char* areas and urban poor. It is also time to rethink development strategy for marginalised people living in *haor*, *char* and river erosion areas. In view of the 2030 Agenda's spirit of "leaving no one behind," the government may consider setting up a 'Haor, Char and River Erosion Area Board'. This body can devise strategy and closely monitor development needs of citizens living in these areas.

Managing the Exchange Rate and Addressing the Weaknesses in the External Sector

The government may need to continue with further downward adjustment of the exchange rate of BDT in the short term. The recent volatility in exchange rate for import has exposed a weakness in the foreign exchange management on the parts of both commercial banks and the central bank. The depreciation of Taka has its demerits; it may raise import costs, leading to higher cost for producers and inflationary pressure for consumers. However, some depreciation of BDT is critically important in view of lower growth of export earnings and falling remittance inflow. To arrest influx of remittance through informal channel, legal actions against illegal platforms as well as parallel initiatives to facilitate speedy and cost-effective remittance transfer will be necessary. To this end, initiatives will be required both at domestic and global levels. In view of emerging pressure in the foreign exchange reserves, it is advised to pursue a rather careful and conservative approach towards Bangladeshi investors' plea to invest abroad.

Addressing the Banking Sector

Inability to initiate the needed economic reforms is a major concern from the macroeconomic management point of view. This is particularly pertinent for the financial sector in Bangladesh. The banking sector is suffering from endemic structural weaknesses due to lack of policy and institutional attention. CPD has repeatedly urged for setting up an IFSRC which needs to come up with appropriate recommendations to address the formidable fault lines in Bangladesh's financial sector. It has now become an emergency to undertake an in-depth review and assessment of the health and performance of the banking sector of the country, and come up with concrete guidelines to deal with NPL, rescheduling of bad debt, and recapitalisation of banks. The proposed commission can be empowered to undertake the required steps. In the context of forthcoming national budget, the government needs to be prudent in allocating taxpayers' money to SCBs for recapitalisation, pending a proper assessment of their performance as well as reform of their operation. Various recent experiences suggest that it is also important not to engage in external interference in governance of the private banks. On the other hand, the recently announced amendments of the Banking Company Act, favouring the sponsor directors, have been very ill-advised.

Boosting the Capital Market

The capital market is also struggling as has been highlighted by this report. A number of reform initiatives has already been taken regarding operation of the capital market. Completion of demutualisation process within the announced timeframe needs to be done, while the other corrective measures including appropriate review of IPOs, alignment of BO accounts with NID and other national databases, proper financial auditing of the firms, transparency of merchant banks and brokerage house operations – need to be ensured. Strengthening of SEC and other regulatory bodies including DSE and CSE are critically important for successful operationalisation of these processes.

Improving the Quality of Statistics

To undertake dynamic macroeconomic management, it is crucial to assess the trends of macroeconomic correlates on a real time basis. In recent times, major weaknesses have emerged in the areas of statistics on the economy. Quality of statistics has come under critical scrutiny. It may be mentioned that CPD has repeatedly highlighted the growing inconsistency of available data from different government agencies. These include, revenue earnings figure from NBR and MoF, ADP expenditure figure from IMED and MoF, and budget deficit and financing figures from Bangladesh Bank and MoF. The estimations of national accounts variables have also been repeatedly critically assessed by analysts. Delivery of open statistics has also weakened. Publication of quarterly LFS data was discontinued. Available fiscal data is not accessible beyond the first four months of the ongoing fiscal year. Indeed, over the years, quarterly reporting on the

state of economy by the Finance Minister to the National Parliament has also become irregular. There is an increasing trend of not sharing of data by various public institutions.

In the era of SDGs, “Data Revolution” is the name of the game. Besides, Bangladesh has also expressed its strong commitment towards this. In this context, it has become exceedingly important to ensure independence and professionalism in the national statistical organisation of Bangladesh. It may be recalled that CPD in its reaction on the national budget for FY2016-17 called for setting up an Independent Statistical Commission to initiate necessary reforms in this area including validation of the macroeconomic correlates.

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ANNEX

Annex Table 1.1		
Comparison of Data Availability		
Indicator	IRBD FY2015-16 (Third Reading)	IRBD FY2016-17 (Third Reading)
	Data Availability Situation	
GDP	Provisional estimates for FY2016	Provisional estimates for FY2017
GIP (medium and large)	Till January FY2016	Till December FY2017
Inflation	April 2016	Till March 2017
Local and foreign investment registration and value	Till March FY2016	Till April FY2017 (did not receive local investment data)
Public Finance		
Revenue collection: NBR sources	Till March FY2016	Till February FY2017
Revenue collection: MoF sources	Till December FY2016	Till October FY2017
Public expenditure	Till December FY2016	Till October FY2017
ADP implementation: IMED sources	Till April FY2016	Till April FY2017
Financial Sector		
Interest rate spread (by bank type)	Till March 2016	Till March 2017
NPL as % of total loans (by bank type)	December 2015	September 2016
Capital to risk-weighted asset (by bank type)	December 2015	December 2016
Profitability ratios (ROA and ROE) (by bank type)	December 2015	December 2016
Outstanding position of term loans	Till December FY2016	Till December FY2017
Disbursement of industrial term loans	Till December FY2016	Till December FY2017
SME loan disbursement (quarterly)	Till December FY2016	Till December FY2017
Agricultural credit and non-farm rural credit	Till March FY2016	Till March FY2017
External Sector		
Export	Till April 2016	Till April 2017
Import payments (23 items)	July-March FY2016	July-March FY2017
L/C opening and settlement	July-March FY2016	July-March FY2017
Migration	Till April 2016	Till April 2017
Remittances (by destination)	Till April FY2016	Till April FY2017
Forex	18 May 2016	24 May 2017
BOP	July-March FY2016	July-March FY2017
State of the Economy Report by the Hon'ble Finance Minister for the National Parliament	July-December FY2016	July-March FY2017

Source: Author's compilation.

Chapter 2

State of the Bangladesh Economy in FY2016-17

(Second Reading)

CPD's Recommendations
for the Upcoming Budget

2.1 INTRODUCTION

The CPD budget proposals for FY2017-18 is also the second reading of the state of the economy for FY2016-17, prepared under the *Independent Review of Bangladesh's 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 FY2016-17. This second reading presents CPD's perspectives in the context of the upcoming FY2017-18 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 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 FY2016-17, to be released prior to the presentation of FY2017-18 budget.¹ The final instalment of this year's IRBD will come up with CPD's reactions to the FY2017-18 budget once it is presented in the National Parliament in June 2017.

2.2 MACROECONOMIC BACKDROP IN THE RUN-UP TO THE NATIONAL BUDGET FOR FY2017-18

Designing of national budget for FY2017-18 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 the performance of key macroeconomic indicators in the ongoing fiscal year, and sets the benchmark for the upcoming national budget.

2.2.1 Macroeconomic Correlates in Positive Trend

Headline inflation continued to decline albeit some rise in food inflation

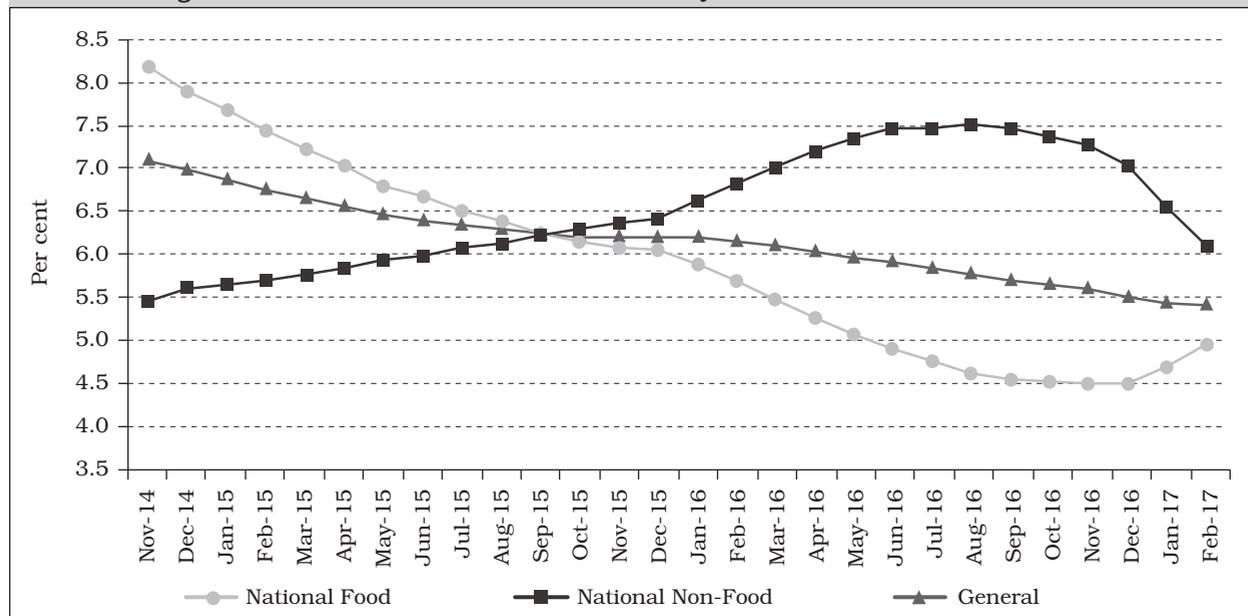
Consumer Price Index (CPI) inflation in Bangladesh has maintained the declining trend in FY2016-17, till February 2017 (Figure 2.1). Annual average inflation was 5.41 per cent in February FY2016-17, which was well within Bangladesh Bank's Monetary Policy Statement (MPS) target of 5.3-5.6 per cent for FY2016-17. 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 trends 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.

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 it had been a year ago. Also, average rice price in Bangladesh is about

¹Included as Chapter 1 of the present volume.

Figure 2.1

Annual Average Inflation Rate: November 2014 – February 2017

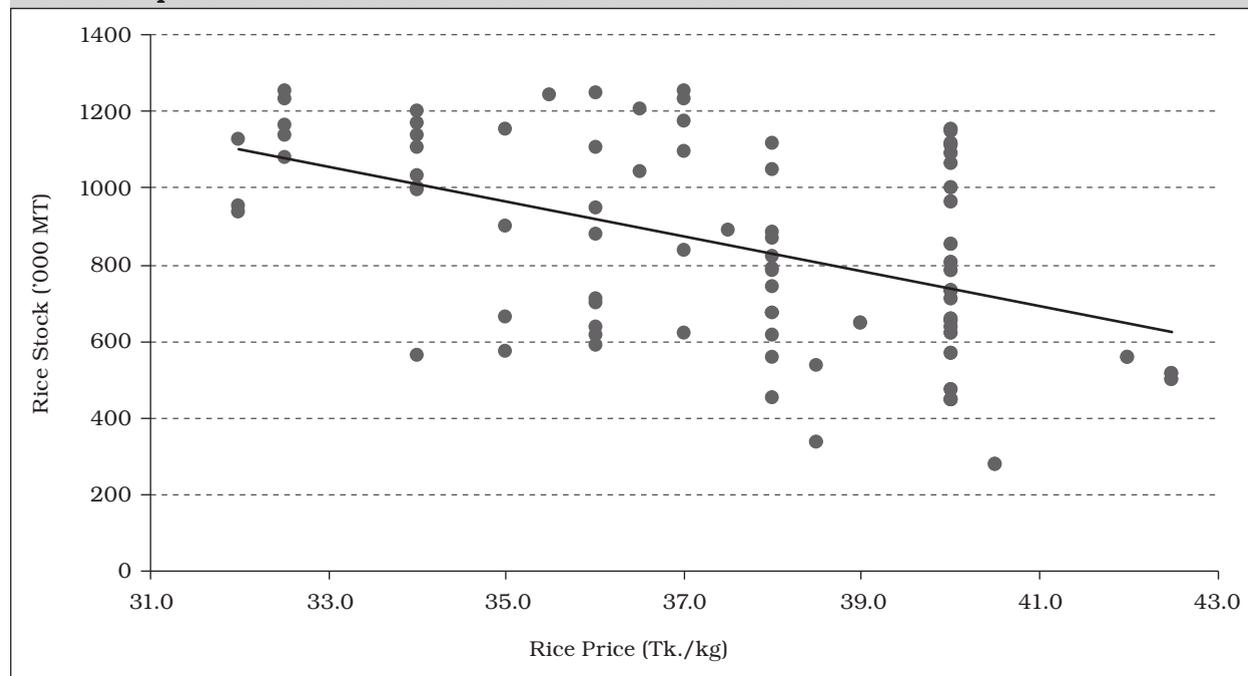


Source: Bangladesh Bank data.

27.9 per cent higher than that of India.² 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, FY2016-17 marks the

Figure 2.2

Relationship between Public Stock of Rice and Retail Price of Rice



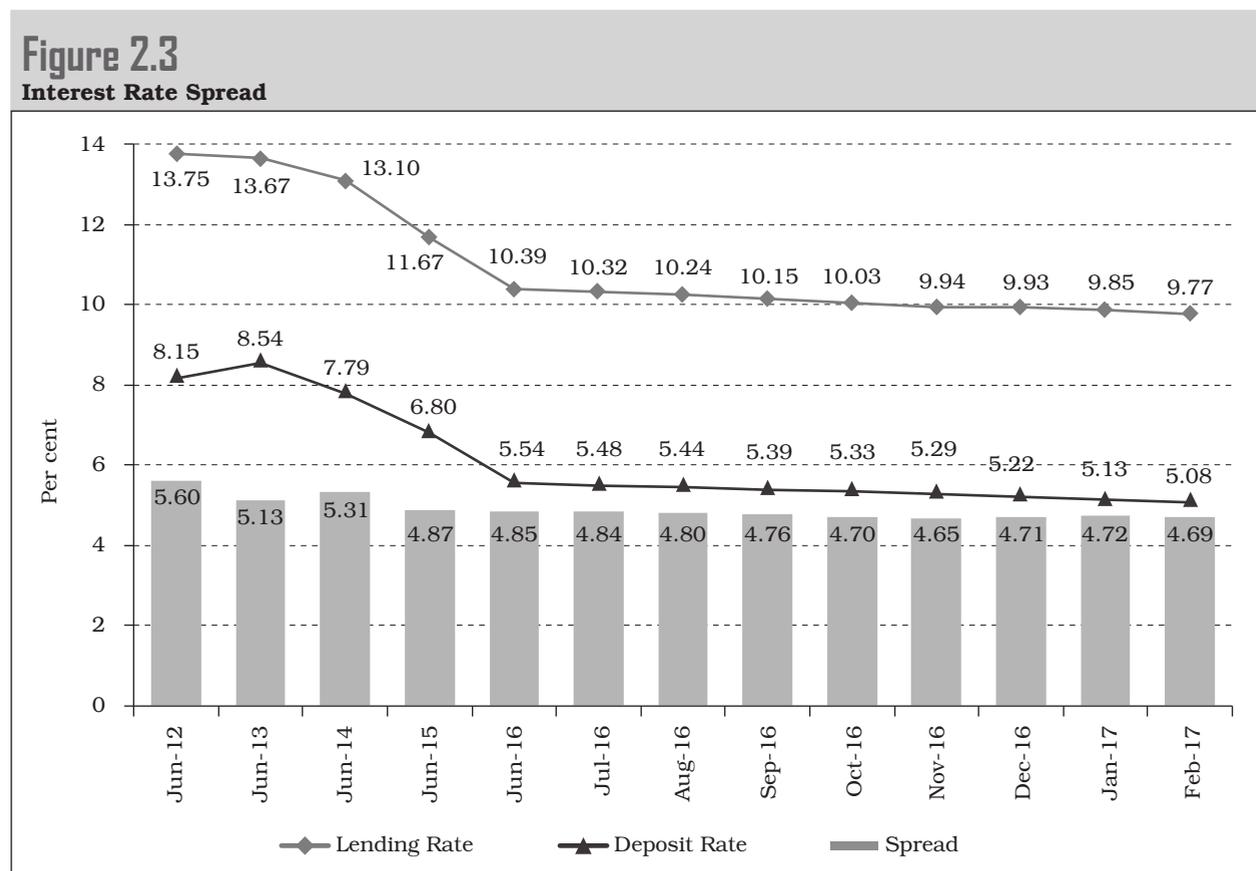
Source: Calculated from the Bangladesh Bank and Food Planning and Monitoring Unit (FPMU) data.

²Prices of medium-quality Aman rice and 5 per cent parboiled rice were considered for Bangladesh and India respectively; data collected from the Food Planning and Monitoring Unit (FPMU), Ministry of Food, Bangladesh.

lowest level of rice stock in March since FY2011-12. Also, Aman procurement (till the end of March 2017) to the tune of 444 thousand metric tonnes (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.

Interest rate continued to fall with sticky spread

Interest rates for both lending and deposit continued to decline throughout the FY2016-17, in line with the declining trends experienced in FY2015-16. 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 (NPLs) and CAMELS (capital adequacy; assets; management capability; earnings; liquidity; sensitivity) indicators, are contributing to a situation where the spread is 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.



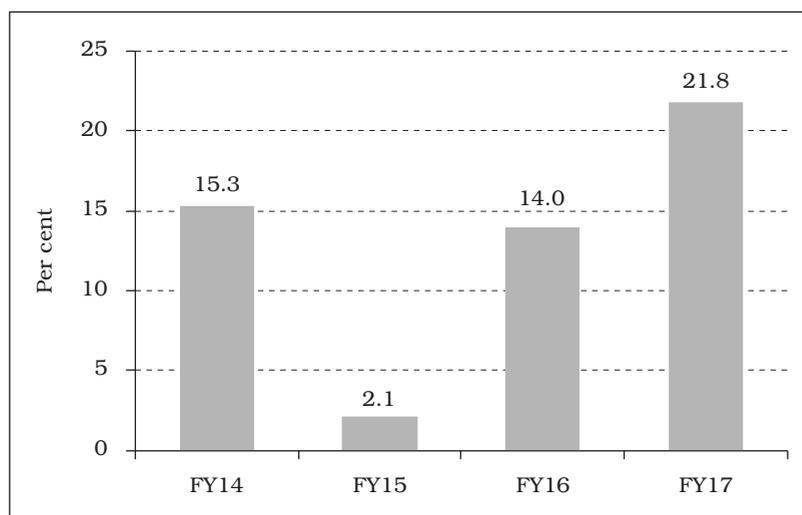
Source: Bangladesh Bank data.

Proxy indicators for private investment show promising signs

FY2015-16 ended with an upturn in private investment-GDP (gross domestic product) ratio. During July-February of FY2016-17, capital machinery import, which has important investment implications, registered an impressive growth of nearly 24 per cent.³ 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

³During the same period, letter of credit (L/C) opening for capital machinery also increased by 13.4 per cent.

Figure 2.4
Agricultural Credit Disbursement
Growth (July-February)



Source: Bangladesh Bank data.

15.9 per cent by the end of February 2017 compared to the corresponding period of FY2015-16. During July-February of FY2016-17, net foreign direct investment (FDI) inflow also increased by 17.4 per cent.

Agricultural credit disbursement registered 21.8 per cent growth during July-February of FY2016-17, which was 14 per cent during the corresponding period of FY2015-16. It is to be noted that, this is the highest attained growth since FY2013-14 (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 (SMEs) rose by 21.7 per cent during July-December of FY2016-17.

On the flipside, industrial term loan disbursement recorded only 6.9 per cent growth during July-December of FY2016-17, which was (-) 3 per cent over the matched period of FY2015-16. As can be seen from Table 2.1, during the January-June period of both FY2014-15 and FY2015-16, growth rate of industrial term loan disbursement was significantly high. Replicating similar growth in FY2016-17 may prove to be difficult.

Table 2.1
Industrial Term Loan Disbursement Growth

(in Per cent)

Period	FY14	FY15	FY16	FY17
July-December	-1.8	45.9	-3.0	6.9
January-June	0.8	36.6	23.6	N.A.

Source: Bangladesh Bank data.

Note: N.A. refers to not available.

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 2.4).

Balance of payments situation is still at a comfortable zone

Up to February of FY2016-17, the overall balance of payments (BOP) was positive (USD 2.5 billion), while current account balance fell into the deficit terrain.⁴ Higher trade deficit alongside the falling remittance inflow have contributed to this. During July-February of FY2016-17, Bangladeshi Taka (BDT)

⁴(-) USD 1.1 billion, which was USD 2.9 billion during the corresponding period of FY2015-16.

has appreciated against Euro, Chinese Yuan and British Pound (GBP); and depreciated against United States Dollar (USD) and Indian Rupee (INR). 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 (GoB) 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 of foreign exchange payments should inform any policy decision in this context.

NBR revenue collection growth improved

FY2016-17 had set an ambitious National Board of Revenue (NBR) revenue growth target of 38.9 per cent compared to the actual collection in FY2015-16. Against this, the attained growth has been 20.6 per cent up to October of FY2016-17⁵ when compared with the corresponding period of the previous fiscal year. The comparable periods for FY2014-15 and FY2015-16 registered a much lower growth of 8 and 10.9 per cent respectively (Table 2.2). However, the required growth of NBR revenue for the remainder of FY2016-17 is 45.8 per cent, which is not likely to be achieved. It is understood that a significant revision of revenue mobilisation target will be made while preparing for the budget for FY2017-18. 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 FY2016-17. 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 FY2017-18 (discussed in detail in Section 2.3).

Table 2.2

Revenue Growth Target and Achievement

(in Per cent)

Source of Revenue	Actual FY15 (Up to Oct)	Actual FY16 (Up to Oct)	Budget FY17	Actual FY17 (Up to Oct)	Required FY17 (Nov-Jun)
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: Author's calculation from the Ministry of Finance (MoF) data.

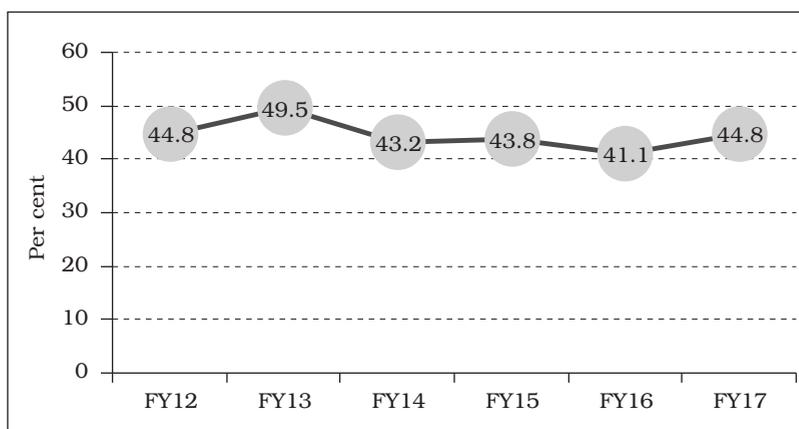
ADP implementation pace recovered somewhat

Implementation of the Annual Development Programme (ADP) was 44.8 per cent during July-March of FY2016-17. This is an improvement over similar timeline of FY2015-16 (41.1 per cent), and the second highest after FY2012-13 (Figure 2.5). It may be said that ADP implementation has recovered from its earlier slump in July-March of FY2015-16 and returned to trend performance pace. However, this recovery is primarily anchored on higher expenditure of local resources. Utilisation of foreign funding is lowest in last five years. Besides, implementation pace of the fast track projects has been mostly unsatisfactory. Up to February 2017, implementation rates in FY2016-17 for the Padma Multipurpose Bridge and Padma Bridge Rail Link were 30 per cent and 14 per cent respectively against their respective allocations for FY2016-17.⁶

⁵ According to Bangladesh Bank data, during July-December of FY2016-17, NBR revenue growth was 17.9 per cent.

⁶ However, for construction of Single Line Dual Gauge Track from Dohazari-Ramu-Cox's Bazar and Ramu to Gundum near Myanmar Border, the corresponding figure was 67 per cent.

Figure 2.5
ADP Implementation (July-March)



Source: Author's calculation from the Implementation Monitoring and Evaluation Division (IMED) data.

Similarly, up to January, allocations for FY2016-17 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 seaport 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 FY2015-16. One should caution that the slow pace of progress of these mega projects will likely result in increased 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.

2.2.2 Macroeconomic Indicators with Disquieting Trends

Overreliance on NSD sales for deficit financing continued

Bangladesh government 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 FY2016-17, which is 74 per cent higher than that of the corresponding period of FY2015-16. It should be noted that the target for net sales of NSD is Tk. 19,610 crore for the entire FY2016-17. 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 (SCBs), specialised banks (SBs), and private commercial banks (PCBs) evinced mixed trends over the last four quarters, foreign commercial banks (FCBs) exhibited upward trends with respect to the NPL. It should be mentioned that the GoB has injected a total amount of Tk. 9,655 crore over the last five years (between FY2011-12 and FY2015-16) in order to recapitalise the SCBs plagued with NPL. In FY2016-17 there was a Tk. 2,000 crore budgetary allocation for this. At the same time, the

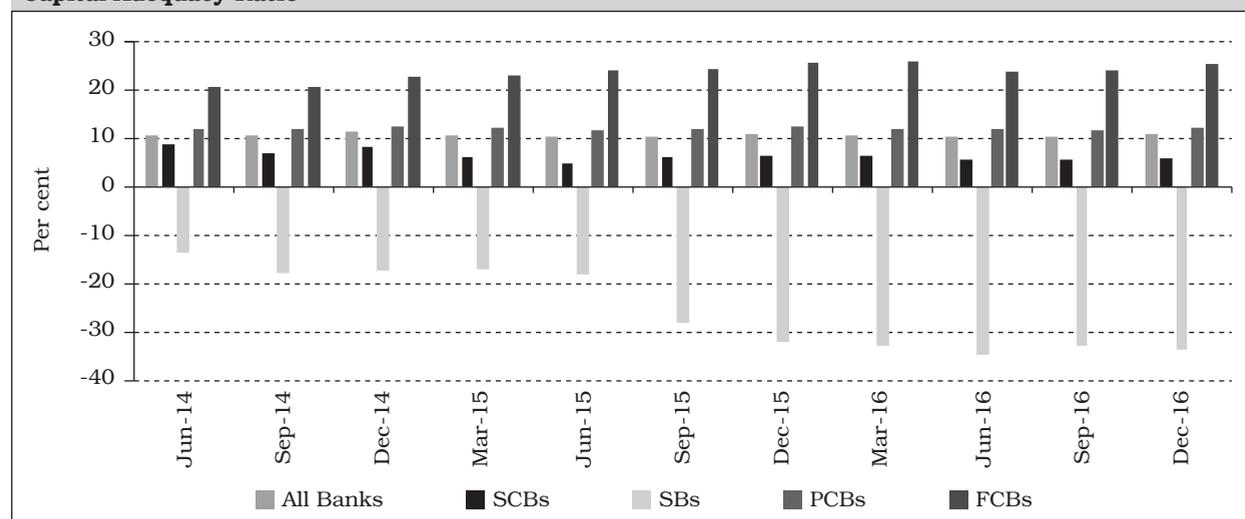
Table 2.3**NPL (Gross) as Percentage of Total Outstanding Loan**

Month	SCBs	SBs	PCBs	FCBs	Total
March 2013	27.05	27.17	6.23	4.60	11.90
June 2013	26.44	26.19	6.62	4.66	11.91
September 2013	28.76	29.39	7.30	6.02	12.79
December 2013	19.76	26.78	4.54	5.46	8.93
March 2014	21.98	30.93	5.77	5.32	10.45
June 2014	23.23	33.12	5.70	6.19	10.75
September 2014	23.92	37.84	6.34	7.01	11.60
December 2014	22.23	32.81	4.98	7.30	9.69
March 2015	22.49	33.46	6.03	8.25	10.47
June 2015	21.89	25.47	5.67	8.25	9.67
September 2015	21.82	24.68	6.09	8.79	9.89
December 2015	21.46	23.24	4.85	7.77	8.79
March 2016	24.27	23.24	5.75	7.51	9.92
June 2016	25.74	26.14	5.44	8.33	10.06
September 2016	25.16	26.14	5.90	8.85	10.34
December 2016	25.05	26.02	4.58	9.56	9.23

Source: Bangladesh Bank data.

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.

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.

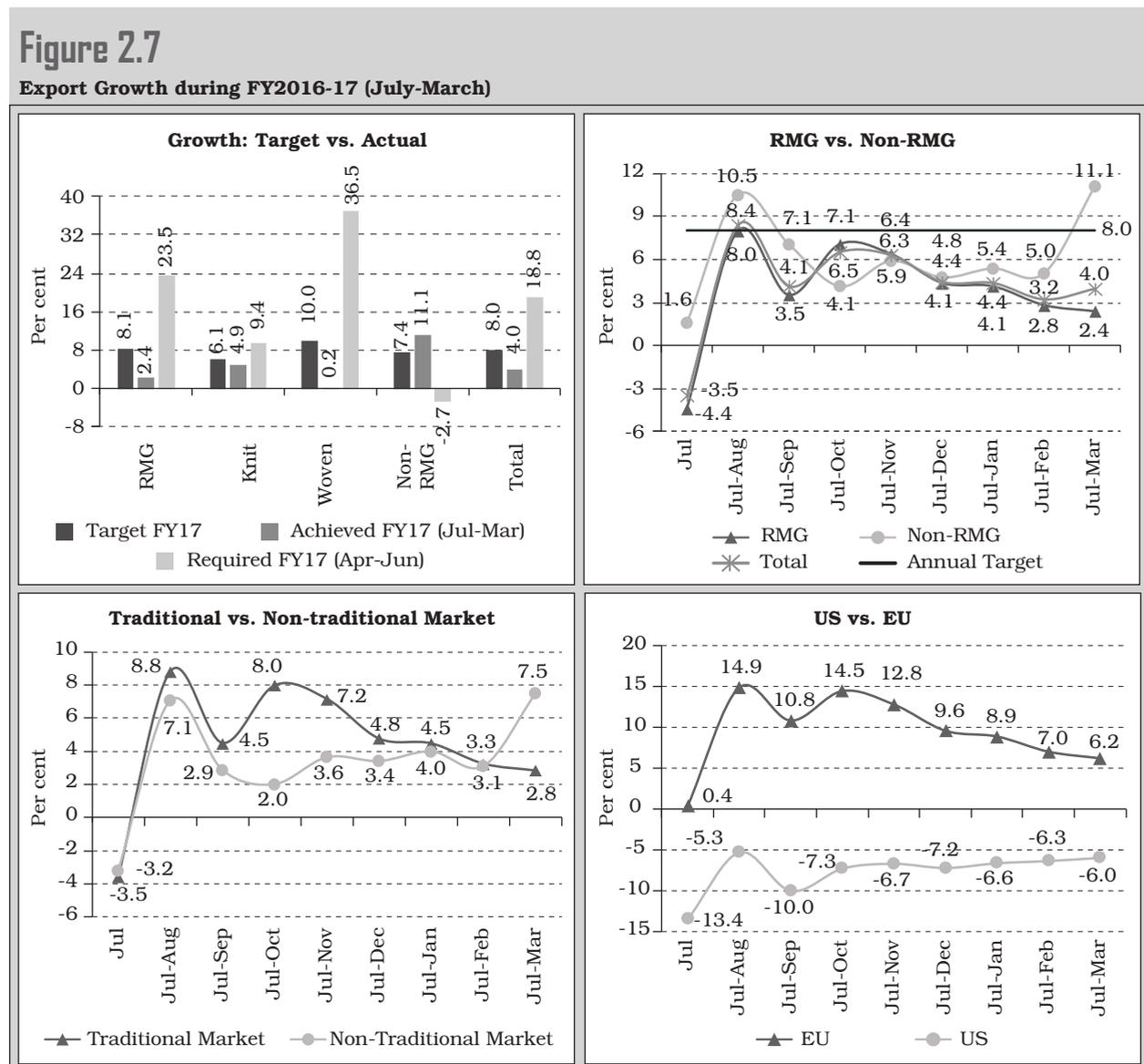
Figure 2.6**Capital Adequacy Ratio**

Source: Bangladesh Bank data.

Of the profitability indicators for banks, both Return on Assets (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, (-) 1.4 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 per cent in December 2015 to 11.09 per cent in December 2016.

Lower growth in export earnings has emerged as a concern

During the first nine months of FY2016-17, export earnings have remained below the annual target (Figure 2.7). According to Export Promotion Bureau’s (EPB) data, export earnings rose by 4 per cent during July-March period of FY2016-17 against the annual growth target of 8 per cent. Export growth of readymade garments (RMG) products (2.4 per cent) was below the target (8.1 per cent). Knit RMG items attained 4.9



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

per cent growth during July-March of FY2016-17 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 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 by 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.

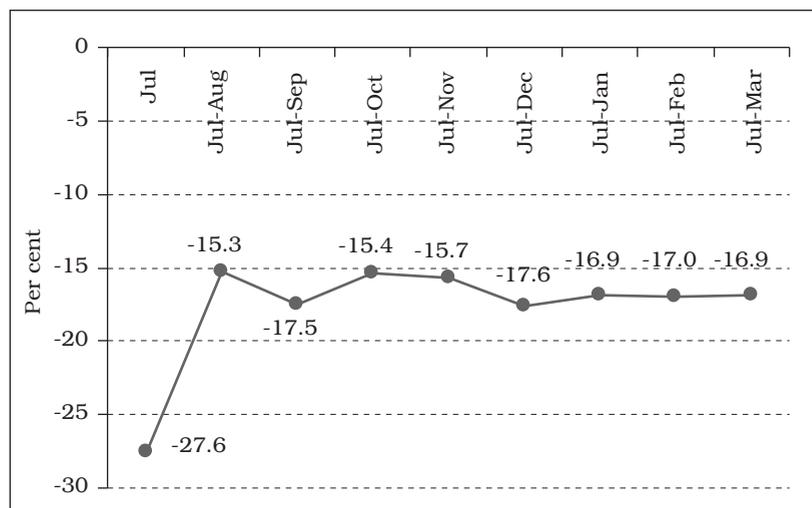
Export performance in the United States (US) market was rather subdued in FY2016-17, although it is showing some signs of improvement in recent months (Figure 2.7). Both knit and woven RMG exports have posted low growth. Performance in the European Union (EU) also has experienced a gradually declining trend. This is particularly so in case of the woven exports.

The sluggish performance of Bangladesh's export originates 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 (NER) 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).

Remittance inflow continued to experience decline

The case of remittance inflow to Bangladesh is rather intriguing. Thus far, for all the months in FY2016-17 remittance inflow has declined compared to the corresponding months of FY2015-16. This has been happening at a time when monthly outward migration flow has seen a robust rise. During the July-March period of FY2016-17, remittance inflow declined by (-) 16.9 per cent (Figure 2.8) while outward migration rose by 30.9 per cent. While depressed economic situation persists in petro-dollar-earning Middle East countries, and the consequent downward pressure on salaries and wages are causes, greater flow through informal channels has also been cited as a reason. Higher flow through money transfer agencies of various types and higher cost of sending are also reasons. A more in-depth study of the possible reasons is called for to identify appropriate policy interventions in this regard.

Figure 2.8
Remittance Inflow Growth



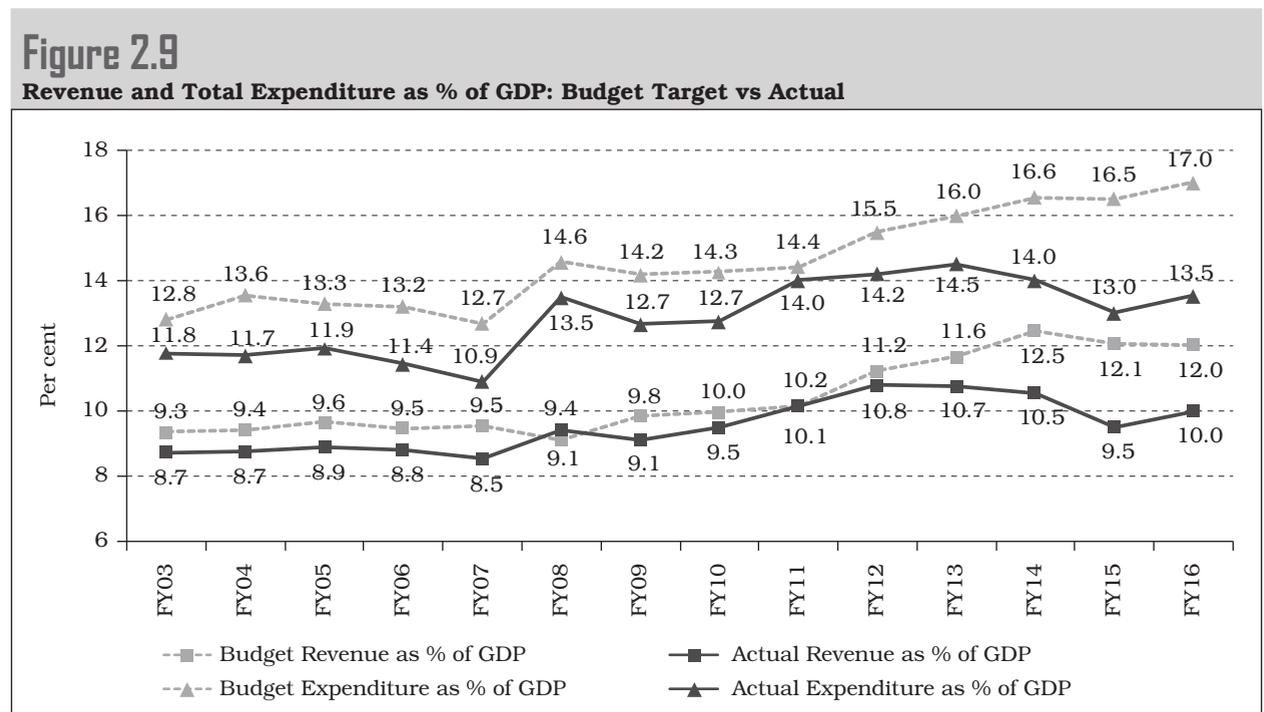
Source: Calculated from the Bangladesh Bank data.

2.2.3 Recommendations for the Budget

The recent trends in major macroeconomic correlates presented above demonstrate a number of strengths on which the national budget for FY2017-18 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 BOP and stable exchange rate provide 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 FY2009-10, the government has formulated national budget in a way that raises public expenditure to GDP ratio. As can be seen from Figure 2.9, the planned public expenditure in FY2015-16 was 17 per cent of GDP which was 14.4 per cent in FY2010-11. Regrettably, actual public expenditure (i.e. realised budget) declined to 13.5 per cent in FY2015-16 from 14 per cent in FY2010-11. Similarly, planned revenue-GDP ratio was increased from 10.1 per cent in FY2010-11 to 12 per cent in FY2015-16. However, actual revenue-GDP ratio was 10 per cent in FY2015-16, a decline from the 10.2 per cent posted in FY2010-11. Indeed, the gap between planned and realised public expenditure has widened over the years (3.5 percentage points in FY2015-16) compared to that between planned and realised revenue mobilisation levels (2 percentage points in FY2015-16). 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.

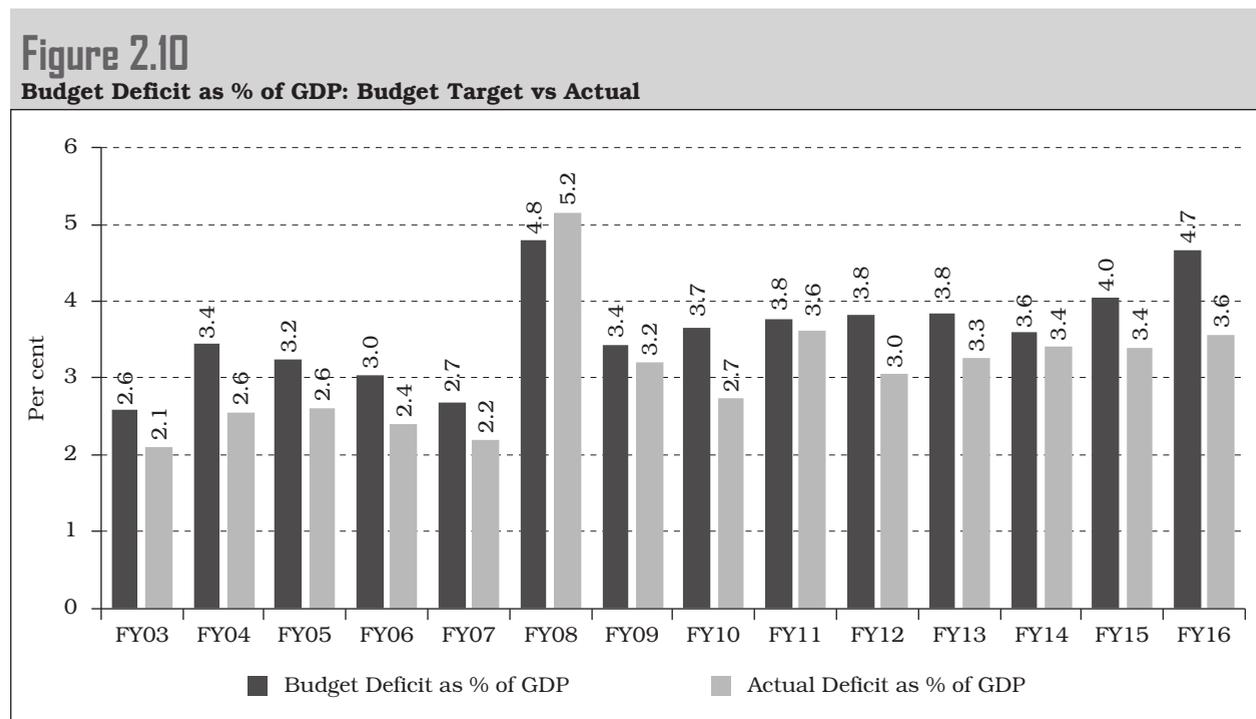
Indeed, a number of planned reform agendas remained unimplemented, and this has severely constrained the capacity of the government to raise the budget implementation rate. Successive delays in implementing the VAT and SD Act, 2012 had also held back several other revenue mobilisation reform agendas (including new Acts on Direct Tax and Customs) which constrained the revenue mobilisation efforts. As is known, the



Source: Author's calculation from the Ministry of Finance (MoF) and Bangladesh Bureau of Statistics (BBS) data.

government had planned a number of reforms to raise the ADP implementation capacity. These included policy on the Project Preparatory Fund (PPF), appointing project directors (PDs) 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 was 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.



Source: Author's calculation from the Ministry of Finance (MoF) data.

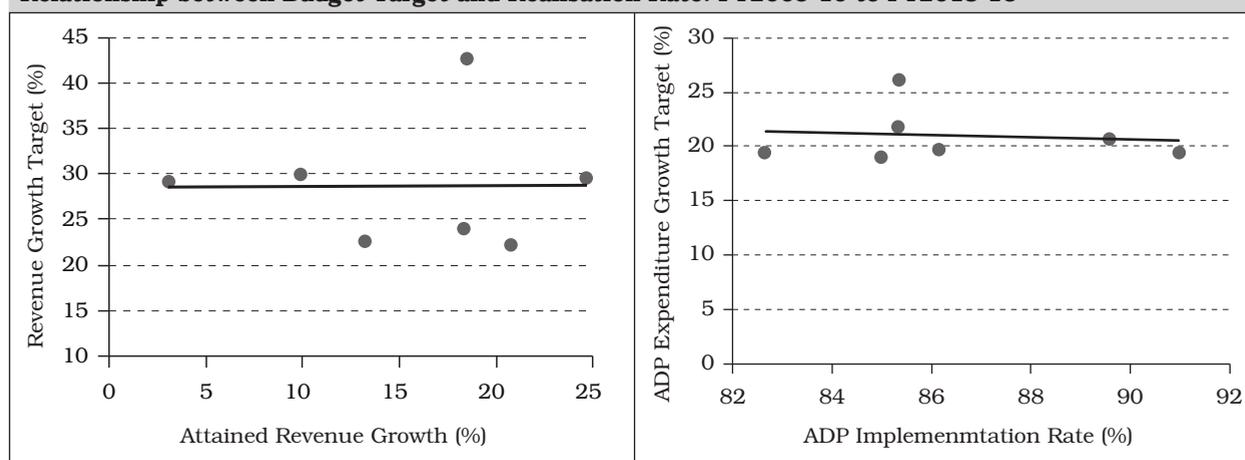
As a matter of fact, budget implementation capacity has become a major concern from the perspective of macroeconomic management in Bangladesh. This issue has been highlighted in several CPD studies of recent years on budget analysis (see CPD, 2014; 2015; 2016b). Indeed, compared to other developing countries,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

It is often argued that opting for an ambitious target may also raise higher realisation rate. However, the scatter diagram in 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.

Table 2.4**Budget Implementation Rate in Various Countries**

Component	2015				2016			
	India	Vietnam	Uganda	Bangladesh	India	Vietnam	Uganda	Bangladesh
Revenue	92.6	101.8	99.7	78.7	104.7	102.4	98.1	83.0
Development expenditure	80.5	104.2	87.2	73.0	155.8	102.4	83.0	74.7
Total expenditure	92.7	101.1	89.3	78.8	100.7	101.8	90.3	79.4

Source: Author's calculation from the data collected from the Ministries of Finance of the aforesaid countries.

Figure 2.11**Relationship between Budget Target and Realisation Rate: FY2009-10 to FY2015-16**

Source: Author's calculation from the Ministry of Finance (MoF) data.

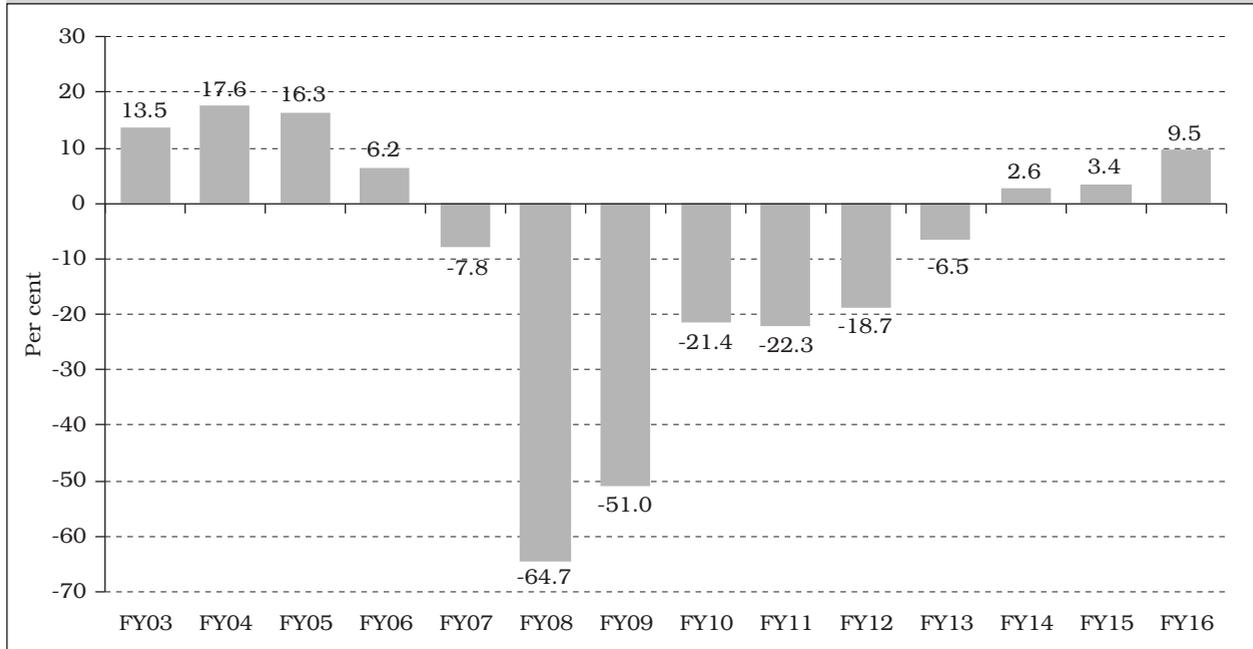
One of the positive developments in the area of national budget implementation is that, over the last three years (FY2013-14 to FY2015-16) at least some part of the ADP financing could be serviced by the revenue surplus (total revenue minus all other public expenditures, including amortisation payment 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 the state-owned enterprises (SoEs) was rather low, which provided the additional fiscal space.

Maintaining this trend will require significant improvements in revenue mobilisation efforts. The Seventh Five Year Plan (7FYP) aims to raise revenue-GDP ratio to 16.1 per cent in FY2019-20 from the 10 per cent in FY2015-16. Considering the shortfall predicted for FY2016-17 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 FY2017-18 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 FY2019-20 from 27.6 per cent in FY2015-16 (Figure 2.13). In order to attain this, income tax mobilisation, on an average, needs to increase by 43 per cent annually over the next three years.

In view of above, while an expansionary fiscal policy for FY2017-18 is called for, the government will need to address the structural weaknesses in budget implementation by undertaking the required reforms. Besides,

Figure 2.12

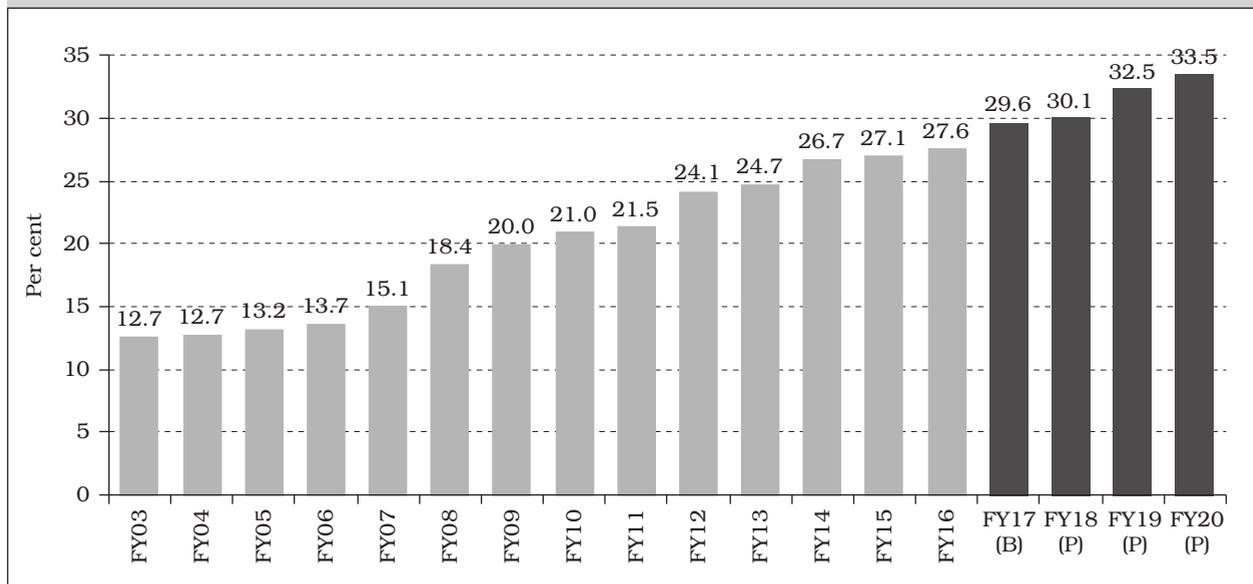
Contribution of Revenue Surplus to ADP Financing



Source: Author's calculation from the Ministry of Finance (MoF) data.

Figure 2.13

Share of Income Tax in Total Revenue



Source: Author's calculation from the Ministry of Finance (MoF) and Seventh Five Year Plan (7FYP) data.

Note: 'B' denotes budget; and 'P' denotes planned.

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 Bangladesh Petroleum Corporation (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 by 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 policy-making 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 FY2017-18. 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.

2.3 ENHANCING RESOURCES FOR THE NATIONAL BUDGET

In Bangladesh, revenue collection has gained momentum in the recent past. In FY2015-16, the revenue collection growth was 19.1 per cent when compared to FY2014-15. However, the revenue-to-GDP ratio, which was only 9.9 per cent in FY2015-16, 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 yielded expected results, capital flight, weak administration and technological backwardness, and delays in implementing necessary administrative and legal reforms. 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 area of tax collection have been planned by the NBR. Regrettably, implementation of these plans has repeatedly

failed to meet the respective timelines. Consequently, over the last five years, the gap between revenue mobilisation target and corresponding realisation figures has 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.

2.3.1 Ongoing Reforms for Resource Mobilisation

In 2011, the GoB adopted a comprehensive NBR Modernization Plan (2011-2016) with the view to achieving higher revenue. Tax policy reforms (modernisation of income tax, VAT [value added tax] 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 programme) – these were some of the major reform agendas. 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 automise 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 (business identification number).⁷ 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 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 factor for efficient management of revenue collection. The administrative and management capacity of the tax persons 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 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.⁸ 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

⁷Businesses which are entitled to pay VAT or turnover tax.

⁸The 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.

Table 2.5
Global VAT Rates in 2013

(in Per cent)

Country/Region	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. Available from: <https://www.usaid.gov/data/dataset/cdeb8a1b-3440-4e88-b6cb-81b2428f8cea> (accessed on 5 April 2017).

appears to be 12 per cent (Table 2.5). It is reckoned that, Bangladesh's proposed uniform VAT rate was on the high side when compared to its 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.

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 rise of VAT rates on utility services (e.g. electricity consumption at household levels for which the 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 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 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 is 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 (ICT); 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, a number of 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 the World Trade Organization's (WTO) requirements; review the current valuation database to ensure that concerned staffs have access to all relevant open and closed sources of information; and augment revenue collection through implementation of Post Clearance Audit (PCA). It is to be noted that, an automated bonded warehouse management system utilising the Automated System for Customs Data (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 (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 (MNCs) through 'transfer mispricing'. In the following year (2015), seven transfer pricing officers (TPOs) were appointed to examine and audit the statements of international transactions of the 175 MNCs operating in Bangladesh. 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, 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 a memorandum of understanding (MoU) with the Organisation for Economic Co-operation and Development (OECD). According to the MoU, experts from the OECD will share technical knowledge and provide training to the TPOs over the next two years with a view to improve their capacity and efficiency. However, more will need to be done if the TPC is 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.

2.3.2 Priority Issues that Need to be Addressed

Personal Income Tax

Personal income tax (PIT) exemption threshold was raised to Tk. 2.5 lakh in the budget for FY2015-16.⁹ In view of the general CPI having experienced a rise of about 11.2 per cent¹⁰ 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 the 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 had recommended introduction of e-TIN (Taxpayer Identification Number) provisions for the foreign nationals working in Bangladesh.

⁹The threshold was raised by about 13.6 per cent (which was Tk. 2.2 lakh in FY2014-15), considering the required inflationary adjustment.

¹⁰CPI has increased by 11.2 per cent between July 2015 and February 2017.

Corporate Income Tax

High growth in income tax collection in the recent past has largely hinged on revenue collected under the head of corporate income tax (CIT). NBR Annual Report 2013-14 showed that, contribution of corporate tax in the income tax collection jumped to 72.5 per cent in FY2013-14, which was about 55 per cent in FY2012-13. Corporate tax rates have 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. FY2017-18 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.

Tax Deducted at Source

As is observed from Table 2.6, tax deducted at source (TDS) has emerged as a relatively more effective mode of collecting income tax. Due to informal nature of the labour market¹¹, 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 2.6

Share of Various Types of Income Tax Collection Methods in FY2013-14

(in Per cent)

Form of Collection	Share	Incremental Share
TDS	57.6	79.1
Article 64: Advance income tax (AIT)	25.6	-4.1
Article 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 Ltd company (without TDS)	0.7	4.1
Others	3.2	22.5
Total	100.0	100.0

Source: NBR (2015).

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 had also recommended earlier, in view of budget for FY2016-17, introduction of a progressive TDS for higher income earners.¹² 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.

¹¹The 2013 Bangladesh Labour Force Survey (LFS) 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.

¹²Tax collected through these measures will be adjusted when a taxpayer/entity submits his/her return. Therefore, these measures would not pose any significant burden on taxpayers under the tax net.

Property Tax

In the absence of well-crafted land/property tax, incentives to invest in productive sectors could easily be distorted in favour of investing in landholdings and real estates. While the government may continue with the existing wealth surcharge system for the next few years, as a forward-looking strategy, it should also 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.

2.3.3 Recommendations for the National Budget for FY2017-18

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 need immediate actions are listed below:

Fiscal Measures

- 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 CIT 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 collections.
- Introduce e-TDS as an alternative effective income tax collection method.
- 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 act 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/point of sale (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.

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 the Customs Act on an urgent basis. This should correspond with the current industrial and export policies (including export diversification strategies).
- Constitute the long-awaited IFSRC to operationalise the Financial Reporting Act 2015 (FRA) without delay.
- Establish an independent fiscal policy authority, and separate the existing unit from revenue collection authority.

2.4 PROMOTING PRIVATE INVESTMENT: HOW TO STRENGTHEN POLICY INSTRUMENTS

2.4.1 Background

Over the last several years, private investment has been struggling to maintain growth momentum that was 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 USD. In this backdrop incentivising 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 be little '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 to 33 per cent (Table 2.7). Interestingly, a significant share of the involved

Table 2.7

Results of Various Surveys on Incentives Offered for Promoting Private Investment

Author	Focus of Survey	Conclusion		Did Incentives Influence the Investment Level? (% Saying Yes)
Facility for Investment Climate Advisory Services (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

(Table 2.7 contd.)

(Table 2.7 contd.)

Author	Focus of Survey	Conclusion		Did Incentives Influence the Investment Level? (% Saying Yes)
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: Adapted from James (2014).

entrepreneurs felt that such policies suffered from both lack of targetting as also their appropriateness in terms of meeting the actual demands of the investors (James, 2014). Table 2.7 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 behaviour. There are important lessons to learn from these perception surveys to draw appropriate strategies for Bangladesh at a time when the country is preparing the budget for FY2017-18. These include whether incentives offered for promoting private investment in Bangladesh have contributed differently than what was observed in other developing countries.

2.4.2 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 the targets set in terms of sectorial composition, spatial distribution, sectorial efficiency and productivity, market orientation, and development of vertical linkages. According to Table 2.8, a large part of private investment, in most cases underwritten by debt financing, is overwhelmingly dominated by large-scale industries (LSIs) (over 75 per cent of total disbursed term loan in FY2015-16) with relatively very low share of medium- and small-scale industries (14.3 per cent and 10.6 per cent respectively). Thanks to a number of targeted measures, share of small-scale and cottage industries (SSCIs) in terms of disbursed term loans has experienced some increase, but this has been at the cost of declining share of medium-scale industries (MSIs). In other words, there appears to be a 'missing middle' in the composition of private investment.

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 a limited number of economic

Table 2.8

Disbursement of Term Loan: Share of LSIs, MSIs and SSCIs

(in Per cent)

Year	LSI	MSI	SSCI	Total
FY2009	73.43	22.67	3.90	100.00
FY2010	73.42	21.27	5.31	100.00
FY2011	68.27	24.75	6.98	100.00
FY2012	62.13	31.09	6.78	100.00
FY2013	65.73	27.21	7.05	100.00
FY2014	68.65	22.66	8.70	100.00
FY2015	76.06	16.21	7.74	100.00
FY2016	75.15	14.27	10.58	100.00
FY2017 (Jul-Dec, 2016)	73.89	15.47	10.64	100.00

Source: Bangladesh Bank.

Table 2.9**FDI-GDP Ratio in Bangladesh and Selected Countries***(in Per cent)*

Country	2005	2010	2015
Bangladesh	1.10	1.07	1.73
India	0.87	1.65	2.10
China	4.55	3.99	2.27
Vietnam	3.39	6.90	6.10
Thailand	4.34	4.33	2.28
LMICs	2.36	2.14	2.26
UMICs	3.34	3.29	2.52

Source: World Bank (n.d.).**Note:** UMIC: Upper middle-income country.

activities.¹³ These trends are also observed in case of FDI flow to the country. Despite various efforts to attract FDI, the realised rate of FDI is still at a low level; Bangladesh's FDI-GDP ratio is lower than that of average for LMICs, and is lower than its major competing countries including India, Vietnam, China and Thailand (Table 2.9).

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

2.4.3 Policy Intervention through Fiscal Measures and their likely Implications for Selected Industries

CPD has carried out an exercise covering five selected sectors that received benefits in successive national budgets, between FY2009-10 and FY2014-15, 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.¹⁴

CPD exercise found that imposition and/or changes in the SDs did not necessarily generate the expected results (Table 2.10). Out of the 13 product categories (at HS [Harmonized Commodity Description and Coding System] code 4 digit level), seven experienced slowdown or decline in import during the post-change period, while rest six experienced rise in import during the same period. For example, import of finished plastic products did slow 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.

¹³Major economic activities (in terms of establishments) are concentrated in weaving and finishing of textiles, manufacturing of wearing apparels, manufacturing of knitted apparels, manufacturing of luggage and handbags, footwear, printing, plastic products, metal products, treatment of metals, metal furniture, packaging materials, jewellery, etc.

¹⁴While the SDs may also have served revenue mobilisation purpose, the primary objective for this fiscal measure (as cited in the budget documents) was to give protection to domestic industries.

Table 2.10**Imposition/Changes/Withdrawal of SDs in Selected Products**

Industry (Finished Products)	Product HS Code	Products	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 footwear	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
Tiles and ceramics	6907	Unglazed ceramic flags and paving, hearth or wall tiles; ceramic mosaic cubes and the like, whether or not on a backing; finishing ceramics	Rate increased	21.30 (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 like, whether or not on a backing	Rate increased	115.03 (2010-12)	(-) 3.70 (2013-15)	Import decreased
	6910	Ceramic sinks, wash basins, wash basin pedestals, baths, bidets, water closet pans, flushing cisterns, urinals and similar sanitary fixtures	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	Ceramic tableware, kitchenware, other household articles and toilet articles; other than of porcelain or china	Rate increased	(-) 25.71 (2010-12)	591.81 (2013-15)	Import increased
	6913	Statuettes and other ornamental ceramic articles, nes	Rate increased	171.90 (2010-12)	1099.70 (2013-15)	Import increased
	6914	Ceramic articles, nes	Rate increased	779.76 (2010-12)	24.56 (2013-15)	Import slowed down
	Electrical appliances	8415	Air conditioning machines; comprising a motor driven fan and elements for changing the temperature and humidity, including those machines in which the humidity cannot be separately regulated	Newly imposed	13.11 (2010-12)	9.76 (2013-15)

(Table 2.10 contd.)

(Table 2.10 contd.)

Industry (Finished Products)	Product HS Code	Products	Type of SD Applied	Yearly Growth (%) (Period Considered)		Likely Effect
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 (including mopeds) and cycles; fitted with an auxiliary motor, with or without side-cars; side-cars	Rate increased	16.45 (2010-11)	11.85 (2012-15)	Import slowed down

Source: Author's estimates based on various published data.

Note: nes: Nowhere else specified.

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 behaviour, including relative (domestic/imported) prices, level and pattern of demand, change in consumer choices, etc. However, what continues to remain true, and has been well-established in relevant global literature, is that, if fiscal policies are not appropriately designed and are not supported by other reinforcing policies and measures, there is a high possibility that they will fail to attain the declared objectives.

The logic of fixing the rates of SDs for different products belonging to different industries remains unclear, if not arbitrary. One common practice is administering same rate 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 currently at place, 10 per cent on five products, 20 per cent on 11 products, 30 per cent on eight 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 USD, the rate of SD was further raised in 2012 to 60 per cent when total import was only USD 40 thousand. There was an imposition of duty of 20 per cent on another ceramic product (6906) where import ranged between zero to USD 33 thousand during the period under scrutiny. Table 2.11 has tried to capture the various rates of SDs in FY2014-15 for selected industries with shares of respective import value for these products in total, with a view to understanding if there was a rationale behind setting the rates based on the level of import. However, 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

Table 2.11**Share of Import vis-à-vis Rates of SDs**

(in Per cent)

SD Rate	Share of Total Import in 2015 (Import Data Available at 4 Digit HS Code)				
	39	64	69	84	87
Single rates (at 8 digit level)					
15				46.60	
20	38.50		7.28		33.40
30	5.30	45.20			3.15
45		54.80		34.00	
60	10.90		92.70		

(Table 2.11 contd.)

(Table 2.11 contd.)

SD Rate	Share of Total Import in 2015 (Import Data Available at 4 Digit HS Code)				
	39	64	69	84	87
Multiple rates (at 8 digit level)					
20-45	40.20				
20-60	5.20				
20-100				19.40	
30-250					36.60
45-500					26.90
Total	100.00	100.00	100.00	100.00	100.00

Source: Author's estimates based on ITC (n.d.).

for 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.

An examination of growth and performance of the selected manufacturing industries when juxtaposed to different public policy instruments, 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 regard (Table 2.12). 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 the growth of industries is not overwhelmingly influenced by the fiscal measures offered through the national budget.

Table 2.12**Changes in the Composition of Selected Manufacturing Industries: 2006 and 2012**

(in Per cent)

Sector	Change in Establishments	Change in Number of Workers per Unit	Change in Amount of Assets per Unit
Plastic	38.74	44.65	116.20
Footwear	37.66	39.45	121.58
Electrical appliance	311.55	-19.35	-77.62
Motor vehicles	87.67	-48.08	27.24

Source: BBS (2010, 2013).

2.4.4 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.¹⁵ The focus of the alternate approach will not be on sectors alone, but on activities as well, which will encourage innovation and ensure long-term productivity

¹⁵In 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.

growth.¹⁶ In this backdrop, government should put due consideration on following issues in the upcoming national budget for FY2017-18.

There should be 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 vehicles 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 will be highly important with a view to appreciating their contribution in terms of enhancing investment, production and employment generation in targeted activities.

Fiscal incentives should be timebound 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 SDs, etc. are mostly 'open-ended' in nature. There is often no timeline 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 'timebound'.

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-value products/services, investing on research and development (R&D), setting up high-tech machineries, and producing raw materials which significantly enhances domestic capacity). Besides, these should contain 'performance requirement criteria', with a view to ensuring proper use of the provided facility by the entrepreneurs. The criteria should include various performance indicators, such as level of productivity, efficiency, employment generation and social compliance. In order to carry out the exercises such as identification of industries and assessing the performance of industries, the existing databases available to NBR and Bangladesh Tariff Commission, will 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 be a prior assessment in case of implementing any kind of change (imposition/change/withdrawal) in SD.

A well-functioning institutional set-up for assessment and monitoring of policy instruments

There should be 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, during its initial announcement, should disclose the amount of 'revenue forgone' for undertaking those tax measures. Under the institutional arrangement, the performance of the beneficiaries

¹⁶To facilitate this, various types of interventions are to be deployed which are categorised as 'horizontal' and 'vertical' policy interventions. 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 timebound, i.e. 'terminated' after a pre-specific period, and supporting activities should be not so distant in terms of existing specialisation.

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 of the targeted goals have been achieved through undertaking those measures.

2.5 MOVING BEYOND A STATUS QUO BUDGET FOR THE SOCIAL SECTOR

2.5.1 Introduction

Social sector, in particular health, education and social security, has to receive special focus in the national budget through higher allocation and relevant fiscal measures. Public spendings on health and education have 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 policymakers as the country aspires to move forward with greater economic momentum. The sphere of social safety net has to be broadened as well, in order to reduce poverty and inequality in the society.

2.5.2 Allocation for Health, Education and Social Safety Net

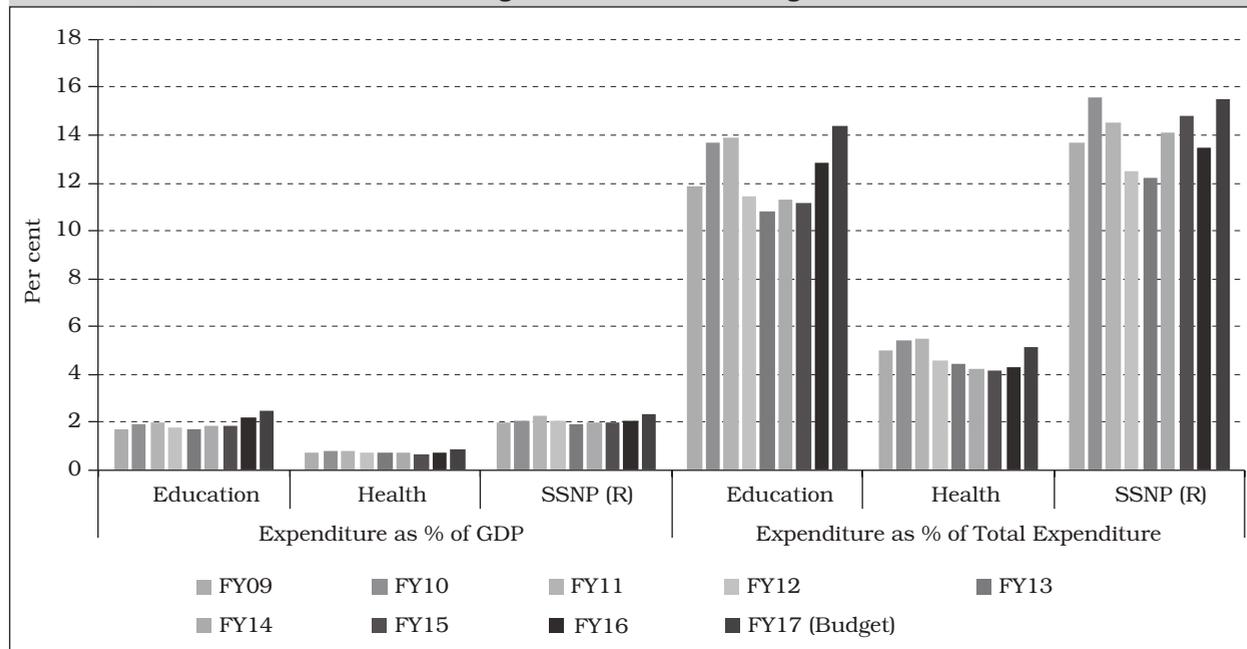
Expenditure on education and health as percentage of GDP and budget has increased to some extent in recent years. However, the pace of increase in case of allocation and expenditure is not the same as planned in the budget. For example, allocation for health was 0.74 per cent of actual GDP both in FY2014-15 and FY2015-16, while expenditure for the sector was 0.69 per cent and 0.73 per cent respectively. Resource allocation for social safety net programmes (SSNPs) is hovering around 2 per cent of GDP (for example, 2.08 per cent in FY2015-16) (Figure 2.14). The planned expenditure was 3 per cent of GDP in the Sixth Five Year plan (SFYP), which was revised downward to 2.3 per cent of GDP in the 7FYP. According to Medium-Term Budgetary Framework (MTBF) and 7FYP, allocation for six ministries¹⁷, related to social welfare, has improved in FY2016-17, though a declining trend during FY2013-14 to FY2018-19 is observed (Figure 2.15). The need for a boost in expenditure for these ministries is obvious.

When compared against various national and international targets, expenditure on social sector in Bangladesh seems very low (Table 2.13). CPD has carried out an estimation to understand how much resources will be required in FY2017-18 to achieve the spending target of 7FYP by FY2019-20. The exercise shows that budget for the education sector should be at least 2.7 per cent of GDP in FY2017-18 in order 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 FY2017-18 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 sixth highest position in terms of out-of-pocket expenditure in the world in 2014. This was also highest in the SAARC (South Asian Association for Regional Cooperation) 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 (SSN), allocation includes pension for government employees which occupies 0.86 per cent of GDP (total SSN allocation is 2.31 per cent of GDP in FY2016-17).

¹⁷ These include Ministry of Education, Ministry of Primary and Mass Education (MoPME), Ministry of Health and Family Welfare (MoHFW), Ministry of Social Welfare, Ministry of Women and Children Affairs, and Ministry of Disaster Management and Relief.

Figure 2.14

Education, Health and SSNP as Percentage of GDP and Total Budget

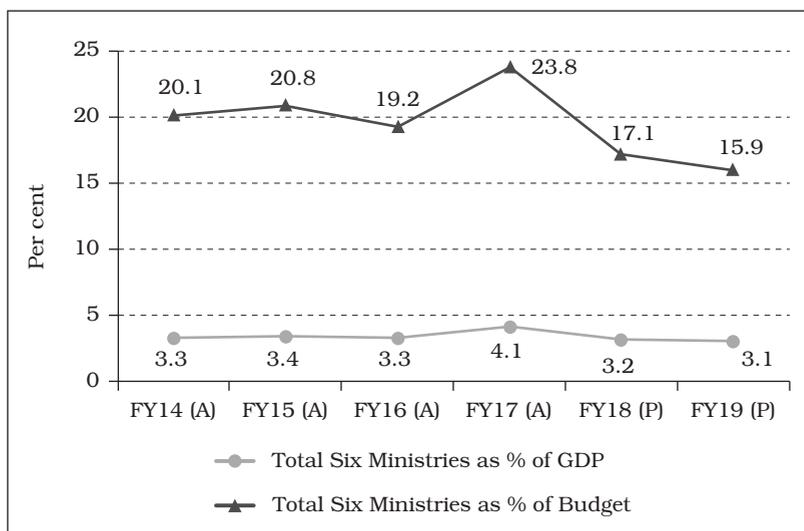


Source: Author's calculation from MoF (various issues); Budget documents (various years, Statement 2), Ministry of Finance (MoF); BBS (2015-16).

Note: For Education and Health sectors, figures up to FY2015-16 are actual expenditures, while for FY2016-17 the figure is for budget. For SSNP figures up to FY2015-16 are for revised budget, and for FY2016-17 the figure is for budget.

Figure 2.15

Allocation for Social Sector as Percentage of GDP and Budget



Source: Calculated from MoF (various years); GED (2015).

Note: 'A' denotes budget allocation; 'P' denotes MTBF projection.

Table 2.13**Target and Reality of Social Sector Expenditures**

Document	Targets	Where are We?	What is Needed?
Education			
7FYP	Increase spending on education 3 per cent of GDP (pg. 86, 7FYP)	Allocation for education was 2.5 per cent of GDP in FY2017, while expenditure was 2.2 per cent in FY2016. Allocation was 14.4 per cent of total budget in FY2017; expenditure was 12.8 per cent in FY2016.	Education and health budget should be increased as share of GDP and total budget considering the national and international standards. The estimated budget for the education sector should be at least 2.7 per cent of GDP for FY2018, to achieve 3 per cent of GDP, as set in 7FYP.
Incheon Declaration, 2015 ¹⁸	The Education 2030 Framework for Action set two benchmarks on domestic financing for education: <ul style="list-style-type: none"> ▪ 4-6 per cent of GDP ▪ 15-20 per cent of public expenditure 		
Health			
7FYP	Increase spending on health 1.2 per cent of GDP (7FYP)	The allocation on health was 0.9 per cent of GDP in FY2017, while the actual expenditure was 0.7 per cent in FY2016.	Budget for the health sector should be at least 1 per cent of GDP in FY2018, to achieve the target of 1.2 per cent of GDP, as set in 7FYP.
WHO's observation	World Health Organization (WHO) sometimes observes country expenditure on a benchmark of 5 per cent of GDP or gross national income (GNI)		
Social Safety Net			
7FYP	Spending on social protection as a share of GDP to be increased to 2.3 per cent of GDP (7FYP)	The allocation on SSN was 2.3 per cent of GDP. But when government pension is excluded, it amounts to only 1.4 per cent of GDP in FY2017. The revised expenditure was 2.1 per cent in FY2016 and 2 per cent in FY2015.	Budget for SSN should be excluded from government pension, and allocation for SSN excluding government pension should be 2.3 per cent of GDP.

Source: GED (2015); World Education Forum (2015); WHO (2003).

2.5.3 Progress in Health, Education and Social Security

The largest programme on primary education titled the Third Primary Education Development Programme (PEDP-III) is going to end in 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.

¹⁸United Nations Educational, Scientific and Cultural Organization (UNESCO), together with the United Nations Children's Fund (UNICEF), the World Bank, United Nations Population Fund (UNFPA), United Nations Development Programme (UNDP), UN Women and the United Nations High Commissioner for Refugees (UNHCR) organised the *World Education Forum 2015* in Incheon, Republic of Korea, from 19-22 May 2015. 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. Available from: <http://www.uis.unesco.org/Education/Documents/incheon-framework-for-action-en.pdf>

The PEDP-III, successor of PEDP-I (1997-2003) and PEDP-II (2004-2011), covering 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 PEDP-III'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 summarised below (details Annex Table 2.1, based on Ministry of Primary and Mass Education (MoPME)).

- Overall, Bangladesh has been performing well in enrolment and reducing differences between households, and between genders in primary education. However, dropouts 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 grades III and 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 points 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 points 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.

The 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 billion¹⁹ for 2011-16, of which GoB and development partners' contributions were 78 per cent and 22 per cent respectively (MoHFW, 2016).

The 2016 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 (Annex Table 2.2).²⁰ If it progresses at the same pace, other things remaining unchanged, it will take additional five years after June 2017 to achieve the remaining 72.5 per cent targets of the programme. It is appreciable that the fourth HPNSDP 2017-21, involving Tk. 1.15 lakh crore, has already received approval of the Executive Committee of National Economic Council (ECNEC) in March 2017.

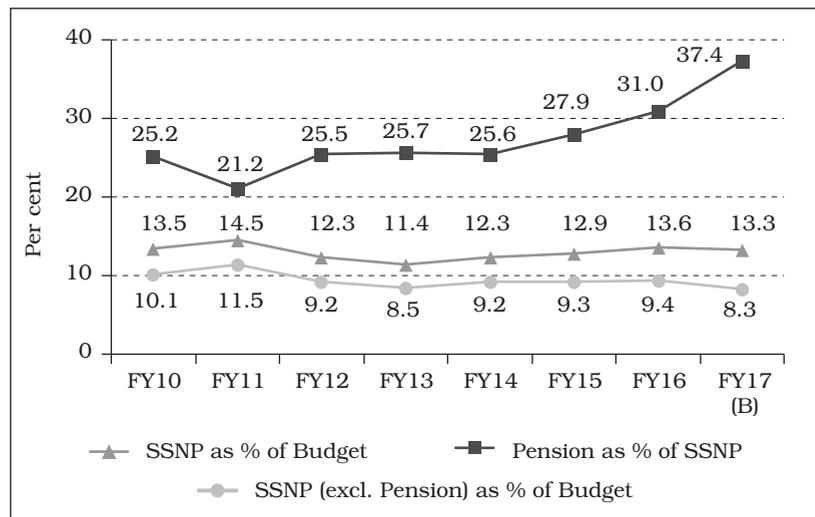
The government has developed a National Social Security Strategy (NSSS) to be implemented gradually during the 7FYP starting from FY2015-16. NSSS revisits social security system by combining tax-funded SSNPs with contributory social insurance and employment regulations. This is a promising initiative 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 are 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 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 2.16). Pension is 31 per cent in revised budget of FY2015-16 and 37.4 per cent in FY2016-17 budget, while this was 27.9 per cent in FY2014-15 before the inception of NSSS. On the other

¹⁹ Later extended to up to December 2016.

²⁰ Data after 2014 are not available.

Figure 2.16
Total SSNP Expenditure Over Time



Source: Author's calculation from the Ministry of Finance (MoF) data.

Note: Except for FY2016-17, revised budgets for all other years are used for calculation.

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 FY2015-16, and only 53.5 per cent of NSSS target in FY2016-17. Similar situation is observed in case of child school benefit and allowances for vulnerable women.

2.5.4 Recommendations for the Upcoming Budget

In view of the above discussion on allocation and performance of social sector and SSNPs, a number of recommendations can be made for the upcoming budget for FY2017-18.

- 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 targets of the Sustainable Development Goals (SDGs).
- Budget for the education sector will have to be at least 2.67 per cent of GDP in FY2017-18 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 FY2017-18 itself rather than by 2020.
- Health sector needs utmost priority as allocation has been measurably low. Improved public health facilities and reduction of out-of-pocket expenditure will require substantive allocation. Budget for the health sector has to be equivalent to at least 1 per cent of GDP in FY2017-18 to achieve the target of reaching 1.2 per cent of GDP, as set in 7FYP.
- Pension for the retired government employees and their families needs to be separated from the SSN budget; allocate the full amount (i.e. 2.3 per cent 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.

2.6 CONCLUDING REMARKS

The overarching macroeconomic objective of the national budget for FY2017-18 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 chapter 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 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 need to be harmonised to do away with the current divergences.²¹ 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 FY2016-17, urged for transparency in several budget-related areas including disclosure of financial accounts of SoEs, government’s asset acquisition, defence budget, local government financing, non-government organisation (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 – both in 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; however, 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 FY2017-18, 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 the new VAT and SD Act, possible depreciation of exchange rate, rise of rice price which is the major wage-good, and another round of upward adjustment of the tariffs for electricity and gas. Rational downward adjustment of kerosene and diesel prices can provide some relief to the investors as well as the consumers by raising their disposable 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 present 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 FY2017-18 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 the 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.

²¹CPD (2017), the first reading of the State of the Economy in FY2016-17, discussed this issue in details, analysing data on revenue collection by the NBR, ADP expenditure, and budget deficit and financing.

The government may opt for an early attainment of 7FYP allocation targets for education and health sectors (3 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 in this respect.

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 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 2.1

Priority Indicators with Benchmarks and Targets of the PEDP-III

KPI SI.	Indicator	Baseline 2010	Status in 2011	Current Status 2016	Year Interval	Achievement	Target 2017	Comments/ Others	
Results Area 1: Learning Outcomes									
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	
	Results Area 2.1: Universal Access and Participation								
	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 (%)									

(Annex Table 2.1 contd.)

(Annex Table 2.1 contd.)

KPI Sl.	Indicator	Baseline 2010	Status in 2011	Current Status 2016	Year Interval	Achievement	Target 2017	Comments/ Others
5.	Girls (%)	17		9.0 (2014)				Need progress
	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	115.0	5	+6.60		Achieved
6.	Net enrolment rate, primary education (boys and girls) [EFA 6] (%)	94.8	94.9	97.96	5	+3.06	98	Achieved
	Boys (%)	92.2	92.7	97.11	5	+4.41	97	Achieved
	Girls (%)	97.6	97.3	98.83	5	+1.53	99	Achieved
Results Area 2.2: Reducing Disparities								
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 per cent of households by consumption quintile (%)	88		88 (2014)	4	0	90	Inconclusive
	[Participation] Net enrolment rate – bottom 20 per cent of households by consumption quintile (%)	77		80 (2014)	4	+3	82	Inconclusive
	Difference between top 20 per cent and bottom 20 per cent of households by consumption/wealth quintile (%)	11		8 (2014)	4	+3	8	Achieved
9.	Upazila-level composite performance indicator: Annual improvement of 20 per cent lowest performing upazilas	1.26	1.31	1.17 (2015)	4	-0.14	1.56	Need attention
	Upazila-level composite performance indicator: top 10 per cent of upazilas	2.36	2.23	2.00 (2015)	4	-0.23	2.5	Need attention
	Upazila-level composite performance indicator: bottom 10 per cent of upazilas	1.04	1.15	1.04 (2015)	5	-0.11	1.5	Need attention
	Range between average value of index for top 10 per cent and bottom 10 per cent of upazilas	1.2	1.10	0.96 (2015)			1	On track

(Annex Table 2.1 contd.)

(Annex Table 2.1 contd.)

KPI Sl.	Indicator	Baseline 2010	Status in 2011	Current Status 2016	Year Interval	Achievement	Target 2017	Comments/ Others
Results Area 3.1: Decentralization								
10.	Percentage of AOP budget allocation for unconditional block grants (SLIPs and UPEPs) (%)	5.1	6.9	7.01 (2015)			10	
	Percentage of AOP budget allocation for unconditional block grants (UPEPs for upazilas) (%)	0.1	6.9	0.005 (2015)			10	
	Percentage of AOP budget allocation for unconditional block grants (SLIPs for schools) (%)	5.2	0	7 (2015)			10	
11.	Expenditure of unconditional block grants (UPEPs and SLIPs) by upazilas and schools (%)	95	99.7	100 (2015)			95	
	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	
Results Area 3.2: Effectiveness								
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	17.0 (2015)			13	Need attention
	Grade 1	8.5		0.7				
	Grade 2	3.0		2.9				
	Grade 3	7.7		4.2				
	Grade 4	12.2		9.8				
	Grade 5	9.5		1.5				

(Annex Table 2.1 contd.)

(Annex Table 2.1 contd.)

KPI Sl.	Indicator	Baseline 2010	Status in 2011	Current Status 2016	Year Interval	Achievement	Target 2017	Comments/ Others
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: MoPME (2016a, 2016b).**Note:** EFA: Education for All; AOP: Annual Operational Plan; SLIP: School Learning Improvement Plan; UPEP: Upazila Primary Education Plan.

Annex Table 2.2
Key Performance Indicators of HPNSDP 2011-16

Indicator	Status in 2010 or 2011 or 2012	Update 2016 (Based on 2014 Data)	Change between 2011 to 2014	Target 2016	Gap (Target - 2014 Data)	Achieved	Proportion done Each Year	Required Years
IMR	43	38	-5	31	7	No	-1.7	4.2
U5MR	53	46		48		Yes		
Neonatal mortality rate	32	28	-4	21	7	No	-1.33	5.25
Maternal mortality ratio per 100,000 live births	194	170	-24	<143	27	No	-8	3.38
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
ANC coverage (at least 4 visits)	25.5%	31.2%	5.7	50%	18.8	No	1.9	9.9
PNC within 48 hours (at least 1 visit)	27.1%	33.9%	6.8	50%	16.1	No	2.3	7.1
CPR	61.2%	62.4%	1.2	72%	9.6	No	0.2	8
Unmet need for family planning	11.7%	12%	0.3	9%	3	No	0.1	30.0*
Measles immunisation 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	0.6	No		

(Annex Table 2.2 contd.)

(Annex Table 2.2 contd.)

Indicator	Status in 2010 or 2011 or 2012	Update 2016 (Based on 2014 Data)	Change between 2011 to 2014	Target 2016	Gap (Target - 2014 Data)	Achieved	Proportion done Each Year	Required Years
Use of modern contraceptives in low performing areas	Slht: 35.2 Chtg: 44.5	Slht: 40.9 Chtg: 47.2	Slht: 5.7 Chtg: 2.7	Slht & Chtg: 50	Slht: 9.1 Chtg: 2.8	No	Slht: 1.9 Chtg: 0.9	Slht: 4.8 Chtg: 3.1
Number of upazilas with women targeted by improved voucher scheme	53	53	0	70	17	No		
Rate of exclusive breastfeeding infants up to 6 months	64%	55.3%	-8.7	50%		Yes		
Number of children 6-23 months fed with appropriate Infant and Young Child Feeding practices	20.9%	22.8%	1.9	52%	27.2	No	0.6	42.9
Number of CCs with increasing number of service contacts over time	NA	13006		13500	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% 2008-09	47% 2008-09	0	60%	13	No	0	
Percentage of annual work plans with budgets submitted by line directors within 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 policymakers, 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/SACMO/MA: 21.2%	Physicians: 37.8%; Nurses: 19.3%; FWV/SACMO/MA: 9.0%	-23.30 -4.59 -16.20	Physicians: 22.8%; Nurses: 15%; FWV/SACMO/MA: 8.5%	Physicians: 15 Nurses: 4.3 FWV: 0.5	No	-7.77 -1.53 -5.40	1.93 2.81 0.74

(Annex Table 2.2 contd.)

(Annex Table 2.2 contd.)

Indicator	Status in 2010 or 2011 or 2012	Update 2016 (Based on 2014 Data)	Change between 2011 to 2014	Target 2016	Gap (Target - 2014 Data)	Achieved	Proportion done Each Year	Required Years
Number of additional providers trained in midwifery at upazila health facilities	115	2025	1910	3,000	975	No	636.7	1.5
Number 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		
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*
Percentage 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		
Utilisation rate of Reimbursable Project Aid against RADP	85%	66%	-19	100%	34	No	-6.3	5.4

(Annex Table 2.2 contd.)

(Annex Table 2.2 contd.)

Indicator	Status in 2010 or 2011 or 2012	Update 2016 (Based on 2014 Data)	Change between 2011 to 2014	Target 2016	Gap (Target - 2014 Data)	Achieved	Proportion done Each Year	Required Years
Percentage of OPs with spending >80 per cent of ADP allocation	N/A	34%		100% (by 2013)	66	No		
Percentage of serious audit objections settled within the last 12 months	7% (2007-08)	68%	61	>80%	12	No		0.6

Source: MoHFW (2012, 2016).**Note:** Average required years after 2014 to fulfil the targets=7.11.

Average required years after June 2017 to fulfil the targets: 7.11-2.5=4.61, or it can be considered as 5 years.

*Average is made of excluding the indicators those showed inverse trend in between the years 2011-2014. Number of observations are 20 categories from 17 indicators except for *.

IMR: Infant mortality rate; U5MR: Under-5 mortality rate; TFR: Total fertility rate; HIV: Human immunodeficiency virus; MARP: Most at risk population; ANC: Antenatal care; PNC: Postnatal care; CPR: Contraceptive prevalence rate; TB: Tuberculosis; SIht: Sylhet; Chig: Chittagong; CCs: Community clinics; EmOC: Emergency obstetric care; MIS: Management Information System; OPs: Operational plans; DPs: Development partners; FWV: Family welfare visitor; SACMO: Sub-assistant community medical officer; MA: Medical assistant; HEU: Health Economics Unit (MoHFW); USAID: United States Agency for International Development.



Under its Independent Review of Bangladesh's Development (IRBD) programme, the Centre for Policy Dialogue (CPD) has been preparing analyses of the major macroeconomic performance indicators of Bangladesh economy, on an ongoing basis, for more than two decades now. Following is a list of publications that have been brought out by the CPD under the CPD-IRBD programme:

- Bangladesh Economy in FY2015-16: Interim Review of Macroeconomic Performance
- Bangladesh Economy in FY2014-15: Third Interim Review of Macroeconomic Performance
- Bangladesh Economy in FY2013-14: Third Interim Review of Macroeconomic Performance
- Bangladesh Economy in FY2012-13: Second Interim Review of Macroeconomic Performance
- State of the Bangladesh Economy in FY2011-12 and Outlook for FY2012-13
- Bangladesh Economy in FY2011-12: Third Interim Review of Macroeconomic Performance
- State of the Bangladesh Economy in FY2010-11 and Outlook for FY2011-12
- Bangladesh Economy in FY2010-11: Second Interim Review of Macroeconomic Performance
- State of the Bangladesh Economy in 2009-10 and Outlook for 2010-11
- বাংলাদেশের অর্থনীতি পর্যালোচনা ২০০৮-০৯
- Bangladesh Economy in FY2009-10: An Interim Review of Macroeconomic Performance
- State of the Bangladesh Economy in FY2008-09 and Outlook for FY2009-10
- Development of Bangladesh with Equity and Justice: Immediate Tasks for the New Government
- Bangladesh Economy in FY2008-09: An Interim Review of Macroeconomic Performance
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