Independent Review of
IRBD
Bangladesh's Development
বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

The First 100 Days of the New Government

Tracking Electoral Pledges and Implications for the National Budget for FY2019-20

(Draft)

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Contents

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The CPD IRBD 2019 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

The First 100 Days of the New Government

Second Reading

SECTION I. INTRODUCTION

A large part of the recent development discourse in Bangladesh has been dominated by the country's economic growth narrative. Indeed, Bangladesh has been experiencing stable acceleration in economic growth since FY2013, which distinguishes it from the majority of the developing countries. The history of economic growth theory would suggest that over time different schools of thoughts have emphasised different sets of factors as drivers of economic growth. Earlier theories such as Classical school underlined the importance of capital investment, while Harrod-Domar model highlighted the role of savings. More recently, endogenous growth models have put greater emphasis on human capital and technological progress. Institutional capacity through required reforms and external sector policies are other factors whose role have been emphasised by multiple schools of thoughts.

Development policymakers and practitioners have increasingly put emphasis on compositional and distributional aspects of economic growth. This has shifted the global attention from the growth-centric development discourse to human development, well-being economics, and more recently to Sustainable Development Goals (SDGs). In the present context, not only in Bangladesh, but also in many developing countries, 'job-less growth' has emerged as a key concern for particularly labour surplus economies. The need to broad-base the economic growth for attaining the SDGs for the 'left behind' has added a new dimension to this discourse. Thus, issues related to the structural changes in the economy, sources of economic growth, decent employment require closer scrutiny for understanding the implications of relatively high growth for inclusive development. Understanding these implications of growth is further relevant for supporting broader development correlates as well as sustainability of the present growth trajectory.

This report, prepared under CPD's flagship programme titled *Independent Review of Bangladesh Development (IRBD),* seeks to address the aforesaid questions in the context of Bangladesh. The present report, which is the second instalment of the *State of the Bangladesh Economy in FY2019*, also seeks to relate the economic growth narrative with the progress in macroeconomic variables. Correspondence and consistency between the growth trajectory and the progress in macroeconomic correlates are critically important for economic growth's effectiveness, reliability and sustainability. Along with this, macroeconomic policy is also pertinent for economic growth and development. For example, capital accumulation in the form of private investment is a key factor for economic growth. Sectoral policies including fiscal and monetary policies and sound financial sector management have important ramifications for private investment. Similarly, development of human capital, an important driver of economic growth, will call for adequate and efficient use of public resources. Progressive fiscal policy plays an important role in ensuring that the outcome of growth is distributionally fair. As was noted above, trade and external sector policies also drive growth outcomes. Taking cue from the above, the present report tracks development in some key areas of macroeconomic management to have a deeper understanding of a number of important growth drivers of Bangladesh. In connection with the above, it may be recalled that, the present government was sworn in January, 2019. The ruling party, Bangladesh Awami League, had put forward several pledges as regards macroeconomic management in its election manifesto of 2018.

The Awami League election manifesto has put forward several strategies and measures including in the following areas:

i. towards the targets of increasing GDP and investment;
ii. in order to increase the rate of new capital generation in the private sector;
iii. towards estimated revenue collection;
iv. to stop money laundering;
v. towards making necessary reforms in budget process;
vi. in order to increase export earnings;
vii. towards developing banking and financial sector; and,
viii. in order to utilise demographic dividend.

These pledges may serve as guiding principles for economic growth and macroeconomic policies of the present government over the next five years. There is a need to establish clear benchmarks as regards the pledges not only to monitor the activities geared towards attaining medium term development objectives, but also to identify immediate challenges as regards macroeconomic management. The forthcoming national budget for FY2020 is the first major opportunity to take comprehensive fiscal-budgetary steps to realise the development aspirations outlined in the election manifesto. The budget also offers an opportunity to discuss stance as regards policy and institutional reforms in a cohesive manner. In this backdrop, the present report puts forward policy recommendations in the area of macroeconomic management in the run up to the FY2020 budget in view of the election pledges. The review also explores areas which need immediate policy attention but have been overlooked by the election manifesto.

Thus, the objectives of the present report are:

- to review the present economic growth trajectory of Bangladesh to understand its sources, reliability and sustainability;
- to assess to what extent policy measures taken over the first hundred days of the government are likely to be 'front-loaded' or 'backloaded';
- to appraise consistency between electoral pledges and post-election policy measures; and,
- to identify how policy interventions and allocative priorities can be improved qualitatively and quantitatively in view of the forthcoming national budget.

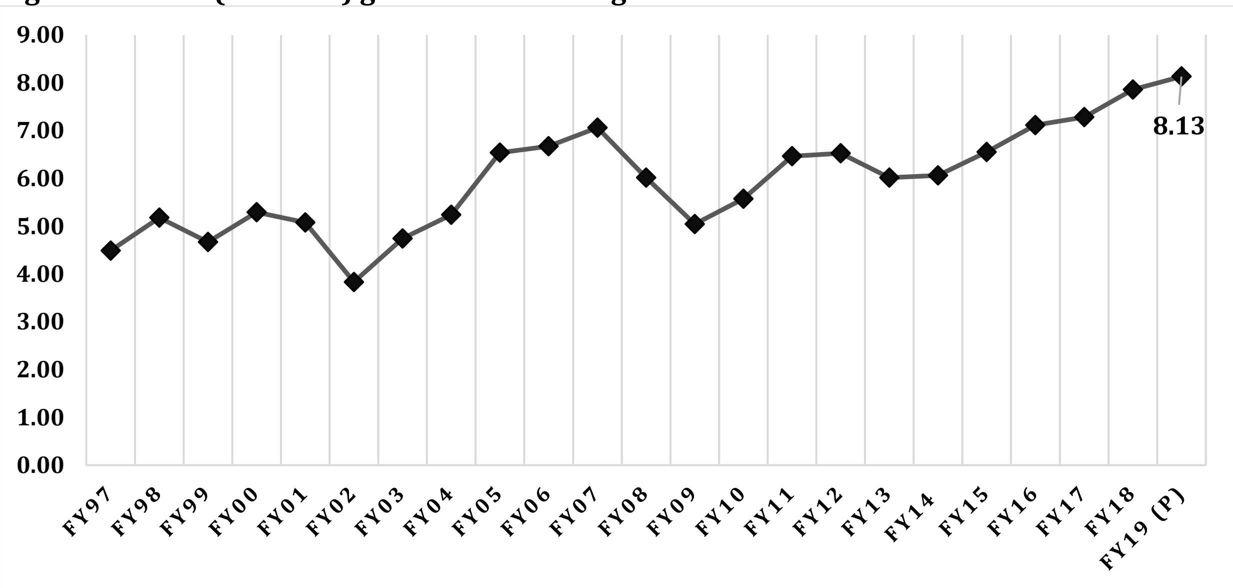
Following this introductory section, this report addresses the identified issues in five thematic sections: (a) economic growth (Section 2); (b) fiscal management (Section 3); (c) private investment (Section 4); (d) monetary policy and banking sector (Section 5); and (e) external sector (Section 6). Finally, the report closes with some concluding remarks outlining the policy stance recommended to the government.

The analyses in this report include a growth decomposition model using the 'Job Generation and Growth Decomposition (JoGGs) Tool' developed by the World Bank. The report also makes use of the most recent data from available official and credible international sources, as well as insights gleaned from key informants, to review and analyse the trends of relevant macroeconomic correlates and recent policy initiatives. It needs to be put on record that, dearth of the needed up-to-date and disaggregated data has put significant constraints in undertaking this exercise.

SECTION II. ECONOMIC GROWTH

Over the past decade Bangladesh has registered one of the fastest and stable economic growth rates in the world. While Bangladesh is projected to be registering the fastest GDP growth in Asia in 2019 by ADB (2019), it is likely to be among the top ten fastest growing developing countries in world according to the projection of United Nations (2019). According to the provisional estimates by the Bangladesh Bureau of Statistics (BBS), for the first time in history of the country, in FY2019 the GDP growth is expected to cross the 8 per cent threshold to reach 8.13 per cent (Figure 2.1). This implies that Bangladesh is likely to reach the said landmark one year earlier than the 7FYP target. This outstanding growth trajectory is rare if not unique even in the contemporary global landscape[1]. With this remarkable growth, the per capita GDP of the country reached a new height of USD 1827; the GNI per capita increased to USD 1909 – a rise of more than two-fold over the last decade. No doubt this unique economic growth story deserves attention as well as investigation to reveal the drivers and its implications in terms of distribution, labour productivity and poverty reduction. This section includes an analysis of the composition of the Bangladesh's current growth performance. Additionally, an indepth exercise has undertaken to assess the nature of the growth the economy experienced over the post-2000 period.

Figure 2.1: GDP (constant) growth rate of Bangladesh since FY1997



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

The projected GDP growth in FY2019 is largely driven by the growth of the manufacturing sector, followed by the services sector.[2] In the latter case, growth was mainly driven by the contribution of the whole sale and retail trade (to the tune of 1.03 percentage points) and transport, storage and communication sector (to the tune of 0.73 percentage points). Of the estimated growth rate of 8.13 per cent in FY2019, agriculture sector's contribution is expected to be to the tune of 0.48

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[1] A number of LDCs are expanding at an average annual growth rate of 7 per cent or more. These include Bangladesh, Bhutan, Burkina Faso, Cambodia, Ethiopia, Lao People's Democratic Republic, Myanmar and Senegal.

[2] This has also helped to progress further in the area of structural change in the composition of the GDP. Manufacturing sector in FY2019 has contributed about 20.0 per cent which was 19.0 per cent in FY2018. The share of agricultural sector, industry sector and services sector in GDP is 13.3 per cent, 31.3 per cent and 55.4 per cent respectively in FY2019.

percentage points (0.59 percentage points in FY2018), while for the industries sector this is about 4.21 percentage points (3.75 percentage points in FY2018), and for the services sector the figure is 3.25 percentage points (3.24 percentage points in FY2018) (Table 2.1). In the contrast to the service sector which is projected to post modest growth, manufacturing sector is estimated to register a record-breaking growth (14.73 per cent) thanks to the envisaged significant contribution of large and medium scale manufacturing industries. Indeed, if the GDP growth rates of FY2018 and FY2019 are compared, of the additional growth of 0.26 percentage points, 0.43 percentage points is expected to be contributed by the manufacturing sector with agriculture's contribution being negative (-) 0.11 percentage points. Contribution of the monetary intermediation sectors appears to be stable in terms of its incremental share.

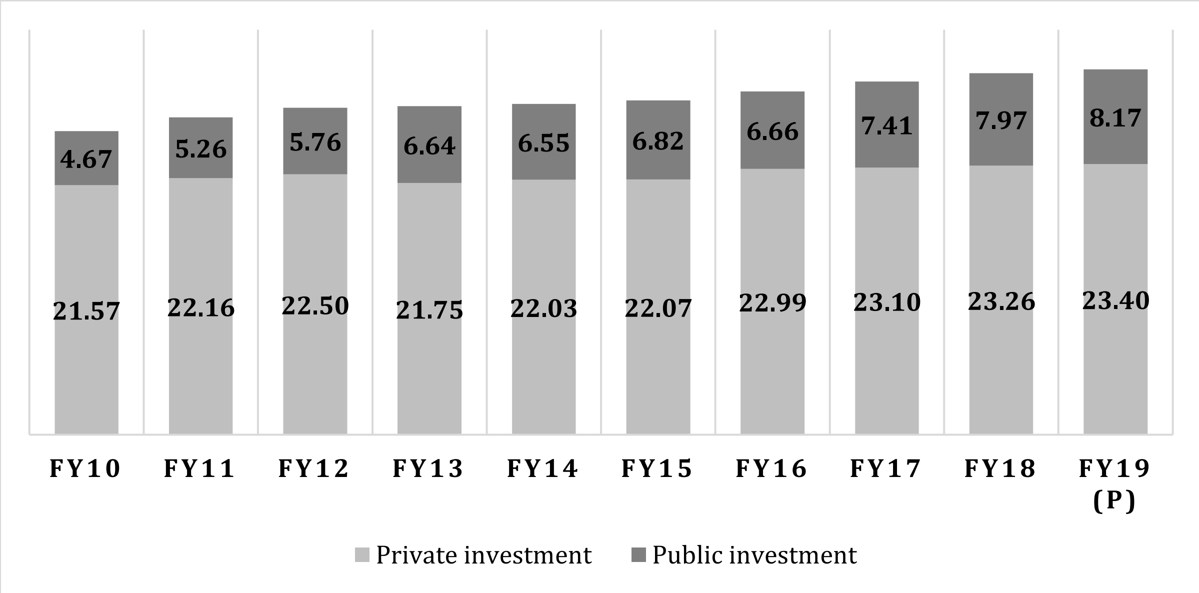
Table 2.1: Contribution to GDP growth over the last ten years (in percentage point)

Sectors	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19(p)
Agriculture	1.07	0.78	0.52	0.41	0.70	0.53	0.43	0.44	0.59	0.48
Industries	1.77	2.31	2.47	2.59	2.27	2.74	3.24	3.10	3.75	4.21
Manufacturing	1.08	1.64	1.69	1.80	1.60	1.93	2.26	2.21	2.80	3.23
Large and medium	0.82	1.46	1.47	1.52	1.38	1.64	1.95	1.87	2.46	2.86
Services	2.89	3.25	3.43	2.88	2.92	3.00	3.21	3.41	3.24	3.25
Wholesale and retail trade	0.78	0.89	0.90	0.83	0.90	0.86	0.88	0.99	1.00	1.03
Transport, storage and communication	0.78	0.89	0.98	0.69	0.67	0.66	0.67	0.73	0.71	0.73
Land Transport	0.50	0.50	0.48	0.41	0.39	0.43	0.44	0.49	0.46	0.47
Water transport	0.03	0.03	0.03	0.03	0.03	0.03	0.02	0.03	0.02	0.03
Air transport	0.02	0.02	0.01	0.00	0.00	0.01	0.00	0.00	0.00	0.01
Support transport services, storage	0.06	0.07	0.11	0.02	0.02	0.03	0.03	0.04	0.06	0.04
Post and Tele communications	0.18	0.28	0.37	0.23	0.23	0.15	0.17	0.18	0.16	0.19
Monetary intermediation	0.07	0.28	0.40	0.27	0.22	0.23	0.24	0.28	0.24	0.27
Tax less subsidy	-0.17	0.12	0.10	0.13	0.16	0.28	0.24	0.34	0.28	0.19
GDP	5.6	6.5	6.5	6.0	6.1	6.55	7.11	7.28	7.86	8.13

Source: Calculated from Bangladesh Bureau of Statistics (BBS) data.
Note: p denotes provisional estimates.

Investment as share of GDP is also projected to rise from 31.23 per cent in FY2018 to 31.56 per cent in FY2019, with the public investment accounting for the larger part of the growth (Figure 2.2). Regrettably, private investment as share of GDP is estimated to increase only marginally (by about 0.14 percentage point) to 23.40 per cent.

Figure 2.2: Investment scenario: FY2010 to FY2019(p) (%)



Source: Bangladesh Bureau of Statistics (BBS).
Note: p denotes provisional estimates.

Manufacturing sector's robust growth is backed up by data of the Quantum Index of Industrial Production (QIIP), which posted 16.38 per cent growth for large and medium scale manufacturing industries during the July-November period of FY2019. Besides, data from Petrobangla also indicates that industrial gas use increased by 11.1 per cent during the July-September period of FY2019. The strong growth in export earnings (17.24 per cent) during the July-November period of FY2019 was largely dominated by RMG, which is reflected in the growth of QIIP for the sector. However, the BBS estimation perhaps did not consider the deceleration of export earnings in the following months. During the December-February period of FY2019 export growth decelerated to 6.65 per cent. Hence, for overall QIIP growth to hold, domestic market oriented industrial production will need to increase faster. Besides, among other manufacturing sectors, leather and leather related products appear to have registered a very high growth rate according to QIIP but without a commensurate reflection in the export performance. For instance, according to the data from export promotion bureau (EPB), export earnings of leather and leather products during the first five months of FY2019 declined by (-)16.11 per cent, while according to the QIIP the industry registered a robust growth of 32.53 per cent. A similar picture was also observed in the previous fiscal year (CPD, 2018a).

In an ideal scenario, the expected rise in GDP in FY2019 should be transmitted to, and reflected in, other major macroeconomic correlates such as tax collection and credit flow. According to the data from the Ministry of Finance (MoF), tax-GDP ratio (1.93 per cent) as of September FY2019 stands lower than the figure of FY2018 (1.97 per cent). However, VAT collection according to the NBR statistics, remained much lower than the estimated growth rate of nominal GDP of 12.7 per cent (see Section 3). According to the latest data from the Bangladesh Bank, private sector credit registered a growth of 12.5 per cent as of February FY2019 which is 6 percentage points lower than that of the previous year (18.5 per cent). Agricultural credit growth (-17.3 per cent) has also experienced a fall in July-January FY2019 compared to the 5.8 per cent growth posted in the corresponding period of the previous fiscal year.

Curiously, the growth rate of nominal GDP is 12.69 per cent which is the lowest since FY2015. This essentially implies that it was the relatively lower GDP deflator of 4.23 per cent which has driven the high real GDP growth. Indeed, GDP deflator growth was significantly lower than the inflation rate (5.48 per cent as of March 2019).

It is to be noted that the provisional estimate is constrained by varying levels of availability of the required data. For example, crop production data was almost absent when the GDP estimate was made. Large and medium manufacturing production data was available for five months while data on financial sector was available for six to seven months. Besides, it is also known that while estimating GDP in Bangladesh, for a large part of the total value added, real time annual data is not considered. These issues have been raised in a number of previous IRBD reports of the CPD and also in other credible studies including study by World Bank (2018). Hence, such incoherent evidence between GDP estimates and proxy indicators suggest that there is a need to test the robustness of growth estimate so as to have credible policy guidance.

A number of studies carried out by the CPD over successive years has put the spotlight on issues of quality of economic growth in Bangladesh – distribution and effectiveness in creating jobs, raising labour productivity (wages) and reducing poverty (CPD, 2018a, 2018b). The revealed disquieting trends in the backdrop of spectacular growth performance calls for exploring the sources as well as the nature of growth in Bangladesh to identify who had been the real beneficiaries of the recent economic growth dynamics in Bangladesh.

Some of the key development policy questions concerning economic growth may be posed in the following manner:

i. Does the attained economic growth originate from employment creation of/and increased productivity of labour?

ii. Is the observed increase in output per worker (often seen as a proxy of labour productivity) because of higher productivity within the sectors, or owing to shifts of employments from relatively lower productive to higher productive sectors?

iii. How far the increase in output per worker is related to enhanced total factor productivity originating from efficient use of resources compared to additional resources such as increase in capital?

iv. What has been the role of the 'demographic dividend' in the observed acceleration in the economic growth?

In connection with the above, the present report has conducted a decomposition analysis of the economic growth in Bangladesh during the post-2000 period following the methodology of '*Job Generation and Growth Decomposition (JoGGs) Tool*', as presented in World Bank (2012). First, the growth of the 2000-2010 period has been decomposed and then the same exercise was carried out for the 2010-2017 period. As the Household Income and Expenditure Survey (HIES) and Labour Force Survey (LFS) are not available for FY2018, the analysis has used LFS 2016-17 and national accounts data of FY2017 of the BBS as the data source. The analytical exercise has used growth of GDP per capita (value added) for decomposition purpose. Although growth of GDP and growth of GDP per capita (value added) are technically different, it is essentially two sides of the same coin.[3]

Decomposition of the first period (2000-2010) growth reveals relatively encouraging results as opposed to that of the second period (2010-2017). Decomposition exercise of the first period shows that, growth was driven by increase in output per worker, employment rate and share of working age population. More specifically, for the 2000-2010 period, of the total growth of per capita value added i.e. GDP (to the tune of 50.44 per cent), more than half (56.11 per cent) can be explained by output per worker (alternatively, labour productivity), 24.45 per cent can be explained by the changes in demographic structure[4] while the rest (19.44 per cent) can be linked to changes in employment rate (Table 2.2). As changes in employment rate accounts for 19.44 per cent of the growth of the GDP per capita (value added), it may be inferred that the recorded economic growth during the said period was not 'job-less'. This means that if productivity and the number of dependents per working age member remained unchanged, the higher rate of employment would have generated a growth of 9.8 per cent.

Table 2.2: Decomposition of Growth in per capita Value Added, Bangladesh

Indicator	BDT	Percent of total change in per capita value-added growth	BDT	Percent of total change in per capita value-added growth
	2000-2010		2010-2017	
Growth linked to output per worker	7,330.42	56.11	15,816.91	90.75
Growth linked to changes employment rate	2,540.07	19.44	-800.53	-4.59
Growth linked to changes in the share of population of working Age	3,193.55	24.45	2,412.17	13.84
Total Growth in per capita GDP (value added)	13,064.04	100	17,428.55	100

Source: Authors' estimation.

Sectoral decomposition of employment reveals that, agriculture sector of Bangladesh absorbed the largest share of the labour, while labour productivity in this sector appeared to be the lowest. However, in terms of labour productivity, mining and quarrying and utilities sector took the lead with both sectors absorbing lowest amount of employed population. The analysis is taken one step further through a sectoral decomposition of the change in employment rate during the 2000-2010 period (4.33 percentage points). The findings show that, manufacturing, construction and transport sectors were the drivers of the change in employment rate (Table 2.3). Analysis shows that, total labour productivity of the economy registered a growth of 26 per cent for the first period (2000-2010). To investigate the actual source of productivity growth, a decomposition exercise was carried out as regards total output per worker (net of inter-sectoral shifts) at the

[3] This is particularly true when population growth rates during these two periods remained fairly similar which is true for Bangladesh.

[4] Here, it was assumed that each of the working age adults faced the same employment rate and productivity in both periods, the lower dependency increased per capita output.

aggregate level. The analysis shows that, the growth in output per worker was largely driven by a very high capital labour ratio. However, an important share of growth in output per worker was also due to movement of the labour force into transport and commerce sectors from the less productive sectors of the economy. In fine, the results show that, the growth of GDP per capita (value added) of Bangladesh over the period 2000 to 2010 was driven by productivity reinforced by demographic dividend of the economy. Despite prevailing higher capital labour ratio, the growth could create jobs that enabled workers to enjoy the benefits of growth.

Table 2.3: Contribution of employment changes to overall change in employment rate, Bangladesh

Sectors	Contribution to change in total employment rate (percentage points)	
	2000-2010	2010-2017
Agriculture	0.20	-4.22
Mining and Quarrying	-0.12	-0.02
Utilities	-0.05	-0.04
Manufacturing	2.03	1.03
Construction	1.26	0.38
Commerce	0.22	0.25
Transport	0.84	0.60
Government Services	-0.50	0.35
Other Services	0.46	0.72
Total employment rate	4.33	-0.95

Source: Authors' estimation.

In contrast, decomposition of the growth performance during 2010-2017 period shows a somewhat different picture. Analysis shows that, the growth of per capita GDP (value added), to the tune of 44.73 per cent, was mainly driven by output per worker (labour productivity). While the share of growth linked to demographic structure fell from 24.45 per cent to 13.84 per cent, growth linked to changes in employment rate decreased from 19.44 per cent to (-) 4.59 per cent (Table 2.2). This has a number of important implications. First, this implies, if labour productivity and population structure would have stayed the same as 2010, the lower rate of employment would have caused the GDP per capita (value added) to fall by about 2.05 per cent; this essentially means the economy was going through a job-less growth phase. Second, the fall in contribution of population structure to total growth implies that, the demographic dividend of the economy has worn out gradually in the 2010-2017 period compared to the 2000-2010 period. Several studies have raised concern regarding the above-mentioned issues concerning the Bangladesh economy. Rahman *et al*. (2014) found that demographic dividend will continue to offer Bangladesh significant opportunities over the coming 20-25 years; it is anticipated that after 2035 the dependency ratio in Bangladesh will start to rise again.

As the results of the decomposition indicate, it is high time for Bangladesh to leverage the existing demographic dividend by taking appropriate measures, and also to prepare for the higher dependency ratio in future. In this context, addressing the declining female labour force participation, and at the same time generating decent jobs for them, ought to be seen as a priority for Bangladesh's policymakers. However, during the 2010-2017 period, change in employment rate was negative [(-) 0.95 percentage points], with majority of the adverse effect originating from agriculture alongside the subdued performance in manufacturing, construction and transport (see Table 2.3).

Although decomposition results provide an encouraging picture as regards labour productivity, detailed analysis concerning sources of productivity growth is needed to have a deeper understanding about the involved factors. Analysis shows that, total labour productivity in the economy is increasing at an increasing pace with growth of total output per worker rising from 26 per cent to 40 per cent between the two periods. In this context, there could be three possible sources of the recorded growth. First, it may be due to inter-sectoral labour relocation which means labour shifted from low productivity sector to high productivity sector. Second, this may be due to the fact that, each worker is now equipped with more capital to work. Third, it may be due to increase in total factor productivity.

Decomposition of total output per worker (net of inter-sectoral shifts) at the aggregate level indicates that, an important share in the growth in output per worker was due to movement of labour into manufacturing and commerce from the less productive sectors of the economy. This suggests some degree of structural transformation taking place in the economy. Between the two considered time periods, contribution of intersectoral labour relocation in productivity gain has increased from 6.4 per cent to 20.7 per cent. This implies that, on average, labour moved from lower than average productivity sectors to above average productivity sectors. Compared to the first period, capital-labour ratio appears to have declined in the second period although this remains the major factor driving labour productivity growth in both the time periods. From the results it can be clearly discerned that, labour productivity improved mainly due to higher capital labour ratio followed by inter-sectoral labour relocation (Table 2.4).

Table 2.4: Decomposition (% change) of output per worker, capital stocks, capital labour ratio and share of capital in total income of Bangladesh

	% change between 1999-00 to 2009-10	% change between 2009-10 to 2010-17
Share of capital in total income (%)	34.77	15.41
Capital	131.87	80.18
Total output per worker	25.81	39.90
Output per worker net of inter-sectoral shifts	24.16	31.63
Capital labour Ratio	66.27	60.56
TFP residual net of inter-sectoral shifts	-47.96	-28.54

Source: Authors' estimation.

Based on the above discussion, it is clear that, over the 2010-2017 period, Bangladesh's economic growth has been relatively less employment generating. Indeed, if the employment generation of the earlier phase is considered, economic growth forgone for not sustaining the employment generation pace is estimated to be as high as 2.05 per cent. While economic growth has been mostly driven by productivity of labour, the benefits of growth are likely to be mostly reaped by the owners of capital within the economy. It appears that, Bangladesh has been passing through a period of 'productivity revolution', if the national accounts data quality is not subject to questioning. Findings of the exercise also indicate that, demographic dividend is getting less pronounced over the years as its contribution to total growth in GDP (value added) per capita appears to be on the decline.

Taking the revealed nature of the quality of both current and past economic growth into cognisance, policymakers will be well-advised to emphasise more on the nature of growth rather than its quantitative outcomes. Besides, Bangladesh will need to undertake targeted policies to address the challenge of the rising number of young people belonging to the category of 'not in employment, education or training' (NEET). This must be seen as a key component of the strategy to reap the potential benefits of the demographic dividend.

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SECTION III. PUBLIC FINANCE: 'FRONT-LOAD' REFORMS IN THE NEXT BUDGET

Revenue mobilisation ought to be at the centre stage of policy discourse in Bangladesh in the course of budget discussion over the coming months. The issue demands renewed attention in light of Bangladesh's journey towards *dual transition* i.e. graduation to World Bank's lending category as lower middle-income country and the upcoming graduation from the least developed country (LDC) status. Both these transitions have significant repercussions by way of increased cost of external borrowing for development finance with more stringent conditionalities. Towards smooth transition, Bangladesh's development strategy will, thus, need to prioritise mobilisation of revenue for financing public service delivery and investments in physical infrastructure and human capital. Issues of domestic resource mobilisation calls for greater attention also in the context of the Sustainable Development Goals (SDGs) since implementing the Goals in Bangladesh will call for deployment of significant financial resources. Alongside, the capacity of the government to align its public spending in accordance with the priority needs, efficient utilisation of its scant resources and management of the outstanding debt will impact attainment of the aforesaid objectives. The present section sets the context in terms of trends and policy positions in areas related to public finance identified from the election pledges, and tracks the follow-up actions and policy measures. The section concludes with putting forward fiscal-budgetary recommendations in view of the national budget for FY2020 along with necessary reform measures.

3.1 Revenue mobilisation

It is safe to argue that, as far as revenue mobilisation is concerned, the Bangladesh development narrative has lost the plot. It is becoming increasingly evident that revenue mobilisation in Bangladesh is not being able to match the demands of accelerating economic growth — has lost the momentum gained between FY2015 and FY2017. As is evinced from Table 3.1, in FY2018 Bangladesh's revenue–GDP ratio was only 9.6 per cent.[5] The ambition of 7FYP to reach a revenue–GDP ratio of 16.1 per cent (and a tax–GDP ratio of 14.1 per cent) by FY2020 appears to be a far cry at this moment.

Table 3.1: Revenue as share of GDP (in per cent)

Source	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	BFY 19
a. Total revenue	9.2	9.5	10.1	10.9	10.7	10.4	9.6	10.0	10.2	9.6	13.4
a.1 Tax revenue	7.5	7.8	8.7	9.0	9.0	8.6	8.5	8.8	9.0	8.6	12.1
a.1.1NBR Tax	7.1	7.5	8.3	8.7	8.6	8.3	8.2	8.4	8.7	8.3	11.7
a.1.2 Non-NBR Tax	0.4	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
a.2 Non-tax revenue	1.7	1.7	1.5	1.8	1.7	1.8	1.1	1.2	1.2	1.0	1.3

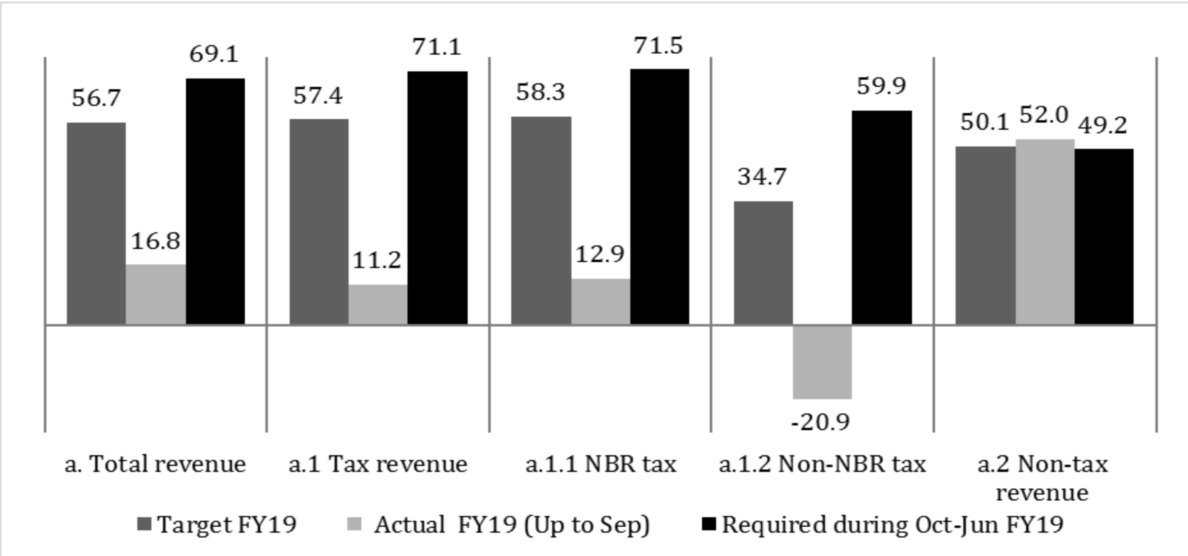
Source: Authors' calculations based on the data from the Ministry of Finance (MoF) and Bangladesh Bureau of Statistics (BBS).
Note: 1. For FY2009 to FY2017, data used in this analysis was compiled from MoF's *Budget in Brief* documents for the FY2011 to FY2019 period. Data for FY2018 was taken from MoF's Monthly Fiscal Report.
2. NBR: National Board of Revenue.
3. 'B' denotes target set during budget.

[5] As a matter of fact, GDP elasticity of revenue declined from 1.2 in FY2017 to 0.5 in FY2018. Amongst the components of revenue, GDP elasticity of tax revenue decreased to 0.7 in FY2018 from 1.2 in FY2017 and GDP elasticity of non-tax revenue deteriorated to (-) 0.3 in FY2018 from 0.7 in FY2017. In fact, between FY2014 and FY2018, GDP elasticity of revenue was only 0.8. If this scenario prevails, then revenue growth in FY2019 is going to be approximately 10.2 per cent and, thus, taking the revenue–GDP ratio to 9.4 per cent.

In FY2018, actual revenue generation was Tk. 71,445 crore less than the target set in the budget for the year. Of this shortfall, tax revenue constituted 87.0 per cent with the remaining 13 per cent originating from non-tax revenue. Among the various components of tax revenue, income tax, VAT and import duty accounted for 36.6 per cent, 32.1 per cent and 14.2 per cent of total shortfall respectively. Revenue mobilised by the NBR in FY2018 was Tk. 61,094 crore less than the targeted amount (which was 85.5 per cent of the total shortfall).

The revenue mobilisation scenario in FY2019 appears to be even more dismal. According to MoF data, during July-September of FY2019, total revenue rose by 16.8 per cent over the corresponding period of FY2018. However, the growth target of total revenue for the entire fiscal year was set at 56.7 per cent — thus requiring an unprecedented 69.1 per cent growth for the remainder of the year (Figure 3.1). Only non-tax revenue was able to attain the target growth rate in the first quarter of FY2019. However, as non-tax revenue constitutes only 9.8 per cent of the total revenue target, the attained growth till now will impact the attainment of the revenue target only marginally. In fact, NBR tax, which constitutes 87.3 per cent of the total targeted revenue, registered a 12.9 per cent growth in July-September period of FY2019, thus requiring a 71.5 per cent growth over the remaining months of FY2019. According to the NBR data, during July-September of FY2019, NBR tax revenue attained a growth of 5.2 per cent, which differs significantly from the aforestated MoF data. The growth rate increased to 7.0 per cent up to February of FY2019. Within NBR tax revenue, VAT and income tax recorded 6.1 per cent and 12.1 per cent growth respectively during July-February of FY2019 over corresponding period of FY2018. This implies that a growth of 99.2 per cent will be needed for total NBR tax revenue during the March-June period of FY2019.

Figure 3.1: Growth scenario of revenue mobilisation up to September FY2019 (in per cent)



Source: Authors' calculations based on Ministry of Finance (MoF) data.

If the current trend in revenue mobilisation continues, as reported by the MoF data, the total revenue shortfall, comprising of both tax and non-tax revenue, may reach about Tk. 85,000 crore at the end of FY2019. Even if revenue collection is able to achieve the highest annual growth recorded in the last ten years (i.e. 23.4 per cent in FY2012), the revenue shortfall in FY2019 is going to be to the tune of Tk. 72,000 crore. Hence, it may be said with certainty that maintaining the status quo will not be enough if Bangladesh is to attain the ambitious revenue mobilisation targets in the budget and in the Plan. Delay in implementation of needed reforms, allowing tax incentives on an ad hoc basis, widespread tax evasion and lack of administrative capacity are holding back the country from mobilising the domestic revenue which is needed and which the country has the potential to generate.

Commitments in the election manifesto and follow-up actions

Prior to the 2018 national elections, the ruling party – Bangladesh Awami League – put forward a number of commitments in their election manifesto pertaining to revenue mobilisation. These are presented in Table 3.2.

Table 3.2: Election pledges and follow-up actions on revenue mobilisation

CPD recommendations	Commitments in the manifesto	Follow-up action
Raise revenue—GDP and tax—GDP ratio	• The revenue collection will be enhanced after making necessary reforms with respect to income Tax, VAT and Supplementary Duty.	• Imposition of 15 per cent VAT on all Bangladeshi advertisements going to online platforms, like, Facebook, Google, and YouTube.
	• Making Value Added Tax (VAT) Law rational and implementable, the existing problems will be solved. Imposition of cascading (wrong notion of recurring taxes) will be avoided. The use of Alternative Dispute Resolution (ADR) will be increased. Considering success in audit report and ADR, activities to give rewards and incentives to tax officers will be made more effective.	• Implementation of the new VAT and SD Act from the forthcoming FY2020.
	• The tax officers will be imparted training on Business Finance, Accounting, Business Law, International Business and other subjects in different organizations.	• No noteworthy steps taken.
Focus on raising share of direct tax	• The extent of income tax will be increased gradually in harmony with earning.	• Formation of a taskforce to identify the foreign nationals working in Bangladesh to bring them under the tax net.
Commit to curb illicit financial flows and black money	• Bribery, unearned income, black money, extortion, earning through manipulated tender, and muscle power will be eradicated. • Priority has been given on preventing laundering of money acquired through tax evasion and crimes, and also on strategy to recover the laundered money. All activities relating to controlling money laundering will go on.	• Deployment of the Money Laundering Prevention Rules 2019.

Source: Authors' elaboration based on CPD (2019) and various official and unofficial sources (e.g. circulars, guidelines, SROs, media reports, key personnel interviews etc.).

During the first 100 days of the incumbent government, efforts towards increasing revenue mobilisation centred around the implementation of VAT and Supplementary Duty (SD) Act 2012. As is known, implementation of the said law suffered successive delays for various reasons – disagreements over implementation modalities, pushback from business community on account of single VAT rate and elimination of exemptions and rebates (World Bank, 2019). This delay has caused a substantial amount of revenue to be forgone. According to World Bank (2018), implementing the VAT law at the proposed uniform rate of 15 per cent would have mobilised additional revenue from VAT to the tune of 1 per cent of GDP in FY2018 and 0.8 per cent of GDP in FY2019. The new government has already expressed its commitment to implement the new VAT and SD Act from the next fiscal year, i.e. FY2020.

As has been indicated by a number of policymakers and several media reports[6], the earlier proposed single rate of 15 per cent for VAT may not be implemented. Rather, four different rates, i.e. 5, 7.5, 10 and 15 per cent, may be proposed at the national budget for FY2020 in addition to the 'zero rate' for a select set of 'essential commodities'. The '15 per cent rate' is likely to be applied for the majority of goods and services. It is also speculated that businesses availing the lower than 15 per cent rate may not be eligible for 'VAT credit'. Also, VAT exempt turnover limit will be increased to Tk. 50 lakh from the current Tk. 36 lakh. It was also reported that the ceiling of turnover tax will be expanded to Tk. 3 crore from Tk. 80 lakh with the tax rate to be increased from the current 3 per cent to 5 per cent. Although it was assumed that the *package VAT* will be discontinued from the coming fiscal year, it was later reported that in the upcoming budget a similar instrument may be introduced. It was also said that VAT registration will be made compulsory from FY2020.[7] The legal regime of VAT may continue, with multiple VAT registrations by same businesses (business identification number) in lieu of the single registration provision advocated by the VAT and SD Act 2012. The new legal provision may also allow flexibility on the issue of automation. All these propositions are, however, still under consideration. It is likely that only the final budget proposals to be presented before the national parliament will be able to confirm the final stance of the government as regards this important issue. Regrettably, it is doubtful that the narrow window of time after the presentation of the budget (less than three weeks) will be adequate to discuss the provisions and give opportunity to stakeholders including revenue administration and businesses for taking preparations.[8] More importantly, no steps have been taken to due conduct an ex-ante impact analysis of the new provisions, called for by the CPD for some years now.

Besides VAT and SD Act 2012, the other issue that garnered much attention in the recent times is the extent of tax exemption in Bangladesh economy. It was reported that the government provided approximately Tk. 1,47,699 crore worth of tax exemption at import stage since FY2015 to January of FY2019 (The Financial Express, 2019) which is about 62 per cent of total revenue mobilised at import stage during the said period. In fact, until January of the ongoing FY2019, the NBR allowed about Tk. 27,108 crore as tax exemptions only at import stage to various sectors. Although such exemptions may be necessary in consideration of 'development needs', it is reckoned that often these are allowed on an ad-hoc basis, without proper cost-benefit analysis. In view of the need for raising revenue mobilisation, a review of the exemptions has become an urgent necessity.

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[6] These propositions are compiled from key informant interviews, and news reports including The Daily Star (2019a), The Daily Star (2019b), New Age (2019), and Dhaka Tribune (2019).
[7] At present, VAT registration is not obligatory for businesses having annual turnover of Tk. 8 lakh or below.
[8] The International Monetary Fund (IMF) already expressed its concerns as regards risk of revenue leakage in a multi-rate VAT system on account of accidental or deliberate misclassification of goods and report of VAT outputs at decreased rates than the law requires. Moreover, multiple rates may create administrative complications and impede the tax authority's ability to efficiently enforce the legislation. Hence, the IMF suggested to assess the fiscal impact before modifying the VAT law.

After much delay, MoF has recently issued the Money Laundering Prevention Rules 2019 (BFID, 2019). The rules have come into effect seven years after enactment of the Money Laundering Prevention Act 2012, and three years after its amendment in 2015. In the Rules, responsibilities of relevant government agencies have been specified. Further, 27 money laundering related crimes were specified on which six government agencies are to act. Of the said agencies, the Criminal Investigation Department will investigate 21 out of 27 types of crime, either on its own or in collaboration with the other agencies. The remaining five agencies include the Anti-Corruption Commission (ACC), Narcotics Control Department, National Board of Revenue (NBR), Directorate of Environment and Bangladesh Securities and Exchange Commission. The new rules will enable the aforesaid bodies to submit charge sheets before a court after completing investigations. This will, indeed, remove previous ambiguity concerning competent authority, and also assist in smooth implementation of the law.

3.2 Public expenditure

Planning and delivery capacity of public expenditure

Inability to deliver on the planned budgetary allocations highlights the weakening state of macroeconomic management in recent years; this has continued in FY2019.[9] The progress of the first quarter (July-September) of FY2019, as evidenced by the public finance data which is available in the public domain, indicates that majority of the fiscal parameters will not be achieved. ADP as well as operational expenditure will need to grow by 82.8 per cent and 48.5 per cent respectively over the remaining nine months of FY2019 to reach the public expenditure targets of the budget for FY2019 (Table 3.3).

Table 3.3: Fiscal framework (growth, %)

Parameters	Target FY18	Actual FY18	Target FY19	Up to Sep FY19	Required for Oct-Jun FY18
Revenue Collection	**43.1**	**7.6**	**56.7**	**16.8**	**69.1**
Total - Expenditure	**53.1**	**16.5**	**52.5**	**9.5**	**60.4**
ADP	98.4	29.5	72.9	-10.2	82.8
Non-ADP	34.0	11.0	42.6	15.2	48.5
Overall Deficit (Excl. Grants):	**-84.8**	**-44.9**	**-42.4**	**101.3**	**-45.0**

Source: Calculated from MoF data.

Expenditure during the first three months of FY2019 was mainly driven by the non-development component which registered a growth of 15.2 per cent. The moderate growth in pay of establishments (43.2 per cent) and interest payments (17.5 per cent) has contributed to the overall growth of non-development expenditure. Higher demand for subsidies may also put pressure on the overall expenditure in the remaining months of FY2019 compared to recent years.[10]

[9] According to MoF data, during FY2009-FY2018 period, the average discrepancy between original approved budget and the actual expenditure was 14.5 per cent and stood at 23.9 per cent in FY2018, highest since FY2001. This discrepancy is higher for development component compared to the non-development component of public expenditure.

[10] Expenditure for subsidies and incentives is targeted to grow by 253.4 per cent in FY2019 over the actual expenditure of FY2018 mainly contributed by LNG imports.

As has been the case for the last seven years, budget deficit was well within the planned limit, when the first quarter of FY2019 is considered. However, a significant revenue shortfall coupled with relatively higher public expenditure rate (particularly non-development expenditure) may result in higher overall deficit financing by the end of the fiscal year compared to the recent years.[11]

Commitments in the election manifesto and follow-up actions

The ruling party did not put forward any specific commitment for improving the planning and implementation capacity of public expenditure in their election manifesto (Table 3.4).

Table 3.4: Election pledges and follow-up actions on public expenditure planning and delivery

CPD recommendations	Commitments in the manifesto	Follow-up action
Prioritise planning and delivery capacity of public expenditure	No commitments made.	• Finance Division has published a circular on February 12, 2019 with regard to implementing different programmes under the 'single budget' system.

Source: Authors' elaboration based on CPD (2019) and various official and unofficial sources (e.g. circulars, guidelines, SROs, media reports, key personnel interviews etc.).

The new government however, has taken an important initiative recently concerning public expenditure. With a view to reducing lack of coordination (between development and non-development budget), and duplication in the existing budget formulation process, the government plans to initiate a process of implementing different programmes under a 'single budget' system (Ministry of Finance, 2019a). At the initial stage, the Ministry of Finance and Ministry of Education have been selected for adopting this system beginning from FY2020 budget, on a pilot basis. Finance Division has published a circular on February 12, 2019 regarding scheme selection, formulation, appraisal and approval, implementation and arrangement, and monitoring and evaluation of the schemes.

The government has previously made an attempt to introduce a 'unified budget' along with the budget proposal for FY2011 and the Ministry of Finance (2010) also prepared a concept note on 'Unified Budget' and 'District Budget'. However, this could not be implemented because of the absence of identical economic codes for allocation in the annual development programme (ADP), and also due to donor obligation as regards formulation of separate development budget. The necessity to develop a single harmonised budget was also highlighted in the Public Financial Management (PFM) Reform Strategy 2016-2021 (Government of the People's Republic of Bangladesh, 2016).

It is envisaged that the proposed 'single budget' mechanism will enhance efficacy of public expenditure and improve the delivery capacity of public administration. Many developed and developing countries have adopted this system. At the operational level introduction of this

[11] According to Bangladesh Bank (2019), deficit financing registered a growth of 69 per cent during July-January of FY2019 compared to the corresponding period of the previous fiscal year.

system will need creation of unique economic codes. More importantly, to make this initiative successful, the government will need to ensure adoption of sectoral programmes linked with the objectives of the national development plan and the SDGs instead of traditional project-based budget allocation. This will also call for improved modalities of financial management concerning both domestic revenue, and also foreign aid where better coordination with development partners will be required.

Delivery of development budget

According to the data for the first eight months (July-February), actual spending under ADP was 38.8 per cent of the originally planned allocation of Tk. 173,000 crore which is highest since FY2013.[12] Higher utilisation (40.4 per cent) of foreign aid (second highest since FY2006) is a positive sign in the context of budget implementation trends in FY2019. This has happened thanks to Ministry of Science and Technology (the Rooppur Nuclear Power Plant) and Power Division. During July-February of FY2019, utilisation of 'Taka component' (38.0 per cent) was similar to the average rate of implementation over the past five fiscal years. Five key sectors (e.g. Transport, Rural Development and Institutions, Education and Religious Affairs, Science, Information and communication Technology, and Health, Nutrition, Population & Family Welfare) which constitute about 60 per cent of the total ADP were subjected to significant cuts in the revised ADP (RADP) for FY2019 due to slow pace of implementation of the associated government agencies[13]. ADP for FY2019 was slashed by Tk. 6,000 crore (or 3.6 per cent) to bring the size down to Tk. 167,000 crore. Project aid component was reduced by Tk. 9,000 crore (or 17.6 per cent) while local resources (Taka) component was increased by Tk. 3,000 crore (or 2.7 per cent).

In its successive reports prepared under the Independent Review of Bangladesh's Development (IRBD), CPD has been highlighting a number of factors undermining the effectiveness and efficiency of delivering ADP. These include overcapitalisation of projects, delays in implementation due to delays in land acquisition and release of funds, and adoption of 'symbolic' projects (CPD, 2019). The number of unapproved ADP projects that received allocation in the RADP has been on the rise over successive fiscal years. In contrast, the reduction in total allocation has also been increasing in the RADP when compared with the ADP; this sends a contradictory signal. A total of 430 fresh projects were included in RADP of FY2019 which was the highest over the last 14 fiscal years (Table 3.5). At the same time, RADP of FY2019 was downsized by Tk. 6,000 crore which was the second highest since FY2009.

[12] However, data discrepancy among MoF and IMED is a major concern here. According to MoF data, ADP implementation during July-September of FY2019 was 5.5 per cent while IMED reported the implementation rate to be 7.9 per cent for the corresponding period.

[13] Road Transport and Highways Division, Ministry of Railway, Bridges Division, Secondary and Higher Education Division, Health Services Division, all had below the average rate of implementation for the period of July-February FY2019.

Table 3.5: Number of new projects vs. reduction in RADP allocation

Fiscal year	ADP	RADP	Number of New Projects	Reduction (in Crore Tk.)
FY09	904	1,040	136	2,600
FY10	886	1,062	176	2,000
FY11	916	1,185	269	2,620
FY12	1,039	1,231	192	4,920
FY13	1,037	1,205	168	2,634
FY14	1,046	1,254	208	5,872
FY15	1,034	1,204	170	5,315
FY16	999	1,315	316	6,000
FY17	1,123	1,415	292	0
FY18	1,192	1,511	319	7,550
FY19	1,346	1,785	439	6,000

Source: Author's compilation from Planning Commission data.

In addition, 121 out of these 430 projects (28.1 per cent) received symbolic allocations of Tk. 1 crore or less, while 43 projects received allocation of only 10 lakh or less. Majority of these symbolic projects are from Transport (35) and Physical Planning, Water Supply & Housing (19) sectors. These symbolic projects are perhaps included in the RADP due to political considerations; however, these remain unimplemented for reasons of inadequate resource allocation. Indeed, this may continue to undermine the overall quality of ADP planning. CPD analysis reveals that two projects under Industry and Transportation sectors which received less than Tk. 10 lakh in the ADP for FY2017 continue to receive a symbolic allocation of Tk. 1 lakh in RADP for FY2019.[14] These projects were scheduled to be completed in or before FY2017, but had been carried forward more than once with only symbolic allocation due to insignificant or no cumulative progress.

Following inadequate financial progress and being in limbo for a long time[15] with symbolic allocations, ageing projects are often declared as completed without 100 per cent actual physical completion. During FY2008-FY2018, about 63.4 per cent (on an average) of all completed projects were stated as complete without 100 per cent physical progress, though the situation has somewhat improved since FY2015. This rate should decline further since it undermines the overall quality of delivering the development programmes.

Commitments in the election manifesto and follow-up actions

The ruling party has made two pledges in their election manifesto as regards public investment programme and enhancing its management effectiveness (Table 3.6).

Table 3.6: Election pledges and follow-up actions on delivery of development budget

CPD recommendations	Commitments in the manifesto	Follow-up action
Improve capacity of development administration	• To double the Annual Development Programme, that is to say, with a view to spending 9 per cent of the	• The government has downsized the allocation for RADP to 6.6 per cent of GDP in FY2019 from the original size of 6.8 per cent of GDP.

[14] These projects include BISIC Industrial City Kumarkhali, Kustia (1st Revised) and Establishment of Ashuganj Internal Sea Port.

[15] 11 of the 586 investment projects of ADP for FY2019 are 10-16 years old while 4 of them are more than 15 years old.

CPD recommendations	Commitments in the manifesto	Follow-up action
	total national earning in ADP, the adjustment will be made in the budget strategy.	• Finance Division has issued an amended guideline on the release of development fund for FY2019. • In the circular for revised budget of FY2019, Finance Division has directed the ministries and divisions to keep the number of projects limited. • Another direction was to propose similar type of projects under an agency in a cluster rather than individual projects. • Finance Division has issued a circular on December 3, 2018 with regard to creating necessary positions and recruiting the required manpower after the completion of development projects.
	• As part of investment and production-oriented welfare, monthly remuneration will be given to trainees during their skill development training.	No steps taken.

Source: Authors' elaboration based on CPD (2019) and various official and unofficial sources (e.g. circulars, guidelines, SROs, media reports, key personnel interviews etc.).

Due to inadequate spending by some key ministries, the government has downsized the allocation for RADP to 6.6 per cent of the GDP in FY2019 from the original size of 6.8 per cent of GDP. However, the government has taken a number of initiatives with an objective to strengthen management, expedite implementation and raise impact of development programmes.

In the circular for revised budget of FY2019, Finance Division has directed the ministries and divisions to keep the number of projects limited. However, the number of new projects was the highest in RADP for FY2019 in recent years. Another direction was to propose similar type of projects under an agency in a cluster rather than individual projects. However, this was also violated by a flurry of small and symbolic projects in the last RADP, mainly in Transport and Physical Planning, Water Supply and Housing sectors.

Besides, with a view to expedite development work, Finance Division has issued an amended guideline on the release of development fund for FY2019. According to the guideline, project directors will not need approval from the concerned ministry or finance division with regard to using the money of GoB component for the first two instalments (July-September and October-December periods) at a time.

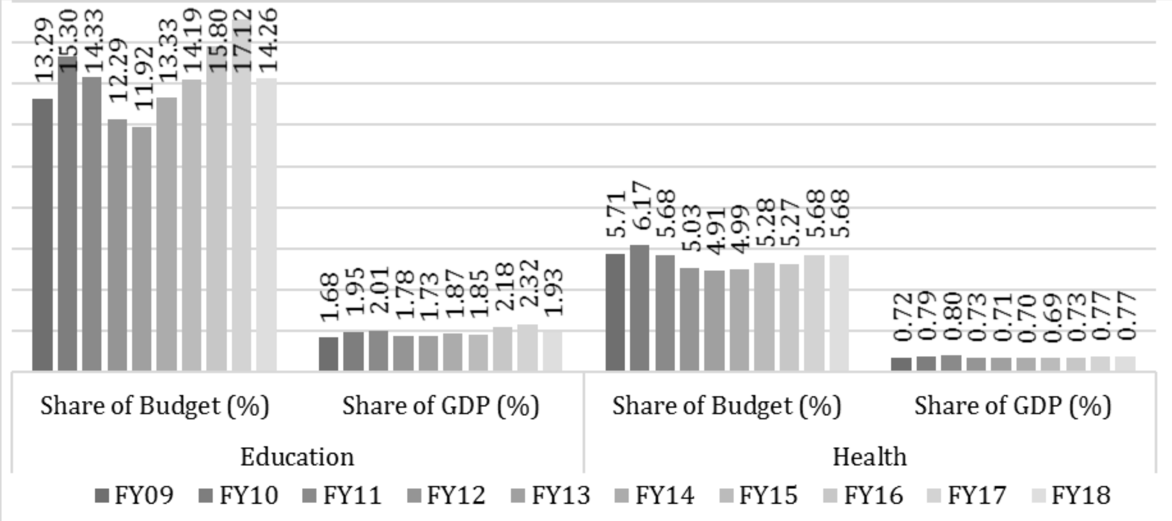
Furthermore, towards delivery of the main objectives of a project, and to enable citizens to get actual services from the projects following completion, Finance Division has issued a circular on December 3, 2018. The circular states that associated ministries/divisions for projects which require post-completion human resources, initiative will be undertaken to create positions two years before the completion of the projects, and will start the process of recruiting for the required posts at least one year before the project completion. This will be done by following the rules and regulation under the revenue budget and in compliance with the permission of the Ministry of Public Administration and the Finance Division.

Public expenditure for quality education, healthcare and social safety net

With limited resources and higher investment demand for infrastructure development, the government faces formidable challenge in allocating adequate resource for competing social sectors. In view of government's commitment to attain the SDGs, particularly in areas such as education (SDG 4: Ensuring quality education for all by 2030) and health (SDG 3: Ensuring healthy lives and promote wellbeing for all by 2030), the urgency to address the attendant deficits has risen manifold in the current context. Ensuring adequate allocations for these two SDGs are also important since they have synergetic effect on other SDGs. Notwithstanding the marginal rise over the past years, Bangladesh is still one of the lowest ranked countries in the world in terms of public expenditure for social sectors (CPD, 2018a).

Regrettably, share of government exchequer in social sectors, particularly in health and education sectors, has not experienced any significant improvement during the last ten years (CPD 2017, 2018a, 2018b). Public expenditure for education and health as a share of GDP increased from 1.68 per cent and 0.72 per cent in FY2009 to 1.93 per cent and 0.77 per cent respectively in FY2018 (Figure 3.2). Over the past decade, shares of education and health in total public expenditure declined compared to each preceding year during FY2010-2013 while it increased marginally during FY2014-2017 period before falling again in FY2018. This was coupled with deterioration of the overall budget utilisation (from 97 per cent in FY2011 to 76.1 per cent in FY2018) resulting in major improvement in social sector spending in relative terms. Meanwhile, government budget for education and health as a share of GDP increased to 2.09 per cent and 0.92 per cent respectively in FY2019 which are considerably lower than the respective 7FYP targets of 2.84 per cent and 1.12 per cent for the respective sectors.

Figure 3.2: Expenditure on education and health as a percentage of GDP and total budget



Source: Calculated by authors from various budget documents of MoF; BBS (2018).
Note: Education budget includes figures only from Ministry of Primary and Mass Education, Secondary and Higher Education Division, and Technical and Madrasah Education Division.

Social safety net budget also has been hovering around 2 per cent of the GDP during FY2009-FY2019 (CPD, 2018c). In FY2019, the social safety net budget was 2.5 per cent of the GDP, which exceeded the target of 2.3 per cent of GDP outlined in the 7FYP. However, a close scrutiny of the allocation for social safety net programmes indicates that, in FY2019, 35 per cent of the budget for social security was allocated for pension of government officials (CPD, 2018c). In fact, the social safety net budget excluding pension for public sector declined, from 2.1 per cent of GDP in FY2011 to 1.6 per cent of GDP in FY2019 (CPD, 2018c). Moreover, as may be observed from earlier trends, budgetary targets did not consider the proposals set out in the NSSS. Compared to the NSSS target, the budget allocation during the period of FY2016-FY2019 reveals a significant gap (CPD, 2018c). Government's efforts towards social safety net programmes are not only inadequate in monetary terms but also from the perspective of coverage (CPD, 2016, 2017, 2018c).

Commitments in the election manifesto and follow-up actions

Bangladesh Awami League, in its election manifesto included a total of 10 objectives and action plans to prioritise education, health and social protection (Table 3.7).

Table 3.7: Election pledges and follow-up actions on public expenditure for social sector

CPD recommendations	Commitments in the manifesto	Follow-up action
Increase public education budget to at least 4 per cent, and eventually to 6 per cent, of GDP	• Giving highest allocations for education and the proper utilization of the fund will be ensured.	• Education & Religious Affairs received the highest allocation among the new projects included in RADP for FY2019.
Make teaching a prestigious and attractive profession	• Despite all welfare initiatives including the salary and status enhancement of the teachers, there may still remain some disparities in the salary structure of primary school teachers, which will be dealt judiciously in the next term.	• The government plans to arrange a 7-day overseas training for 7,000 primary school teachers.
	• Encouragement and assistance will be provided to university teachers for research. Allocations for this purpose will be increased.	• Allocations have increased for all the key projects targeted to attain quality secondary, technical and vocational and higher education in the RADP as compared the original ADP for FY2019.
Reform the Technical and Vocational Education and Training (TVET) system	• There will be more investment in technical education and ICT sector to make education from school to university time-befitting in the face of the challenges of 21st century.	
Invest more resources on healthcare to reduce health inequity	• Making the health and nutrition services available to every citizen of the country will be ensured.	• In RADP for FY2019, health sector received a meagre share of 2.1 per cent in the total allocation for new projects.
	• Every person below one year and above 65 will be given health services free of cost	No steps taken.
Recruit and retain human resources for a better health sector	• Increasing the number of doctors, improving the quality of services and the availability of medical persons in the rural health centres will be ensured.	• Three core projects including 'Maternal, Child, Reproductive and Adolescent Health (MNCAH)', Community Based Health Care (CBHC)' and 'Health Information Systems (HIS) and E-Health' which are aligned with the election
Improve governance of the health system	• Health service systems will be made friendlier and fault-free by introducing modern	

CPD recommendations	Commitments in the manifesto	Follow-up action
through decentralised structure	technologies in the health service centres and hospitals. Services of the specialised medical practitioners from home and abroad will be made available online.	manifesto commitments faced cuts in their allocation in RADP for FY2019.
Re-evaluate existing SSNPs to improve targeting, reduce leakages and avoid overlaps	• Steps will be taken to extend the number of inclusion and the amount of assistance under 'Social safety network' programme.	• Introduction of direct transfer of benefits from government to people (G2P) through electronic fund transfer (EFT). • Establishment of digital database of all social protection beneficiaries.
Reorient SSNPs to attain the 2030 Agenda - 'leave no one behind'—by targeting the most vulnerable groups	• Allocations for Social Safety Net will be increased as per necessity, in which elderly men folks will also be included. The coverage of the existing programme and expenditure for ultra-poor, widow and elderly women will be enhanced.	

Source: Authors' elaboration based on CPD (2019) and various official and unofficial sources (e.g. circulars, guidelines, SROs, media reports, key personnel interviews etc.).

The Finance Ministry has indicated an increase in the allocation for education which is also reflected in the RADP allocation for education. Education & Religious Affairs received the highest allocation (23.3 per cent) among the new projects included in RADP for FY2019 thanks to the '4th Primary Education Development Programme (PEDP-4)', which received the highest allocation among these projects. Indeed, this was the single programme set out by the Ministry of Primary and Mass Education in National Action Plan (NAP) for the implementation of SDG4 (GED, 2018). However, this high allocation share of education in the RADP is only concentrated in the development of primary education. There is almost no new project with noticeable allocation dedicated for enhancing the quality of secondary education, technical and vocational education, research in higher education and teachers' training in the RADP for FY2019. Nonetheless, allocations have increased for all the key projects targeted to attain quality secondary, technical and vocational and higher education in the RADP as compared to the original ADP for FY2019. These include: 'Teaching Quality Improvement in Secondary Education' (134,700 per cent), 'Skills and Training Enhancement Project' (6 per cent), 'Secondary Education Sector Investment Programme' (35 per cent), and 'Higher Education Quality Enhancement Project' (73 per cent).

Meanwhile, health sector continues to remain neglected both in terms of adoption of new projects and allocation priorities which is also reflected in RADP for FY2019.[16] The largest project for health sector is the '4TH Health Nutrition and Population Sector Program (HNPSP)', planned to be implemented over a five year period (2017-2022) and is linked to several important targets of SDG3. Overall, only 32.1 per cent of the total ADP allocation for Ministry of Health could be spent during July-February of FY2019 which is lower than the overall ADP spending (38.8 per cent) for the corresponding period. Furthermore, due to slow pace of implementation, three core projects under this programme which are aligned with the election manifesto commitments faced cuts in

[16] In RADP for FY2019, only 19 out of 430 new projects belong to the health sector with a meagre share of 2.1 per cent in the total allocation.

respective allocation in RADP for FY2019. 'Maternal, Child, Reproductive and Adolescent Health (MNCAH)', Community Based Health Care (CBHC)' and 'Health Information Systems (HIS) and E-Health' registered a 20.8 per cent, 1.3 per cent and 2.4 per cent reduction respectively in the RADP of FY2019. This scenario will not help the government to achieve its key health-related commitments.

The government has recently taken two measures for enhancing the effectiveness of the social security programmes. These include: introduction of direct transfer of benefits from government to people (G2P) through electronic fund transfer (EFT) and establishment of digital database of all social protection beneficiaries. These are important initiative which could improve both right selection and appropriate use of allowed funds. Necessary steps should be taken for their earliest implementation.

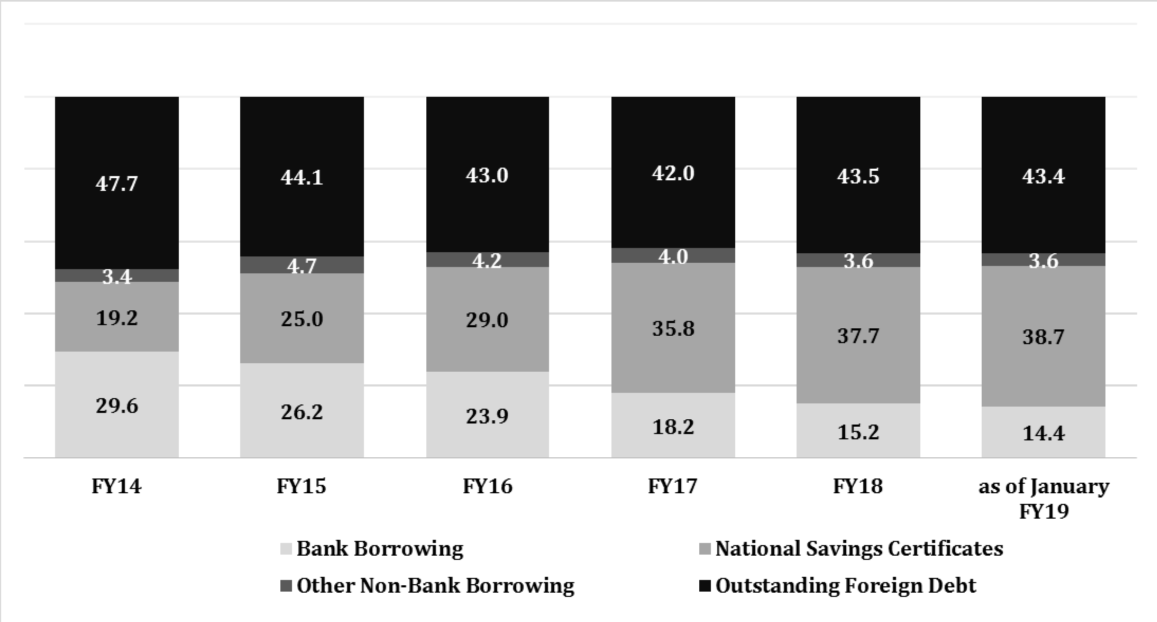
3.3 Financing of budget deficit

The structure of deficit financing in recent years has been characterised by low net intake from foreign financing sources as against a heavy reliance on domestic financing sources.[17] Within domestic financing structure, buoyant sale of high yielding national savings certificates (NSD) was once again the key contributor in FY2019. Since a large share of the financing has already been secured from the sale of NSD certificates, the need for bank borrowing may rather be limited. Net sales of NSD certificates stood at Tk. 30,996 crore during July-January of FY2019 which is already 18.3 per cent higher than the annual target set for FY2019. However, improvement in the utilisation of foreign resources was a positive sign and needs to be consolidated further.

Meanwhile, the structure of debt and debt servicing in the future will hinge on the government's ability to use more of the low-cost foreign borrowings as against high cost domestic borrowing. This, however, is not observed in recent years. Within the domestic sources, debt from non-bank sources has been on the rise, spearheaded by the net sales of NSD; in contrast, debt from bank sources is on the decline. This has led to a gradual shift in the overall composition of the public debt towards more costly domestic borrowing. Indeed, as of January 2019, debt against sale of NSD certificates accounted for 38.7 per cent of total public debt and 68.2 per cent of the total outstanding domestic debt liability of the government (Tk. 268,763 crore) (Figure 3.3). The corresponding figure was about 36.8 per cent (Tk. 76,398 crore) in FY2014.

[17] According to Bangladesh Bank (2019), domestic sources contributed to 63.6 per cent while foreign borrowing contributed to 36.4 per cent of the overall deficit financing.

Figure 3.3: Composition of outstanding public debt



Source: Estimated from the Economic Relations Division (ERD) and Bangladesh Bank (BB) data.

Commitments in the election manifesto and follow-up actions

In the election manifesto, the ruling party made two commitment with regard to deficit financing (Table 3.8).

Table 3.8: Election pledges and follow-up actions on deficit financing

CPD recommendations	Commitments in the manifesto	Follow-up action
Bring back balance in financing deficit	• The effective use of foreign fund will be ensured.	• Foreign aid utilisation rate in ADP for FY2018 was the highest since FY2006.
	• The deficit financing from banks will be kept under control.	• The deficit financing from banks has been kept well under control. • The Ministry of Finance in a recent notice on March 24, 2019 has made few changes with regard to the purchase of NSD certificates. These include: submission of TIN, use of beneficiary bank account for transactions, and the introduction of 'National Savings Scheme Online Management System'.

Source: Authors' elaboration based on CPD (2019) and various official and unofficial sources (e.g. circulars, guidelines, SROs, media reports, key personnel interviews etc.).

The proportion of outstanding foreign debt in the overall debt portfolio has been rather steady (43.4 per cent). On a positive note, foreign aid utilisation rate in the ADP has been quite impressive in the last fiscal year largely driven by the mega infrastructure projects[18] which has

[18] According to IMED data, in FY2018, total project aid utilisation rate in ADP was 86 per cent which was the highest since FY2006.

been continuing in FY2019 as per the utilisation rate of first eight months. However, owing to Bangladesh's graduation to a lower middle-income country (LMIC) and expected graduation from the least developed country (LDC) list, major development partners have made their lending terms and conditions harder and costly for Bangladesh from FY2019.[19] Meanwhile, deficit financing from banks has been kept well under control. As of end January 2019, financing from banking sources accounted for only 14.4 per cent of total public debt.

One of the major challenges for budget FY2020 will be to bring back an optimum mix in the financing of the budget deficit. With regard to foreign aid, key lessons from the experience of Pakistan, Sri Lanka, Tanzania and Zambia is that Bangladesh should be cautious in pursuing excessive foreign aid associated with higher loan elements without enhancing its aid utilisation and repayment capacity (CPD, 2019). Besides, in view of higher interest rates entailed by the NSD instruments and resultant higher debt servicing liability, CPD (2017) urged for strict adherence to the maximum ceiling on purchase. Another necessary step proposed relates to creating an integrated electronic database for the NSD certificate purchase so that the purchase limit clause can be enforced without harassing small investors. On a welcome note, the government has recently made a move to imposed stiff restrictions on purchase of NSD certificate. As per a recent notice from the Ministry of Finance (2019b), the government has made it mandatory to submit tax identification number (TIN) in case of purchase of NSD certificate exceeding one lakh taka. Besides, all the transactions in the savings certificate are now required to be done through bank account. Further, selling activities through identical software under the 'National Savings Scheme Online Management System' has begun in order to collect relevant information about the buyer in a database, to address the issue of purchase of NSD with corruption or undisclosed income (Ministry of Finance, 2019b). To start with, the process of selling savings certificates through using the software has been started experimentally in four channels including Bangladesh Bank's Motijheel office, Sonali Bank's local office, Bureau of NSD and head office of Bangladesh Post Office. As per the notice, all the offices associated with the NSD sales have been directed to make all transactions under the NSD online management system.

3.4 Recommendations for the National Budget for FY2020

The forthcoming fiscal year will be the last of the ongoing Seventh Five Year Plan (7FYP). The incumbent government will have to design and implement the Eighth Five Year Plan in view of the aspirations of the SDGs while devising adaptive measures to tackle the challenges emanating from the aforesaid dual transition. Apart from these medium to long term issues, public finance management also has critical implications for recurrent issues such as budgetary and development planning. Based on the assessment of available information on policy initiatives (e.g. circulars, guidelines, SROs, media reports, key personnel interviews etc.), the follow-up actions pertaining to revenue mobilisation can be broadly categorised in two sets. The first set includes new initiatives such as formation of a taskforce to bring foreign workers under the tax net. The second set is comprised of initiatives which are essentially culmination of longstanding reform issues e.g. VAT law, Money Laundering Prevention Rules and imposition of 15 per cent VAT on

[19] The World Bank has increased their loan interest rate to 2.0 per cent from the previous 0.75 per cent while reduced their repayment period to 36 years from the previous 40 years. The Japan International Cooperation Agency (JICA) has enhanced their loan interest rates to 1.0 per cent from the long charged 0.01 per cent and reduced their repayment period to 30 years from the previous 40 years. Similar is the case with the country's second largest multilateral development partner-the Asian Development Bank (ADB).

online platform advertisements. However, no serious step can be observed as regards raising the share of income tax. It may be recalled that a recent CPD study showed that amongst the eligible taxpayers, only one-third paid income tax in 2017. Indeed, 37 per cent of the top earners were included in the non-taxpayer category (Khan, 2018). In the case of public expenditure, it was found that there was a mix of both commitment-driven new policy initiatives (e.g. higher allocation for education in RADP) as well as follow-up measures of old plans and strategies (e.g. brining out guideline for the release of funds and directions of keep the number of development projects limited). There are also new initiatives (e.g. 'single budget' and changes in NSD purchase and transaction provisions) which were not specifically mentioned in the election manifesto but are eventually important.

Given that the upcoming national budget is the first from the incumbent government's current term, it provides a unique opportunity to initiate some much-needed policy reforms concerning public finance management. The new government should make an early stride to this end since such initiatives may prove difficult to implement in later years. In light of the discussion above, the following recommendations are put forward for consideration in the upcoming budget:

Revenue mobilisation

Policy issues

1. In view of the available information, it appears inevitable that the new VAT and SD Act will be implemented from the upcoming FY2020 allowing multiple VAT rates. CPD has earlier proposed to gradually converge the VAT rate to a uniform 12 per cent (CPD, 2017). The next budget should provide a clear timeline for converging the multiple VAT rates to a single rate of 12 per cent in a staggered manner over the medium term, with a reassessment of VAT exemption provisions.

2. Automation should be kept as an integral part of the new VAT regime. Hence, the new VAT provision needs to allow the aspiration of automation in the VAT collection process with a clearly specified dateline. Any departures from full automation should only be considered as a short-term exigency rather than a long-term solution.

3. Since there are some ambiguities as regards the structure and implementation process concerning the VAT law, the government should clarify the proposed changes to businesses and stakeholders well in-advance, preferably before the budget session. This will allow more time to the stakeholders for discussion and preparation towards smooth implementation of the law from 1 July 2019.

4. Other reforms, which are already under consideration (e.g. Customs Act and Direct Tax Act) should be given a viable timeline for completion to initiate the implementation process as early as possible.

5. For the upcoming budget, CPD reiterates its earlier proposal to introduce wealth and property tax in Bangladesh (CPD, 2019). At the same time, an inheritance tax, following international best practices, could also be introduced. These initiatives would not only generate additional revenue but also contribute towards building a more equitable society.

6. It is often emphasised that tax evasion has become a common phenomenon in Bangladesh. The recent Rules related to money laundering may help enforcement of the Act. The key challenge remains in the area of execution. It is to be noted that legal provision of the Money Laundering Act can only partially contribute to this end. Relevant government agencies will

need to put emphasis on enforcement of law in all areas related to illicit financial flows. Such agencies including the Transfer Pricing Unit and Customs Wing of NBR which need to be encouraged and endowed with resources to further develop their capacities in this area. Coordination and cooperation among government agencies will be critical for the government's efforts to be effective in curbing illicit financial flows.

Operational issues

1. Ad-hoc provisions of tax exemptions should be curtailed. There is no official estimate of how much the government provides as tax exemptions every year. This indicator should be calculated on an annual basis so that it is possible to have a more informed debates about the necessity of such provisions. It will also allow the NBR to measure its ability to deliver the revenue mobilisation targets.

2. In the budget for FY2016, personal income tax exemption threshold, at the general level, was increased to Tk. 2.5 lakh from the previous ceiling of Tk. 2.2 lakh in FY2015. This threshold has been maintained since then. At the same time, general CPI has experienced a 23.4 per cent increase between July 2015 and March 2019. If this inflation is accounted for, then the aforesaid threshold surpasses Tk. 3.0 lakh. However, given the low number of taxpayers in the country, the minimum exemption threshold may not be increased at this moment. However, to provide some respite to the taxpayers, the first slab of personal income tax rate may be reduced from the current 10 per cent to 7.5 per cent. This will provide an opportunity to enhance the tax base by incentivising the new taxpayers.

3. At the same time, using the electronic taxpayer's identification number (e-TIN) database, the NBR could pursue individuals who are registered in the system but are not submitting returns. For example, the NBR could set up a mechanism to make phone calls, send SMSs or emails to TIN holders to follow up on return submission and tax payment. The initiative will put moral pressure on TIN holders.

4. Further efficiency in revenue mobilisation could be attained through broader use of technology. Such an initiative may include introduction of electronic tax deduction at source (e-TDS) with issuance of tax certificates by the NBR against an e-TIN linked to each TDS collection.

Public expenditure

Policy issues

1. In order to implement the 'single budget' system successfully for the two ministries primarily, and for other ministries and divisions gradually:
    - The government will require to adjust the new budget and accounting classification system (BCAS), which was introduced in FY2019.
    - Concurrently, measures should be taken to harmonize the budget preparation calendar, circulars, and guidelines of the ADP and non-development budget.
    - Also, the recurrent costs of closed public investment projects should be included in the medium-term budgetary framework (MTBF) and in the derived annual budgets.

- To this end, the Finance Division should emphasise the 'Bangladesh PFM Improvement Programme 2018-2023' towards implementing the PFM Reform Strategy 2016-2021 as planned in the national action plan (NAP) for the SDGs.

2. In order to raise the efficacy of delivering the development budget:
    - The concerns as regards overcapitalisation of public sector projects should receive required attention from the government. The government should constitute an independent Public Expenditure Review Commission to this end.
    - Ministry of Planning and Ministry of Finance, from time to time, have proposed a number of good initiatives for raising the effectiveness of public investment programmes. However, adequate follow up remains a recurring concern. It is suggested that the upcoming budget should report on the progress made as regards proposed actions.
3. In order to enhance the capacity of delivering the social protection programmes:
    - The digital database (disaggregated by gender, age, union/upazila) of social safety net must be publicly available with regular update in order to ensure transparency.
    - Local public administration needs to be encouraged to disseminate the beneficiary lists of the programmes at the local level, in an open and transparent manner.
    - The timely completion of effective use of the 'National Household Database' is also of critically importance.
    - Besides, the government also needs to take concrete steps to fully implement the NSSS.
    - The government should report the follow-up as regards the progress towards attaining the two core pledges as regards universal pension scheme and universal health care.
4. With a view to bring back the balance in financing the budget deficit:
    - The government should ensure adequate follow-up of the changes with regard to NSD purchases and use of an electronic database. Commercial banks should be included in the process at the earliest.
    - Further, since only new sales data may be included in the database, government will need to ensure that data on old savings certificates are also brought within the fold of the database. The possibility of downward revisions of the NSD interest rates should be duly considered.
    - Identification of new sources of external development finance has become a necessity, for example, blended finance opportunities. In view of recent surge in non-concessional financial flows, particularly from the Southern providers, it is high time that the government revisits its current medium-term debt management strategy which was prepared in 2014[20]. The next debt strategy

[20] https://mof.portal.gov.bd/site/page/0368cfea-3972-46ce-b085-2a68c764b046

needs to consider not only external debt but also domestic outstanding debt of the government which is accumulating at an alarming rate.

Allocation and utilisation of resources

1. While aiming for its commitment of raising public investment-GDP ratio to 9 per cent, the government should adequately emphasise the country's needs in the area of social sectors. It is also important for the government not only to focus on raising public investment on a quantitative scale but also enhance its efficacy.
2. Timely completion of mega infrastructure projects should receive priority consideration in view of the next budget. A clear plan to this end needs to set out immediately.
3. The government needs to present a plan as regards improving resource allocation for education sector in the upcoming budget.
    - While it is perhaps pragmatic to anticipate that allocating at least 3 per cent of the GDP, in line with the targets of the 7FYP for FY2020, may not be possible, there has to be a plan to reach the target in the next two years in view also of the aspirations of the SDGs.
    - Emphasis should be given on increasing allocation for promoting quality secondary education, research in higher education and technical and vocational education which are consistent with the 7FYP and the SDGs. To this end, government, after impact evaluation, may re-introduce projects such as 'Teaching Quality Improvement in Secondary Education' and 'Skills and Training Enhancement Project' which are set to be completed by FY2019.
    - The government should also include project in the ADP for FY2020 which are outlined in the NAP such as 'Secondary Education Development Programme' and 'Teaching Quality Improvement in TVET Sector'.
4. With regard to the health sector, government in the upcoming budget should:
    - At least meet the target of the 7FYP set for FY2020 to allocate 1.2 per cent of GDP from the current level of 0.8 per cent.
    - Priority should be given on the timely implementation of key projects on maternal, child and adolescent health and e-health services under the 4th HNPSP through allocating adequate resources.
    - Further, budgetary measures should be there to ensure that citizens above 65 are provided health services free of cost.
5. In order to allocate adequate resources for the implementation of the NSSS, the government should allocate its resources more efficiently. While the targets set forth in the NSSS may appear to be rather ambitious, the reality is that government spending and implementation are lagging far behind the required levels.
    - As is revealed by evidence, over the last eight years, between FY2011 and FY2018, the budget deficit has never reached the target level. For example, in FY2018, the difference between the target and actual budget deficit was Tk. 24,258 crore which is equivalent to the total health sector budget and half the overall social security budget excluding pensions for the public servants in FY2019.

6. With regard to foreign aid, the government should pay more attention to efficacy of its utilisation by raising concerned institutional capacities.

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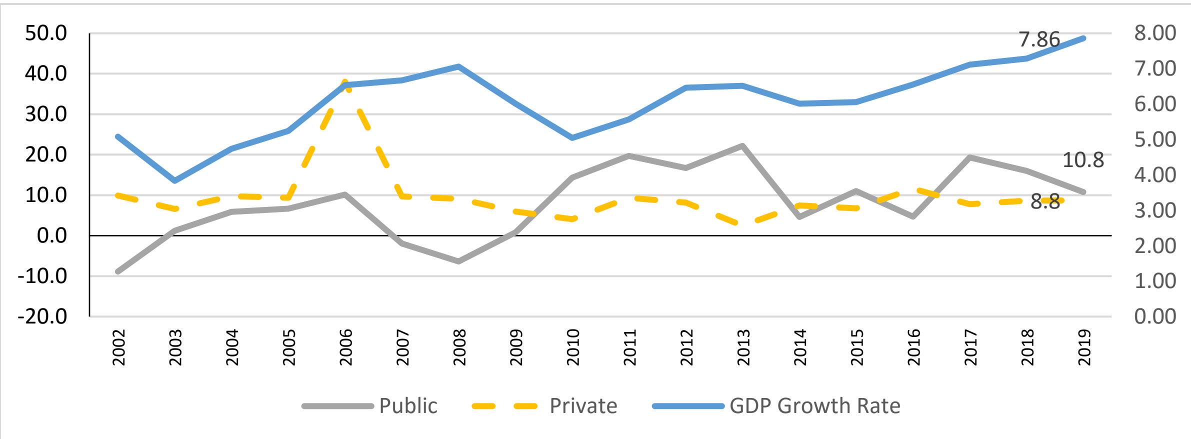
SECTION IV. PRIVATE INVESTMENT IN FY2019: DEMAND, ELECTION PLEDGES AND INITIATIVES UNDERTAKEN

4.1 Private Investment during FY2019

Private investment in FY2019 has maintained 'business as usual' trend which has been observed in recent past. According to the provisional estimate of FY2019, private investment is expected to rise by 7.47 per cent on y-o-y basis in FY2019; this is lower compared to the previous two years (i.e. 8.77 per cent in FY2018 and 8.04 per cent in FY2017) (Figure 4.1). Private investment-GDP ratio is hovering around 23 per cent (23.4 per cent in FY2019 which was 22.99 per cent in FY2016). Total investment in FY2019 was equivalent to 31.56 per cent of GDP which would mean that an additional 8.44 percentage point of investment will be required in order to achieve the target rate of investment by FY2024 (40 per cent of GDP).[21] It is to be noted that over the last one decade (2009-2018), total investment as a share of GDP has increased only by 5.03 percentage points.

The discrepancy of data in national accounts as regards investment and GDP which are reported in different time periods within a fiscal year, makes it difficult to fully capture the nature of relationship between GDP growth and private investment. For example, GDP growth and private-investment-GDP ratio for FY2018 are available in three different sets of figures - national budget; provisional estimate; and actual estimate of FY2018. Similar is the case for FY2019 in which case this data is provided by the national budget and the provisional estimate. National budget for FY2019 projected a GDP growth of 7.8 per cent with a private investment-GDP ratio of 25.1 per cent; after nine months, provisional estimates indicate that GDP growth for this year would by higher than the budget figure (8.13 per cent) but with a significantly lower private-investment GDP ratio (23.4 per cent) (Table 4.1). It is not clear whether these estimates would prevail in the final estimate for FY2019. The only way to explain this is a sharp rise in capital efficiency in FY2019 (ICOR, which was the case in FY2018).[22]

Figure 4.1: Growth in GDP, Public Investment Private Investment



Source: Based on various issues of Bangladesh Economic Review

[21] According to the table on Different Macroeconomic Indices of Bangladesh, target set for national investment (as percentage of GDP) for FY2023-24 is 37 per cent (see, *Election Manifesto 2018 of Bangladesh Awami League, 2018*).

[22] Three ICOR estimates for FY2018 are: 4.3 in the budget, 4.1 in the provisional estimate and 3.97 in the final estimate.

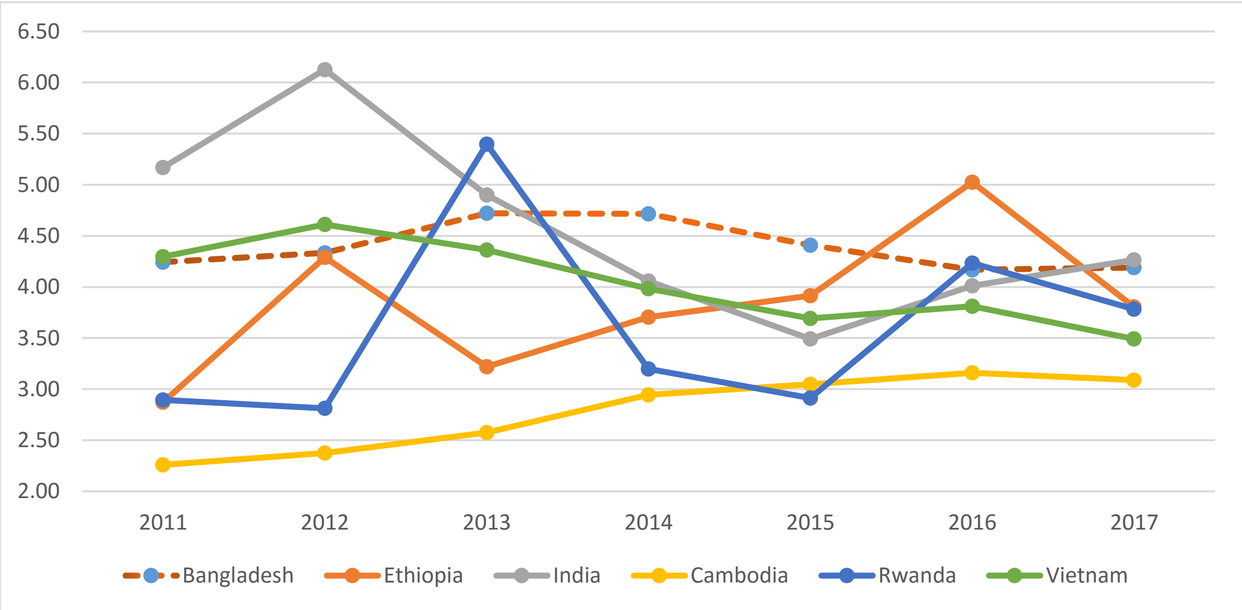
Table 4.1: Discrepancies in the Reported Data of Private Investment

Indicator	FY2018			FY2019		
	Budget	Revised/ provisional	Actual	Budget	Revised/ provisional	Actual
GDP growth	7.4	7.65	7.86	7.8	8.13	?
Pvt inv. -GDP ratio	23.2	23.25	23.26	25.1	23.4	?
Y-o-Y % changes of pvt inv.	12.9	15.63	14.7	23.4	13.4	?
ICOR	4.3	4.1	3.97	4.3	3.88	?

Source: Bangladesh Bureau of Statistics (BBS)

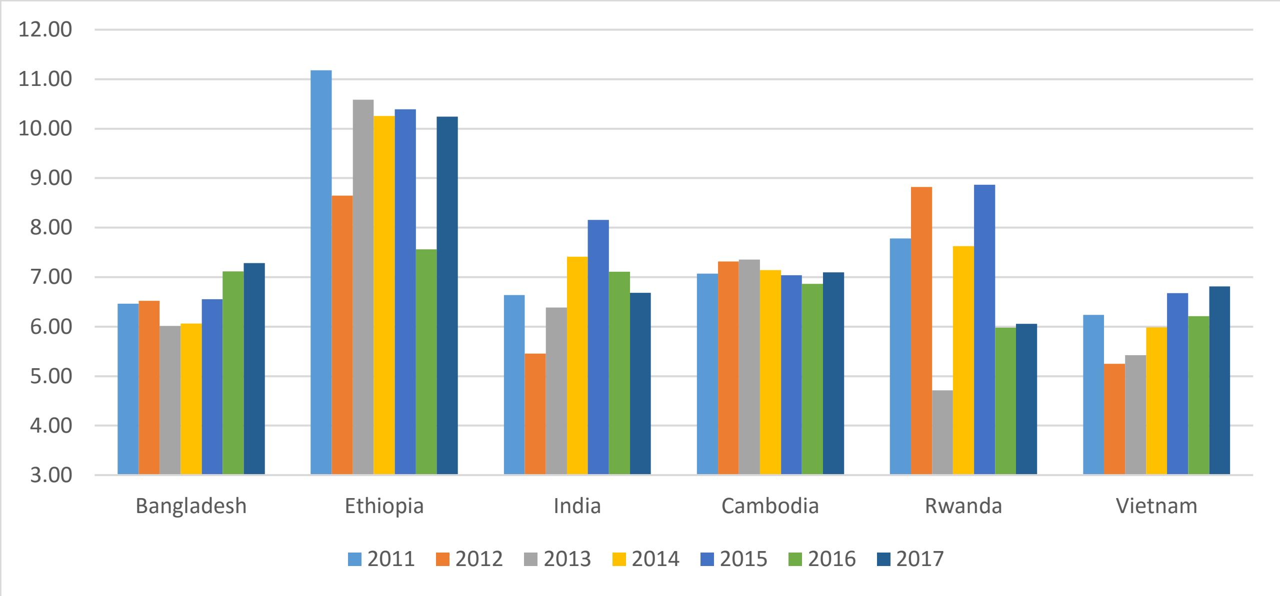
We have reviewed capital efficiency (ICOR) for countries with high GDP growth rates: Bangladesh, Ethiopia, India, Cambodia, Rwanda and Vietnam. It is seen that the trends in capital efficiency vary across countries and time. In other words, role of capital efficiency in the GDP growth of these high performing economies do not shows a consistent pattern. Bangladesh and Vietnam's higher GDP growth in recent years was accompanied by ICOR values which show decelerating trends; on the other hand, the corresponding values for Rwanda, Ethiopia and India show ICOR values that were rising.

Figure 4.2: Trends in ICOR for Selected High-GDP Growth Economies



Source: Based on WDI Data

Figure 4.3: GDP Growth of Selected Economies



Source: Based on WDI Data

4.2 Changes in structure and composition of private investment

Agricultural credit and non-farm rural credit

It is important to note that institutional financing in agriculture sector is lower than that in other sectors (Bangladesh Bank, 2019). More importantly, larger share in agriculture sector financing is for working capital financing for various agricultural activities. During July-January, 2019 disbursement of agricultural credit amounted to Tk.12101.04 crore which is 4.7 per cent lower compared to the same period of the previous year. The disbursed amount is 55.5 per cent of the target set for FY2019 (Tk.21800 crore). It is important to note that the special agricultural refinance programme for sharecroppers which was operated through BRAC, with a short-term revolving fund of Tk.600 crore, ended in June, 2018 and, consequently, is not included in this year's credit programme. A proper assessment of this refinance programme is needed in order to assess future demand for this type of credit.

Non-farm rural credit, on the other hand, was disbursed to the tune of Tk.2457 crore during July-January, 2019 which was 12.3 per cent lower compared to the corresponding period of the previous year. In fact, disbursement of this type of credit had experienced negative growth last year (-0.24 per cent during July-January, 2018). BRDB has disbursed a total of Tk.534.06 crore, and BSBL Tk.1.91 crore, during July-January, 2019. Microcredit operations led by NGOs play an important role in financing farm and non-farm activities. During January, 2019 Grameen Bank and nine major NGOs[23] disbursed Tk. 10462.09 crore for productive and income generating activities in rural areas under respective micro credit programmes (Bangladesh Beak, 2019). Palli Karma Sahayak Foundation (PKSF) disbursed an amount of Tk.172.6 crore to its 278 partners organisation in September, 2018. According to Bangladesh Bank (2019) data, disbursement of

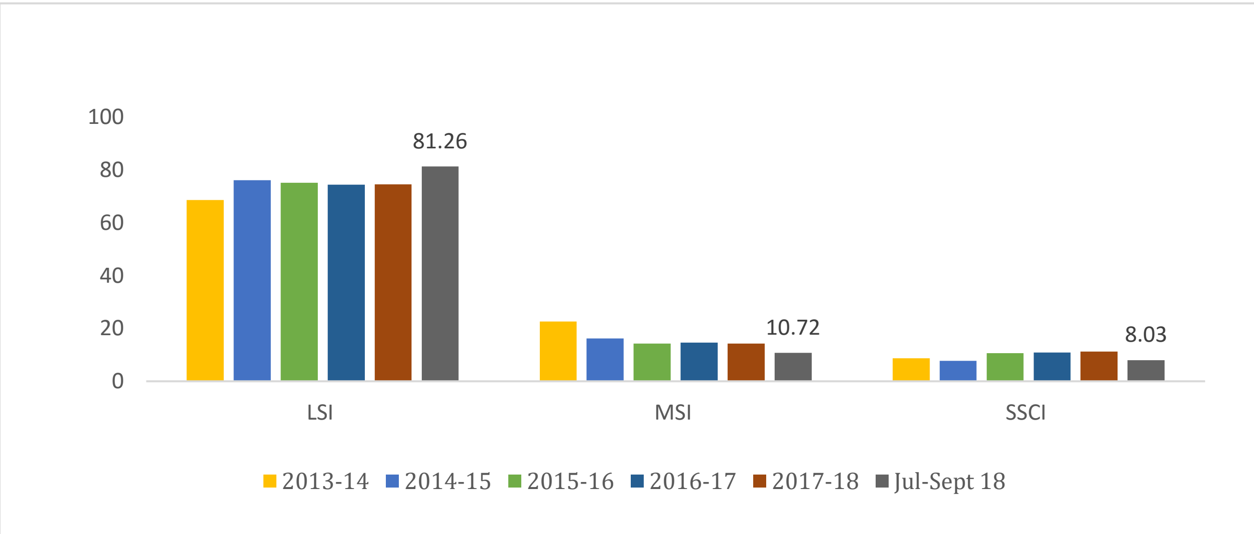
[23] These NGOs are: BRAC, ASA, Proshika, TMSS, RDRS, CARITAS Bangladesh, Jagoroni Chakra Foundation, Society for Social Services (SSS), and Shakti Foundation for Disadvantaged Women (Bangladesh Bank, 2019).

agricultural credit in various sub-sectors such as crops, irrigation equipment, livestock, poultry, fisheries and agri-equipment was higher in FY2019 compared to that of the previous year.

Industrial Term Loan for Manufacturing and Service Sectors

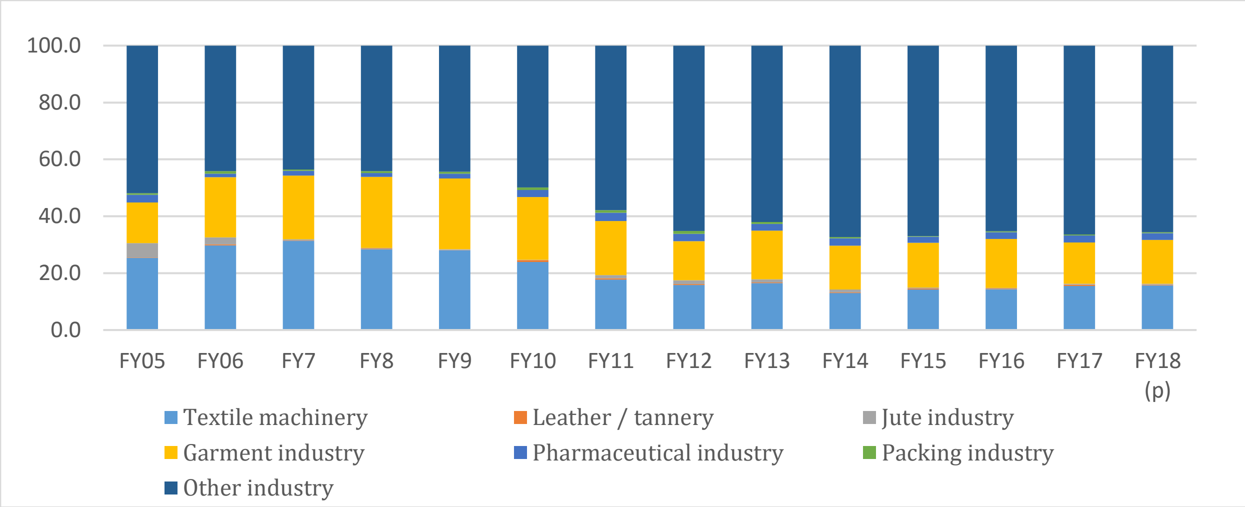
Private investment in manufacturing and service industries in FY2019 is reflected in the industrial term loan disbursed by commercial banks which is reported by the Bangladesh Bank. Distribution of industrial term loan during FY2019 was in line with the changes observed in earlier years. During July-September, 2018, growth of industrial term loan was about 21.2 per cent. There has been a gradual rise in the share of term loans taken by large-scale enterprises, rising from 62 per cent in FY2012 to 81.3 per cent in Q1 of FY2019 (over four-fifths of the total term loan). Second, the remaining amount of term loans went to the small and medium enterprises (SMEs), where the share of medium scale enterprises has seen a consistent decline (from 31% in FY2012 to 10.7% in Q1 in FY2019) (Figure 4.2). In other words, a growing 'missing middle' is emerging in the context of disbursement of term loans to industries (Haider and Akter, 2014). This concern was partially addressed through targeted financing measures in support of SMEs as part of which a total of BDT 11,65,875 crore worth of credit was disbursed by commercial banks over the past decade (about 21.7% of total credit disbursement) (Bangladesh Bank, 2018). However, without undertaking other business-related measures to address the concerns of the SMEs, this small-scale financing was unlikely to change the structure and composition of the private investment. The growth in manufacturing GDP on account of small-scale enterprises lagged behind that of the large- and medium-scale enterprises during the said period. Sluggish credit growth and also various other challenges are adversely affecting the growth of the SMEs (Moazzem, 2015a). In other words, a growing tendency of a dual-nature is discernible in the composition of industrial enterprises in the country—one is the fast growing large-scale export-oriented and partly domestic market-oriented manufacturing enterprises; the second is the moderately growing medium- and small-scale domestic market-oriented manufacturing and service enterprises (Nath, 2012; Moazzem and Halim, 2017).

Figure 4.4: Share of industrial Term Loan



Source: Bangladesh Economic Review, Different Issues

Figure 4.5: Share of Import of Capital Machineries (Settlement of LCs)



Source: Bangladesh Economic Review, Different Issues

An analysis of import data for capital machineries shows the changes in the sectoral composition of import of machineries over time. The share of import of machineries for traditional leading industries such as textiles, leather, jute, garment, pharmaceuticals and packing has been on the decline—from 55.6 per cent of the total import of capital machineries in FY2009 to 34.6 per cent in FY2019 (p) (Figure 4.5). In other words, many of the other industries, mostly the domestic market-oriented ones, have been engaged in imports of machineries (though in small quantities). Besides, the growing import of other machineries such as motor vehicles, bicycle parts and electronic components reflects the growth of different non-traditional manufacturing and services enterprises (such as motor cycle, electronics, parts and components of different machineries and IT enabled services) (Bangladesh Bank, 2018; Ehstiaque, 2014).

Despite attempts to attract FDI, the overall FDI inflow has increased only at a modest pace—from US$ 700 million in FY2009 to US$ 1.58 billion in FY2018. During July-January FY2019, FDI inflow amounted to US$1004 million which was only 4 per cent higher than the same period of the previous year. FDI share in total investment has declined over time (from 3.36 per cent in FY2009 to 2.82 per cent in FY2018). Although registration of new FDI projects has increased over the years particularly in recent years, the gap between registration and realised FDI flow remained significantly high. Indeed, realised FDI as a percentage of FDI registration has dropped significantly in recent years (only 25.1 per cent during FY2018 and FY2019 (upto December)). Sectoral composition of FDI has also been undergoing changes, with shift from energy, minerals and communication sector-oriented FDI towards a more manufacturing sector-oriented one. In other words, recent inflow of FDI is targeted to relatively more labour-intensive, domestic and export market-oriented manufacturing and service industries.

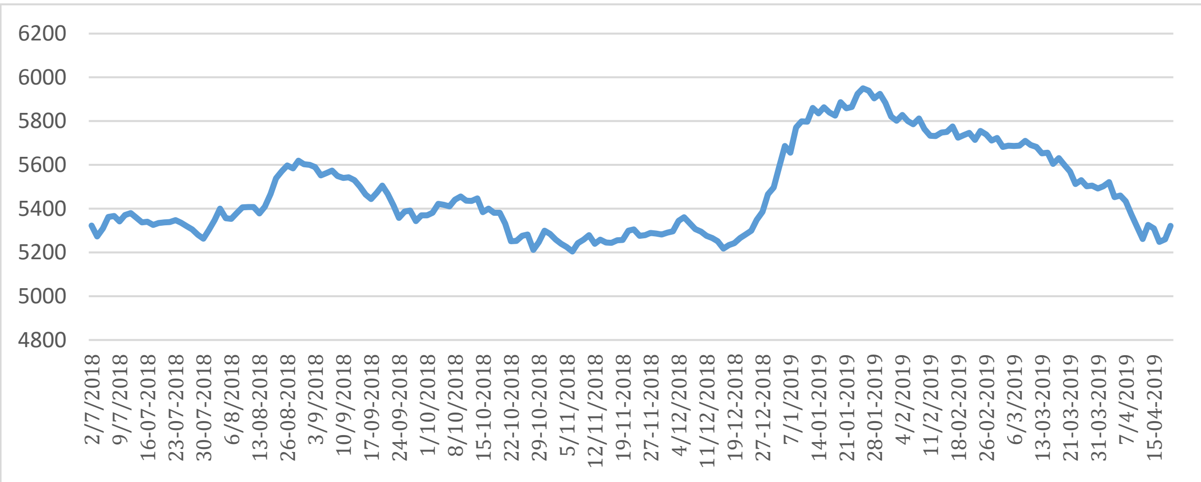
Table 4.2: Difference between Registration of FDI and FDI Inflow

	Registration of FDI (mil Tk.)	Inflow of FDI (mil Tk.)	% of Share of registered FDI realised
2009-11	575347	187513.4	32.6
2012-14	750207	347275	46.3
2015-17	1092271	497627.9	45.6
2018-19*	1165055	292536.6	25.1
Yearly % change	13.7	1.5	

Source: BIDA and Bangladesh Bank

Capital market remained in a weak state over the last decade and failed to emerge as an alternate source for financing industries. FY2019 has experienced a curious trend in term of market transaction: DSEX index has gained by 12.8 per cent within a period of about one month (from 5233 on 18 December, 2018 to 5904 on 28 January, 2019) which started just before the national elections and ended one month after the elections were over.[24] Since then market has fallen sharply – between February, 2019 and April, 2019, DSEX lost by 10 per cent of its value which is close to where the market was before the national elections. Different newspaper reports alleged about possible collusive and illegal activities of vested quarters who played a role in triggering both the rise and the fall in DSEX index. A number of weaknesses and challenges have been reported in recent reports of national dailies which include poor listing of well-reputed companies, over-dependence of financial institutions in the market, illegal transaction of placement shares, controlled price fluctuations through collusive practices and weak surveillance of SECs with limited actions against 'wrong doers'. It is important to examine how the recently formed two committees with regard to private placement shares regulation and the book-building method would strengthen and make transparent in related transactions. Because of these, the confidence on the market has remained at weak state.

Figure 4.6: DSEX Index (FY2019 April)

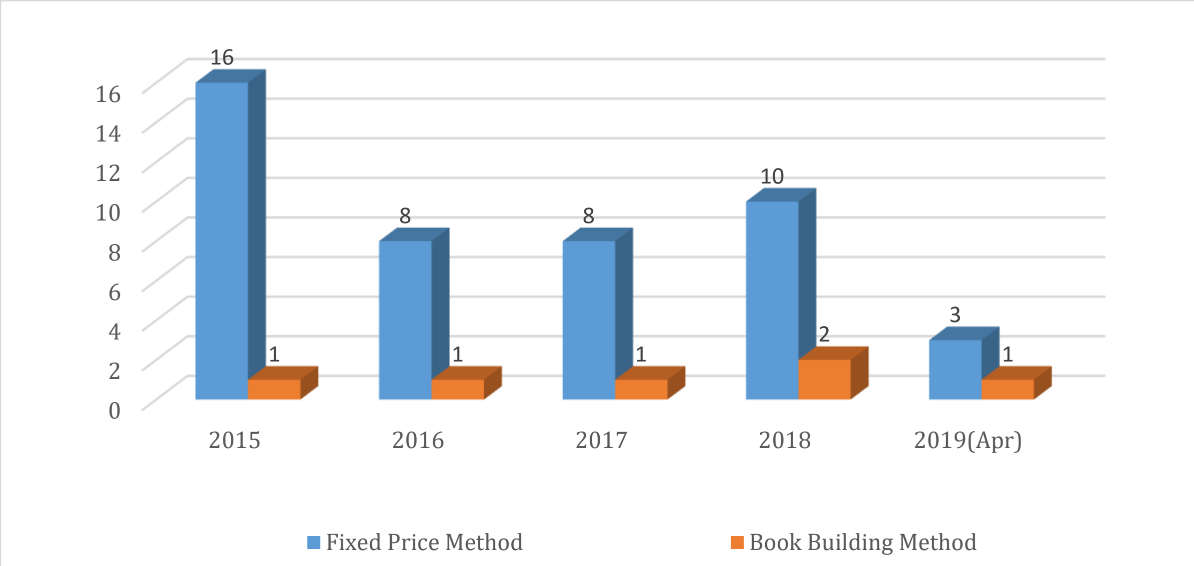


Source: DSE website

[24] https://en.prothomalo.com/bangladesh/news/189442/Stock-market-rises-abnormally-right-after-election

As may be recalled, the collapse of the market in December 2010 was mainly because of governance and institutional failures (Moazzem and Rahman, 2012).[25] Despite various measures undertaken over the last decade, the market remain vulnerable and volatile, subject to manipulations by strong players. Over the years, number of new companies which were listed in the stock markets to raise equity has been on the decline (Figure 4.7). This state of affairs reflect sluggish trend of private investment as also lack of interest of companies to be listed in the market (Figure 4.8). Moreover, there have been allegations of submitting false information in IPO proposals[26] and poor quality of financial reporting of the newly listed companies etc.[27]

Figure 4.7: Number of Companies with IPOs



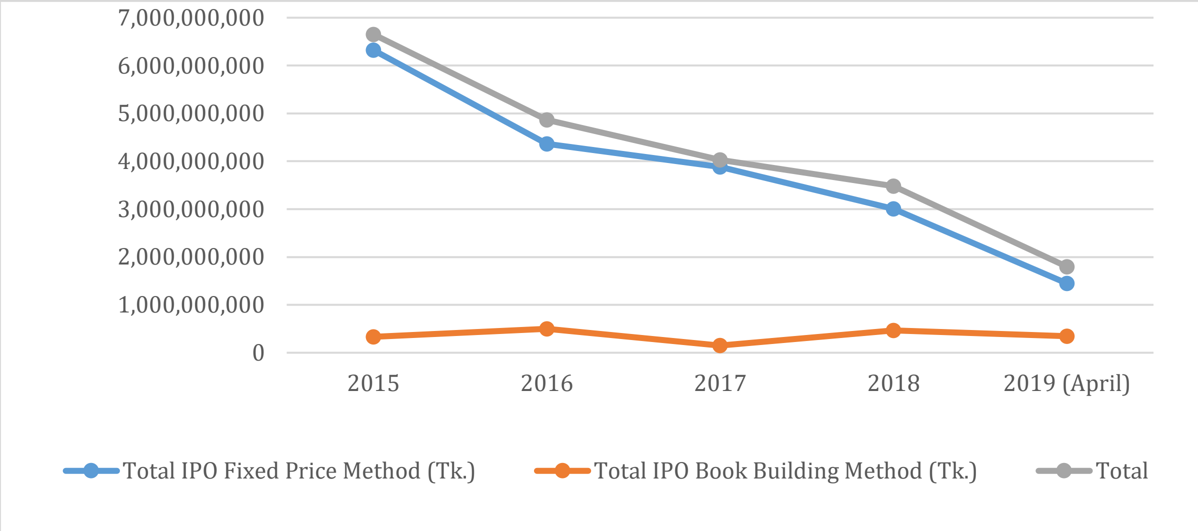
Source: Based on DSE website

[25] According to Moazzem and Rahman (2012), the weaknesses in the capital market that triggered the collapse of the market in 2010 included lack of transparency in beneficiary owner (BO) accounts; presence of bull cartels; poor monitoring of the book-building system; rampant use of placement shares; problems of serial trading; insider trading; faulty audit reports of listed companies; faulty operations of a number of merchant banks and retailer-like behaviour of institutional investors. Besides a number of other weaknesses have been identified such as faulty operations of commercial banks; lack of oversight on the part of the central bank; faulty operations of Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE); inefficient operation of Securities and Exchange Commission (SEC); lack of enforcement of rules and regulations and lack of coordination among different financial institutions.

[26] https://thefinancialexpress.com.bd/views/columns/righting-the-wrong-financials-1545581450

[27] https://www.dhakatribune.com/business/2018/04/28/bsec-chief-urges-merchant-banks-not-use-false-information-raise-funds

Figure 4.8: Size of IPOs Face Value (in Tk.)



Source: Based on DSE website

4.3 Factors affecting Private Investment

CPD (2019) has identified five different reasons contributing to poor flow of private investment. These are:

a) Lack of appropriate policies and weak institutional capacities related to investment and industries

b) Lack of progress in delivering services by new institutions

c) Unavailability of full-packaged infrastructure facility

d) Rising cost of doing business

e) Weak enforcement of business related rules and regulations

It is important to examine how these problems have been addressed in the election pledges of the Awami League, and how the government has planned to take measures to address those challenges.

4.4 Election Pledges of the Awami League and Commitments and Initiatives Undertaken by the Government during First 100 Days

The new government's engagement in promoting private investment during the first 100 days could be reviewed from two perspectives: a) what initiatives the government has been pursuing in implementing ongoing key projects related to promoting investment; and b) what initiatives the government has taken to implement election pledges. It is to be noted that the election manifesto made a number of pledges to reinvigorate and support, and bring dynamism to private sector investment. Following discussion reviews the initiatives of the government taking the aforesaid perspectives into account. Based on CPD's proposals for promoting private investment (which is published in CPD, 2019), the election pledges as well as various initiatives undertaken by the government may be categorised into the following six groups (Table 4.3). These are:

a) Initiatives for raising private investment

b) Ensure inclusive entrepreneurship development
c) Devise sectoral policies, and targeted and predictable incentives
d) Formulate well-packaged infrastructural facilities for different categories of enterprises
e) Initiate regulatory and institutional reforms to ensure the rule of law
f) Strengthening the capital market

Formulate well-packaged infrastructural facilities for different categories of enterprises

An analysis of the initiatives undertaken by the government during the first 100 days shows that majority of the steps are related to investment promotion and facilitation such as infrastructure development, reducing bureaucratic bottlenecks, providing/offering fiscal benefits and raising Bangladesh's demand in international platform. These initiatives include inauguration of activities for setting up new SEZs and operational activities connected with newly set up SEZs,[28] offering fiscal benefits in the form of duty waiver for motorcycle manufacturers, reduction of corporate taxes to export-oriented industries including RMG industry and tightening rules as regards tax benefits for companies which shifted factories to EPZs in order to attract new investment etc. A number of private companies have started operations in their newly set-up factories in these SEZs.[29] In a number of cases the government has made commitments to undertake initiatives to control corruption, particularly in the power and energy sector. The government has offered fiscal benefits for prospective car manufacturers. Despite these initiatives, a number of areas related to investment promotion and facilitation, as committed in the election manifesto, are yet to be addressed by the government. For example, reducing complications as regards land management in connection with setting up factories, sectoral measures targeted to ship building, toy making, jewelry, furniture and tourism sectors, cluster development for small and medium industries based on local raw materials, and plans for developing industrial cities etc.

Ensure inclusive entrepreneurship development

Although entrepreneurship development received priority in the election manifesto, till date only ongoing initiatives have been noticed. For example, programme of 'Start-up Bangladesh' under the ICT ministry for empowering IT related start-ups to succeed, and scale up, and Bangladesh Bank's refinancing scheme to support the SME sector. However, no initiative has been taken with regard to formulating 'youth entrepreneur policy'.

Devise sectoral policies, and targeted and predictable incentives and Initiate regulatory and institutional reforms to ensure the rule of law

Two of the least addressed areas of activities of the government are: a) devising sectoral policies, and targeted and predictable incentives and b) initiating regulatory and institutional reforms to ensure rule of law which will create an enabling business environment. These include efficient

[28] On 02 April, 2019 the Prime Minister inaugurated eleven economic zones which are suitable for setting up industries. These are: Mongla Economic Zone at Mongla in Bagerhat district, Meghna Economic Zone and Meghna Economic Industrial Economic Zone at Sonargaon in Narayanganj, Abdul Monem Economic Zone at Gazaria in Munshiganj, Bay Economic Zone at Gazipur Sadar in Gazipur, Aman Economic Zone at Sonargaon in Narayanganj, City Economic Zone at Rupganj in Narayanganj, Kishoreganj Economic Zone at Pakundia in Kishoreganj, East West Special Economic Zone at Keraniganj in Dhaka, Karnaphuli Dry Dock Special Economic Zone at Anwara in Chattogram, and Sreehatta Economic Zone at Moulvibazar Sadar in Moulvibazar.

[29] The Prime Minister has opened the commercial production of 16 mills and factories and laid foundation stones of 20 others at the function during 2 April, 2019.

and timely delivery public services, transparency and accountability of public offices, reduction of corruption, regulatory and institutional reform in order to reduce hassles in business operations. In fact, the proposed election pledges are not adequate enough to address investment related challenges mentioned above in section three. As per the election commitment, no major initiative has been taken with regard to venture capital, strengthening BIDA and PPP office for the promotion of private investment.

Strengthening the Capital Market

The capital market needs further reforms in order to ensure transparency and accountability in all market related operations and practices. Strengthening of institutions such as SEC, DSE and CSE will be needed so that these can play their role effectively, monitoring and oversight functions of the SEC will need to further strengthened. Good governance will need to be ensured in the dealings of merchant banks and institutional investors etc. The election manifesto focus on further inflow of capital to the ailing market. As mentioned earlier, the market will not be able to stabilize and thrive unless competent overseeing authority, the SEC, is able to ensure 'full transparency and accountability' in the involvement of all stakeholders; effective and stern measures against 'wrong doers' will need to be taken.

Table 4.3: CPD Proposals, AL's Election Pledges and Initiatives Committed/Taken during First 100 Days

CPD proposals	AL's Election Pledges	Benchmarking/Actions Taken and Commitments during first 100 days
Initiatives for raising private investment	a) Investment-GDP ratio: 40 percent b) Adequate infrastructure services	a) Investment-GDP ratio in FY2019: 31.56 per cent b) Private investment- GDP ratio in FY2019: 23.4 per cent c) Initiatives undertaken for development of SEZs
Ensure inclusive entrepreneurship development	a) Up to Tk 2 lac collateral-free loan facility for entrepreneurs and self- employed b) Funding, technology and innovation facility will be increased c) A 'Youth Entrepreneur Policy' will be formulated	a) ICT ministry has a programme: Start-up Bangladesh b) Bangladesh Bank (BB) has a refinancing scheme for SME c) BB has planned to disburse 10 percent out of 25 percent of the bank's allotted SME loan among women d) No initiative as regards 'youth entrepreneur policy' has yet to be initiated.
Devise sectoral policies, and targeted and predictable incentives	a) Transactions of small to medium capital companies and institutions investing in venture capital will be settled quickly	a) Not initiated
Formulate well-packaged infrastructural facilities for different categories of enterprises	a) Continue the task of building a modern, technologically efficient, corruption-free, patriotic and mass-oriented administrative system b) Efforts on ending delay in decision-making and implementation, corruption, bureaucratic complexities and ending of all harassment will continue c) Adequate infrastructure services will have to be provided d) All obstacles to establish industries, especially land management complications, will be removed e) Reasonable protection and incentives will be provided on case by case basis f) Will provide facilities for agricultural processing sector g) Improvement and expansion of the garments and textiles sector, ship building industry, leather, toy making, jewelry, furniture and tourism sectors will be supported h) Pharmaceutical industries and the active pharmaceutical ingredient industries	a) Prime minister has declared 'zero tolerance' against corruption in the power sector b) PM rejects proposal to appoint retired bureaucrat as project directors c) A government order has imposed restrictions on appointing people to higher-grade jobs in the projects through outsourcing. d) Field-level land offices will be brought under automation e) The country's first and the largest private dockyard got license for shipbuilding and repairing from BEZA f) MoF issued new outsourcing guidelines clearing the way for recruiting of people only in the lower grades g) ECNEC approved a project to acquire 1,000 acres of land in Chattogram's Mirsarai for Indian investors h) NBR will provide necessary support to investors who are interested in setting up of car manufacturing units i) Second-tier manufacturers of CKD motorcycles will enjoy full waiver from payment of SD j) The tax authority has tightened rules on tax benefits handed to companies establishing factories in the economic zones k) 19 pharma companies have got the go-ahead in the last one year to set up facilities at an investment of Tk 655 crore l) Establishing an ETP company in Savar Leather Park m) Government has now reduced corporate tax rate further to 0.25 percent

CPD proposals	AL's Election Pledges	Benchmarking/Actions Taken and Commitments during first 100 days
	producing pharmaceutical raw materials will be encouraged. Decisions taken by the Government to utilize the benefits of the exemptions provided by WTO for the API industries of the non-developed countries until 2032 will be implemented promptly i) Plans will be taken to establish industrial cities on both sides of the river Padma as in Singapore j) The "One home one Farm" project of the Government will be linked with the small and medium industries clusters	n) **Prime Minister inaugurated and laid foundation stones of 65 uplift schemes including 24 economic zones** o) WTO trade policy review: Bangladesh sought extension of Pharma waiver
Initiate regulatory and institutional reforms to ensure the rule of law	a) PPP rules and management structures will be reformed. BIDA will be made more proactive	a) No initiatives taken
Strengthening the capital Market	a) Capital market will be deepened through introduction of diversified instruments and encouraging fund flows b) Participation of institutional investors will be increased c) Investment training programmes will be introduced across the country to create awareness about investing in the capital market	a) BSEC has formed two separate committees to amend the private placement (pre-IPO placement) regulation and the book-building method. b) SEC has prepared a four-point formula for boosting institutional investment in bourses. The formula includes addition of certain provisions to the Bank Companies Act to help increase contribution of major institutional investors such as banks to the capital market, creation of scope for investment of pension, life and other funds in securities and fiscal incentives for investment of provident funds in the capital market c) Bangladesh has taken a move to raise Tk 8.78 trillion from the bond market for achieving 8.0 per cent plus economic growth by 2021 d) A tripartite committee has been formed already to boost the country's nascent bond market, particularly the corporate one

Source: CPD (2019); Bangladesh Awami League (2018); Reports from different national dailies

Overall Observations

Based on the analysis of the measures undertaken till date, the election pledges that the government committed and the challenges the investors were confronted with, it may be stated that existing measures will be able to address the type 1 activity, albeit partially only i.e. continuation of ongoing activities to facilitate private investment. However, addressing type 2 activities will be very challenging. These relate to election pledges including, most importantly, reform measures-related initiatives. Government should give high priority to undertaking regulatory and institutional reforms with a view to improve business environment which will facilitate development of new entrepreneurs of small and medium categories in traditional and emerging sectors.

4.5 Suggestions for the National Budget FY2020

There is a growing apprehension that a 'business as usual' trend concerning the development of the private investment sector will further widen the gap between large-scale enterprises and medium- and small-scale enterprises in terms of investment, production, export performance and overall competitiveness. An inclusive pattern of enterprise development needs to be strategically pursued, with participation from all categories of enterprises in the value and production chains. Such a pattern requires an array of supporting instruments and reforms which would support the SMEs in particular. These include measures to access low-cost credit facility, appropriate incentives, full-packaged infrastructure facility, effective investment promotion agencies, and proper monitoring and enforcement of rule of law. Reducing cost of doing business and promoting the cause of ease of doing business should be key targets in this regard. It is expected that the new government will take into account not only its election pledges for promoting investment and enterprise development, but also undertake measures which have not been clearly articulated and adequately reflected in the election pledges. The upcoming national budget is an opportunity to address the gaps in this connection.

Sectoral Polices and Targeted and Predictable Incentives

The policy regime should gradually put more emphasis on the development of vertical policies along with horizontal ones, in order to promote sectoral as well as entrepreneurial development (UNCTAD, 2018). Bangladesh government should put focus on developing sectoral policies which will facilitate developing competitive value chains in different traditional and emerging sectors.[30] Moreover, these policies should be made enforceable. Various incentives to be offered to enterprises and entrepreneurs should be well-targetted and time-bound in nature. However, fiscal incentives for different industries/enterprises should be strategically balanced with a view to ensure diversification of industrial growth.

Well-packaged Infrastructural Facilities for Different Categories of Enterprises

Industrial clusters, which are currently at different levels of development (e.g. SEZs, EPZs, BSCIC industrial estates and industrial parks) should be geared towards serving the needs of different categories of enterprises and entrepreneurs. Building infrastructure for the development of SMEs located outside of major industrial belts deserves special attention. Widespread corruption in public agencies needs to be addressed through enforcement of government's declared *'zero-tolerance policy'* and ensuring through timely delivery of the needed services. This particularly

[30] As part of this process, a policy framework has been developed for motorcycle industry.

relates to getting connections of gas, electricity, water and sewerage, and also in registration and licensing of business without hassle and without paying additional charges.

Regulatory and Institutional Reforms to Ensure Rule of Law

Regulatory reforms should focus more on the enforcement of rule of law in order to ensure competition in the market. State owned enterprises need to be restructured; in the long run, government should be flexible in gradually phasing out some of these enterprises. Public monitoring agencies, departments and other relevant entities need to be strengthened in order to ensure full compliance with national rules and regulations (e.g. human and labour rights, environment and competitive practices). Newly established public agencies mandated to promote investment, including the BIDA, BEZA and the PPP Office, should play more proactive role in realising the goal of rapid industrialisation. They should be given time-bound targets and be held responsible for the results. The capital market needs major reform with regard to ensuring transparency and accountability of the operations of DSE, CSE and SEC and other stakeholders. SEC's regular oversight activities need to be more efficient. Bond market should be developed in order to create new investment opportunities.

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SECTION V. BANKING SECTOR: REFORM FOR THE FUTURE OR REPEAT OF THE PAST?

5.1 Introduction

One of the formidable economic challenges for the present government is to reform and rejuvenate the banking sector of Bangladesh. This is not an easy task, as the banking sector is suffering from several acute problems due to poor governance for a prolonged period of time. Consequently, the newly elected government is required to deal with the problems of the sector in an uncompromising manner, and fulfil its promises for reforms in the financial sector. Over the past several years, CPD has been carrying out in-depth analysis of the concerned issues relating to the banking sector, urging the policymakers to take urgent steps to address governance issues and improve the sector's performance. In this issue of IRBD, CPD has revisited the banking sector with a view to capture and assess new trends and new measures taken during the first 100 days of the current government. In this context, this section attempts to understand the relationship between interest rate and investment. It also examines the state of non-performing loans (NPL) and the actions taken by the government with regard to the banking sector related issues which were promised in the election manifesto of the ruling party, the Bangladesh Awami League.

5.2 Interest rate: is it in the public interest or to cater to the vested interest?

The weighted average interest rate spread in case of the scheduled banks has declined from 4.41 per cent in January 2018 to 4.15 per cent in January 2019, continuing in the downward trajectory that has prevailed since the last spike in June 2014 (Figure 5.1) (Bangladesh Bank, 2019a). Nonetheless, most foreign commercial banks (FCBs) continued to take advantage of lax regulations and a lenient monetary policy to keep their average interest rate spreads above 6 per cent (Bangladesh Bank, 2019a). A recent study by the central bank staff has shown that, given their weighted average deposit rate, operating cost, return on asset, capital charge rate and risk premium, FCBs can hypothetically charge a lending rate of 7.4 per cent, even though they were charging 9.1 per cent, as of August 2018 (Rahman, Hoque, & Siddique, 2019). The same study also reveals that the hypothetical lending rate for state-owned commercial banks (SCBs) was estimated to be 9.7 per cent, which was higher than the actual lending rate of 7.1 per cent that was being charged by the SCBs, as of August 2018 (Rahman, Hoque, & Siddique, 2019). These findings show that the prevailing interest rates in the market are not as flexible as envisaged by the central bank's monetary policy statement for January-June 2019 (Bangladesh Bank, 2019b). Instead, the interest rates are being set by the banks. It appears that the FCBs have set their lending rates in tune with their own business interests, backed by profit motives, while SCBs have set their lending rates in accordance with the public interest. Since there are signals that some banks are using their market power to set high lending rates, the central bank needs to exercise its supervisory role and intervene in order to reduce the interest rate spread.

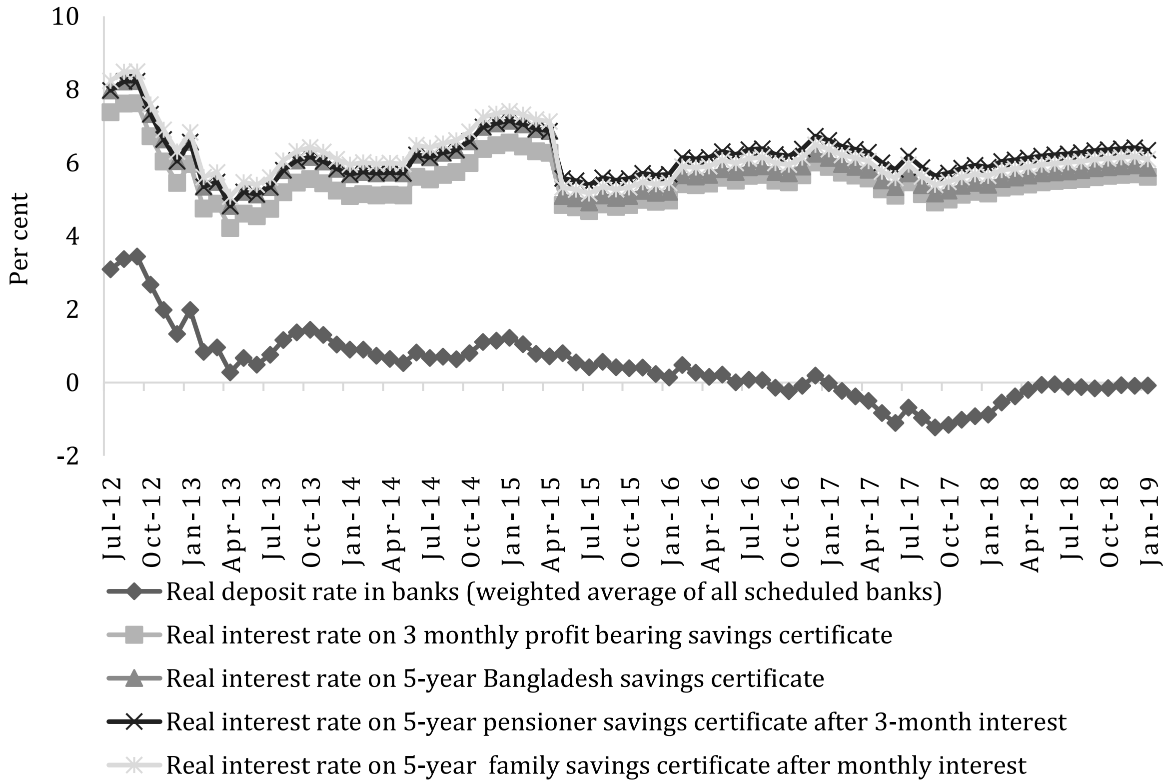
While the interest rate spread is on the decline, it is still at high levels. This is a matter of concern since a high interest rate spread is indicative of inefficiency in the banking system (Demirguc-Kunt, Laeven, & Levine, 2004) (Laeven & Majnoni, 2005). Studies on the interest rate spread in the banking sector of Bangladesh have found that the tendency of making high profits by some banks and incidence of high volume of classified loans are among some of the factors that drive the high interest rate spread in Bangladesh (Sultana & Halim, 2017).

Figure 5.1: Weighted average interest rate spread of scheduled banks

Source: Monthly Economic Trends, Bangladesh Bank.

There have been initiatives to reduce interest rate spread by the central bank. The latest effort was in May 2018 when Bangladesh Bank issued a circular urging all banks to bring down interest rate spread to 4 per cent (Bangladesh Bank, 2018). However, such efforts to reduce the interest rate spread could not be achieved due to the high lending rate. This may be because the real weighted average deposit rate offered by scheduled banks has been below zero since January 2017 (Bangladesh Bank, 2019a). Hence, the general public have little incentive to save their hard earned money in the banks and watch it lose its value over time. On the other hand, the real interest rates on various forms of the national savings directorate (NSD) certificates were around 6 per cent (Figure 5.2). Thus, savings continued to be diverted into the NSD certificates and away from the banks. This disconcerting phenomenon has been taking place for quite some time now. In the absence of adequate social protection, the NSD certificate has transcended its role as a financial product, and transformed into a de facto social safety net mechanism. Consequently, the government has dug itself into an abyss which is proving to be difficult to escape. The high real rate of interest on the NSD certificates means that the government is engaging in expensive borrowing to finance public expenditures. If national savings are directly channelled from the public to the government, then not only are banks deprived of deposits, but also the role of the banks as financial intermediaries is seriously compromised. High dependency on NSD certificates also creates debt burden on the economy as the government has to borrow at a high interest rate.

Figure 5.2: Real rate of interest on bank deposits (weighted average of all scheduled banks) and real interest rate on NSD certificates

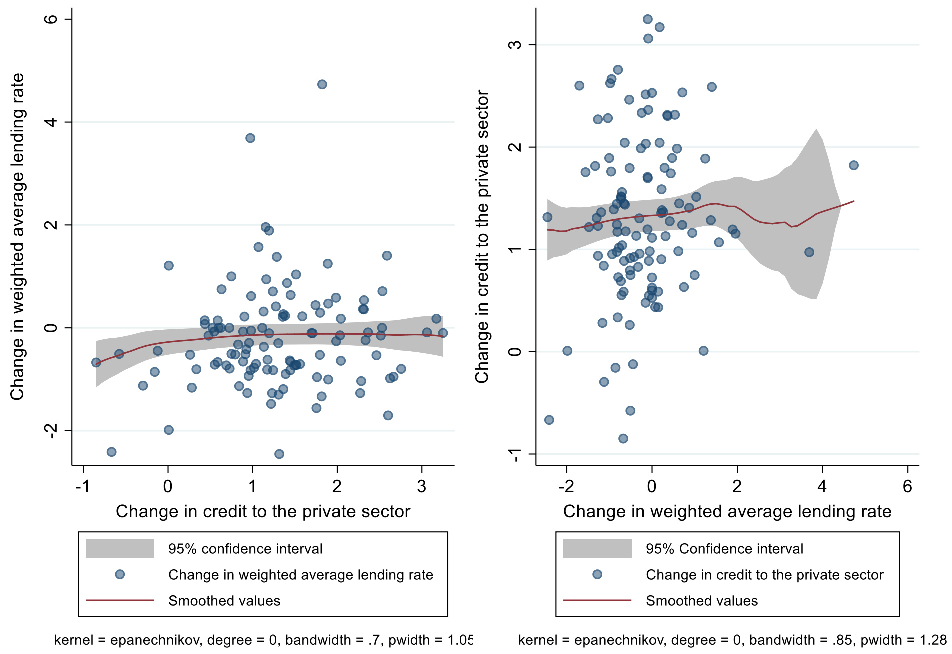


Source: Monthly Economic Trends, Bangladesh Bank.

While the impact of interest rates on the behaviour of savers could be predicted within reasonable limits, the impact of interest rates on the behaviour of investors could not be clearly ascertained. Studies on the interest rate and investment nexus in Bangladesh have yielded mixed results. Simple estimation methods such as ordinary least squares (OLS) have found a weak negative relationship between real lending rate and investment (Islam & Begum, 2005). However, more sophisticated estimation methods, such as error correction mechanism (ECM), have found that the real lending rate is not a statistically significant determinant of investment in Bangladesh (Hassan & Salim, 2011).

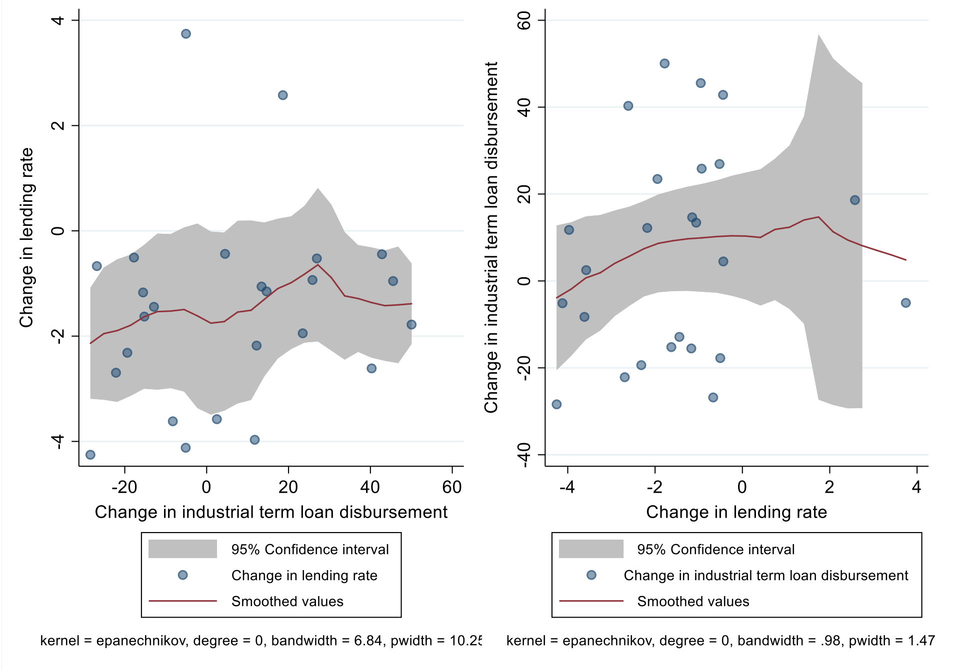
In order to have a new exploratory analysis, in this section, CPD has estimated kernel-weighted local polynomial regressions with the weighted average lending rate and four proxy indicators of investment which are: credit to the private sector, industrial term loans, import of capital machinery and general index of manufacturing (Figures 5.3, 5.4, 5.5 and 5.6).

Figure 5.3: Relationship between weighted average lending rate and credit to the private sector



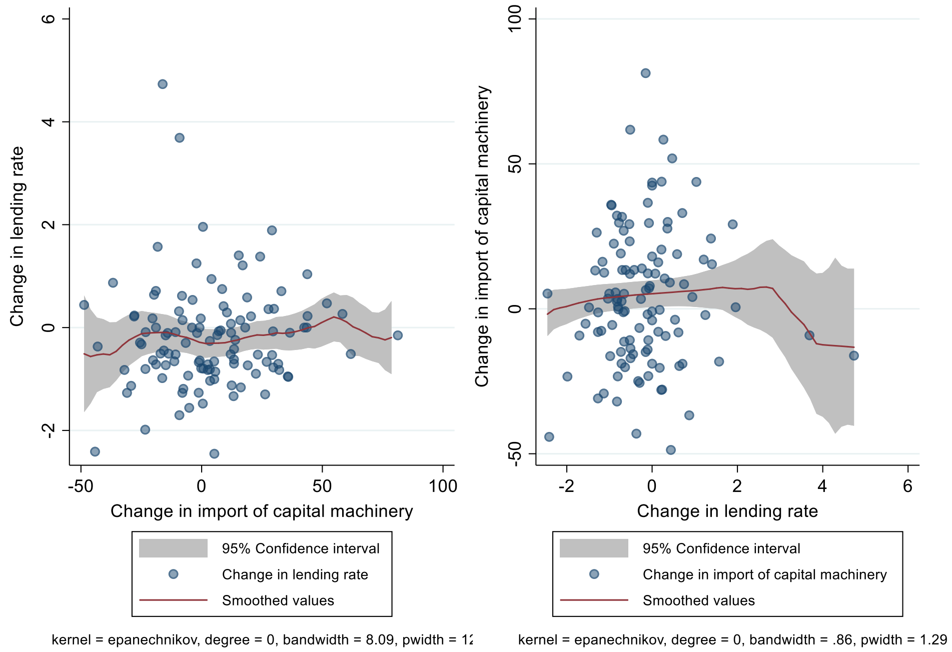
Source: Authors' calculations based on Bangladesh Bank data.

Figure 5.4: Relationship between weighted average lending rate and industrial term loans



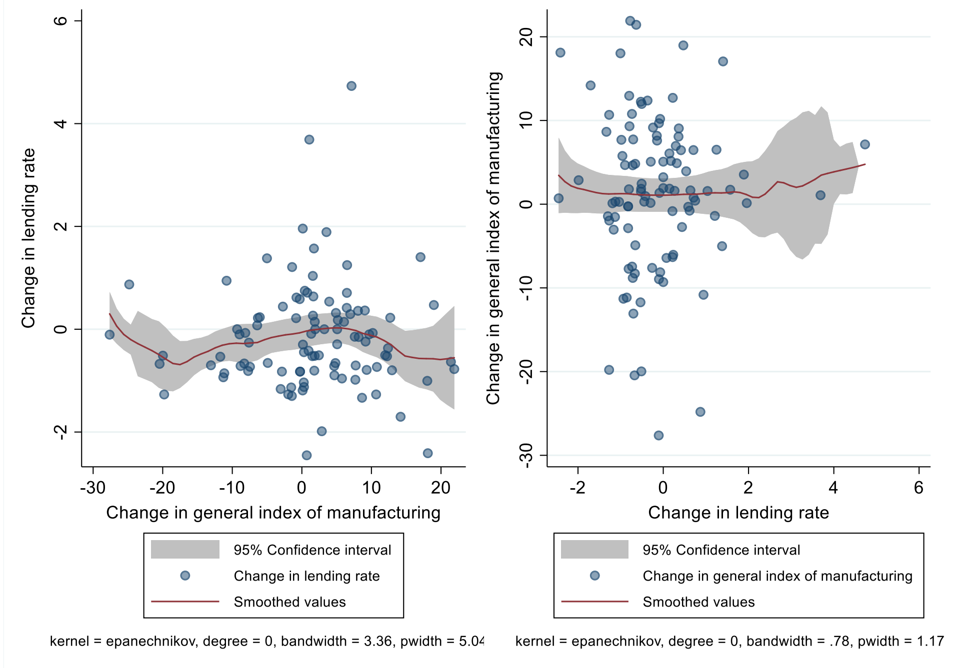
Source: Authors' calculations based on Bangladesh Bank data.

Figure 5.5: Relationship between weighted average lending rate and import of capital machinery



Source: Authors' calculations based on Bangladesh data.

Figure 5.6: Relationship between weighted average lending rate and general index of manufacturing



Source: Authors' calculations based on Bangladesh Bank data.

CPD's analysis indicates that there was no systematic relationship between the weighted average lending rate and the proxy indicators of investment. For more robustness, CPD researchers also investigated the effect of these proxy indicators of investment on the weighted average lending rate. Again, it was found that there was no systematic relationship between the proxy indicators of investment and the weighted average lending rate. Plots of impulse response functions showed that an impulse or positive shock of the weighted average lending rate had a relatively short lived response in the proxy indicators of investment that died down after roughly three months, implying that there may be no significant long-term effect (Figures 5.7A, 5.7B, 5.7C, 5.7D).

Figures 5.7 (A-D): Impact of weighted average lending rate positive shocks on proxy investment indicators

Figure 5.7 (A): Impact of weighted average lending rate shock on private sector credit

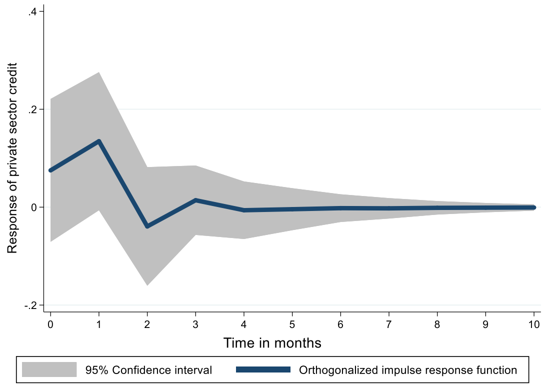


Figure 5.7 (B): Impact of weighted average lending rate shock on industrial term loans

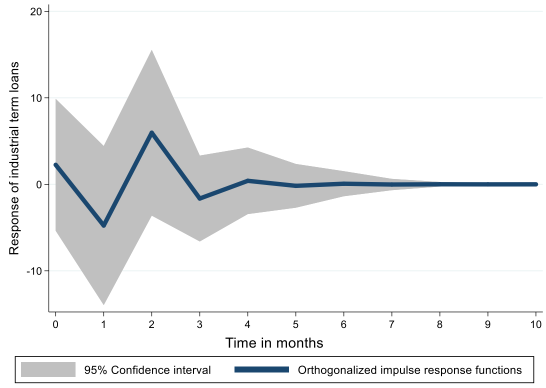


Figure 5.7 (C): Impact of weighted average lending rate shock on import of capital machinery

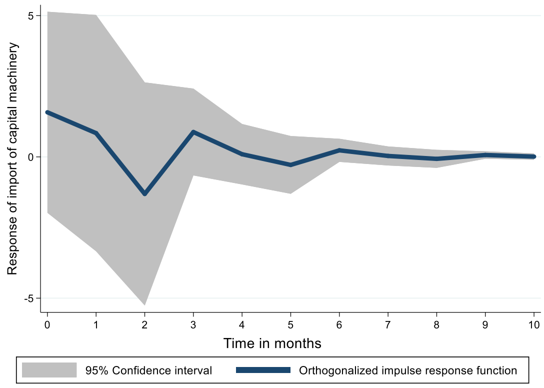
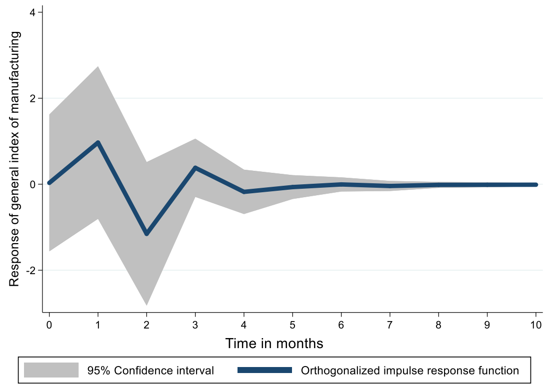


Figure 5.7 (D): Impact of weighted average lending rate shock on general index of manufacturing



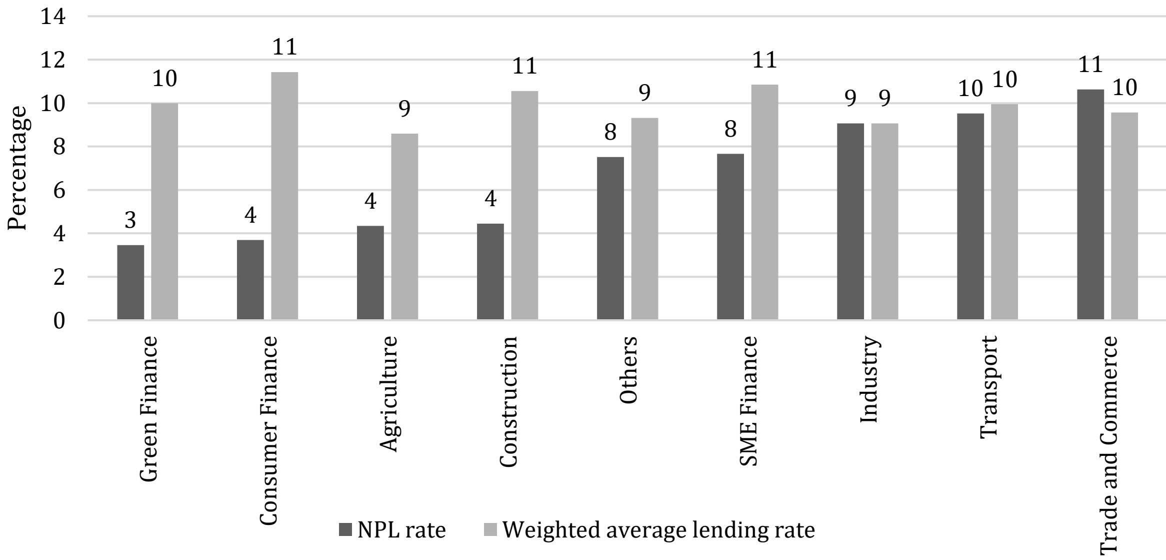
Source: Authors' calculations based on Bangladesh Bank data.

Analyses carried out by CPD researchers indicate that, shocks in the weighted average lending rate did not have any long-term impact on the proxy indicators of investment. From the preliminary analysis, it appears that investment is not very sensitive to interest rate. This result is not only consistent with the ground reality, but also with the World Bank's Doing Business reports, which have repeatedly cited that in the context of Bangladesh, other factors such as enforcing contracts, registering property and obtaining electricity are more important determinants of investment than getting credit (World Bank, 2019). The Bangladesh Business Environment Study 2018 also indicated that factors such as corruption, inadequate infrastructure and inefficient government bureaucracy are more important than access to financing in the context of investment in Bangladesh (CPD, 2018).

5.3 Non-performing loans: no indication of improvement

Conventional economic theory postulates that higher risk should be compensated with higher return (LeRoy & Werner, 2014). In the context of banking, this means that loans which are at greater risk of being defaulted should be assigned with higher interest rates (Freixas & Rochet, 2008). However, it is observed that the reality in the banking sector of Bangladesh was quite the contrary. For example, credit provided for consumer finance had a weighted average lending rate of 11 per cent even though its NPL rate was only 4 per cent, while credit provided for trade and commerce had a weighted average lending rate of 10 per cent despite its NPL rate being as high as 11 per cent (Figure 5.8) (Rahman, Hoque, & Siddique, 2019). In essence, good borrowers were being punished with high interest rates while bad borrowers were being rewarded with low interest rates. This again shows that the market, succumbing to its own whims and vested interests, has become quite distorted, which calls for urgent attention and actions on the part of the regulators.

Figure 5.8: Overall NPL rate and weighted average lending rate in 2017



Source: Bangladesh Bank data, adapted from Rahman, Hoque, & Siddique, 2019.

NPLs have become a central feature that describes the story of the banking sector of Bangladesh. In recent years, NPLs have spiralled upwards, partly due to the fresh funds offered by the government in every budget to recapitalise the NPL-struck banks. The volume of NPLs in the banking sector has been exceedingly high in recent years. In the eight out of nine years between 2010 and 2018, the amount of NPLs was so high that they would have been sufficient to pay for the combined national expenditure of education and healthcare as outlined in the budget (Table 5.1). This alone should suffice to portray the alarmingly high level of NPLs that have accumulated in the banking sector. Nevertheless, it must also be kept in mind that the amount of NPLs would have been much higher had there been no adjustments due to the frequent restructuring and rescheduling of bank loans.

Table 5.1: NPL compared to GDP and budget allocations for education and health sectors

Fiscal year	NPL as percentage of GDP	Education budget as percentage of GDP	Health budget as percentage of GDP
2010	2.85	1.95	0.79
2011	2.47	2.01	0.80
2012	4.05	1.78	0.73
2013	3.39	1.73	0.71
2014	3.74	1.87	0.70
2015	3.92	1.85	0.69
2016	3.59	2.18	0.73
2017	3.76	2.19	0.34
2018	4.17	2.09	0.89

Source: Bangladesh Bureau of Statistics (BBS), Bangladesh Bank Annual Report & Bangladesh Bank Quarterly (various issues), Budget documents (various years), Ministry of Finance.
Note: NPL data is for calendar years; all other data are for fiscal years.

To make things worse, Bangladesh Bank issued a circular on 21 April 2019, stating that if any instalment of a fixed term loan is not repaid within the fixed expiry date, then the amount of unpaid instalment shall be categorised as overdue only after six months of the expiry date (Bangladesh Bank, 2019c). This means that, effective from 30 June 2019, loan defaulters will be given an additional six months time before their defaulted loans get recognised. Such benefits offered by the central bank will simply encourage more people to become defaulters. Moreover, such measures are completely contradictory to international best practices. According to the International Monetary Fund (IMF), loans should be classified as NPLs if: i) payments of principal and interest are past due by 90 days or more, ii) interest payments equal to 90 days interest or more have been capitalized, refinanced, or rolled over, and/or iii) sufficient evidence exists to classify a loan as non-performing even in the absence of a 90 days past due payment, such as when the debtor files for bankruptcy. The 90-day mark is recommended as an upper threshold, and the IMF does not discourage more strict definitions of NPLs (IMF, 2006).

5.4 License for new banks: how long will this continue?

Despite the cautions echoed by experts, the central bank has gone on to approve licenses for three new private commercial banks in Bangladesh on 17 February 2019. Since these banks have not commenced their operations, it is not possible to comment on their performance or impact on the banking sector. However, in the past, issuing licenses to new private commercial banks has created opportunities for swindling public money by crony capitalists. If such incidents recur, it will deepen the adverse impacts on the state of governance in the country's banking sector.

5.5 Pledges in the election manifesto 2018 of Bangladesh Awami League and follow-up measures and announcements of the government in the first 100 days

The 2018 election manifesto published by the Bangladesh Awami League contains a number of pledges pertinent to the banking sector. These included pledges intended to reduce the amount of NPLs, as well as forward-looking initiatives for improving the efficiency of the banking sector, increasing access to finance and accelerating technology adoption (Bangladesh Awami League, 2018). In the first 100 days of the ongoing third term of the current government, very few concrete steps were taken in line with the election manifesto pledges, although several measures have been considered.

Overall, the pledges in the election manifesto do address some of the major issues affecting the banking sector. However, some of the measures being considered may not be the best methods for achieving the objectives of the election manifesto. For example, awarding licenses to new banks cannot guarantee that private investment will increase or financial inclusion will improve. Nevertheless, the central bank has approved licenses for establishing three new private commercial banks. A number of measures that were considered in the first 100 days may do more harm than good. For example, removing the single borrower exposure limit, which prohibits banks from lending more than 35 per cent of their total capital to a single borrower (Bangladesh Bank, 2014), may increase the vulnerability of banks through greater credit concentration. Other measures that have been considered in the first 100 days, such as categorising borrowers as either honest or dishonest, may be prone to subjective biases. A summary of the pledges related to the banking sector in 2018 election manifesto, measures taken and announcements made in the first 100 days of the government and CPD's analysis and comments are presented in Table 5.2.

Table 5.2: Election pledges of Bangladesh Awami League and measures taken or announcements made by the government in the first 100 days

Pledges in the election manifesto 2018 of Bangladesh Awami League	Measures taken or announcements made in the first 100 days	CPD's analysis/comments
• Services of banking and insurance sectors will have to be expanded; skills and accountability will have to be ensured.	• On 17 February 2019, Bangladesh Bank approved three new private commercial banks: Bengal Commercial Bank, People's Bank and Citizen Bank (Dhaka Tribune, 2019) (Daily Star, 2019a) (Daily Star, 2019b).	• Increasing number of banks cannot guarantee higher private investment.
• An effective and sustainable strategy will be determined to lower the ratio of non-performing loans and implement the Bankruptcy Act.	• Bangladesh Bank issued a circular on 6 February 2019, instructing all scheduled banks to create a separate debt cancellation unit to recover written-off loans and stops rescheduling and restructuring of written-off loans (Bangladesh Bank, 2019d). • A special audit will be undertaken in all banks to identify honest and dishonest borrowers (Financial Express, 2019a) (Daily Star, 2019c) and on the basis of this audit, honest borrowers who are unable to repay loans for legitimate reasons will be allowed to pay off loans with a 2 per cent down payment on the loan amount and 7 per cent interest	• Banks can reduce their tax burden by writing off loans, whereas recovering written-off loans can be time consuming and expensive. Therefore, some banks may resist this move or only comply under strict compulsion from the central bank. • A clear, concrete and quantifiable definition of an honest borrower and a legitimate reason for non-payment should be declared before extending such privileges to any borrower.

Pledges in the election manifesto 2018 of Bangladesh Awami League	Measures taken or announcements made in the first 100 days	CPD's analysis/comments
	over 12 years (Financial Express, 2019b) (Daily Observer, 2019). • Single borrower exposure limit will be withdrawn for honest borrowers (Financial Express, 2019c). • Bangladesh Bank issued a circular on 21 April 2019, stating that if any instalment of a fixed term loan is not repaid within the fixed expiry date, then the amount of unpaid instalment shall be categorised as overdue only after six months of the expiry date (Bangladesh Bank, 2019c).	 • Repeal of the single borrower exposure limit will make banks vulnerable to risky large loans. • Such benefits offered by the central bank will simply encourage more people to become defaulters.
• Without undermining the market system, the central bank will keep interest rates under control skillfully by adopting specific strategies.	• In its Monetary Policy Statement for January-June 2019, the central bank has allowed the interest rates to be market determined (Bangladesh Bank, 2019b).	• As of February 2019, the weighted average real deposit interest rate in scheduled banks was negative, and the interest rate spread in most FCBs was above 6 per cent (Bangladesh Bank, 2019a).
• The central bank will take initiatives to inspect banks' skill on loan approval and disbursement and liabilities to clients.	• These measures are yet to be taken.	• This is a good proposal. This will identify the skills gap and requirements of the banks in this regard.
• The ongoing supervision and regulation of the commercial banks and financial institutions will be made more effective and powerful.	• Bangladesh Bank recommended amending Banking Companies Act, Bankruptcy Act, Negotiable Instrument Act as well as Merger and Acquisition (M&A) regulation (Financial Express, 2019d).	• Amendment of the laws and regulations regarding banking is urgently required, but it remains to be seen what changes will actually be implemented.
• Bank frauds including loan defaulters will be subdued and all the involved bank officials, loan receivers and culprits will be brought to trial and punished.	• These measures are yet to be taken.	• This is a laudable announcement. Such measures will set examples for future and help reduce loan defaults.
• Efforts will continue to offer agricultural loans on easy terms.	• These measures are yet to be taken.	• Average interest rate on loans provided to agricultural sector was as high as that provided to the industry sector, even though the average rate of NPL in the agricultural sector was lower

Pledges in the election manifesto 2018 of Bangladesh Awami League	Measures taken or announcements made in the first 100 days	CPD's analysis/comments
		than that in the industry sector (Rahman, Hoque, & Siddique, 2019)
• All transactions of the financial sector will be digitized.	• These measures are yet to be taken.	• Cash-less transactions are very low (Islam, et al., 2016) and most e-commerce is heavily reliant on cash on delivery, instead of electronic payment (Suhan, 2015).
• To motivate and facilitate the women entrepreneurs, necessary Initiatives, including separate banking, credit facilities, technical support and criteria for recommendations, will be made.	• These measures are yet to be taken.	• This is a praiseworthy suggestion. These measures will enable women empowerment and help achieve SDG 5.
• A plan to introduce credit guarantee scheme has been considered so that small entrepreneurs are not deprived of bank loans for lack of collaterals.	• These measures are yet to be taken.	• This plan, if implemented, will help create self-employment which is critically important in the current context.

Source: Authors' compilation from various sources.

5.6 Conclusions and recommendations

The election manifesto of Bangladesh Awami League made quite a number of useful pledges on the banking sector which addressed some of the key attendant challenges. Pragmatically, it is still early to draw any conclusion about the general direction of the banking sector following the 11th National Parliamentary Elections in 2018. However, one cannot but conclude that the measures considered and taken during the first 100 days of the government will not be able to accomplish reforms that were reflected in the election manifesto 2018 of the Bangladesh Awami League. In this context, and in view of the upcoming national budget, CPD presents a number of recommendations for the banking sector of the country:

- Dependency on NSD certificates should be lessened in order to reduce the debt burden of the government. In this regard, the central bank has to revisit both lending and deposit rates.
- Recapitalisation of losing banks should be stopped. This public money can be invested in the social sector.
- No new licenses for new private commercial banks should be issued as most of the existing new banks are not performing well.
- Central bank directives that prohibit rescheduling and restructuring of written-off loans should be strictly imposed.
- A clear, concrete and quantifiable definition of an honest borrower should be announced and a legitimate reason for non-payment should be declared before extending any privileges to any borrower.
- Single borrower exposure limit for commercial banks should not be repealed.

- Banking Companies Act should be amended to reduce both the number of family members in the board of directors and the tenure of each member.
- Bankruptcy Act has to be amended to remove mortgage-related loopholes that delay the course of justice.
- The budget should allocate adequate funds for setting up an independent banking commission. CPD has been continuously urging for such a commission in view of addressing emerging challenges in the sector. The commission will critically assess problems and weaknesses of the sector and suggest concrete recommendations for improving the performance of the banking sector.

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SECTION VI: MANAGING THE EXTERNAL SECTOR IN TIMES OF EMERGING TENSIONS

6.1 Introduction

With the pace of growth of export and import outstripping that of the GDP, Bangladesh's degree of openness and exposure to the global economy has been on a significant rise since the 1990s. Consequently, emerging global trading scenario and external sector performance are having increasingly important implications for the performance of the domestic economy and the GDP growth. From the vantage point of exports, the impacts are reflected in terms of investment performance, growth of manufacturing activities, employment generation and foreign exchange earnings. From that of imports, it is reflected in consumption, inflation, and industrial and development activities.[31] The combined interaction of external sector elements have implications for exchange rate movement, state of foreign exchange reserves, and balance of payments (BoP) and overall performance of the economy.

The time during which the Awami League (AL) manifesto (Bangladesh Awami League, 2018) was presented, the external sector and overall balance situation was under pressure. Indeed, the overall balance situation was unsettling during the whole of FY2018 with significant deterioration from the comfort zone – a positive balance USD 3.17 billion to the negative terrain of USD (-)0.9 billion towards the end of FY2018; and albeit of reduced extent of USD (-)0.5 billion for the period of July-March FY2019, the overall balance is still negative which do not bode well for the economy. With Brexit on the horizon, looming trade war, and volatility in the commodity market the global scenario was also not conducive of positive developments.

In this backdrop, it is of utmost importance that the incumbent government has proper strategies in place to take care of the attendant challenges, and this necessitates analysing the AL Election Manifesto to map the commitments with actions taken till now. While the manifesto did talk about stimulating export sector performance and boosting export earnings, there was no reflection of strategic thinking in the manifesto to address the emergent disquieting trends concerning the external sector.

6.2 Targets and Strategies in AL Election Manifesto

The AL Election Manifesto deals with external sector in three ways: (a) as a cross-cutting area contributing to export-oriented industrialisation and accelerated GDP growth; (b) by setting specific external sector targets; and (c) by articulating policies to harness the potentials of external sectors.

The Manifesto has set an export earnings target of USD 72.0 billion by FY2024, in the backdrop of total export earnings of USD 36.7 billion in FY2018, this would mean a doubling of export earnings with a compound annual growth rate of about 11.9 per cent over the next six years (FY2019 to FY2024). Indeed, if exports are to reach USD 496.8 billion by 2041 (as is mentioned in the Manifesto); this would mean maintaining a double-digit compound annual growth rate of 12.0 per cent beyond 2024 for the subsequent 17 years. Conversely, the imports are projected to rise from USD 56.0 billion FY2018 to USD 110.0 billion in FY2024, a doubling over the corresponding

[31] It is, however, to be conceded that these are also determining factors that impact on external sector performance.

period at an estimated compound growth rate of 11.9 per cent per annum. To compare, compound annual export growth over the past six years (FY2012 to FY2018) was 7.1 per cent; the matched figure of growth for import was 8.5 per cent. By any measure maintaining such a high double-digit growth rate for more than the upcoming two decades will be very daunting, if not challenging.

The AL Election Manifesto (Bangladesh Awami League, 2018) also sets out a number of specific policy initiatives to be pursued by the government. Thus, the manifesto mentions about the followings:

a. Export items will have to be diversified and new markets will have to be tapped in. It is tough to expand export markets depending on limited number of products and markets. Measures will be taken to resolve sector-wise problems in order to diversify export.

b. The government's support—such as rebates in tariff, tax and VAT, cash incentives etc. to boost export—will be modified and readjusted after analysing their overall effectiveness as per requirement. Tariff-tax benefits and incentives will get special attention to help flourish knowledge and technology-based industry.

c. The establishment of the Bangladesh Investment Development Authority (BIDA), providing various export incentives, increased cash incentives from 2 per cent to 20per cent for 27 export items, introduction of One Stop Service and efforts to improve Ease of Doing Business procedure are some of the steps taken by the Government.

d. Economic Zones will increase exports by about 40 billion dollars additionally and will provide jobs to about one crore people.

e. Improvement and expansion of the garments and textiles sector, ship building industry, leather, toy making, jewellery, furniture, and tourism sectors will get the benefits of this programme.

f. Pharmaceutical industries and the active pharmaceutical ingredient (API) industries producing pharmaceutical raw materials will be encouraged. Decisions taken by the Government to utilize the benefits of the exemptions provided by WTO for the API industries of the non-developed countries until 2032 will be implemented promptly.

g. A plant for the disposal of leather industry waste has been created in Savar, which will help increase manifold the export of leather goods by fulfilling the conditions of eco-friendly production.

h. Providing financial initiatives incentives to the export of jute products as a promising sector and its diversification will be continued.

i. Export of IT software, services and digital equipment will be increased to USD 7 billion.[32]

The manifesto mentions about deepening regional cooperation and regional connectivity, policy decision to establish 89 economic zones geared to higher and more diversified production and exports and strengthening of institutions such as Bangladesh Economic Zones Authority (BEZA) and Bangladesh Investment Development Authority (BIDA) in this connection.

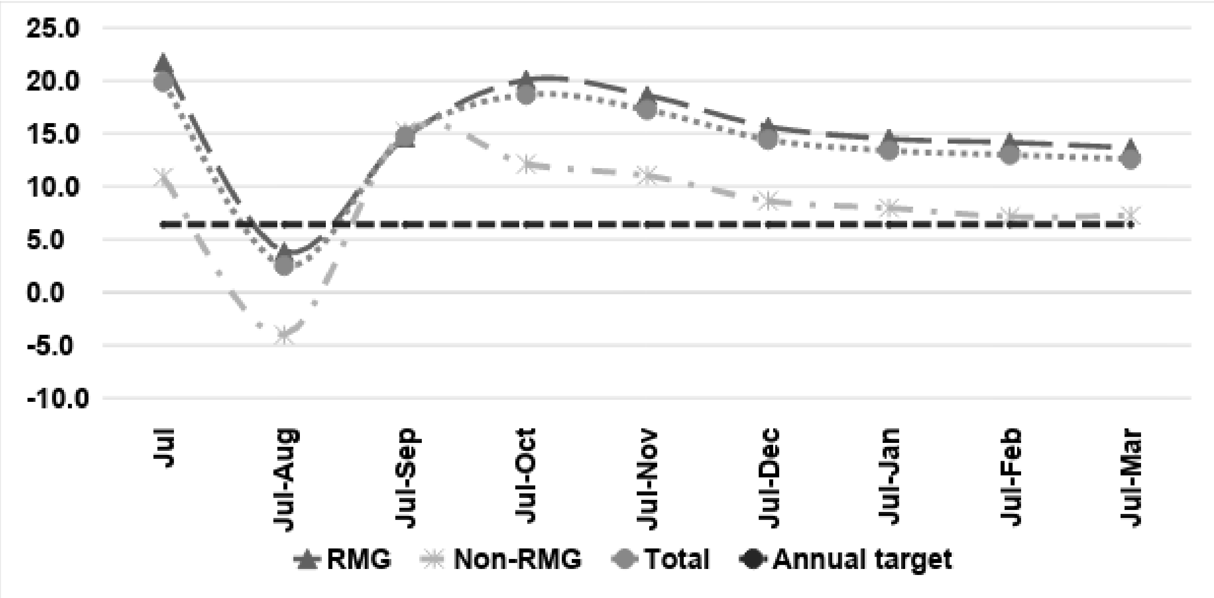
[32] The export from the digital sector has increased to USD 800 million from 2.6 million.

6.3 Analysis of External Sector Performance

Export earnings are gaining momentum

In an encouraging note, exports have picked up in the first three quarters of FY2019, registering a growth of 12.6 per cent compared to the corresponding cumulative period of FY2018 (when growth over the matched period of previous fiscal year was 6.3 per cent). As is seen from Figure 6.1, the growth of export earnings for all other cumulative monthly periods was higher than for July-March period (except for July-August FY2019). As Figure 6.1 shows, export earnings in the first three quarters and till now, remained well above the strategic annual target of 6.4 per cent. For most part, this growth has been underpinned by growth of RMG export earnings, at 13.7 per cent.

Figure 6.1: Target, achieved and required period-on-period growth rates (in per cent)



Source: Authors' calculation from EPB (n.d.)

In contrast, the non-RMG growth was a subdued 7.2 per cent though better than for last fiscal year which was (-) 5.5 per cent (Figure 6.1); with important export items such as leather and leather products (-9.1 per cent), jute and jute goods (-23.2 per cent) and home textiles (-3.4 per cent) posting negative growth (as Table 6.1 shows). Indeed, 90.3 per cent of the incremental export was on account of the RMG sector signalling that export concentration has been on the rise, with share of RMG in total exports rising to 83.9 per cent in the current fiscal from 77.1 per cent a decade back, in FY2010 (Figure 6.2).

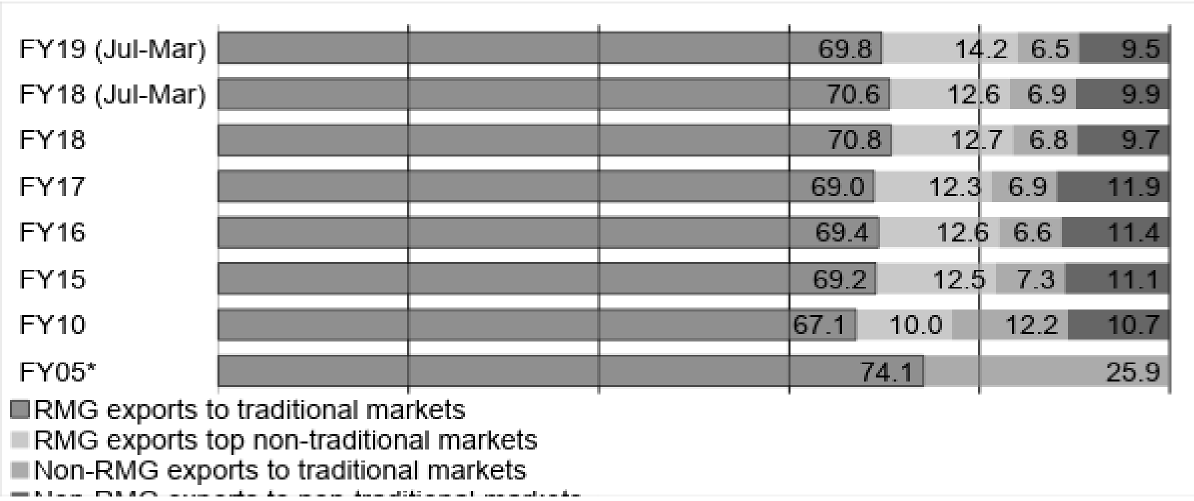
Table 6.1: Incremental share of exports (July-March FY2019)

RMG			Non RMG						All products
Knitwear	Woven Garments	Total	Leather & Leather Products	Jute & Jute goods	Home Textile	Frozen & Live Fish	Other Non RMG	Total	
42.9	47.4	90.3	-2.2	-5.5	-0.7	0.3	17.8	9.7	100.0

Source: Authors' calculation from EPB (n.d.)

Figure 6.2 further elucidates RMG-led growth of export earnings with higher market concentration to traditional markets (i.e. EU, USA, and Canada). In spite of the repeated initiatives towards export and market diversification, the fact of the rising concentration in recent times, on both counts, could not be arrested. Non-RMG exports to the non-traditional markets has decreased over the course of FY2015 to FY2018, and also for July-March FY2019.

Figure 6.2: Market- and product-composition (%) of Bangladesh exports



Source: Authors' calculation using data from EPB (n.d.)

Note: For FY05 data to compose market composition was not available, hence, it only shows product composition (i.e. 74.1 per cent of total export earnings in FY15 was from RMG exports and the rest 25.9 per cent from Non-RMG exports)

In line with product concentration, market concentration has also been on the rise (Figure 6.2). The share of traditional market (US, EU and Canada) was 76.3 per cent in exports over July-march FY2019 period. Share of non-RMG exports to non-traditional markets is equivalent to 59.5 per cent of total non-RMG exports of Bangladesh (in July-march, FY2019). In contrast, as shown in Figure 6.2, 83.1 per cent of the RMG export earnings originates from traditional markets. This has been the case in spite of the 4 per cent incentive for exports to non-traditional market mentioned in the Export Policy 2018-2021 (Ministry of Commerce, 2018).

Import has been relatively moderate

The import structure shows important shift when performances of July-February period of FY2019 and FY2018 are compared. The most notable feature here is the significant deceleration in growth of import payments during July-February FY2019 relative to FY2018, to 5.6 per cent.[33] Further product-level analysis reveals that import payments for foodgrains in July-February period of FY2019 came down by (-)55.9 per cent ; this can be attributed to the import of rice coming down from high import level which was induced by higher domestic demand due to flood.[34] Import payments of consumer goods fell by (-)8.8 per cent in the period of consideration.

[33] For July-February FY2018 the period-on-period import growth was 26.2 per cent. For the full FY2018 annual import growth was 25.2 per cent.
[34] Import payments for rice was significantly high in FY2018 (USD 1309 million) has come down to USD 89.6 million in FY2019 (for the period of July-February). As CPD (2018a) detailed out, the phenomenal

Consumer goods which showed significant high growth in FY2018 (July-February) have mostly recorded negative growth in FY2019 for the same period, for instance, edible oil (-3.0) and sugar (-38.1).[35]

Intermediate goods also experienced a deceleration in growth rates, albeit not very significantly, from 19.8 per cent to 16.6 per cent over the period of July-February FY2019. The rising commodity prices, particularly oil and petroleum-based products which has shown an increasing trend in 2018 and early part of 2019, have contributed to this somewhat maintained growth of import payments for intermediate goods.[36] For July-February FY2019 period, import bills for crude petroleum and petroleum-based products (POL) increased by 20.2 and 37.3 per cent respectively. Furthermore, significant growth has been observed in construction related intermediate goods such as clinker (45.8 per cent), limestone (25.4 per cent), B.P. sheet (100.8 per cent) etc., for the period of July-January FY2019.

Growth of import payments of capital goods came down to 5.0 per cent in July-February FY2019, when compared to 28.2 per cent for the corresponding period in FY2018, which was a significant fall. As CPD (2018a) pointed out, import of capital goods escalated in FY2018 to support a number of important public-sector infrastructure projects. Import of capital goods contribute to 27.7 per cent of the import payment for the period of July-February FY2019 (28.3 per cent for the same period in FY2018); this is indicative of the continued infrastructure-related domestic demand. Import payments for capital machineries have increased only by 8.0 per cent for the period under consideration, in contrast to the high 42.3 per cent growth in FY2018.

As seen from the above discussion, increasing prices of commodities with high import payments such as oil, petroleum-based fuel (POL), and the needs of infrastructure-related imports, could potentially lead to a rise in import growth in the coming months.

Balance of Payments Scenario: disquieting trends persist

The significant deceleration in import growth rates has helped arrest further deterioration in the balance of payments (BoP) situation, although the disquieting trends of FY2018 has persisted. As may be recalled, overall BoP balance was a negative (-) USD 0.88 billion in FY2018. The BoP balance went into the negative terrain in FY2018 for the first time since FY2011. At the end of March, based on figures of first three quarters of FY2019, the overall balance stood at (-) USD 0.50 billion; the corresponding figure for FY2018 was (-) USD 0.98 billion.

A comparison of the two BoP scenarios prevalent in FY2011 and FY2018 throws some important insights. Firstly, a large part of the overall balance situation in the both cases can be explained by the increasing imports and the resultant, deficit in the trade account; with the amount rising from (-)9.94 billion in FY2011 to (-) USD 18.3 billion in FY 2018. Secondly, while the remittance has increased (by 30 per cent) between FY2011 and FY2018, the relatively slow pace could not compensate for the rising trade deficit (which increased by about 84 per cent). Thirdly, the negative overall balance in FY2018 would have been much higher had it not been for the

growth in import payments was contributed by the surge in import of rice in FY2018 originated from the loss of crop in two successive floods and the consequent need to replenish stocks.

[35] The declining growth of import payment of edible oil and sugar seem to be driven by the declining price as seen in Commodity Price data of World Bank (n.d.)

[36]As World Bank (2019) noted, international oil prices dropped strongly from over 100 USD per barrel in the second quarter of 2014 to a low of 34 USD per barrel in the first quarter of 2016. Since then, prices have increased again, and has reached 69 USD per barrel at the end of 2018, more than double the level in the first quarter of 2016.

significant rise in the financial account balance: (+) USD 9.07 billion in FY2018 compared to (+) USD 0.65 billion in FY2011 (Table 6.3). The comparative structure presented in Table 6.3 of the financial account indicates large increase in case of 'medium and long term (MLT) loans' (excluding suppliers credit), from (+) USD 1.03 billion to (+) USD 5.78 billion. This has resulted in the sharp rise in the 'other investment (net)' item, from (-) USD 0.23 billion to (+) USD 7.13 billion. This is indicative of the accumulating debt and rising debt-servicing liabilities in future.

Comparing for the period of July-February FY2019, the financial account stands at (+) USD 3.72 billion; however, this was a 30 per cent decrease over the same period in FY2018. Net FDI flow has increased by 24.8 per cent, whereas portfolio investment decreased by a significant 59.3 per cent. Long term loans (net) has quadrupled while short term loans (net) has decreased by 15.5 per cent for the July-February FY2019 period. This is an important shift in the structure of Bangladesh's foreign loans with consequences for the BoP scenario (which has been discussed in more details later in this section).

Table 6.3: Details of Financial Account Scenario

Items	FY2011	FY2018	FY2019 (July-Feb)
Financial account*	**651**	**9076**	**3723**
A. Foreign direct investment (net inflows)	775	1583	1183
B. Portfolio investment (net)	109	365	127
C. Other investment (net)**	-233	7128	2413
(a) Medium and long-term (MLT) loans	1032	5785	3906
(b) MLT amortization payments	739	1113	766
(c) = (a) - (b)	293	4672	3140
(d) Other long term loans (net)	-101	155	936
(e) Other short term loans (net)	531	1947	951
(f) Other assets	-661	0	0
(g) Trade credit (net)	-135	-1270	-2756
(h) Commercial Bank (net)	-160	1624	142

Source: Bangladesh Bank (n.d.)

Note: * signifies that this item is the sum of the items in A, B and C; similarly, ** signifies that the item C (other investment) is the sum of the elements in (c) to (h).

The emerging scenario in this connection ought to be examined and monitored with due care. This once again underpins the need for ensuring effective use of the money borrowed. This argument is further reinforced by the fact of rising interest of borrowing and more stringent terms (high service charge, shorter loan and grace period etc.) on account Bangladesh having graduated from low to lower middle-income country (LMIC) status. The manifesto does not mention about the emerging challenge of increasing debt servicing and the need to remain vigilant in this connection. The government in its first hundred days has also not recognized this as a concern although the CPD in its earlier studies has repeatedly pointed this out (CPD, 2014; CPD, 2018b).

Increasing remittance flow and decreasing migration

Remittance inflow to Bangladesh had recorded an impressive 18.0 per cent growth in the beginning of FY2019 (July); the pace slowed down in the subsequent months though. Growth in remittance earnings was 10.3 per cent for the period of July-March FY2019. As CPD (2018a) had pointed out, the growth of remittance flow in FY2018 had helped rein in the current account balance from sliding further into the negative terrain.[37] The continued good performance of remittance flow has contributed to reducing the extent of negative overall balance in the BoP in FY2019. On the other hand, the overseas migration scenario is rather grim. For the period of July-March FY2019, growth in number of workers travelling overseas was to the tune of (-) 26.7 per cent. Migration started to fall from the last quarter of FY2018 and the trend has continued through FY2019. If this disquieting trend holds, as CPD (2018a) had pointed out, future remittance flows will likely to be negatively impacted owing to lagged effects of the declining number of migrant workers leaving for overseas jobs. As may be recalled, the number of workers going abroad per month between FY2015 and FY2018 averaged at about 61,100 while in the first nine months of FY2019 the average number was at 56,400.

As can be deduced from the aforementioned discussion in this section, rising export growth and comparatively moderate imports, paired with strong remittance flow has contributed to betterment of the BoP situation.

Exchange rate management

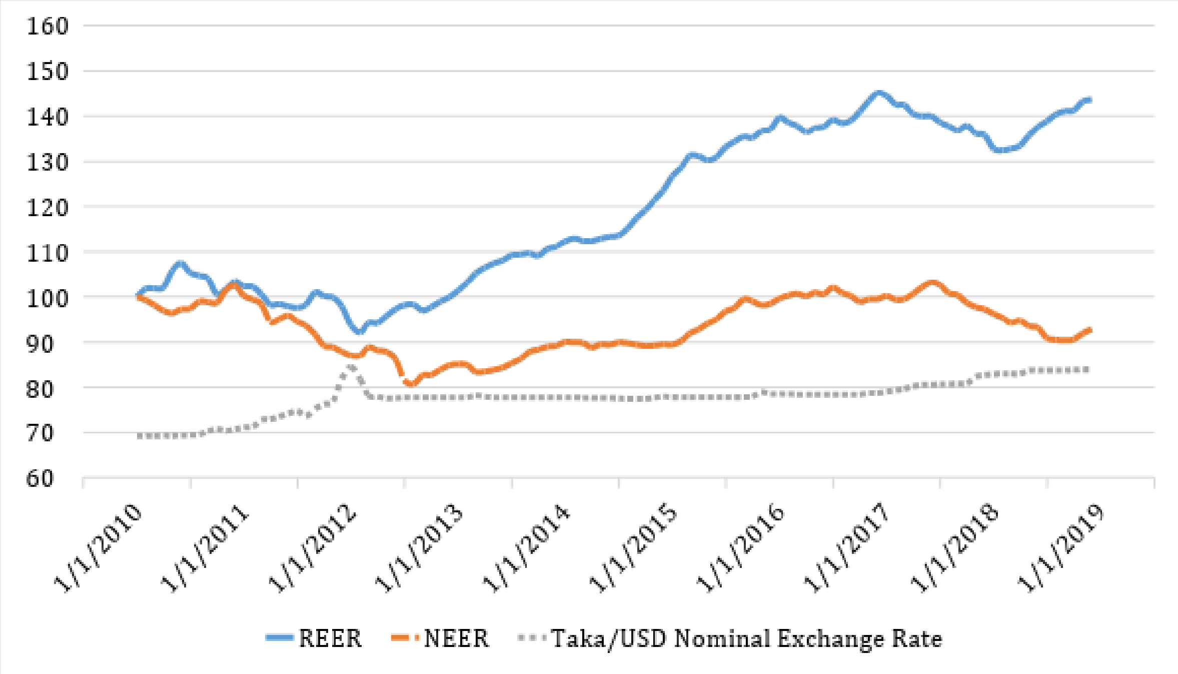
Given the reserves situation[38], the Bangladesh Bank is expected to continue its policy of stabilising the exchange rate through selling of dollars in the market. Bangladeshi Taka (BDT) to dollar exchange rate is currently hovering around USD 1: BDT 83/84 (Figure 6.3). However, in view of the recent overall balance situation, the pressure of debt payment in near-term future and declining purchasing power of reserves (in terms of months of import), central bank's capacity to undertake open market operations to stabilise the exchange rate could weaken. Rising commodity price in the global market could push upward the current low growth rate in import payments experienced in FY2019. From a medium-term perspective, Bangladesh will also need to examine carefully the movement in the nominal exchange rate and the REER and calibrate exchange rate management in line with movements in the REER (Figure 6.3). As relevant literature testifies, exchange rate management must be dictated by the logic of export competitiveness and maintaining macroeconomic stability. A background IRBD paper (Rahman and Al-Hasan, 2019) on the relationship between REER and export performance in Bangladesh also indicates the need to calibrate nominal exchange rate in line with the REER to maintain Bangladesh's export competitiveness.

In writing about real exchange rate, Guzman et al (2018) has argued in favour of pursuing a stable and competitive real exchange rates (SCRER) which require flexible and sustained interventions. This is needed to promote economic development and enhance export diversification, but ought to be pursued in combination and in coordination with a range of other monetary, macro-economic and micro-instruments, including industrial policies.

[37] Growth of remittance flow has been on an increasing trend since the second quarter of FY2018, and it was 17.5 for FY2018.

[38] Reserves have been stalling in the range of USD 32 to 33 billion for the last three fiscal years (FY2016-FY2018). For July-February FY2019, the amount of reserve was USD 32.2 billion.

Figure 6.3: REER, NEER and USD-BDT trends for the period 2010-2018



Source: Bangladesh bank (n.d.) and Darvas (2012).

If 2010 is taken as the base year, as Figure 6.3 shows, there has been a notable rise in the REER (while NEER has risen in a much more subdued way) between 2010 and 2018. This would mean that exports of Bangladesh has become more expensive relative to the country's competitors (whilst imports have become cheaper). As the figure shows, REER of BDT is overvalued and is set to depreciate had there been an open market regime. However, as is known, the central bank has been intervening in an active way, by selling dollars, to arrest significant depreciation of the BDT, in consideration of implications for imports payments and taking into consideration the needs of sound macroeconomic management. As may be seen from the Figure 6. 3, BDT has experienced some depreciation since 2010 and if further adjustments are made in line with REER movement, it may be expected to depreciate further in the foreseeable future. To what extent this will happen is difficult to predict. At present there is a 2-3 taka difference between the official rate and curb market rate. This could give an indication about the extent to which BDT may slide. On the other hand, central bank interventions also have impact on curb market rate. What is important to keep in mind in this connection is the capacity of the central bank to be able to intervene in the forex market particularly in view of the movements in reserve position. With reserves as they are (stalling in recent times), and in view of higher import payments, central bank's capacity to intervene may weaken in the foreseeable future. In this context, BDT may depreciate at a faster pace than has been the case in recent years. In view of this likelihood, it will advisable to go for gradual depreciation of the BDT in keeping with the evolving scenario. However, a lot will depend on the flow of remittances which will have important implications both for forex reserves, and the availability of foreign exchange in the market.

6.4 Assessing the Measures taken by the Current Government to improve the External Sector Performance

Over the past decade, during the tenure of the current government, a number of incentives and measures have been put in place to promote the interests of the export sector. These included: (a) fiscal and other incentives towards market diversification; (b) support for export-oriented investment; (c) fiscal incentives to export-oriented entrepreneurs; (d) policy support through the medium-term Export Policy 2018-2021. Export-oriented sectors and activities have also benefited from duty exemptions and duty waivers on raw materials and intermediate items.

The government has been providing incentives in the range of 2 to 20 per cent of export earnings for 27 items for FY2018 (Bangladesh Bank, 2017). In an effort to diversify products the government had provided new cash incentives for FY2019, to promote nine emerging and new sectors having export potential which includes pharmaceuticals (5 per cent), motorcycles, some chemical products and ceramics (5per cent).

In the Export Policy 2018-2021 (Ministry of Commerce, 2018) the highest priority sector list has been updated with the inclusion of three new sectors – Denim, Active Pharmaceutical Ingredients (API) and Re-agent (shoes made from leather, non-leather and synthetic. This has raised the total number of such sectors to 15. Similarly, five new products that included light engineering products (motor cycle, battery), and toys have been added to the special development-oriented sectors (raising the number from 14 to 19). Besides, new items has been declared as exportables, such as by-product from the wet-blue leather such as wet-blue split leather. The policy mentions pharmaceutical and information technology sectors will be given tax benefits and incentives, as also frozen fish and fish processing industries through tax facilities as export-oriented industries. To facilitate eligibility, local value addition requirement for export-oriented industries has been reduced to 30 percent from the existing 40 percent for most items.

Furthermore, the Export Policy 2018-2021 (Ministry of Commerce, 2018) contains provisions to extend easy term loans and other banking facilities to export-oriented industries from the Export Development Fund (EDF) of the Bangladesh Bank. In this connection, the central bank will set up two new funds: technology development and upgradation fund, and the green fund. Loans will be disbursed from these funds for modernisation and technology upgradation of export-oriented industries.

In a significant move in support of exports, the withholding tax on export earnings was sharply reduced from 0.6 per cent to 0.25 per cent (Table 6.3).[39]

Table 6. 3: Change in policies regarding withholding tax on export earnings

SRO on 5 August 2017	As per the withholding tax rate document applicable for FY2018 (NBR, n.d.a)	SRO on 05 September 2018	SRO on 01 January 2019
0.7 % (except for jute and jute related products)	1% of the total export proceeds of all goods (other than jute goods)	0.6 % (except for jute and jute related products)	0.25 % (except for jute and jute related products)

Source: NBR (n.d.b)

[39] This, however, is not the final settlement.

In the budget speech of FY2019 tax on export earnings for RMG sector was proposed to be increased as per the following:

(a) 12.5 per cent (from 12 per cent) if the company is publicly traded, and 15 per cent (from 12 per cent) otherwise;

(b) 12 per cent for companies with Green Building Certification (from 10 per cent)

However, SRO issued by the NBR on 6 September 2018 has kept the rates as before.

This new tax regime is to remain in force till the next budget which is due in July 2019. Considering the fact that 83 per cent of all exports from Bangladesh comes from ready-made garments (RMG), it is easy to deduce that the greatest beneficiaries of this policy is the RMG exporters. According to CPD estimates, this will result in a revenue loss to the tune of about Tk. 1150 crore of which RMG's gain will be about Tk. 960 crore.

Export Policy 2018-2021 (Ministry of Commerce, 2018) also mentions that the garment sector will be able to send samples worth a maximum of USD 20,000 instead of existing USD 15,000. For FY2019, and the cash incentive for garment exporters in new markets was raised from 3 to 4 per cent.

The Ministry of Commerce had formulated a draft policy titled 'National Active Pharmaceutical Ingredients (API) and Laboratory Reagents Production and Export Policy' in May 2018, to incentivise API production. The policy offered corporate tax holiday facility until 2032 for the API and laboratory reagents manufacturers of the country. The policy aims to reduce raw material import reliance from 97 percent in 2016 to 80 percent in 2032, create 5 lakh jobs by 2032, and encourage entry of new firms in the raw material producing sector and attract USD 1 billion of foreign direct investment.[40] The government has granted 10 percent cash incentive to the ICT industry since FY2018 against exports;[41] it is to be noted that the sector already enjoys tax holiday.

In Export Policy 2018-2021 (Ministry of Commerce, 2018) there are provisions explaining that programmes will be taken to upgrade shoes and leather goods related industries to green standards. Although leather has been declared as a thrust sector, and a number of measures were planned to be undertaken, a lot remains to be done in this context. In the Savar Tannery Industrial Estate (STIE), the central effluent treatment plant (CEPT) is yet to become fully operational and the repair works of the approach roads to the estate are still going on.

Central bonded warehouse was to be set up for storing the raw materials of the leather industries and reducing the lead time. It should be noted that, expansion of bonded warehouse facilities will necessitate raising the efficacy of management and governance in view of the examples of revenue losses and leakages in this connection, experienced in past.

A part of the NBR tax exemptions to the tune of BDT 1.44 trillion over the last four and half years (as reported in Mala, 2019), have benefitted the export-oriented industries. In line with the programme set out in the manifesto, the new government has continued with the initiatives (directly for exports and also tax exemptions on imports). In view of the costs to the economy there is a need to review these measures to (a) examine to what extent these are cost-effective;

[40] However, in December 2018 the NBR informed that it would like to review the feasibility of providing the aforesaid fiscal incentives.
[41] Enterprises exporters situated in economic zones and hi-tech parks will not be eligible for this benefit.

(b) to identify whether some are no more needed; and (c) prepare how the fiscal measures can be made more effective in a time-bound way.

Table 6. 4: Mapping the measures taken in direction to improve the external sector performance with CPD's proposed measures and commitments in the AL Manifesto

CPD proposed measures	Manifesto	Measures taken in this direction
Emphasise export diversification	● Export items will have to be diversified and new markets will have to be tapped in. ● The government's support—such as rebates in tariff, tax and VAT, cash incentives etc. to boost export—will be modified and readjusted after analysing their overall effectiveness as per requirement. Tariff-tax benefits and incentives will get special attention to help flourish knowledge and technology-based industry.	● Export Policy 2018-2021 was published in November 2018 which increased the number of priority sectors to 15 (from 12), and special development sector has been increased from 14 to 19 ● Cash incentive has been increased for garment exporters exporting in the new markets from 3 to 4 per cent (Export Policy 2018-2021) ● 10 per cent cash incentives has been announced to promote emerging and new sectors having export potential ● Withholding tax on export earnings has been decreased from 0.6 to 0.25 per cent on 01 January 2019
Devise sectoral policies, and 75incentives and predictable incentives	● Measures will be taken to resolve sector-wise problems in order to diversify export. ● Improvement and expansion of the garments and textiles sector, ship building industry, leather, toy making, jewellery, furniture, and tourism sectors will get the benefits of this programme ● Pharmaceutical industries and the active pharmaceutical ingredient (API) industries producing pharmaceutical raw materials will be encouraged. ● Providing financial initiatives to the export of jute products as a promising sector and its diversification will be continued.	● 'National Active Pharmaceutical Ingredients (API) and Laboratory Reagents Production and Export Policy' has been formulated in May 2018, to 75incentivise API production. ● 'National Jute Policy 2018' has been published in 2018

Source: Authors' compilation from various sources.

6.5 Proposed Measures in view of Budget FY2020

As the above discussion bears out, the manifesto speaks of high aspirations as regards export sector of the country. Indeed, many initiatives are in place, taken over successive years, to incentivise export sectors and export-oriented industries, as the preceding sections testify. However, in the first hundred days of the present government tangible actions and initiatives which indicated a departure from the business as usual were not visible. On the other hand, attainment of export target of USD 72.0 billion by 2024 and USD 496.8 billion by 2041, creation of ten million jobs in the SEZs, provision of One Stop Service to significantly improve ease of doing business and global competitiveness ranking of Bangladesh call for fast and energetic steps on many fronts.

Firstly, the budget should draw on findings originating from a comprehensive assessment of the effectiveness of the existing fiscal incentives, cost incurred due to incentives and foregone revenues in connection with promoting the export sector. The purpose of this exercise will be to evaluate the cost and benefits and examine whether restructuring of incentives is needed. Many incentives have been in place for many years; on the other hand export-oriented activities with high potentials, in line with investments to be attracted to the SEZs, need to be incentivised with appropriate supportive measures. From this vantage point, such an exercise could be an important first step. Secondly, the budget should provide for adequate support to make the relocated leather hub in Savar. Operationalisation of the CETP and support for environment-friendly production needs to be prioritised to harness the potentials of this highly promising industry. In view of the challenges faced by the sector in marketing its products and in the backdrop of declining exports there is a need for concerted and targetted measures in the budget in support of the sector. Thirdly, the manifesto mentions about support for the pharmaceutical sector and the API Park in this context. However, although the decision was taken in 2008, the progress has been exceptionally slow. Now that some movement is taking place in this context, the budget should make provisions for adequate measures for the API to be up and running. Fourthly, urgent steps must be taken towards framing the rules and regulations to operationalise the One Stop Service Act to incentivise potential export-oriented investors to the SEZs. Fifthly, to take advantage of the potential benefits of initiatives such as BBIN-MVA and BIMSTEC FTA the budget will need to make provisions for investment towards greater trade facilitation for cross-border trade – establishment of single window, ensuring interoperability of system, electronic data exchange etc. Bangladesh is one of the very few countries in the world which does not have bilateral free trade agreement (BFTA), not to speak of bilateral comprehensive economic partnership agreement (CEPA). The budget should allocate adequate resources to strengthen negotiating capacities of concerned institutions to undertake these complex negotiations. Similar is the case as regards the WTO and the budget should foresee strengthening of Bangladesh's negotiating capacity in view of its status as a developing country in the not so distant future.

Surprisingly, the AL Manifesto does not state about specific measures in support of migrant workers and the overseas job market, although soft loan for mainstreaming of returnee migrant and facilitating migration is mentioned. As is known, migrant workers and remittances play an important role in the economy. Budgetary initiatives towards financial inclusion of migrant workers, support for low-cost migration and skills enhancement of migrant workers, through decentralised initiatives, keeping in the purview the evolving demands of the global market, will be needed.

6.6 Concluding Remarks

Bangladesh is set to graduate from the group of LDCs in 2024. CPD (2019a) has carried out in depth study on the possible fall-outs of this in terms of market access and consequent loss of preferences. The projections made in the AL Manifesto needs to be examined in the backdrop of this changing scenario and in the context of the emerging global landscape. The global market scenario is also changing, which will require product diversification into higher quality and fashion and design-driven segment of the demand curve. As our analysis has shown, attaining the targets set out in the manifesto will call for persistent and significantly high growth rates. Bangladesh's LDC graduation challenges will entail formidable challenges in future, particularly in view of preference erosion. As our analyses have shown, the external sector balances will be under increasing pressure in the coming days because of several reasons. In view of this, renewed efforts will be required to enhance export and remittance earnings, maintain competitive exchange rate and robust reserves and to continue with the current impressive debt servicing record.

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SECTION VII: CONCLUDING REMARKS

This report has attempted to analyse the trends of a few selected sectors of the economy during the first 100 days of the newly elected government. The report has also examined if the measures announced or taken by the government in the first 100 days are aligned with the pledges made in the election manifesto of the ruling party. Additionally, keeping in view the upcoming budget for FY2019-20, this exercise has made a number of recommendations for the government to consider.

This exercise also reflects on the initial signals with regard to some critical issues such as quality of growth, employment generation, resource mobilisation, public expenditure, private investment, governance in the banking sector and managing a balanced external sector. Furthermore, the report seeks to interpret the implications of the changes in these areas for the economic growth prospects of Bangladesh.

7.1 Economic growth

With the expected growth rate of over 8 per cent in FY2019, Bangladesh is now recognised as one of the fastest growing economies in the world. While this growth is driven mainly by the manufacturing sector, which has the potential to create jobs, incremental private investment seems to have contributed insignificantly to economic performance. The robustness of the GDP growth estimate has to be examined from the perspective of a number of proxy variables, including tax collection, private sector credit, agricultural credit and growth in some major manufacturing industries. Such an examination of the interface of a number of macroeconomic correlates reveals some inconsistencies, leading one to believe that further scrutiny of the robustness of the estimate may be required. One expects that BBS will have satisfactory explanation to justify the final GDP growth estimate.

The other issue related to growth is its ability to create employment and distributional justice. During 2010-2017, Bangladesh's economic growth has been relatively less employment generating. On the other hand, while economic growth has been mostly driven by productivity of labour, the benefits of growth are likely to be mostly reaped by the owners of capital within the economy. Depleting contribution of demographic dividend to growth is also a major concern.

7.2 Public finance

Major trends in public finance indicate that ADP implementation has slightly improved compared to the previous fiscal year, mainly due to higher spending on foreign aided projects. However, in order to continue the growth momentum, efficiency of public expenditure is essential. The proposed 'single budget' mechanism of the government is proposed with an expectation that it will contribute to enhance efficacy of public expenditure and improve the delivery capacity of public administration. There is also a need for balancing public expenditure among economic and social sectors. Though public expenditure on infrastructure has increased to a great extent, health and education sectors receive much less than what is suggested in the 7FYP. Another challenge that the government has to tackle is reducing reliance on NSD certificates, which are proving to be a costly method for meeting the budget deficit.

The capacity to revenue mobilisation has not improved during the current fiscal year. There may be a shortfall of Tk 85,000 crores in case of revenue mobilisation in FY2019. The upcoming budget is a unique opportunity for the government to initiate much–needed policy reforms in the area of public finance management given that the upcoming national budget is the first from the incumbent government's current term. Such initiatives may prove difficult to implement in later years. Implementation of the new VAT law, automation in VAT collection process, creation of a timeline for completion of Customs Act and Direct Tax Act and introduction of progressive taxation, such as wealth and property tax and inheritance tax may be conducive for generating additional revenue. These initiatives would also contribute towards building a more equitable society.

7.3 Private investment

Private investment in FY2019 has maintained 'business as usual' trend with a private investment-GDP ratio hovering at around 23 per cent. Despite attempts to attract FDI, overall FDI inflow has increased only at a modest pace. Although registration of new FDI projects has increased over the years, the gap between registration and realised FDI flow remained significantly high. Capital market remained in a weak state over the last decade and failed to emerge as an alternate source for financing industries. The number of new companies which were listed in the stock markets to raise equity has been on the decline. Poor flow of private investment was observed due to lack of appropriate policies, weak institutional capacities related to industries, lack of progress in delivering services by new institutions, unavailability of full-packaged infrastructure facility, rising cost of doing business, and weak enforcement of business related rules.

During the first 100 days of the government, the majority of the steps announced or considered were related to investment promotion and facilitation, such as infrastructure development, reducing bureaucratic bottlenecks, offering fiscal benefits and raising Bangladesh's demand in the international platform. Although entrepreneurship development received priority in the election manifesto, till date only continuation of previous initiatives have been noticed. Two of the least addressed areas of activities of the government are: a) devising sectoral policies, and targeted and predictable incentives and b) initiating regulatory and institutional reforms to ensure rule of law which will create an enabling business environment. Special attention is needed in the upcoming national budget for FY2020 on these issues: a) sectoral polices and targeted and predictable incentives; b) well-packaged infrastructural facilities for different categories of enterprises; and c) regulatory and institutional reforms to ensure rule of law.

7.4 Banking sector

The 2018 election manifesto published by the ruling party contains a number of pledges pertinent to the banking sector. These included pledges intended to reduce the amount of NPLs, as well as forward-looking initiatives for improving the efficiency of the banking sector, increasing access to finance and accelerating technology adoption. In the first 100 days of the ongoing third term of the current government, very few concrete steps were taken in line with the election manifesto pledges, although several measures have been considered.

Overall, the pledges in the election manifesto do address some of the major issues affecting the banking sector. However, some of the practices and provisions such as awarding licenses to new banks, removing the single borrower exposure limit, which prohibits banks from lending more than 35 per cent of their total capital to a single borrower and new facility to the bank defaults in terms of getting an additional six months time before their defaulted loans get recognized, are not helpful for improving the bank default situation in the country.

Reform in the banking sector is an unfinished agenda as the banking sector suffers from several acute problems due to poor governance for a prolonged period of time. Consequently, the newly elected government is required to deal with the problems of the sector in an uncompromising manner, and fulfil its promises for reforms in the financial sector. In this context, setting up of a Banking Commission can be reiterated once again. The upcoming budget should allocate adequate funds for setting up an independent banking commission. CPD has been continuously urging for such an independent commission in view of addressing emerging challenges in the sector. The commission will critically assess problems and weaknesses of the sector and suggest concrete recommendations for improving the performance of the banking sector.

7.5 External sector

Managing the external sector during the period of emerging tensions globally will be a challenging task. The AL election manifesto refers to a number of specific policy initiatives to be pursued by the government to boost up the external sector. Some of these include export diversification, tapping of new markets, and provision of various government support, such as rebates in tariff, tax, VAT and cash incentives. Tariff-tax benefits and incentives will get special attention to help flourish knowledge and technology-based industry. The election manifesto of the ruling party also pledged to encourage pharmaceutical industries and industries producing pharmaceutical raw materials. They promised to continue to provide financial incentives for the export of jute products. Export of IT software, services and digital equipment was targeted to be increased to USD 7 billion. The manifesto mentions about deepening regional cooperation and regional connectivity, establishing 89 economic zones and strengthening of BEZA and BIDA.

The manifesto speaks of high aspirations as regards the export sector of the country. Many initiatives are in place, taken over successive years, to incentivise export sectors and export-oriented industries. However, in the first 100 days of the present government tangible actions and initiatives which are different from the business as usual were not visible. Indeed, implementation of these measures calls for fast and energetic steps on many fronts. In the backdrop of Bangladesh's graduation from the LDC status and in the context of the emerging global landscape, product diversification will have to be combined with higher quality. In order to deal with the pressure on the external sector due to preference erosion as a result of Bangladesh's LDC graduation, efforts will be required to enhance export and remittance earnings, maintain competitive exchange rate and robust reserves and continue with the current impressive debt servicing record.