April 2019

Bangladesh Development Update

Towards regulatory predictability

THE WORLD BANK
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BANGLADESH DEVELOPMENT UPDATE

Towards Regulatory Predictability

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Preface

This report provides an assessment of the state of the Bangladesh economy, outlook, risks, and the key reform challenges the economy is currently facing. The coverage includes developments in the real sector focusing on growth and its components; inflation; monetary and financial sector developments; external sector developments focusing on the balance of payments, foreign exchange reserves and the exchange rate; and fiscal developments focusing on revenue mobilization, public expenditures, and deficit financing. The special focus in this update is on regulatory predictability based on an analysis of firm level survey data.

Acknowledgements

This report was prepared by a team comprising of Zahid Hussain (Lead Economist), Syed Akhtar Mahmood (Lead Private Sector Specialist), Nazmus Sadat Khan (Economist), Afroza Alam (Research Analyst) and Shegufta Shahriar (Team Associate). A. K. M. Abdullah (Senior Financial Sector Specialist) made valuable contribution on Financial Sector. Miah Rahmat Ali and Stephen Rimmer provided inputs to the section on regulatory predictability. Mona Prasad (Lead Economist) and Christian Eigen-Zucchi (Program Leader) provided extremely valuable comments on the full report. Catherine Masinde, Practice Manager, Global Business Regulations Unit (GMTBR) provided guidance on the section on regulatory predictability. Manuela Francisco (Practice Manager) provided overall guidance in the preparation of the report.

Abbreviations

ADP	Annual Development Program
ADR	Advance-Deposit Ratio
ALM	Asset Liability Management
AML/CFT	Anti-Money Laundering and Countering Financing of Terrorism
B2G	Business-to-Government
BAB	Bangladesh Association of Bankers
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladeshi Taka
BIDA	Bangladesh Investment Development Authority
BOP	Balance of Payment
BPC	Bangladesh Petroleum Corporation
BSC	Bangladesh Shipping Corporation
BUILD	Business Initiative Leading Development
CCI&E	Chief Controller of Imports and Exports
CEO	Chief Executive Officers
CETP	Central Effluent Treatment Plant
CIB	Credit Information Bureau
CPD	Centre for Policy Dialogue
CRAR	Capital to Risk Weighted Asset Ratio
CRMG	Comprehensive Risk Management Guideline
CRR	Cash Reserve Ratio
DAE	Department of Agricultural Extension
DB	Doing Business
DNS	Directorate of National Savings
DPP	Development Project Proposal
DSEX	Dhaka Stock Exchange
DTF	Distance to Frontier
ECNEC	Executive Committee of the National Economic Council
EMDE	Emerging Market and Developing Economies
EPZ	Export Processing Zone
EU	European Union
FAO	Food and Agricultural Organization
FDI	Foreign Direct Investment
FY	Fiscal Year
GBD	Global Burden of Disease
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GNFS	Goods and Non-Factor Services
GW	Gigawatt
HCI	Human Capital Index
HIC	Higher Income Country
ICT	Information and Communications Technology
IMED	Implementation Monitoring and Evaluation Division

IMF	International Monetary Fund
IPOs	Initial Public Offerings
IT	Information Technology
kWh	Kilowatt Hour
LC	Letter of Credit
LNG	Liquefied Natural Gas
LPI	Logistics Performance Index
LTU	Large Taxpayers Unit
M&E	Monitoring & Evaluation
MLT	Medium and Long Term
MPS	Monitory Policy Statement
MT	Metric Ton
MW	Megawatts
NBR	National Board of Revenue
NEET	Not in Employment, Education or Training
NGOs	Non-Governmental Organizations
NPL	Non-Performing Loan
NSC	National Savings Certificate
NSD	National Savings Directorate
NSW	National Single Window
OECD	Organization for Economic Co-operation and Development
OSS	One Stop Shop
PCB	Private Commercial Banks
PFM	Public Financial Management
PIM	Public Investment Management
PMO	Prime Minister's Office
QIIP	Quantum Index of Industrial Production
REER	Real Effective Exchange Rate
RIA	Regulatory Impact Assessments
RMG	Ready-made garments
SBW	Special Bonded Warehouse
SCB	State-owned Commercial Bank
SD	Supplementary Duty
SDBs	Specialized Development Banks
SDGs	Sustainable Development Goals
SLR	Statutory Liquidity Ratio
SOE	State Owned Enterprise
SRO	Statutory Regulatory Order
T&D	Transmission and Distribution
T-bills	Treasury Bills
TVET	Technical and Vocational Education and Training
UMIC	Upper Middle-Income Country
VAT	Value Added Tax
WBG	World Bank Group
WEF	World Economic Forum
WHO	World Health Organization

Executive Summary

Bangladesh has maintained its robust growth performance. Exports and remittances have been buoyant. Agriculture had bumper harvests. Overall inflation has slowed as decelerating food inflation offset a pickup in non-food inflation. Monetary expansion has been short of target as private sector credit growth slowed and the Bangladesh Bank siphoned off banking liquidity by selling dollars to defend the taka. Vulnerabilities in the banking system and capital market persisted. Higher export and lower import growth reduced the current account deficit, but a decline in the financial account surplus diluted the impact of the current account deficit decline on the overall balance of payments deficit. The budget deficit increased in FY18 but remained below the 5 percent of GDP target. Low revenue collection continues to be a major challenge as policy and administrative reforms have stalled and, in some instances, reversed. Key structural reform challenges are to mitigate the financial sector vulnerabilities, strengthen revenue mobilization, manage public investments better, meet the infrastructure gap, enhance human capital and streamline business regulation. Addressing these reform challenges will be critical for reinforcing future productivity growth.

The Bangladesh economy continues to grow at an impressive rate. On the supply side, the growth is being driven by manufacturing and construction. Rapid growth of electricity generation appears to have energized the urban formal and rural non-farm economy. Bumper crop harvests helped further. On the demand side, private consumption has remained strong, underpinned by strong remittance and rural income growth. In addition, exports growth has accelerated, benefiting from the US-China trade dispute while import growth has decelerated.

Slowing food inflation has reduced headline inflation. Core inflation has been trending upwards, driven by aggregate demand expansion and high inflationary expectations, notwithstanding contractionary monetary outcomes. Domestic monetary management has been constrained by dollar liquidity support provided by the Bangladesh Bank (BB) in the foreign exchange market. BB did well in keeping the key monetary and credit aggregates in line with the path indicated in their Monetary Policy Statement for the first half of FY19.

The growth of bank credit to the private sector has slowed in line with slower growth in deposits. Banking regulation and supervision have been ineffective due to lack of enforcement and regulatory independence. High nonperforming loans (NPLs) compounded by an eroding capital base continue to pose financial stability risks. Interest rates have tended upwards with the tightening of availability of loanable funds. Corporate governance weaknesses, especially at state-owned banks, and legal complexities in contract enforcement are adversely affecting the ability of banks to improve risk management and loan recovery. This is limiting the expansion of access to and usage of financial services.

Pressure on the exchange rate induced sustained BB intervention. A significant reduction in trade deficit due to an acceleration in export and easing of import growth, together with strong remittances, have narrowed the current account deficit. However, a decline in the financial account surplus because of increased trade credit and outflows due to banking transactions diluted the impact of lower current account deficit on the deficit in the balance of payments before reserve changes. This led to continued pressure on the official foreign exchange reserves as the BB intervened in the foreign exchange market by selling over $1.8 billion in the first nine months

of FY19 to moderate the depreciation of the taka against the US dollars. With the US dollar gaining strength in international markets, there was a nominal appreciation of the taka against the euro and the pound-sterling in FY19. Real effective exchange rate has appreciated further both because of nominal exchange rate appreciation against other trading partners as well as higher domestic inflation relative to the trading partners.

The fiscal deficit has increased but remains well within sustainable thresholds. Domestic financing of the deficit has begun to shift towards less expensive sources with restraints on sales of National Saving Certificates (NSCs). Maintenance of a prudent cap on budget deficits have helped management of inflation and avoid crowding out of credit to the private sector. Tax revenue mobilization has slipped, reflecting the impact of several ad hoc tax cuts and exemptions as well as slow progress in the automation of administrative processes. Increased subsidies to exports and energy have increased recurrent spending and a rush of new development projects in the Annual Development Program (ADP) added more pressure. Low revenues have shrunk the fiscal space for meeting the spending gaps in infrastructure, health, education and social protection.

Bangladesh is poised to maintain 7 percent plus growth in the medium-term. Domestic demand growth is strong with private investments set to gain some momentum from dissipation of political uncertainties and the implementation of reforms aimed at lowering the cost of doing business. With actual output exceeding the potential in the short-term, macroeconomic stability may be tested. Coupled with elevated global risks, this reinforces the need for accelerated structural reforms to increase potential output and build fiscal and external buffers.

The new cabinet faces several short and long-term development challenges. An immediate challenge is to address the banking sector vulnerabilities, revenue shortfall and pressure on foreign exchange reserves. At the same time, there is the need to prepare for tighter external financing conditions in the near and medium-term. These will have to be complemented with reforms to improve infrastructure, boost human capital and make business regulation less onerous and more predictable.

- The banking sector governance reforms require (i) ensuring true autonomy of BB, including full oversight and enforcement powers on the state-owned banks; (ii) more clarity on the government's long-term goals, the mandates and objectives of the state-owned banks to improve corporate governance arrangements and strengthen the capacity of the Financial Institutions Division (FID) to act as owner; (iii) decrease reliance and restructure the National Savings Certificates (NSCs) to allow capital markets development.

- Key fiscal issues include low revenue mobilization and a taxation structure still too dependent on indirect taxes, especially trade taxation. Equally important will be addressing the bottlenecks in public financial management as envisaged in the government's Public Financial Management Action Plan 2016-21. Better use of assets invested in SOEs and SCBs promises large gains.

- Narrowing the infrastructure gap requires not only more spending, but also improving the maintenance of existing assets. The infrastructure challenge, in key sectors such as transport

and energy, can be addressed by adopting a comprehensive infrastructure financing strategy based on a combination of tax funding, partnership with the private sector and cost recovery. Structural issues around bankability, coupled with near-term challenges, may hold back private sector participation.

- A growing and youthful workforce in Bangladesh provides a time-bound window of opportunity to improve productivity and accelerate economic growth. Weak learning outcomes across the education system translate into a failure to realize fully the potential of human capital. Equipping the young generation with the skills needed for productive jobs remains crucial. To expand individuals' potential, a coherent skills development strategy across the different learning environments and schooling stages is imperative.

- Improving the ease of doing business could reduce informality by reducing the cost of entry and operating in the formal sector. Measures to reduce the time, cost, and complexity of registration, coupled with high quality public services as well as enhanced monitoring and enforcement, would improve the business climate and foster growth. These require designing comprehensive policies, including streamlining tax codes, easing firm and labor regulations to create a level playing field for both formal and informal participants, and expanding access to finance and public services to help increase productivity in the informal sector.

- Businesses face regulatory uncertainty on many fronts. A multi-pronged approach is needed to reduce regulatory uncertainty including high-level actions on systemic reforms accompanied by additional, more specific reforms. Bangladesh's regulatory system needs the establishment of a technical regulatory oversight body at the center of government to oversee, lead and report on regulatory reforms. Specific actions include introducing regulatory impact assessments, holding structured and inclusive consultations on draft laws and regulations, reviewing existing laws and regulations to identify gaps, inconsistencies and redundancies, publishing immediately all Statutory Regulatory Orders (SROs) through widely-accessible means, and introduction of business-to-government feedback loops on regulatory service quality.

This report focuses especially on the issue of regulatory predictability based on a survey of sample of businesses operating in Bangladesh.

Recent Economic Developments

Strong and steady economic growth

The economy continues to grow at an impressive 7 plus percent rate. On the supply side, the growth is driven by manufacturing and construction. Bumper crop harvests helped further. On the demand side, private consumption has remained strong, underpinned by strong remittance and rural income growth, while exports growth has accelerated and import growth weakened. Private investments have remained subdued.

Agriculture is performing well helped by benign weather conditions. Aman, the second biggest crop out of the three rice crops produced in a year, had a bumper harvest in 2018. Aman output, which typically accounts for 40 percent of annual rice production, is estimated to rise to 14.1 million metric tons (MT) in FY19, compared with 13.5 million MT last season, according to the Bangladesh Bureau of Statistics (BBS). More than 5.65 million hectares of land were brought under aman cultivation, which is 3.5 percent higher than last year, induced by remunerative producer prices at planting time. The Department of Agricultural Extension (DAE) estimated that aus production (the smallest of the three rice crops) increased 7 percent in 2018 from that a year ago. The Food and Agricultural Organization (FAO) has projected paddy output to rise to 53.6 million MT in 2018, higher than the five-year average of 51.7 million MT, because of higher plantings by growers and favorable weather. Maize production is also estimated to have increased 6 percent to 3.7 million MT in 2018. In contrast, wheat production is likely to have dropped to 1.3 million MT, slightly below the 5-year average due to contraction in acreage. In FY18, the agriculture sector grew at a solid rate of 4.2 percent, an improvement from 3 percent growth in FY17.

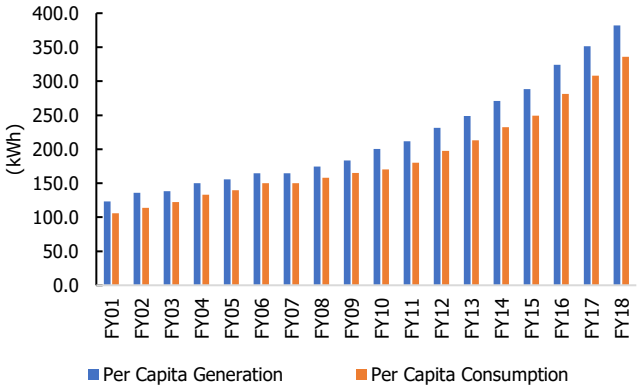
Rice import data corroborate bumper harvests. Imports of rice and wheat were 24.87 lakh metric tons during July-November 2018, a reduction of 42 percent from the same period of the previous year. Procurement of rice during this period was 8.46 lakh metric ton, significantly higher than the 3,10,000 metric ton recorded in the previous year for the same period. The government-re-imposed 28 percent import duty in July 2018 (25 percent customs duty and 3 percent regulatory duty) to support local farmers after it had been slashed earlier in 2017.

Industrial growth remained buoyant. The Quantum Index of Industrial Production (QIIP) increased by 18.5 percent in July-October 2018 relative to the same period the previous year, driven by 24.5 percent in growth of textiles which carries a 34.8 percent weight in the composite QIP. Pharmaceuticals, non-metallic minerals, leather and chemical products, which together account for 24 percent of the QIP, also had decent double-digit growth in July-October 2018. This performance follows the 12.1 percent industrial growth achieved in FY18, led by growth in the large and medium scale manufacturing. Growth in the small-scale manufacturing, however, has been subdued. Constructions appears to be growing strongly in FY19, as indicated by the rise in imports of iron, steel, base metal and capital machinery increasing by more than 13 percent during the first half of FY19. The construction sector is playing an increasingly strong role in the

economy amid continued urbanization and an array of large infrastructure projects undertaken by the government.

A further easing of electricity constraint has stimulated manufacturing. Growth in electricity generation appears to have been a critical factor in sustaining the industrial expansion. Installed capacity was 18,275 megawatts (MW) in November 2018, with peak production for the year at 11,623 MW. Within eight years, the real capacity increased by a factor of 3.3, and energy served, or actual energy generation more than doubled over the past decade. [1]Another significant achievement has been the successful cross border electricity trade with India.

Figure 1:Per Capita Electricity Generation and Consumption (kWh)



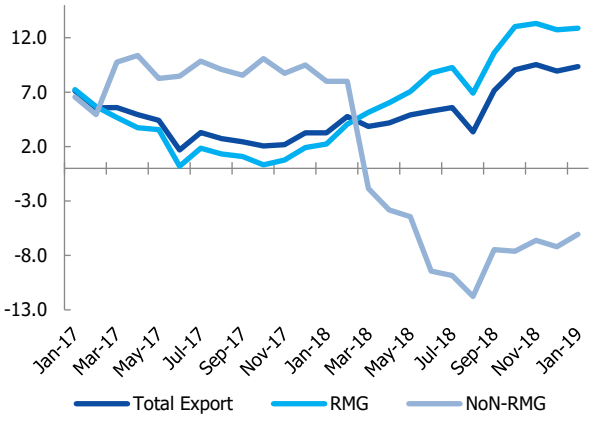
Source: Bangladesh Power Development Board (Annual Report 2017-2018)

Export growth has picked up. After a modest 5.3 percent expansion in FY18, cumulative export earnings in the first seven months of FY19 surged to $24.2 billion, an impressive 13.4 percent increase from the same period of the previous year. This reflects 14.5 percent growth in ready-made garments (RMG) and 8 percent growth in non-RMG exports, rebounding from a 9.5 percent decline in FY18. Strong US economic growth and the US-China trade dispute have played a role in this growth. Export to US markets rose by 17.4 percent, compared with only 1.4 percent growth during the same period last fiscal year. Exports to China grew by 30.3 percent, compared 27.2 percent decline during the same period last year. Growth was led by exports of agricultural products, pharmaceuticals, plastic products and home textile. However, leather and leather goods, the second largest source of export earnings, declined 5.4 percent.

[1] During the same period the per capita electricity consumption almost doubled, from 165 kWh to 308 kWh in FY17 (Figure-1). Electricity access also increased considerably - from 54 percent of the population benefiting from electricity coverage in 2009 to 90 percent currently. Good progress was also made in reducing system losses (transmission and distribution (T&D)), from 17 percent to 12 percent.

Export product diversification remains a challenge, notwithstanding improved outcomes so far this year. The RMG sector currently accounts for 83.5 percent of total exports. Exports of leather and leather goods have been above the $1 billion mark for the past five years but stagnated. The shifting of tanneries from Hazaribagh in Dhaka to Savar on the outskirts, the delay in the construction of the Central Effluent Treatment Plant (CETP) and other administrative complications have hampered competitiveness of the sector. Given the availability of raw leather in Bangladesh, however, the potential in this sector remains substantial. Currently, more than half of the finished leather produced locally is exported instead of used in the production of higher value-added leather goods. Raw jute and jute goods, another major contributor to non-RMG export earnings, also failed to perform well recently, declining by double digits in the first five months of FY19. Decline in demand for jute and jute goods from Turkey, USA, China, India and some African countries due to increased tariffs and the real appreciation of the taka contributed to decline in jute exports. [2]

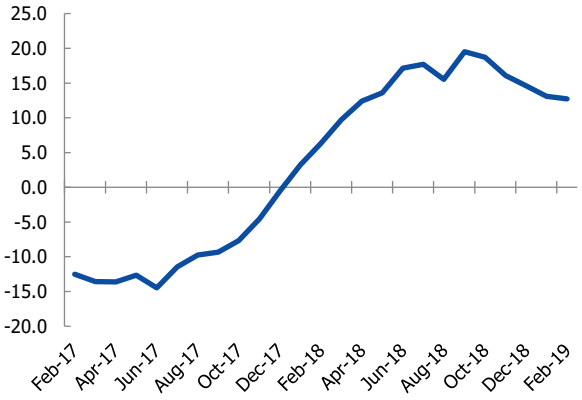
Figure 2: Exports, RMG, and Non RMG Growth (Twelve Months Moving Average, percent)



Source: Export Promotion Bureau

Aggregate demand was stimulated by strong remittances and gains in net exports. Officially recorded remittances in the first eight months of this fiscal year reached $10.4 billion, an increase of 10 percent from the same period of the previous year. Remittance from Gulf Cooperation Council (GCC) countries during this period rose 15.1 percent. Remittances from Saudi Arabia, the main source for Bangladesh, increased by 20.9 percent and accounted for over a third of the total increase in remittances during the first eight months of FY19. Remittance from the USA, however, declined by 8.1 percent. The larger stock of Bangladeshis working abroad, the national election, strengthened surveillance against hundi informal channels and a depreciating currency against the US dollar are likely to have contributed to the increase in officially recorded remittances. Even if remittances in the remaining four months of FY19 are only 90 percent of the remittances received in the last four

Figure 3: Remittance Growth (Twelve Months Moving Average, percent)



Source: Bangladesh Bank

[2] The reason jute exports may have been adversely affected by real appreciation has to do with higher price elasticities which for jute are higher.

months of FY18, Bangladesh will have achieved an historic high on the size of annual remittances.[3]

Net exports have been negative in the national income accounts but narrowed by $1.7 billion in the first half of FY19. This reflects the combined effect of accelerated export growth, mentioned above, and slower import growth. Following a staggering 25.2 percent increase in FY18, total merchandise import in the seven months of FY19 stood at $33.5 billion, only a 7.4 percent higher than the same period of the previous year. This is mostly driven by a 14.1 percent rise in iron, steel and other base metals imports. Implementation of several mega projects including the Padma Bridge led to the rise in imports of these goods.

Private investment remains subdued. Foreign Direct Investment (FDI) remains low at less than 1 percent of GDP. Net FDI inflow amounted to $910 million in the first half of FY19, compared with $823 million in the first half of FY18. The rise in production costs in China and other emerging economies could induce some industrial relocation if the domestic investment environment is hospitable enough For Bangladesh to be an attractive destination for these industries, it is imperative that land, electricity and gas and skilled human resource be available. In addition, it will be important to simplify the tax structure and the process for starting a business and repatriating profits. Foreign firms also consider changes in energy prices, limitations in the governance framework, risks of cyber-attacks, skills shortages as the key impediments to investment in Bangladesh (WEF 2018). Domestic private investors also appear to be shying away as indicated by the 5 percent decline in Letters of Credit (LC) settlement and 27.6 percent decline in LC opening for the import of capital machinery in the first half of FY19. Also, the share of machinery in total imports for leading industries such as textiles, garments, pharmaceuticals, packing and leather has been declining, reaching 31.8 percent in July-November 2018 from 55.6 percent in FY09.

Despite robust growth, the labor market situation remains largely unchanged. According to the latest *'Asia-Pacific Employment and Social Outlook'* report, the labor force participation rate and employment to population ratio, have both declined during the period 2010-2017. Bangladesh has one of the highest youth unemployment rates, which increased by 6.4 percentage point during the same period. The difference between male and female is large. Female youth not in employment, education or training (NEET) as a percentage of the youth population is more than four times that of the male youth population. According to the report, 35 percent of women and 57 percent of men consider it unacceptable for women to have paid work outside of home. Those with higher education are not much better off. The unemployment rate among youth with a tertiary level degree is 10.7 percent, second highest among all the 27 countries in the sample.[4] Finally, the quality of jobs is also low. According to the report, the share of vulnerable employment and informal employment in total employment is above 55 percent and 80 percent respectively, again one of the highest in the sample.

[3] The highest ever received annually was in FY15 when total remittances received exceeded $15.3 billion.
[4] For further analysis on unemployment based on gender, age and level of education, see ILO (2018).

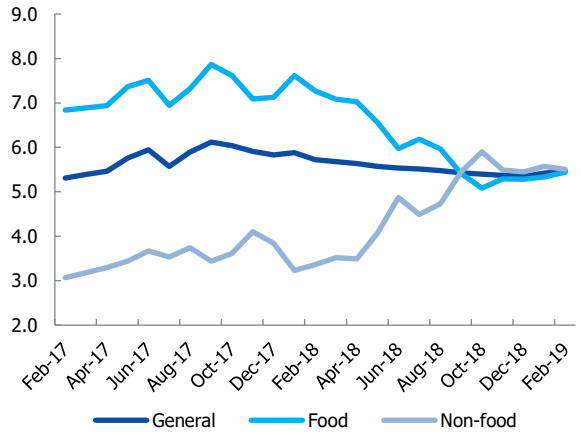
Headline inflation has moderated

Slowing food inflation has reduced headline inflation, but core inflation has been trending upwards, driven by aggregate demand expansion and high inflationary expectations, notwithstanding contractionary monetary outcomes. Domestic monetary management has been constrained by the Central Bank of Bangladesh efforts to support dollar liquidity in the foreign exchange market.

Headline inflation abated in the first half of FY19. Inflation peaked in September 2017 when food inflation reached 7.9 percent, a level not seen since July 2014 (Figure-4). Since then the general index for inflation has been on a decelerating trend mostly due to slowing of food price increases. From 6.1 percent in September 2017, overall inflation eased to 5.5 percent in February 2019, declining almost every month subsequently, except in January-February 2019. The deceleration was driven by food inflation which slowed to 5.4 percent.

Non-food inflation has picked up. It gained every month for the first ten months of 2018 and stood at 5.5 percent in February 2019. Increasing transport costs and buoyant domestic demand played an important role in the price rises.[5] Among the non-food items, price hikes for clothing and footwear are noteworthy. From as low as 2.2 percent at the beginning of FY18, the inflation rate in this category jumped to 6.9 percent in January 2019. This is the only category which is currently experiencing a double-digit inflation rate. Medical and health care costs are also currently on an accelerating trend. On the other hand, inflation related to recreation, entertainment, education and cultural services slowed sharply in 2018 (from 6.2 percent in December 2017 to 0.9 percent in December 2018).

Figure 4: Inflation (Base:2005-06, y-o-y, percent)



Source: Bangladesh Bureau of Statistics

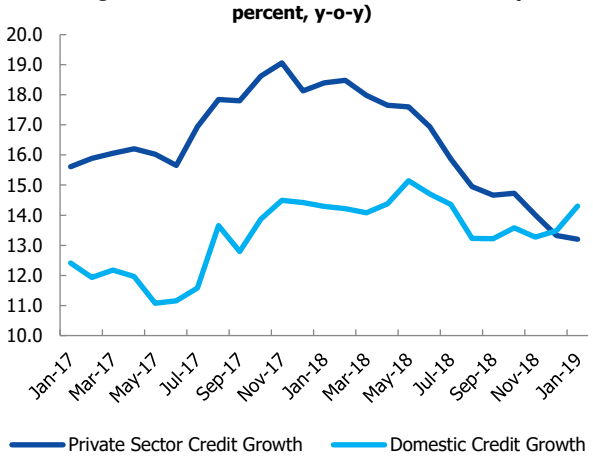
The gap between rural and urban inflation has been narrowing in the last three years. Overall rural and urban inflation currently stands at 5.1 percent and 5.8 percent respectively. In FY16, they were 5.3 percent and 7.1 percent. The difference in inflation between rural and urban areas has been most prominent in non-food items. In the first eight months of FY19, non-food inflation (y-o-y) moved up by 0.1 percentage points in rural areas whereas in urban areas the increase was 1.4 percentage point.[6]

[5] Inflation in the transport and communication category rose to 7.7 percent (y-o-y) in February 2019, compared with 3.3 percent in February 2018.

[6] The concentration of wealth creation has been in the urban areas mostly. With the rise of the rich, consumption pattern shifted more towards non-food items, causing the demands for these goods to rise. This can be one explanation of the divergence.

Monetary outcomes have been contractionary. Broad money has been on a low growth trajectory of late, increasing by 10.2 percent year-on-year in January 2019, lower than the BB's target of 12 percent for FY19. Growth of credit to the private sector slowed to 13.2 percent (below the growth ceiling of 16.8 percent initially set by the BB for FY19) at the end of January 2019. Domestic credit growth stood at 14.3 percent (Figure-5), lower than the FY18 growth rate of 14.7 percent and the BB's FY19 target of 15.9 percent. Due to the increased sale of USD to keep the exchange rate stable, net foreign assets declined by 1.4 percent through January from a double-digit growth rate just two years ago. The liquidity released when the BB in April 2018 reduced the Cash Reserve Ratio (CRR) by 100 basis points to 5.5 percent and repo rates by 75 basis points to 6 percent have been siphoned off by the BB's foreign exchange market interventions. Moreover, to ease tightening liquidity conditions, the BB increased available repo tenors to 7, 14 and 28 days. Under the term repos, banks can now borrow from the BB for a longer period through an auction process by bidding at rates higher than 6 percent.

Figure 5: Private and Domestic Credit Growth (percent, y-o-y)



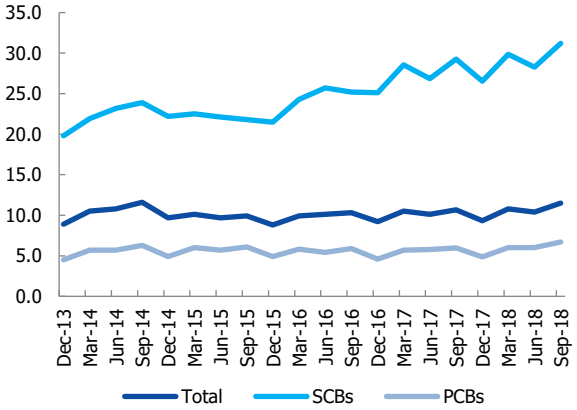
Source: Bangladesh Bank

Financial sector yet to turnaround

Growth in bank credit has moderated. Banking regulation and supervision have not been effective due to lack of enforcement and limited BB independence. High nonperforming loans (NPLs) compounded by an eroding capital base pose financial stability risks. Corporate governance weaknesses, especially at state-owned banks, and legal complexities in contract enforcement are adversely affecting the banking sector. This is limiting the expansion of access to and usage of financial services.

Credit growth has moderated and non-performing loans (NPLs) continue to rise. The asset size of the scheduled banks increased to BDT 14,004 billion at the end of FY18 from BDT 13,326 billion at the end of March 2018, with private commercial banks (PCB) holding over 65 percent of assets. However, total assets declined as a percentage of GDP from 67.4 percent in FY17 to 62.2 percent in FY18. The Advance-Deposit Ratio (ADR) increased from 73.9 percent in June 2017 to 76.7 percent in June 2018, remaining well below the macro-

Figure 6: NPL as percent of Outstanding Loan

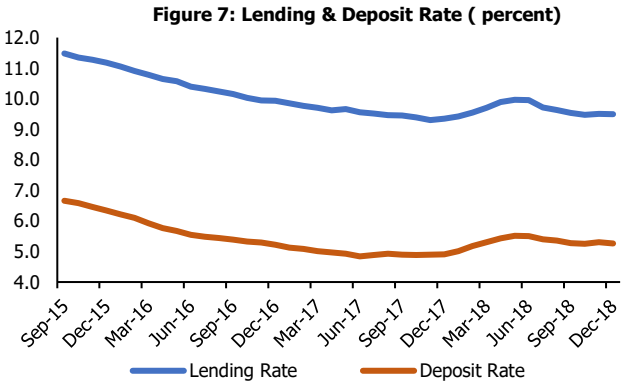


Source: Bangladesh Bank

prudential limit of 83.5 percent.[7] The NPLs at the end of FY17 was BDT 743 billion. It reached BDT 939.1 billion by the end of 2018 (Figure 6). The gross NPLs accounted for 10.4 percent of the outstanding loans from the banking sector at the end of FY18 and increased to 10.3 percent in December 2018 from 9.3 percent in December 2017. The 26.4 percent growth in NPLs in 2018 has been the highest increase in the last five years. NPL's are not evenly distributed among banks. Five banks are responsible for almost half of the total NPLs. NPLs of State-owned Commercial Banks (SCBs) is 31 percent and State-owned Development Banks (SDBs) 22 percent. Directed lending, poor risk management, and weak corporate governance lead to the rise in NPL. The practice of loan rescheduling and write-offs also increased, creating further stress on banks. BB approved loan rescheduling of BDT 191 billion in 2017 and BDT 200 billion in 2018. Notably, the NPLs are increasing despite these wholesale approvals of loan rescheduling.

Meanwhile, in a bid to address write-off and NPL issues the BB issued a circular on February 6, 2019 allowing banks to (i) write-off loans that remain classified as bad debt for three years instead of the previous five years, subject to full provisioning; (ii) write-off bad loans up to BDT 200,000 without filing any law-suit instead of the previous threshold of Tk 50,000; and (iii) write-off loans without keeping 100 percent provisions. This is expected to clean balance sheets but may send the wrong signals to the defaulting borrowers and could result in weaker NPL collection efforts post-writeoff. BB has approved three new private commercial banks (Bengal Commercial Bank Limited, Peoples Bank Limited and Citizen Bank Limited), increasing the number of banks to 62. BB raised the minimum paid up capital requirement from Tk 4 billion to Tk 5 billion for the new banks.

Lending rates remain downwardly rigid. In June 2018, the Bangladesh Association of Bankers (BAB), a forum of the owners of private commercial banks, suggested to fix the lending rate and deposit rate at 9 percent and 6 percent respectively. It was expected that the new rates would go into effect from May 2018. However, the banks have struggled to keep the lending rate at such a low level (Figure 7). The large difference in interest rates between the National Savings Directorate (NSD) certificates (which currently offers double digit interest rate) and the rate fixed by BAB disincentivizes for individual households from bank savings instruments. Deposit growth in 2018 slowed to 9.4 percent from 10.2 percent growth in 2017. Lower growth of bank deposits coupled with higher NPL has reduced the availability of loanable funds in the banking system. Moody's has put Bangladesh's banking system on 'negative watch' in their recent report primarily due to worsening asset quality arising from weak corporate governance within the banking sector. Two other global



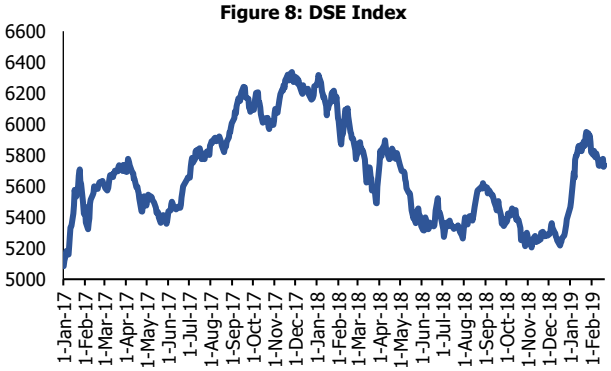
Source: Bangladesh Bank

[7] Thanks to mandatory requirements to keep 50 percent of government deposits in SCBs, their ADR in June 2018 was only 54.8 percent whereas the ADR of domestic Private Commercial Banks was 85.6 percent which was still higher than the prudential limit.

rating agencies – Standard & Poor's and Fitch – also expressed concerns over the health of the banking sector.

A post-election stock market boom is losing steam. The DSEX, the benchmark index of the main bourse Dhaka Stock Exchange had been on a downward trend since the beginning of 2018 but turned around rapidly after elections. The DSEX reached as high as 6318 in January 2018 and then fell by more than a thousand points to 5262 at the end of July 2018 (Figure 8). The index maintained a stable position in the last half of the year until closing for the year at 5,385.64, a 13.75 percent drop year-on-year. The fall of the index during January 2018 to July 2018 was due to the poor performance of the financial sector as well as the shrinking liquidity in the banking sector. Political and exchange rate uncertainty also had a role, as most foreign investors opted to realize profits and reduce risk. Investors appear to have been on a 'wait and see' mode before the national elections. The number of Initial Public Offerings (IPOs) slowed down and the market capitalization as a percentage of GDP has been on a downward trend. There has been a rise in the volatility of the capital market in the last couple of years mostly due to the role played by the institutional investors including merchant banks and brokerage firms.

Figure 8: DSE Index



Source: Dhaka Stock Exchange Ltd.

BOP deficit and pressure on the exchange rate

A significant reduction in the trade deficit due to an acceleration in export and deceleration of import growth, together with strong remittances, have significantly reduced the current account deficit. However, a reduction in the financial account surplus diluted the impact of this reduction on the overall balance of payment deficit, leading to sustained pressure on official foreign exchange reserves as the BB intervened to moderate the depreciation of the taka against the US dollar. With the US dollar gaining strength in international markets, this has resulted in nominal appreciation of the taka against the euro and the pound-sterling so far in FY19, and the real effective exchange rate has appreciated further.

Although the current account deficit declined, the overall balance of payments deficit remained large. The current account deficit stood at $4.3 billion in the first seven months of FY19, compared with $5.4 billion in the corresponding period of FY18. This reflects a reduction in trade and services accounts deficit driven by a drastic fall in merchandize import growth and significant increase in exports of merchandize and services as well as increased remittances (as discussed above). However, a reduction in the financial account surplus moderated the impact of the reduced current account deficit on the overall balance of payments deficit, which declined to $975 million

Table 1: Balance of Payments
US$ million

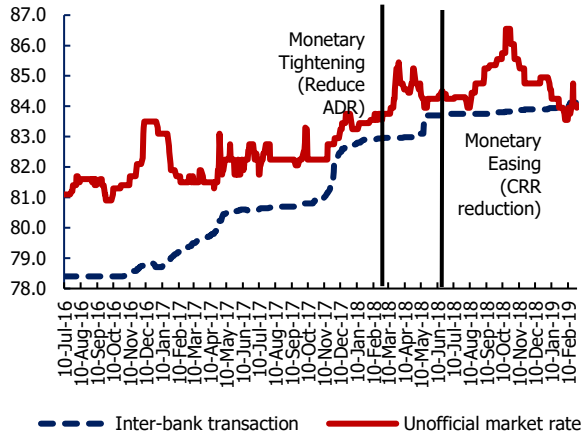
Items	FY15	FY16	FY17	FY18	FY18 (Jul-Jan)	FY19 (Jul-Jan)
Trade balance	**-6,965**	**-6,460**	**-9,472**	**-18,258**	**-10,077**	**-9,684**
Merchandise export f.o.b. (inc. EPZ)	30,697	33,441	34,019	36,205	21,099	23,802
Growth (percent)	***3.1***	***8.9***	***1.7***	***6.4***	***7.5***	***12.8***
Merchandise import f.o.b. (inc. EPZ)	-37,662	-39,901	-43,491	-54,463	-31,176	-33,486
Growth (percent)	***3.0***	***5.9***	***9.0***	***25.2***	***25.2***	***7.4***
Services (net)	-3,186	-2,708	-3,288	-4,574	-2,017	-1,944
Income (net)	-2,869	-1,915	-1,870	-2,392	-1,834	-2,071
Workers' remittance	15,170	14,717	12,769	14,982	8,312	9,086
Growth (percent)	***7.5***	***-3.0***	***-13.2***	***17.3***	***17.6***	***9.3***
Current Account Balance	**2,875**	**4,262**	**-1,331**	**-9,780**	**-5,402**	**-4,337**
Capital account (net)	496	478	400	292	**163**	**156**
Financial account	**1,925**	**944**	**4,247**	**9,076**	**4,282**	**3,522**
o/w Foreign direct investment (net)	1,830	1,285	1,653	1,583	960	1,065
MLT loans (excludes suppliers' credit)	2,472	3,033	3,218	5,785	2,893	3,116
Growth	***8.6***	***22.7***	***6.1***	***79.8***	***132.4***	***7.7***
Other short-term loans (net)	-105	-435	1,030	1,947	-39	965
Trade Credit (net)	-2,508	-2,101	-1,185	-1,270	-644	-2,165
Errors and omissions	-923	-634	-147	-473	**-77**	**-316**
Overall Balance	**4,373**	**5,050**	**3,169**	**-885**	**-1,034**	**-975**

Source: Bangladesh Bank

in the first seven months of F19, from slightly over $1 billion in the first seven months of FY18. The reduction in the financial account surplus from $4.3 billion in the first seven months of FY18 to $3.5 billion in the corresponding period of FY19 is attributable largely to a $1.5 billion increase in trade credit outflows and $1.2 billion decrease in inflows from international financial transactions by the banks and non-bank financial institutions over the same period. A net $1.8 billion inflow on account of "other" short and long-term credit cushioned the impact of expanded trade credit and reduced inflows from banking transactions on the financial account surplus.

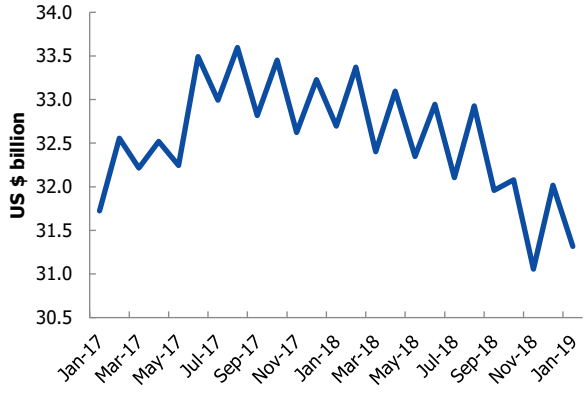
The BB's foreign exchange market intervention has continued. After the Bangladesh taka depreciated by 4 percent against the US dollar in FY18, the inter-bank exchange rate depreciated further to Tk 84 per US dollar in February 2019, while the unofficial market exchange rate stood at 83.8 (Figure 9). The BB intervened frequently to moderate the depreciation of the taka by selling USD. By early March 2019, it had sold a cumulative $1.7 billion in FY19, following sales of $2.3 billion in FY18. Persistent BB intervention on the supply side in the interbank market reduced demand in the informal market, leading to near elimination of the difference between the informal market and the interbank average exchange rates. Against the Euro and pound-sterling, however, the taka has appreciated so far in FY19 from Tk 97.40 per euro and Tk 110.96 per pound-sterling in June 2018, to Tk 94.20 and Tk 107.76, respectively, in February 2019. Despite the decline, foreign exchange reserves have remained adequate at nearly 5.9 months of prospective GNFS imports in FY19 (Figure 10).

Figure 9: Inter-bank and Informal Exchange rate



Source: Bangladesh Bank

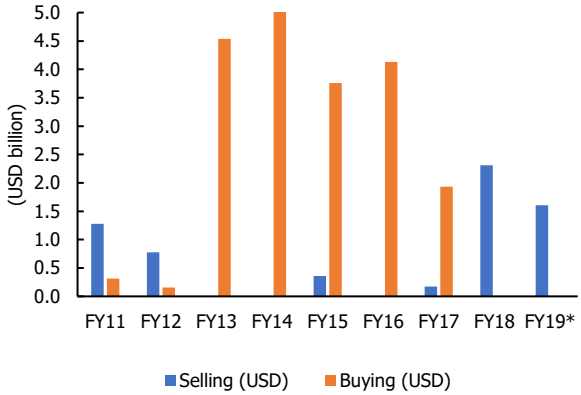
Figure 10: Foreign Exchange Reserves (end of Period)



Source: Bangladesh Bank

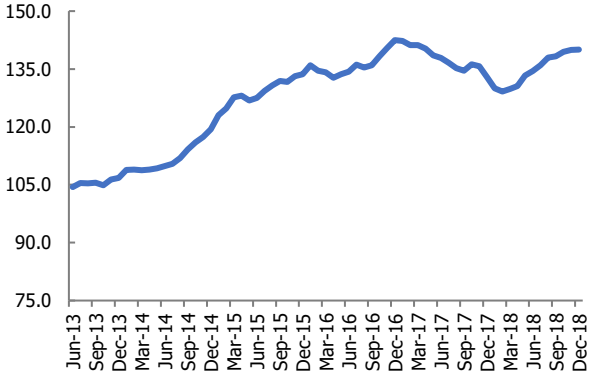
While helping maintain exchange rate stability, BB interventions in the foreign exchange market are contributing to a loss of price competitiveness (Figure 11). The Real Effective Exchange Rate (REER)[8] appreciated by 4.1 percent in the second half of 2018 relative to its level in June 2018 (Figure 12). This more than reversed the 2.5 percent depreciation in the REER in FY18. Consequently, the taka in real effective terms was 33 percent higher in December 2018 relative to its level in June 2013, despite depreciating by 8.7 percent in nominal terms against the US dollar during the same period. The real appreciation of the taka is attributable to faster domestic inflation relative to inflation in Bangladesh's key trading partners, as well as the nominal appreciation of the taka against other major trading partners' currencies. The taka appreciated by 11.1 percent and 6.8 percent in nominal terms against the pound-sterling and the euro, respectively, between June 2013 and December 2018.

Figure 11: Bangladesh Bank's Foreign currency transaction



Source: Bangladesh Bank
**Until Jul-feb*

Figure 12: Real Effective Exchange Rate (Index)



Source: IMF

[8] This the IMF's REER index that includes a total of 35 countries comprising China, United States, Germany, India, Japan, UK, France, Italy, Spain, South Korea, Singapore, Netherlands, Taiwan, Turkey, Canada, Belgium, Thailand, Poland, Russian, Malaysia, Australia, Vietnam, Indonesia, Switzerland, Pakistan, Sweden, Mexico, Saudi Arabia, Brazil, Austria, Denmark, United Arab Emirates, Czech Republic and Ireland.

Fiscal stance broadly consistent with macroeconomic stability

The fiscal deficit widened but remains well within sustainable thresholds. Domestic financing of the deficit has begun to shift towards less expensive sources, and the GoB has restrained somewhat the sale of NSCs. The maintenance of a prudent cap on the budget deficit has helped mitigate inflationary pressure and avoid crowding out credit to the private sector. Tax revenue mobilization has slipped further, reflecting the impact of several recent ad hoc tax cuts and exemptions, as well as slow progress in the automation of administrative processes. Subsidies to exports and energy increased, and there was a rush of new development projects in the Annual Development Program but no concomitant increase or focus on improving the quality of expenditure. Low revenues have shrunk the fiscal space for meeting spending gaps in infrastructure, health, education and social protection.

The fiscal deficit stayed below the budget target. This has been the trend for five consecutive years, with the actual deficit hovering around 4 percent of GDP while the budget target is set at 5 percent. In line with previous years, both revenue and expenditure in FY18 fell short of their original budget targets. However, expenditure growth exceeded growth in revenue, leading to an increase in the deficit from 3.5 percent of GDP in FY17 to 3.9 percent in FY18. Total public debt as a percentage of GDP increased from 31.0 percent in FY17 to 31.5 percent in FY18. This increase was mostly accounted for by a rise in external debt, which increased from 11.3 percent

Table 2: Fiscal Outcomes
Taka in Billion *(percent of GDP)*

	FY14	FY15	FY16	FY17	FY18
Total Revenue	**1403.8**	**1459.7**	**1729.5**	**2012.1**	**2165.4**
	(10.4)	***(9.6)***	***(10.0)***	***(10.2)***	***(9.6)***
o/w Tax Revenue	1160.3	1288.0	1518.9	1780.8	1943.2
	(8.6)	*(8.5)*	*(8.8)*	*(9.0)*	*(8.6)*
Total Expenditure	**1882.1**	**2043.8**	**2384.3**	**2695.0**	**3045.6**
	(14.0)	***(13.5)***	***(13.8)***	***(13.6)***	***(13.5)***
o/w Current Expenditure	1105.6	1189.9	1444.3	1644.9	1756.4
	(8.2)	*(7.9)*	*(8.3)*	*(8.3)*	*(7.8)*
ADP	553.3	603.8	793.5	840.9	1000.5
	(4.1)	*(4.0)*	*(4.6)*	*(4.3)*	*(4.4)*
Others 1/	223.1	250.0	146.6	209.1	288.7
	(1.7)	*(1.6)*	*(0.8)*	*(1.1)*	*(1.3)*
Deficit	**-478.3**	**-584.2**	**-654.8**	**-682.9**	**-880.2**
	(-3.6)	***(-3.9)***	***(-3.8)***	***(-3.5)***	***(-3.9)***
Net External Financing	**97.1**	**72.3**	**147.4**	**123.0**	**72.4**
	(0.7)	***(0.5)***	***(0.9)***	***(0.6)***	***(0.3)***
Net Domestic Financing	**381.4**	**511.7**	**507.3**	**559.9**	**807.8**
	(2.8)	***(3.4)***	***(2.9)***	***(2.8)***	***(3.6)***
o/w Non-Bank Borrowing (Net)	199.7	506.6	401.2	643.6	693.4
	(1.5)	*(3.3)*	*(2.3)*	*(3.3)*	*(3.1)*
General Government Debt Stock	4258.4	4819.3	5455.2	6131.1	7002.7
	(31.7)	*(31.8)*	*(31.5)*	*(31.0)*	*(31.1)*
External	1895.4	1856.4	2058.9	2242.1	2688.5

	(14.1)	*(12.2)*	*(11.9)*	*(11.3)*	*(11.9)*
Domestic	2363.0	2962.9	3396.3	3889.0	4314.1
	(17.6)	*(19.5)*	*(19.6)*	*(19.7)*	*(19.2)*

Source: Ministry of Finance
1/ others include food account, and non-ADP capital and net lending

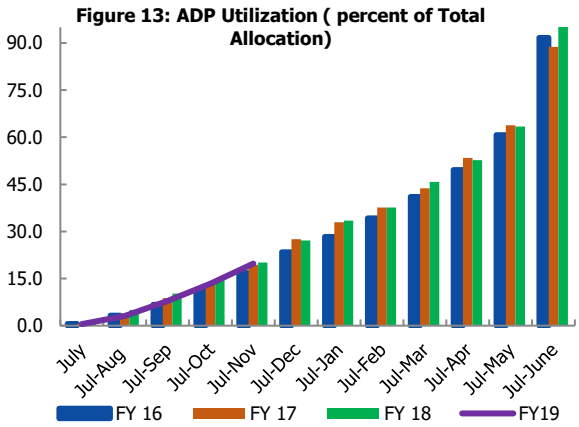
of GDP in FY17 to 11.9 percent in FY18. In contrast, the share of total domestic debt in GDP decreased from 19.7 percent to 19.2 percent in the previous fiscal year (Table 2).

Revenue growth weakened further. Total revenue collection in the first six months of FY19 stood at BDT 980.2 billion, which is only 6.4 percent higher than the same period of the previous year, the smallest in recent memory and 77.8 percent of the target for this period. The increase in revenue collection came from an 11.1 percent increase in income taxes, an 11.4 percent increase in VAT from imports and a 10.5 percent increase in domestic VAT revenues. The tax to GDP ratio in FY18 was 8.6 percent, which remains very low even by developing country standards. A recent study[9] shows that 68 percent of the eligible taxpayers and more than one-third of the top earners did not pay income tax in 2017.

Significant tax cuts were allowed after the approval of the FY19 budget. Several tax concessions made in the run up to the elections in December 2018 have made achieving an already overambitious 34 percent revenue growth target for FY19 even more difficult. The reduced 15 percent income tax benefit for the Asset Management Companies on their income from the management of mutual funds was extended until 2023. Bangladesh Shipping Corporation (BSC) was allowed a 15 percent VAT exemption to import six cargo vessels. Travel agents have also got 15 percent VAT exemption on their commission earnings from the sales of air tickets. RMG exporters will enjoy a full waiver of 5 to 15 percent VAT on expenditure on workers' welfare and entertainment, laboratory test fees, IT-enabled services, and a rent-a-car facility. Moreover, the advance income tax on garment exports has been lowered from 0.6 percent of the shipment value of exports to 0.25 percent. The tax exemption has been extended from 3 years to 7 years for firms operating in hi-tech parks. Here, the rate of tax waiver will be 70 percent from the 8th to the 10th year, after which it will be completely phased out. Furthermore, NBR has issued a Statutory Regulatory Order (SRO) waiving 5 percent custom duty on import of Liquefied Natural Gas (LNG). Along with tax exemptions, NBR has also reduced the withholding tax on the total proceeds from exports for all items, except for jute goods to 0.25 percent. Previously, the source tax was increased to 1 percent in the FY19 budget for cloth and other manufactures with the aim of increasing revenue. According to NBR, these tax concessions together could result in revenue losses of about Tk 150 billion in FY19**.** The impact of the tax cut on the fiscal balances are likely to be exacerbated by **the** extension of export subsidies to eight new products and increased the size of existing subsidies.[10]

[9] See CPD (2018)
[10] Before the expansion, cash incentives ranging from 2 to 20 percent were in place for 26 product categories. The new products will get subsidy of 5 to 10 percent. Note that industries set up in the export processing and economic zones are not entitled to cash export subsidy as they enjoy various tax benefits.

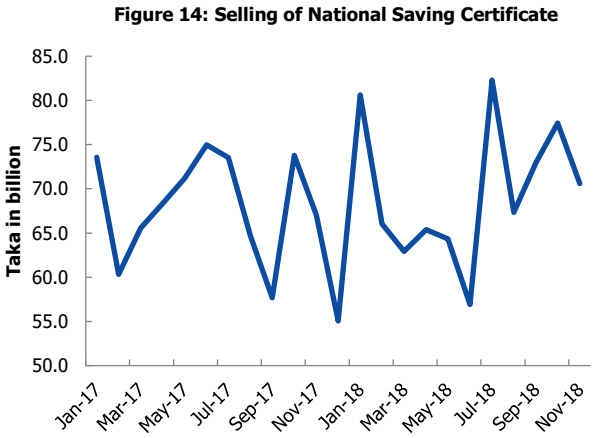
Annual Development Program (ADP) implementation continues to be a challenge. Implementation Monitoring and Evaluation Division (IMED) data show that 34.2 percent of FY19 ADP allocation was utilized during the first seven months of FY19. The total released is 13.7 percent more than during the same period of the previous year. Project aid utilization was 38.1 percent, while 32.4 percent of allocated local resources were spent (Figure 13). Concerns about the quality of expenditures remain. According to a recent study, during FY08-17, among all the projects that were stated completed, about 66.6 percent (on average) were without 100 percent physical completion (see CPD 2018). In order to improve the quantity and quality of ADP implementation, IMED suggested adding several features in the 'Development Project Proposal (DPP), including a compulsory feasibility study report, annual maintenance chart, analysis of stakeholders, and responsibilities of project directors and executing agencies.



Source: IMED- ERD

There was a pre-election boom in development project approvals. The Government of Bangladesh's Executive Committee of the National Economic Council (ECNEC) set a new historical record by clearing 85 projects for Tk 568.2 billion in six meetings between July and September, and another 82 projects for Tk 887.8 billion in four meetings held alone in October. In November, it approved 28 projects costed at Tk 302.3 billion. While some of these are projects funded by the World Bank and the ADB, most of the approved projects lack identified sources of financing. These projects aim at enhancing rural and district roads, improving the electricity distribution system, boosting city corporation development, building schools and colleges in the rural areas, and constructing residential facilities for public officials.

Overall government borrowing increased. The government continued to rely heavily on domestic borrowing to finance the fiscal deficit. On average domestic borrowing consisted of about 80 percent of total borrowing in the last few years. This includes both bank and non-bank borrowing. Net government domestic borrowing stood at Tk 254.2 billion during the first five months of FY19, which is 35 percent higher than during the same period the previous year. Borrowing from the banking system increased during this period. The government borrowed Tk 24.2 billion through T-bills and bonds. In the FY19 budget, the government fixed the target for borrowing from domestic sources



Source: Bangladesh Bank

at Tk 712.2 billion, of which Tk 420.3 billion is targeted from the banking sector and the rest from the non-banking sector.

NSD certificates dominate domestic borrowing. Non-bank government borrowing during the first five months of FY19 stood at Tk 230 billion, about 98 percent of which came from the sale of NSD certificates (Figure 14). In the revised budget of FY18, Tk 440 billion was to be borrowed from NSD certificates. However, the actual borrowing amounted to Tk 465 billion. During FY14-18, the share of outstanding public debt from the banking sector decreased gradually, whereas the debt liabilities from the more expensive NSD certificates increased significantly.

The rise in total public debt is well within sustainability thresholds. According to the latest IMF-WB Debt Sustainability Analysis, the risk of external debt distress and overall debt distress continue to be low. All debt indicators under the baseline remained within respective policy dependent thresholds. Only the threshold for the external debt service to revenue was breached temporarily under the most extreme stress test scenario, but the breach is small.

State-owned enterprises (SOEs) remain a fiscal burden. Financial losses of SOEs, especially those in the energy and financial sectors, continue to draw upon the government budget. The losses of the power sector SOEs for FY17 are estimated at about Tk 51.4 billion (US$620 million), or 0.3 percent of GDP, compared with Tk 38.6 billion (0.22 percent of GDP) in FY16. The increase in losses was mainly due to underpricing of energy products in domestic markets. Biman (the national airline) and Bangladesh Chemical Industries Corporation were the other main loss-makers. The losses of the SOEs have exacerbated weaknesses at the Nationalized Commercial Banks. These raise some fiscal risks and will make any future divestment of these banks more expensive.

The GoB recapitalized the state-owned banks by injecting over Tk 145 billion since 2009, yet the shortfalls have persisted due to lingering weaknesses in their corporate governance. Government loan guarantees continued to rise, reaching 3.2 percent of GDP in FY18. Financial losses of the SOE's and the consequent pressures for financing either through the state-owned banks or the central government budget, remains a concern. Subsidies to Bangladesh Petroleum Corporation (BPC) are likely to come back if oil prices keep increasing.

Box 1: NSD Saving instruments

National Savings are issued at an average interest rate of 11.76 percent, serving about 20 million investors. The main aim of these savings certificates is to protect women, retired government employees, senior citizens, non-resident Bangladeshis and disadvantaged marginalized citizens. In the absence of a well-functioning pension and social security system, these savings certificates have been working as a social safety net for many people. Therefore, it has become very difficult for the government to discontinue the high yielding assets, as it will reduce lucrative investment options for many people who depend on these for old age insurance. However, the government can take steps to remove the loopholes so that these certificates only serve the intended section of the population who really need financial assistance, rather than using it as a major source of deficit financing. For example, some of the saving certificates (such as 'Family Savings Certificates') have limits on how much one individual can buy. However, there is no effective mechanism to keep individual records. As a result, it becomes impossible to trace whether one is crossing the limit or buying them under a different identity. If the aim is to limit

these bonds to marginalized women and retirees, then a mechanism should be in place to check the income level and the wealth of the people who are buying these instruments.

For some bonds, there are no limits on how much an individual or family can buy, and even where there are limits, they are too high, allowing relatively wealthy individuals to invest. For 'Wage Earners Bonds', a system should be in place to confirm that the foreign currencies that are being used to buy the bonds are earned as wages in a foreign country and are not re-entering the country after being illegally taken out. In addition to imposing much stringent eligibility criteria and reducing the interest rate, the government should also reduce the amount they seek to collect from the sale of these NSD certificates. With banks paying interest rates on deposits not much higher than the rate of inflation, individual households will not be inclined put their money into bank deposits when they are getting a guaranteed double-digit interest rate on NSD certificates whenever they can buy them.

Outlook and Risks

Bangladesh is poised to maintain 7 percent plus growth over the medium-term. Domestic demand growth is strong, with private investment likely to gain momentum from the dissipation of political uncertainties and implementation of ease of doing business reforms. With actual output exceeding potential in the short term, price stability may be tested. Coupled with elevated global risks, this reinforces the need for accelerated structural reforms to increase potential output and build fiscal and external buffers.

Global growth is projected to moderate.[11] Activity in advanced economies is expected to slow, as capacity constraints become more binding and accommodative policy is phased out. The recovery in trade and manufacturing activity is losing steam. The recovery in emerging market and developing economies (EMDEs) is projected to be weaker than previously anticipated, with some large economies losing momentum due to financial stress. Global growth is expected to moderate from 3 percent in 2018 to 2.9 percent in 2019, and to level off at 2.8 percent in 2020-21.

Economic activity in advanced economies has been diverging of late. Growth in the United States is expected to slow to 2.5 percent in 2019 and soften further to 1.8 percent in 2020 with the unwinding of the fiscal stimulus and the rise in policy interest rates. The projected pace of expansion is above the estimated potential growth rate of US economy in both years. Growth in the euro area is set to moderate from 1.8 percent in 2018 to 1.6 percent in 2019 and increase to 1.7 percent in 2020. Growth rates are projected to weaken for many economies, notably Germany, Italy and France. There is substantial uncertainty around the baseline projection of about 1.5 percent growth in the United Kingdom in 2019-20. These four accounts for nearly 50 percent of Bangladesh's total merchandize export destination countries. With stalled recovery in EMDEs, growth in this group of countries is predicted to remain at 4.2 percent in 2019, with a markedly weaker-than-expected pickup in commodity exporters accompanied by a sharper-than-expected deceleration in commodity importers. In China, activity remains robust but is decelerating, with the negative impact of trade tensions buffered by calibrated policy interventions.

Global inflation is likely to be stable. Crude oil prices have been volatile since August, reflecting US policy on Iranian oil exports and, more recently, fears of softening global demand. As of early January, crude oil prices stood at around $55 a barrel, and average oil prices are projected at around $67 per barrel in 2019 and 2020. Metals prices are expected to decrease 7.4 percent (y-o-y) in 2019 and to remain roughly unchanged in 2020. Prices of metals and agricultural commodities have softened slightly since August, in part due to subdued demand from China. Consumer price inflation has generally remained contained in recent months in advanced economies, but has inched up in the United States, where above-trend growth continues. Among emerging market economies, inflationary pressures are easing with the drop in oil prices. For some, this easing has been partially offset by the passthrough of currency depreciations to domestic prices.

Downside global risks are elevated. Key sources of risk to the global outlook are the outcome of trade negotiations and the direction financial conditions will take in near-term. If countries

[11] Based on the World Bank, Global Economic Prospects 2019.

resolve their differences without raising distortive trade barriers further, and market sentiment recovers, then improved confidence and easier financial conditions could reinforce each other to lift growth. However, the balance of risks remains skewed to the downside. Global trade, investment, and output remain under threat from policy uncertainty, as well as from other ongoing trade tensions. Failure to resolve differences and a resulting increase in tariff barriers would lead to higher costs of imported intermediate and capital goods and higher final goods prices for consumers. Beyond these direct impacts, higher trade policy uncertainty and concerns over escalation and retaliation would lower business investment, disrupt supply chains, and slow productivity growth. A range of catalyzing events in key systemic economies could spark a broader deterioration in investor sentiment and a sudden, sharp repricing of assets amid elevated debt burdens. Global growth would likely fall short of the baseline projection if any of these events were to materialize. The rising possibility of a disruptive, no-deal Brexit with negative cross-border spillovers adds to the downside risks, particularly if it leads to significant weakening of the pound against the US dollar, which will cause appreciation of the taka against the pound. Another source of systemic financial stability risk is a deeper-than-envisaged slowdown in China, with negative implications for trading partners and global commodity prices. Beyond the possibility of escalating trade tensions and a broader turn in financial market sentiment, other factors adding to increased risk to global investment and growth include uncertainty about the policy agenda of new administrations, as well as geopolitical tensions in the Middle East and East Asia.

Bangladesh's growth outlook remains strong and stable due to sound macroeconomic fundamentals and resilient domestic demand over the near-term. Output growth in FY19 is projected at 7.3 percent, driven by industry and services on the supply side and private consumption and exports on the demand side. Strong growth in garment exports and remittances and bumper agricultural harvests are driving private consumption growth, while deceleration in import growth is projected to narrow the size of negative net exports in FY19. The dissipation of political uncertainties and ongoing doing business reforms will unlock private investment, while accelerated implementation of mega public projects will boost public investment in FY20-21. Doing business reforms to attract private investment include instituting a more streamlined environment for investment facilitation, establishing a One-Stop-Shop (OSS), and easing company regulation; modernizing customs; and increasing access and improving efficiency of the bonded warehouse regime. Expected to be completed by the end of 2020, these reforms will reduce the cost and time to set up and operationalize a business, increase the speed and predictability of processing times for importing and exporting, thereby enhancing the competitiveness of exporters as well as firms using imported inputs to sell into the domestic market. Increased transparency and efficiency of the Special Bonded Warehouses (SBW) program will enable more firms, particularly from sectors outside RMG, to benefit from the SBW regime, supporting expansion in labor intensive, export-oriented manufacturing sectors. Together, these will contribute to increased investment and jobs growth through a significant increase in new business registrations as well as firm expansions, underpinning sustained growth above 7 percent in the medium term.

Macroeconomic stability likely to continue, notwithstanding some pressures. Inflation is projected to remain high at around 6 percent, induced by actual output over potential and expansionary fiscal policy. The current account deficit is projected to narrow moderately as import growth slows reflecting a significant reduction in food and capital machinery imports. A large shortfall in government revenue is expected due to a reduction in taxes on garments, LNG, travel agencies and banks, as well as a lack of revenue enhancing administrative measures. Also, additional pressures on expenditures are likely due to expanded export subsidies, the need for bank recapitalizations, and spending associated with the Rohingyas. These together may widen the budget deficit and increase the Debt-GDP ratio.

Monetary policy vigilance is needed. The BB released the Monetary Policy Statement (MPS) for the second half of FY19, keeping the repo and reverse repo rates at current levels of 6 and 4.75 percent, respectively. Monetary policy seeks to maintain the growth momentum while keeping inflationary pressure at a reasonable level. The broad money (M2) and domestic credit growth ceiling were kept unchanged from the last MPS at 12 percent and 15.9 percent, respectively. However, the private sector credit growth ceiling was revised down by 0.3 percentage point to 16.5 percent, given the decline in recent months. The BB recognizes the constraints on the two-way flexibility of interest rates and the monetary policy transmission channels arising from the heavy reliance on non-market instruments like NSCs. Monetary policy implementation can be made more effective through market based NSC pricing.

Table 3: Macro Indicators
(annual percent change, unless indicated otherwise)

	2015	2016	2017	2018	2019p	2020p	2021p
Real GDP growth, at constant market prices	6.6	7.1	7.3	7.9	7.3	7.4	7.3
Private Consumption	5.8	3.0	7.4	11.0	6.8	6.9	6.9
Government Consumption	8.8	8.4	7.8	15.4	8.0	9.5	10.7
Gross Fixed Capital Investment	7.1	8.9	10.1	10.5	11.2	11.2	10.3
Exports, Goods and Services	-2.8	2.2	-2.3	8.1	5.2	5.4	4.8
Imports, Goods and Services	3.2	-7.1	2.9	27.0	10.5	11.1	10.4
Real GDP growth, at constant factor prices	6.5	7.2	7.2	7.9	7.3	7.4	7.3
Agriculture	3.3	2.8	3.0	4.2	4.1	3.5	3.1
Industry	9.7	11.1	10.2	12.1	9.9	10.0	9.9
Services	5.8	6.2	6.7	6.4	6.6	6.7	6.5
Inflation (Consumer Price Index)	6.4	5.9	5.4	5.8	6.0	6.3	6.1
Current Account Balance (percent of GDP)	1.5	1.9	-0.5	-3.5	-3.2	-2.8	-2.9
Net Foreign Direct Investment (percent of GDP)	0.9	0.6	0.7	0.6	0.6	0.5	0.5
Fiscal Balance (percent of GDP) 1/	-3.7	-3.7	-3.4	-3.9	-4.2	-4.4	-4.6
Debt (percent of GDP)	31.8	31.5	31.0	31.1	32.8	34.7	35.1
Primary Balance (percent of GDP) 1/	-1.7	-1.8	-1.6	-2.1	-2.2	-2.2	-2.3

Source: WB staff estimation; Bangladesh Bureau of Statistics; Bangladesh Bank, Ministry of Finance
1/Including grants
P=projection

With growth projected to remain strong and expectations of one year ahead average inflation in the 6-7 percent range,[12] the BB needs to remain prudent in the execution of the announced monetary program. The BB operates a quantity-based policy regime to keep broad money growth in line with its inflation objective. Steps are being taken over the medium term to strengthen the monetary policy transmission mechanism by moving towards interest rate targeting, emphasizing the importance of price stability as the primary objective, greater exchange rate flexibility, further development of financial markets, and improved forecasting of banking and government liquidity. Despite some nominal depreciation against the US dollar, the real effective exchange rate has continued to appreciate. While intervention in the foreign exchange market is warranted to avoid excessive volatility, enhanced flexibility would help buffer the economy against external shocks, preserve the level of reserves, and increase monetary policy autonomy.

Overall fiscal prudence needs to continue. Fiscal policy is expected to keep the public debt ratio within sustainable thresholds over the medium term. As in previous years, the FY19 budget is based on ambitious projections for revenue growth and correspondingly ambitious capital spending targets. Current spending is rising due to expanding subsidies on energy and exports, as well as expenditure on public pensions and interest payments. The medium-term fiscal deficit target of less than 5 percent of GDP is appropriate. Revenue mobilization is expected to be strengthened by the planned implementation of the VAT in July 2019, and subsequently by the implementation of the new Customs Law. At the same time, efforts are underway to expand the tax base by improving tax administration. In parallel, the government is implementing the Public Financial Management Action Plan 2018-2023, along with further reforms to improve financial control of budget allocations, real-time monitoring of budget execution, and integration of recurrent and capital spending.

Downside external risks have deepened while domestic risks are balanced. Expansion in major advanced economies, Bangladesh's largest export markets, may slow. Key uncertainties are the trajectory for monetary tightening and its impact on emerging markets, the intensity and economic fallout from U.S.-China trade frictions, the adverse impact of Brexit on the UK and EU economies and tighter financial conditions in the euro zone. These could dent growth of demand for Bangladesh's exports and slow remittance inflows. The peaceful conclusion of national elections in December 2018 has significantly improved prospects of continued political stability. Increases in NPLs and weak corporate governance in the banking sector could limit its ability to finance growth and lead to continuing a fiscal burden. To mitigate these risks, the government will need to continue implementing macroprudential measures, including strictly enforcing the new ADR limits on commercial banks, and avoiding relaxing existing caps on credit growth in the state-owned banks. Contingent liabilities from high non-performing loans in state owned commercial banks and SOE losses could result in higher domestic debt.

[12] Bangladesh Bank, Monetary Policy Statement, January-June 2019, page-7

The Reform Challenges

The new cabinet faces several short and long-term development challenges. An immediate challenge is to address the macroeconomic stability concerns rooted in banking sector ailments, revenue shortfalls, and pressure on foreign exchange reserves. At the same time, there is an urgent need to bolster the capacity to cope with tighter external financing conditions. Ensuring financial stability, strengthening revenue mobilization, improving infrastructure, enhancing human capital and streamlining business regulation would also help address the challenges associated with informality, thus reinforcing the basis for future productivity growth.

The government's Vision 2041 seeks to eliminate extreme poverty and secure upper middle-income country status by 2031 and achieve high income country status by 2041. Converging towards these targets within the specified timeframe will require massive investments in physical capital, human capital and innovation, enabled by structural reforms in key areas such as the financial sector, fiscal policy, infrastructure, human development, and business regulation. Any reform effort requires a clear strategy, political champions supported by a capable reform team, and well-established consultation and coordination mechanisms to ensure a high level of coordination among all relevant stakeholders.

Achieving the government's vision will require addressing some challenges. These include:

Reducing financial sector fragilities

The dominant banking sector is characterized by poor asset quality and concerns over the supervisor's enforcement capacity. Stress testing by BB indicates that loan defaults are the most significant risk on capital adequacy. Sensitivity is particularly high to the top large borrowers. Default by the top three large borrowers results in 23 banks falling below the minimum regulatory Capital to Risk Weighted Asset Ratio (CRAR). Much of this is driven by the burdensome court litigation process – Bangladesh is ranked 189 out of 190 in *Doing Business 2019* (DB2019) for enforcing contracts.[13] Further, DB2019 estimates that loan recovery rates are as low as 28.3 cents on the dollar. These severely limit the supervisor's enforcement capacity.

The SCBs and SDBs pose a financial and fiscal stability risk, exhibiting high losses, low capital and weak corporate governance. SCBs and SDBs underperform on capital adequacy, NPLs and profitability. State-owned banks suffer from weak internal controls and risk management practices, as well as significant inefficiencies. There is inadequate clarity in defining ownership purpose and rationale, and setting criteria for developmental impact, as well as commercial and operational success. While SDBs have a higher concentration on agricultural loans, SCBs are mostly in direct competition with the private sector.

The BB has been strengthening supervision and regulation. BB has issued new risk management guidelines for all banks, aiming to control the NPLs and the increasing risks in the banking sector. These will replace the guidelines issued in February 2012 and September 2015.

[13] Several borrowers appear to have had their NPL status and credit information report stayed by the Courts, allowing them to receive fresh loans and potentially further contributing to the NPL issue.

The new guidelines require each bank to prepare a Comprehensive Risk Management Guideline (CRMG) to be approved by the respective bank's Board and submitted to BB. Banks are required to appoint Chief Risk Officer as the head of the risk management department and reconstruct the risk management organogram. The BB also asked lenders to increase the use of electronic payment channels, such as the 'Real-Time Gross Settlement' and 'Bangladesh Electronic Fund Transfer Network,' to promote transparency and efficiency. The BB has asked banks to maintain an 'Internal Credit Risk Rating' to help them manage and control credit risks.

The BB has introduced a new policy for offshore banking operations. Banks, which are or intend to engage in offshore banking, must invest at least 75 percent of total outstanding offshore operations' funds inside the country and comply with the cash reserve requirement (CRR) and the statutory liquidity ratio (SLR). Any bank wishing to operate offshore banking must obtain approval from BB. Moreover, banks must follow Asset Liability Management (ALM) guidelines for their offshore banking operations. In addition, closure of a bank's offshore banking operations, as well as shifting and merging of any offshore banking unit, requires prior permission from BB. Loans under offshore banking operations are required to be reported to the Credit Information Bureau (CIB) of the BB.

There are continuing concerns regarding enforcement capacity. Bangladesh appears to be ahead of other South Asian countries with Basel III implementation, which includes the definition of capital, the establishment of a capital conservation buffer, and the meeting of leverage ratios and liquidity standard measures. Nevertheless, there are capacity related concerns on the BB stemming from the overall state of the banking sector as well as negative repercussions of anecdotal market concerns over political pressures. Ten banks failed to maintain the regulatory capital in in the first quarter of 2018, and nine banks failed to comply with NPL provisions, calling into question BB's credibility and ability to take prompt corrective actions. Financial institutions have never been allowed to fail, and the contingency planning and lender of last resort policies introduced in 2013 have never been tested. Finally, the Asia-Pacific Group on Money Laundering released a mutual evaluation report in 2016 and a follow up in 2018 that cite numerous gaps on the country's anti-money laundering and combating the financing of terrorism (AML/CFT) system, placing the country on enhanced follow-up.

Given the overall state of the banking sector and the outlook, improving banking sector governance calls for policy action. These include: (i) ensuring true autonomy of the BB as the sole regulator of the financial sector, including full regulatory oversight on the state-owned banks;[14] (ii) tightening regulation on loan rescheduling and stopping special rescheduling; and (iii) integrating risk-based supervision and risk-weighted classification of assets in the BB's supervisory framework.

Fiscal reforms

The government's development commitments underscore the urgency to improve domestic revenue mobilization and to deepen public financial management reforms aimed at improving

[14] Undermining Bangladesh Bank's regulatory prerogative by influential quarters like Bank owners' association is damaging integrity of the financial sector.

the efficiency of service delivery. Domestic resource mobilization is a core priority in the sustainable development agenda. Increasing the tax-GDP ratio must be one of the major objectives of the government. In the absence of an effective VAT and SD Law 2012, which is expected to come into effect in the beginning of FY20, the government has been exploring alternative avenues of revenue mobilization.[15] Weak institutional capacity and a plethora of tax exemptions reduce the revenue base. The number of slabs in the VAT was reduced to five from nine in the FY19 budget. Reduction of VAT and SD rates and casting the VAT net more widely to new services such as Uber and different e-commerce is likely to have counteracting effects. To limit tax evasion, the National Board of Revenue (NBR) introduced a new clause in the 'Income Tax Ordinance' which will require all private organizations to inform the NBR about their employees' income tax information each year.

Contribution from direct taxes needs to increase further. Notwithstanding some visible improvements over time, the tax structure depends too heavily on indirect taxes, especially taxes on trade (Table-4). Preparation and implementation of the new Direct Tax Act can be another important milestone in the revenue reform effort. The corporate tax rate is higher in Bangladesh than the Asian average of 21 percent and the global average of 24 percent.[16] Corporate tax has also been a major source for revenue, accounting for about 65 percent of total income tax collection. Corporations in Bangladesh already receive several tax benefits including tax holidays and reduced tax rates in selected sectors and economic zones. There is evidence that tax incentives do not work as well in developing countries as they do in developed countries (OECD 2002). It is imperative to overhaul the corporate tax regime by lowering rates and eliminating tax exemptions and holidays that have outlived their original tenures.

Table 4: Structure of Total NBR tax collection

	FY00	FY05	FY10	FY15	FY18
Indirect Tax	81.6	80.3	71.8	64.4	68.2
Trade Tax	54.9	50.4	36.9	28.2	29.9
Domestic Tax	26.7	29.9	34.9	36.1	38.2
Direct Tax	18.4	19.7	28.2	35.6	31.8

Source: National Board of Revenue (NBR)

. **Moving forward, the following appear to be key fiscal reform priorities**:

- *Implementing the VAT and SD law 2012*[17] *with as little modification as possible from its current design*. There are pressures for multiple rates and restoration of truncated base. These need to be judiciously managed. Implementation of the SD part of the law will help reduce the incidence of trade taxation.

[15]The government made attempts to digitalize some activities through the introduction of the automated return process, bank search tool, advanced tax reminder tool, LTU-VAT mobile app, customs e-payments, VAT East and Benpass software etc. These steps, however, are unlikely to increase the revenue base by a significant margin as the taxpayers might not have enough incentive to use them.

[16] Based on corporate tax rate table by KPMG.

[17] VAT law implementation has suffered long delay due to delays in the design of implementation modalities and at the same time stiff resistance from the business to having a single VAT rate and complete elimination of all exemptions and rebates. These issues are still under discussion.

- *Overhauling the income tax regime*. Lowering and unifying corporate tax rates while eliminating exemptions and holidays will yield gains in efficiency and compliance. Simplifying the personal income tax regime by removing all direct interface between the taxpayers and tax collectors will help expand the currently very low personal income tax base.

- *Improving public investment management (PIM)* by focusing initially on (i) introducing a multi-year Public Investment Program; (ii) strengthening project design, appraisal and approval; and (iii) institutionalizing the PIM reform agenda. Targeting reforms at the selection and budgeting stage of PIM can contribute to addressing the challenge of a suboptimal selection mechanism, which combined with existing budgeting and implementation practices, lead to an overloaded ADP. With a strong framework provided by a multi-year PIP, the design, appraisal and approval system could be strengthened. Institutionalization of the PIM reform agenda through establishing effective consultation and coordination mechanisms is a prerequisite for successful reforms.

- *Addressing bottlenecks in public financial management* as envisaged in the government's Public Financial Management Action Plan 2018-23. PFM bottlenecks affect the efficient allocation, availability, and use of resources for social service delivery. The annual budgets are mostly incremental with limited flexibility for equitable resource allocation geographically or among different programs. Delays in budget releases are often cited as one of the biggest bottlenecks to smooth and efficient service delivery. Social sector budgets are fragmented because of the vertical programs and externally financed interventions that pose several management challenges at the level of the budget holders and frontline service providers.

- *Delinking SOEs from the national budget* to harden their budget constraint and incentivize the agents managing SOEs to look for better return on assets or face restructuring, liquidation or privatization. This is a long-term agenda. In the short-term, better reporting and improved monitoring and evaluation of SOEs can lead to more efficient and effective operations, reducing the need for government subsidies or increasing dividends accruing to government shareholdings.

Meeting the infrastructure gap

Infrastructure is a key input to competitiveness, yet the infrastructure gap is large (Table-5)**.** The solution is not just to spend more, but also better maintenance of existing assets. Improving services typically requires much more than just capital expenditure. The infrastructure challenge can be addressed by adopting a comprehensive infrastructure financing strategy based on a combination of tax funding, partnership with the private sector, and cost recovery. Structural issues around bankability, coupled with near-term challenges, may hold back private sector participation. The government will need to address near-term concerns in the context of longer-term market improvements. There is also an urgent need to improve project preparation and sustain the supporting conditions, such as through better information for market players. Greater risk sharing between financiers can help cushion the impact from increased borrowing costs.

The entire primary road network is in poor condition and saturated with traffic. Consequently, the opportunity costs of passengers and cargo traveling through Bangladesh is very high.

Excessive reliance on roads has proven costly both financially and in terms of environmental degradation. Reforms need to be directed at improving the inter-modal balance with higher priority given to inland waterways and railways. Ports and airports need urgent investments and have higher commercial viability and importance for connectivity. In addition, the two sectors share similar constraints (customs, labor, SOEs). Urban mass transit is a major issue. Bus operations, both rapid transit and the regular bus feeder system, has a good potential of private sector engagement.

Table 5: Comparison of Infrastructure Quality 2018

Country	Overall Infrastructure Ranking	Scores					
		Overall Infrastructure Score	Roads	Efficiency Rail road	Port	Air	Electric power transmission and distribution losses
South Asia							
Bangladesh	109	53.4	35.2	40.9	40.9	45.5	92.7
Sri lanka	65	68.6	46.7	38.6	51.1	57.3	96.9
India	63	68.7	57.4	57.9	60.4	64.1	84.8
Pakistan	93	59.0	49.1	46.4	51.3	52.3	86.3
Nepal	117	48.5	27.0	5.2	13.1	33.4	78.1
East Asia							
Korea, Rep	6	91.3	78.8	81.4	72.8	80.6	100.0
China	29	78.1	59.7	59.0	58.6	60.7	98.8
Indonesia	71	66.8	48.1	61.4	54.1	66.7	94.3
Thailand	60	69.7	55.9	27.4	51.5	66.8	97.7
Philippine	92	59.4	42.2	23.5	43.9	51.4	94.7
Cambodia	112	51.7	38.8	19.2	43.3	42.7	89.9
Vietnam	75	65.4	36.0	39.2	46.4	47.4	94.7

Source: Global Competitiveness Report 2018
Note: Scores ranges from 0 to 100. Higher is better

Urgent action is needed to reduce human fatalities on the road network, where it is estimated more than 20,000[18] people are killed and 200,000 seriously injured every year in road traffic crashes. In addition to associated human tragedy, the economic cost of this major social and economic crisis is estimated at 2-3 percent of GDP annually. Road crashes are responsible for 12 percent of all deaths among men in the 15-49 age bracket, for whom transport injuries in 2016 was the 2nd leading cause of death, up from 11th in 1990. The rapid expansion of motor vehicles on the roads (growing by about 15 percent per annum)[19] and expected increases in transport demand of 10 percent per annum, underlines the urgent need for high level commitment to intervene and mitigate this crisis through coherent policy, regulatory, institutional and operational reforms.

While Bangladesh has tripled its generation capacity in the last decade, the share of renewable energy in the energy mix remains very low and can be improved. Similarly, the country's

[18] Depending on the source, the estimates of annual deaths range from 2,538 (reported fatalities in 2012) to nearly ten times that – between 20,736 (Global Burden of Disease, 2016)[18] and 21,316 (WHO, 2015).[18] The Global Burden of Disease (GBD) estimate implies a death rate of 12.8 per 100,000 people.
[19] As per Bangladesh Road Transport Authority

potential for improved energy efficiency remains largely untapped. The need for developing a long-term primary energy policy is becoming increasingly pressing. Incentives must be improved in favor of sustainable sources through a combination of eliminating fossil fuel subsidies and implementing a carbon tax, and through further expansion of regional energy trade. To support economic growth and meet 10 percent annual demand increase, the government intends to double capacity by 2021, and reach 50 GW by 2041. Planning and implementation of energy infrastructure is often slow and inefficient and has not kept up with the increasing demand. Inadequate power supply and suboptimal operation of the system has led to frequent outages and load shedding (1GW on average), shaving close to 3 percent from GDP and inhibiting private investment in productive sectors. Dispatch does not follow merit-order and there is further room to reduce distribution losses. The current transmission and distribution capacity is not enough to support the increased generation capacity, which causes power outages. Transmission planning needs to refocus on building a flexible high-voltage backbone, enabling generation and import from several sources to be accommodated without requiring a major rework of the grid.

Enhancing human capital to boost productivity.

A growing and youthful workforce in Bangladesh provides a window of opportunity to improve productivity and accelerate economic growth. Technological progress is rapidly changing the nature of work in manufacturing and services. Firms need to not only constantly adjust their business and production modalities with these technological changes, but also require highly-skilled manpower who can enable such change processes. Equipping the young generation with skills needed for such jobs remain crucial.

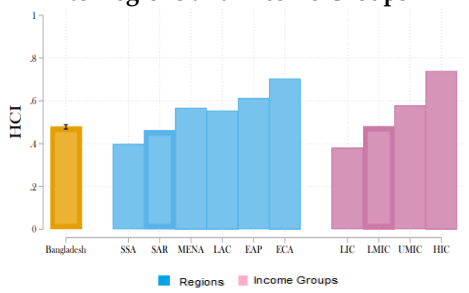
Bangladesh fared relatively well on the Human Capital Index. It ranked 106th among 157 countries in the first Human Capital Index (HCI) prepared by the World Bank, surpassing both the South Asian average and the lower middle-income average in all criteria, except for stunting (Figure 15). Based on the index, a child in Bangladesh today is likely to achieve 48 percent of full potential during his/her lifetime (Table-6). He/she has a 97 percent probability of surviving until age 5 and has 11 years of expected schooling. However, learning adjusted years of schooling is only 6.5, reflecting the learning gap in education resulting in part from learning disabilities due to nutritional deficiencies in early childhood.

Table 6: HCI by Gender

	Boys	Girls	Overall
HCI	0.46	0.49	0.48
Survival to age 5	0.97	0.97	0.97
Expected years of school	10.7	11.3	11
Harmonized test scores	367	370	368
Learning-adjusted years of School	6.2	6.7	6.5
Adult Survival Rate	0.85	0.90	0.87
Not Stunted Rate	0.63	0.64	0.64

Source: World Development Report, 2019

Figure 15: Bangladesh's HCI position compared to Regions and Income Groups



Adequate nutrition is necessary for normal brain development. The first couple of years are critical periods for the brain, which lay the foundation for the development of cognitive, motor and socioeconomic skills throughout childhood and adulthood. Stunting remains a major development challenge for Bangladesh. Sub-optimal feeding practices have detrimental effects on a child's brain by causing changes in brain maturation and resulting in cognitive deficits. More than one-third of under five children that are stunted and underweight are at risk of failing to reach their developmental potential, thereby having long-term effects on academic achievement and economic productivity.[20] In addition, stunting and wasting among children under five is higher if the mother was under 18 at the time of her baby's birth. Bangladesh has had a consistently high rate of child marriage – in 2011, 50 percent of adolescent girls surveyed who were under 18 were already married.[21]

Skills develop progressively over an individual's life, from early childhood development, to basic education, to tertiary education, and on-the-job training. It is a lifelong process involving the acquisition of varied skill types: (i) basic cognitive skills, such as literacy and numeracy, typically acquired during pre-primary and primary school; (ii) job-specific skills usually acquired in TVET or higher education or through apprenticeships and on-the-job training, and (iii) non-cognitive or soft skills, such as social and emotional skills, acquired all along, often by interactions with family members, peers, or colleagues. To expand individuals' potential, coherence in skills development across the different learning environments and schooling stages is imperative. Low learning outcomes across the education system underwrite failure to fully realize the potential of human capital.

Cognitive and analytical skills are increasingly dominating the skills requirement for the job landscape globally. Technological advancements have made skills requirements less predictable. Consequently, workers with higher adaptive skills are being valued more and more. Specifically, tertiary education and skills training are the hubs for equipping young minds with relevant skills and expertise needed to meet the changing technology and skills demands of the modern economy, as well as creating and disseminating new knowledge through cutting-edge research and innovation. The higher education and vocational institutions in Bangladesh still have a long way to go in responding to the economic changes and the quality standards both in the domestic and overseas labor markets.

Business Regulation

Bangladesh's rankings on ease of doing business indices points to the need for major regulatory improvements. The country ranked 176th out of 190 countries in the latest *Ease of Doing Business Index* published by the World Bank (Table 7). This puts Bangladesh in the lowest position among all the South Asian countries despite moving up one spot in the index compared to last year. Out of the ten categories of a business lifecycle, Bangladesh's Distance to Frontier (DTF) score improved most in the 'getting electricity' category. There were slight improvements

[20] In addition, about 18 percent of women between 15-49 years suffer from chronic undernutrition and 23 percent of the infants are born low birth weight. Young motherhood increases the risk of intra-uterine growth retardation and low birth weight. and subsequent stunting outcomes.

[21] Grantham-McGregor, S. et al., 2007. Development potential in the first five years for children in developing countries. The Lancet, (369: 60–70)

in four other categories (starting a business, dealing with construction permits, registering properties and resolving insolvency), and no improvement in the remaining five categories (getting credit, protecting minority investors, paying taxes, trading across borders and enforcing contracts). Bangladesh ranked highest (89th) in the 'protecting minority investors' category, and lowest (189th) in the 'enforcing contracts' category.[22]

Table 7: Bangladesh's Ranking on the Ease of Doing Business

Year	2014	2015	2016	2017	2018	2019
Ease of Doing Business Rank	170	173	178	176	177	176
Starting Business	111	115	115	122	131	138
Dealing with Construction permits	142	144	138	138	130	138
Getting Electricity	189	188	187	187	185	179
Registering Property	183	184	186	185	185	183
Getting Credit	125	131	152	157	159	161
Protecting Minority Investors	43	43	69	70	76	89
Paying Taxes	78	83	148	151	152	151
Trading Across Borders	140	140	173	173	173	176
Enforcing Contracts	188	188	189	189	189	189
Resolving Insolvency	146	147	153	151	152	153

Source: Doing Business Reports

Initiatives are needed to overcome the challenges of informality. Informal employment is concentrated among young, low-skilled, female, and rural workers. Policies targeting training and education of these groups, especially in rural areas, could help their transition to formal employment. Country-specific studies have found that reductions in tax and regulatory burdens have often been associated with lower informality. Policies aimed at invigorating private sector activity and productivity, as well as leveling the playing field for all workers and firms, particularly measures to make the labor market more flexible, the regulatory framework more adaptable, and governance more effective, can lower informality and improve working conditions in the informal sector. The probability of reducing informality rises when reforms are accompanied by business development and training programs, public awareness campaigns and stronger enforcement.[23]

There is significant room to improve the ease of doing business in Bangladesh.[24] This could reduce informality by reducing the cost of entry and operating in the formal sector. Measures to reduce the time, cost, and complexity of registration would also improve the business climate and foster growth. High quality public services can provide an incentive for informal firms to become formal in order to access these services. Enhanced monitoring and enforcement, including of tax regulations, could help discourage informality. These require designing comprehensive policies,

[22] For further details, see World Bank (2019).
[23] The World Bank, Global Economic Prospects, January 2019.
[24] The government took several initiatives through the Bangladesh Investment Development Authority (BIDA) to reform the laws and regulatory processes related to doing business. These, among others, include the enactment of the one-stop-shop (OSS) law, initiation of efforts to establish a national single window (NSW), and streamlining of eligibility rules for Special Bonded Warehouse (SBW) facilities. These need to be brought to closure expeditiously.

including streamlining tax codes, easing firm and labor regulations to create a level playing field for both formal and informal participants, and expanding access to finance and public services to help increase productivity in the informal sector.

Ensuring regulatory predictability is a high priority. Perceptions of unpredictable and opaque administrative processes, as well as the uneven enforcement of regulations, can deter firm creation and investment, push them towards informality and ultimately impede productivity in the formal sectors. As in many other countries in the world, entrepreneurs in Bangladesh continue to raise concerns about the difficulties and delays when dealing with the administration of regulations, particularly in terms of what is perceived as a discretionary application of rules and regulations. Entrepreneurs seeking to introduce new ways of doing business often face additional regulatory barriers, since regulators usually lag innovations in the economy.

Businesses face regulatory unpredictability on many fronts. The most pressing are concerns about inconsistencies in laws and regulations, and undue use of discretion by officials, with more than 60 percent of respondents to a survey identifying these factors as problematic. They are also concerned about poor access to information about rules and regulations, adverse and often sudden changes in laws and regulations, and lack of effective grievance mechanisms. These problems are a manifestation of deficient regulatory governance. Regulatory governance remains weak because most regulatory reforms in the past have focused more on streamlining individual regulatory processes with inadequate attention paid to systemic reforms.

Addressing regulatory uncertainty will require a multi-pronged approach aimed at systemic reforms that strengthen regulatory governance. A set of high-level actions accompanied by more specific reforms are needed. High-level actions include the development of a "whole of government" vision, policy and strategy for the regulatory system and the establishment of a technical regulatory oversight body at the center of government (such as in the Prime Minister's Office) to oversee, lead and report on regulatory reforms. Specific actions, some of which may be piloted before wider roll-out, include introducing the practice of evidence-based regulatory impact assessments, structured and inclusive consultations on draft laws and regulations, a review of existing laws and regulations to identify gaps, inconsistencies and redundancies, immediate publication of all Statutory Regulatory Orders (SROs) through widely-accessible means, and introduction of business-to-government feedback loops on regulatory service quality and reform implementation gaps.

The following section provides a more detailed analysis of regulatory unpredictability based on international experience and a business perception survey data in Bangladesh. Annex I provides information on the profile of the respondents covered by the survey.

Regulatory Unpredictability: Causes, Consequences and Remedies

Bangladesh aspires to achieve the SDGs by 2030 and become a high-income country by 2041. To this end, the development strategy emphasizes economic diversification and productivity improvements, taking advantage of technological developments, including digital technology. It envisages a critical role of the private sector in achieving the SDGs, including in areas that had traditionally been considered the domain of the public sector and/or NGOs. The success of this development strategy will hinge on increased private investment and innovation. Investments will be needed in new ways of doing things: new products, new technologies and new business models. This requires an enabling environment, and regulatory predictability is an important dimension.

Why does it matter?

Regulatory uncertainty makes property rights insecure, which is a deterrent to investment. Insecurity of property rights takes many forms, ranging from threat of outright asset expropriation to policy and regulatory actions that make costs and revenue streams more uncertain (on top of normal commercial risks). Examples include changes in rules of the game after an investment has been committed, non-payment by government for goods and services procured, and discriminatory or confiscatory taxation. A recent World Bank global survey of more than 700 CEOs of multinational companies identified policy and regulatory uncertainty as the second most important deterrent to foreign investment after political instability (World Bank Group: Investment Competitiveness Report 2017).

The literature on regulatory uncertainty and its impact in developing countries is limited. Bigsten and Soderbom (2006)[25], which reviewed research based on firm level surveys in Africa, concluded that uncertainty has a negative impact on investment. However, these studies looked at uncertainty associated with economic variables, such as market demand and exchange rate fluctuations, and not regulatory uncertainty.

The "growth diagnostics" framework, articulated by Hausmann, Rodrik, Velasco (2004)[26], identifies the appropriability of the returns to economic activity as an important driver of private investment. While market failures, such as coordination externalities and information externalities, are one source of low appropriability of returns, a variety of government failures also lower appropriability of returns and thus discourage investment. Following this framework, Hallward-Driemeier, Khun-Jush and Pritchett (2010)[27] argue that regulatory uncertainty, or more generally policy implementation uncertainty, "creates risks to the appropriability of the gains from firm-level investment or innovation". The paper makes a distinction between policies and policy actions, the former referring to policies and rules as written on paper and the latter

[25] Bigsten, Arne and Mans Soderbom, "What have we learned from a decade of manufacturing enterprise surveys in Africa?", *Worls Bank Research Observer 21(2),* 2006.
[26] Hausmann, R., D. Rodrik and A. Velasco, "Growth Diagnostics", Cambridge, MA: Harvard University, mimeo, 2004.
[27] Hallward-Driemeier, Mary, G. Khun-Jush, and L. Pritchett, "Deals versus Rules: Policy Implementation Uncertainty and Why Firms Hate It", NBER Working Paper 16001, May 2010.

referring to the way these are implemented in practice by officials. De jure policy and rules may change, often unexpectedly, and cause uncertainty for businesses. However, even when policies and regulations remain stable on paper, there may be uncertainty about their implementation in practice.[28]

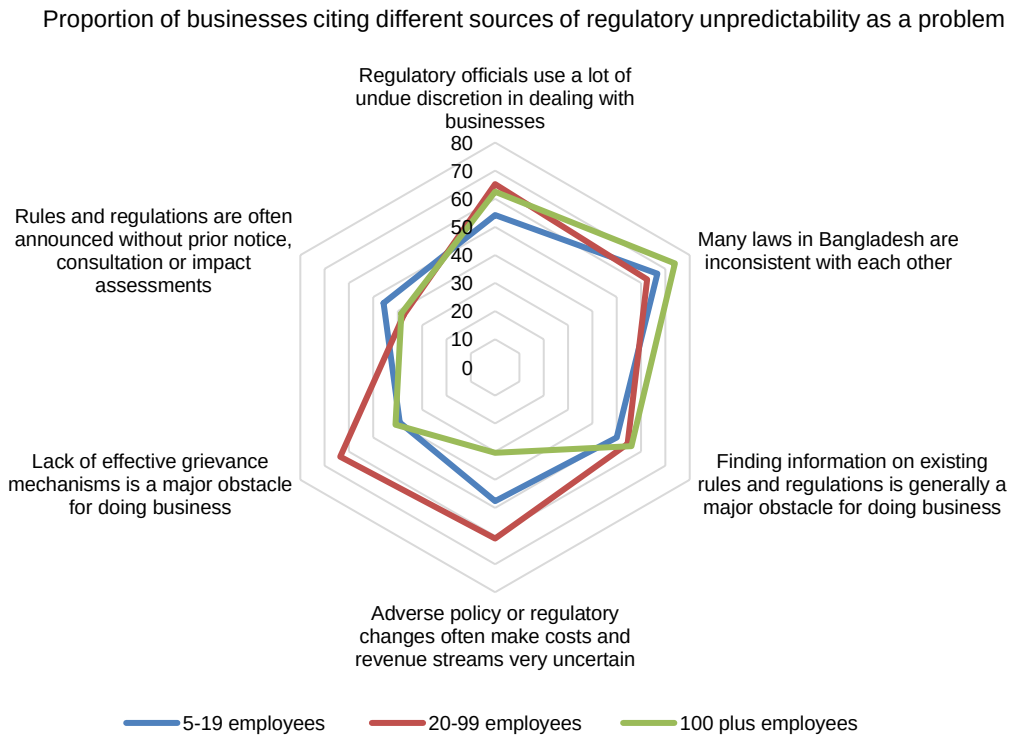
Hallward-Driemeier, Khun-Jush and Pritchett (2010) assess the impact of policy and regulatory uncertainty in Africa. Using Enterprise Survey data for more than 20 African countries, the authors show that even within the same country wide variations exist across firms in complying with various regulatory interfaces, such as time taken to obtain an operating license or time taken for imports to clear customs, and that such variations are correlated with the proportion of firms that reported a high degree of policy and regulatory uncertainty in their business environment. Finally, the authors find a significant negative relationship between high variance in policy implementation and in firm employment growth.

Who faces the most regulatory unpredictability?

Regulatory unpredictability is felt differently by businesses depending on their size (Figure 16). Such variation may reflect differences in firm-size specific characteristics, such as visibility and influence over government officials. The relationship between firm size and the experience with regulatory unpredictability is not linear. In most cases, the medium sized firms seem to bear the brunt of regulatory unpredictability, more than large or small firms. Large and medium sized firms believe more than small firms that regulatory officials use a lot of undue discretion in dealing with businesses; 62 percent, 65 percent and 54 percent, respectively (Figure 16). However, although 62 percent of large firms believe discretionary behavior exists, only one-third complains that adverse policy or regulatory changes - often the result of discretionary behavior - make costs and revenue streams uncertain for them. This suggests that large firms can cope better with discretionary behavior.

[28] The authors state: "Even when policy is unchanging and even when there is macroeconomic stability, firms faced massive risk and uncertainty about their operations and profitability due to variability in policy actions that results from weak capability for implementation of regulatory and economic policy". Given the absence of a one-to-one relationship between the policies/rules on paper and their implementation on the ground, firms may also invest in influencing the decisions of officials, including through the payment of bribes. In other words, they reach a deal with officials.

Figure 16: Regulatory unpredictability as experienced by different firm size groups



What causes regulatory unpredictability?

Discretionary behavior by regulatory officials is at the core of regulatory uncertainty, including non-uniform interpretation of rules and requirements. It is often the most serious source of unpredictability. In this context, it is useful to distinguish between: a) the *de jure* space created for discretionary behavior; and, b) the degree to which that space is used *de facto* by regulatory officials (Box 2).

To understand this phenomenon better, a survey of businesses operating in Bangladesh assessed their views on the manifestations and impact of regulatory unpredictability. The survey was carried out in November-December 2017 in collaboration with the public-private dialogue platform Business Initiative Leading Development (BUILD). The survey questionnaire was prepared by the World Bank Group and put on SurveyMonkey. BUILD sent out the questionnaire using SurveyMonkey to about 150 businesses. Of these, 72 sent a complete response. The analysis presented here is based on these responses. Annex 1 provides a profile of the respondents.

Box 2: The drivers of regulatory unpredictability

The de jure space for discretionary behavior

The space for discretionary behavior is often created by weaknesses in the rule-book. Policies, laws and regulations, as written, may not be relevant, consistent or robust. Such deficiencies may leave regulatory gaps and leave huge scope for differing interpretation of laws and regulations. The weaknesses in the rule-book are often accentuated by the fact that regulatory agencies do not provide adequate guidance to the front-line officials on how to interpret and administer the rules.

The roots of weak regulatory design lie in poor rule-making processes. This includes inadequate use of evidence when making rules, such as lack of consultation with stakeholders and little use of impact assessment. Rules and regulations may be announced without prior notice, consultation or impact assessment. Thus, regulatory design does not benefit from the ground-level knowledge of businesses. Moreover, even when well designed, sudden regulatory enactments cause problems for businesses. The problems are accentuated if the rules are to be enforced immediately, as often happens in practice.

Inconsistencies in rules and regulations also create the space for discretionary interpretation by regulatory officials. Government agencies often impose their own rules and procedures without considering possible conflicts with rules and procedures imposed by other government agencies. The resulting inconsistency may mean that regulatory officials do not get clear guidance from the rule book and use this as an excuse to apply their own discretion in interpreting laws and regulations.

Regulatory gaps are also a serious issue. This is particularly so for innovative activities whose legality may be questioned if there are gaps in the legal and regulatory framework, or grey areas subject to discretionary interpretation.

The de facto use of the space for discretionary behavior

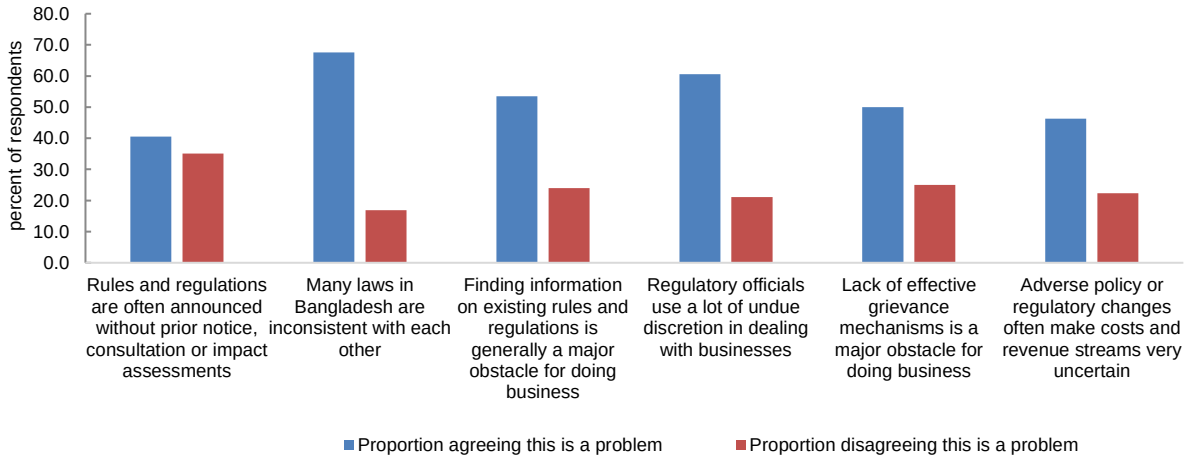
The extent to which regulatory officials exploit the space for discretionary behavior depends on several factors. For example, officers may be encouraged to abuse their discretionary powers if they know that businesses have difficulty in accessing rules and regulations. Businesses often lack adequate knowledge on what rules, regulations and procedures they need to comply with, be it at the entry, operational or exit stages. Even if they are aware of rules or procedures, businesses may lack knowledge of the detailed requirements, such as documents required, fees, or where to apply. This informational asymmetry reduces the ability and incentive of businesses to challenge regulatory officials.

Regulatory officials are further encouraged to use undue discretion if effective grievance mechanisms are absent. Many regulatory areas lack effective grievance mechanisms through which businesses can complain about regulatory decisions that adversely affect them. Even if businesses can voice their grievances, there may be inadequate or no follow-up by the relevant agency, with businesses having no recourse to higher authorities. Effective grievance mechanisms, and good access to information on laws and regulations, can act as restraints on discretionary behavior since such accountability and transparency mechanisms can increase the costs to regulatory officials of indulging in discretion. Thus, their absence encourages officials to use the space that exists for discretionary behavior.

Businesses face regulatory unpredictability on many fronts (Figure 17). Businesses are most concerned about inconsistencies in laws and regulations and undue use of discretion by officials. More than 60 percent of respondents identified these factors as problematic. Businesses are relatively less concerned about the announcement of regulations without prior consultation. However, they find it difficult to access information about existing regulations. Almost half of respondents believe that adverse policy or regulatory changes often make costs and revenue streams uncertain.

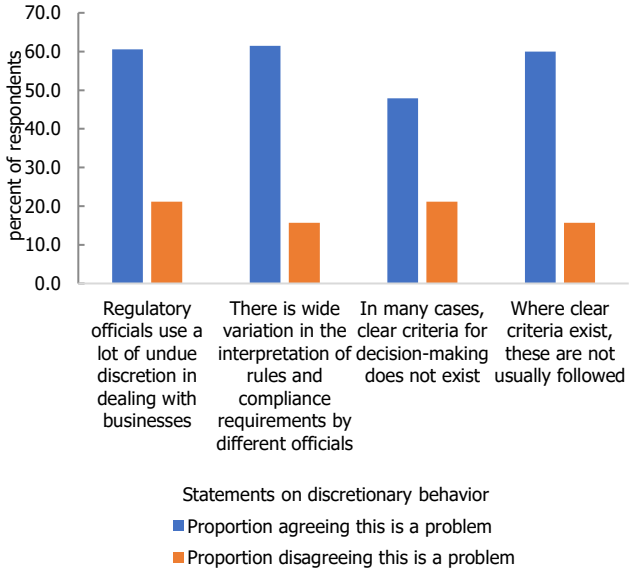
Regulatory officials use a lot of undue discretion in dealing with businesses (Figure 18). Nearly two-thirds reported wide variation in interpretation of rules and compliance requirements among officials. About half of the respondents believed that there are no clear criteria for decision-making in many areas. However, even where such criteria exist these are not followed in decision-making. Indeed, businesses consider non-adherence to decision-making criteria as a bigger issue than the absence of criteria. Box 3 provides an example of how inadequate guidance for decision-making encourages discretionary behavior.

Figure 17: Business views on different aspects of regulatory unpredictability in Bangladesh



Note: these proportions do not add up to 100 percent because some respondents neither agreed nor disagreed with the statement

Figure 18: Business views on discretionary behavior by officials in Bangladesh

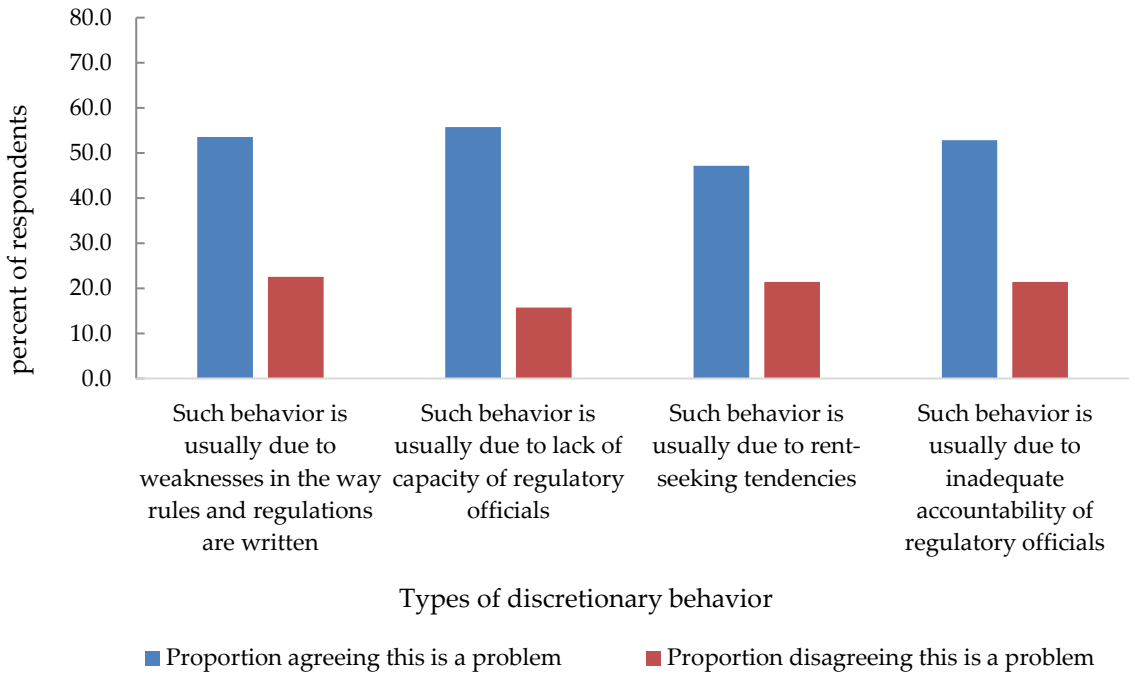


Box 3: Lack of proper definition of sample items lead to discretionary behavior by customs officials

According to the Government of Bangladesh's Import Policy, "samples" can be imported free of cost and without a permit from the office of the Chief Controller of Imports and Exports (CCI&E). This is because sample items do not have a commercial value (they are not eligible for further re-sale), do not require the opening of an import letter of credit (L/C), have no HS codes, and are sent free of charge. However, there is no appropriate definition of which items are categorized as "samples". As a result, importers often face great difficulty in releasing sample items from the port, and customs officials impose taxes and VAT on these goods in a discretionary manner. Furthermore, the officers-in-charge impose fines on businesses for bringing these goods without opening an import L/C. Releasing these sample items from customs takes 7-13 days causing significant delays and raising costs and uncertainty for businesses.

Discretionary behavior has many roots. Among these, weaknesses in the way rules and regulations are written, lack of capacity of regulatory officials, rent-seeking behavior and inadequate accountability of regulatory officials are most salient**.** Businesses feel that all these factors are important in Bangladesh (Figure 19). For example, weaknesses in the way rules and regulations are written is cited as a major problem – this response is consistent with the responses on inconsistent laws and regulations. It may be noted that these are not mutually exclusive factors but can be complementary. Thus, weaknesses in the way rules are written create the space for discretionary behavior. Given the space to do so, the extent to which officials indulge in discretionary behavior may be influenced by how much oversight they face. Annex II provides more details on deeper correlates of regulatory unpredictability.

Figure 19: Business views on causes of discretionary behavior by officials in Bangladesh



Access to information on rules and regulations. Information on business regulations is difficult to find and, when available, is often of poor quality**.** One out of two businesses in Bangladesh feel that finding information on existing rules and regulations is a major obstacle to doing business. There are also concerns about the credibility of available information, with almost two-thirds complaining that it is not updated regularly and is often incomplete.

A manifestation of this problem is the absence of a government website providing the VAT, customs, and income tax laws/ordinances in one place, including all amendments. The widespread and increasing practice of issuing rules and regulations through Statutory Regulatory Orders (SROs) further accentuates the problem. Ministries and agencies frequently issue such SROs, without necessarily rescinding old ones. On many subjects, there are even hundreds of SROs in circulation, leading to widespread misunderstanding and misinterpretation of rules. The problem is accentuated by the fact that no complete documentation of such SROs is available in one place. Thus, considerable effort is required on the part of businesses to find SROs relevant to them.

Regulatory gaps. Innovative businesses need legal underpinnings and clear rules of the game. As the economy becomes more dynamic and connected to the global world, entrepreneurs leverage technological developments and seek to pursue innovative activities, be it new products or new ways of doing things. Where an enabling legal and regulatory framework exists, new activities and markets are created - mobile banking is a good recent example. The government supported its Digital Bangladesh agenda through several legal acts, including an ICT Act and an E-payment Act. Such legal actions have helped create new markets. For example, the E-payment Act, by legalizing electronic fund transfers, helped catalyze the creation of a new financial market - mobile banking. However, in many cases, the government has not enacted relevant laws and regulations. Rather, when confronted with a new technology or business model, it has reacted in an ad-hoc manner, causing uncertainty and enabling harassment of innovative firms (Box 4).

Box 4: Regulatory gaps are creating uncertainty for innovative businesses

International ICT-based innovative businesses are interested in investing in Bangladesh. These include Uber and other transportation services, e-commerce (dress, groceries, and food delivery among others). However, Bangladesh is struggling to realize the potential of the Digital Bangladesh agenda due to regulatory unpredictability. The unpredictable nature of the law and service delivery hampers business operations, as well as growth and future business decisions. ICT-led transportation services, including Uber, are operating illegally, as the government has failed to provide them registration, limiting their growth potential. Many investors initially financed cars for ICT enabled transportation service providers, but many are now people discouraged, as they are not legally registered and subject to harassment by traffic police or other regulatory officials.

Lack of ex-post regulatory review mechanisms. Bangladesh lacks structured mechanisms for ex-post reviews of regulations after they are enacted. Such reviews can help identify deficiencies in the way regulations are being administrated, as well as any unintended consequences of the regulation. An example illustrating the need for such review mechanisms comes from the jute

industry. With global car manufacturing companies using jute fibers to manufacture its interiors, demand for jute is increasing rapidly worldwide. However, businesses in Bangladesh were unable to fully benefit from this opportunity due to the ban on the export of raw jute imposed in 1984, 2009 and 2015. Many car manufacturers worldwide faced a shortage of natural fiber, and one of them wrote to the government of Bangladesh about lifting the ban. The policy was finally withdrawn in January 2018. The persistence of sub-optimal regulations, such as in this case, are often a result of the lack of effective policy evaluation and impact assessment mechanisms.

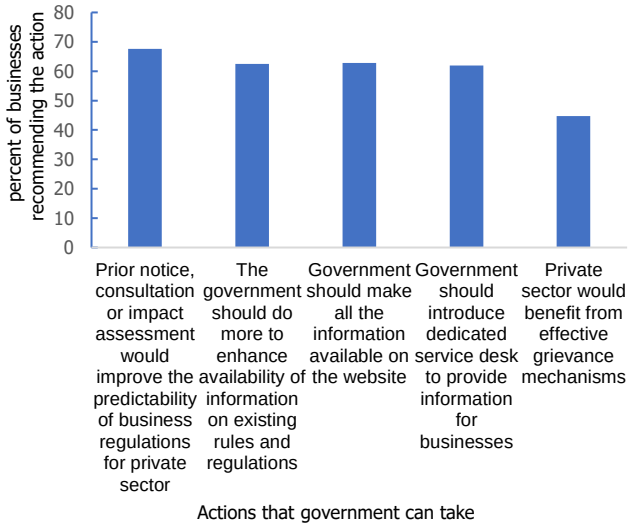
Addressing regulatory unpredictability

A systemic approach is needed to address regulatory uncertainty. This means going beyond streamlining individual rules and regulatory processes to make the regulatory framework in Bangladesh suitable for a fast-changing world and encourage innovation and risk-taking. Bangladesh, like many other developing countries have been slow to address regulatory unpredictability, in part due to the lack of knowledge about the intensity, manifestation, root causes, and adverse impact on businesses.

Surveys of firms about the drivers of discretionary behavior in Bangladesh provide rich insights and clues about what needs to be done to address the problem of regulatory unpredictability. The top reason for discretionary behavior cited by firms is lack of capacity of regulatory officials (56 percent). Next comes weaknesses in the way rules and regulations are written (54 percent), followed by inadequate accountability of regulatory officials (53 percent). Interestingly, rent-seeking is cited the least as a cause for discretionary behavior, but is nonetheless important with 47 percent of businesses citing this as a driver. These responses are consistent with the other findings on inconsistencies in the legal framework (a product of weak legal and regulatory design) and the absence of grievance mechanisms (which contributes to low accountability).

Businesses emphasize the need for increased transparency and accountability to enhance regulatory predictability (Figure 20). More than two-thirds of businesses believe that prior notice, consultation or impact assessment on proposed laws and regulations will improve the predictability of business regulations. This is consistent with the view of firms that weaknesses in the way laws and regulations are written creates fertile ground for discretionary behavior. A little over 60 percent of them want government to do more to enhance the availability of information on existing rules and regulations, for example by using the

Figure 20: Business views on what can improve transparency and accountability



internet and setting up dedicated service desks to provide information. Almost half (45 percent) of businesses feel they will benefit from effective grievance mechanisms – no surprise given that lack of accountability of regulatory officials is a major reason for their discretionary behavior.

There is a need for a multi-pronged approach in addressing the identified problems. The government has a track record of reforming individual regulatory processes and procedures. However, challenges remain, especially when multiple stakeholders within and outside government are involved. More recently, the government established a one-stop-shop to facilitate regulatory approvals for starting a business. This automated facility, which is about to be launched, will involve the streamlining of individual processes administrated by separate agencies (underpinned by Standard Operating Procedures), provide information on regulatory compliance requirements, and lead to better coordination between agencies and processes through an automated inter-operability mechanism. While this is a good beginning, Bangladesh now needs to focus on more ambitious systemic reforms that improve regulatory governance and enhance regulatory predictability.

An ongoing exercise to assess the quality of regulatory policy and delivery in Bangladesh has identified significant systemic problems[29]. For example, Bangladesh currently lacks a clear policy and strategy outlining how the regulatory system will be managed, including principles, objectives and reform modalities. The quality of the rule-making process is deficient. While stakeholders are periodically consulted on regulatory issues, the consultation processes are ad-hoc and not applied in a systematic or predictable manner. The establishment of the public-private dialogue mechanism BUILD and its alignment with the Private Sector Coordination Committee in the Prime Minister's Office has brought greater structure to the dialogue. However, scope remains for further significant improvement since many stakeholders, especially small businesses, may still be left out of the process, and the importance of regular consultation for reducing regulatory uncertainty may not be uniformly appreciated across government.

Processes for ensuring the quality of new proposed rules need strengthening based on evidence. The Rules of Business (1996), which establish the processes and rules for the preparation of policy proposals and legislation in Bangladesh, require extensive consultation within government, but do not mandate the preparation of Regulatory Impact Assessments (RIA) or the use of evidence in policy development. As a result, rules are often developed without systematic analysis of the impact on businesses, as well as the ability and costs of enforcing the regulations. Nonetheless, some beginnings have been made. These include pilot RIAs, such as a 2014 RIA on customs regulatory reform (prepared with ADB support), an agreement in 2017 between the Ministry of Law and Parliamentary Affairs and the WBG to raise awareness of RIA, undertake further pilots, and build RIA capacity, as well as the July 2018 RIA training event delivered by the WBG. The government may build upon this to establish a systematic approach to evidence-based regulatory design.

[29] World Bank Group (2018), Regulatory Policy and Delivery Review: Regulatory Governance in Bangladesh, Working draft, November 2018.

Improving regulatory governance is necessary to enhance regulatory predictability. This requires consideration of the following high-level actions:

- Develop and publish a whole of government vision, policy and strategy for Bangladesh's regulatory system, including regulatory governance priorities, principles, targets, criteria, responsibilities and use of tools. The policy and strategy should include short and medium-term priorities and be prepared in a consultative and transparent manner with relevant stakeholders, along with preparation of a detailed implementation plan.
- Establish a technical regulatory oversight body at the center of government (such as in the Prime Minister's Office) to oversee and lead the regulatory reforms and modernization needed to achieve the government's objective of Bangladesh becoming an upper middle-income country by 2031. In this regard, the Government may also revisit the idea of the short-lived Regulatory Reform Commission set up in late 2017.
- Develop government-wide consultation guidelines and procedures for important regulatory issues and proposed regulations, including minimum time periods for public consultation and standardized consultation documents and procedures with on-line access.

The high-level actions need to be backed up by more specific actions, including:

- Gradually introducing and requiring the use of RIAs for all major regulatory interventions. This new practice may be overseen by the technical oversight body, such as an RIA Unit in the PMO or the Ministry of Law and Parliamentary Affairs, which could provide quality control as well as training.
- Establishing a systematic approach for the review and overhaul of existing laws, acts, rules and SROs, and identifying redundancies, conflicting areas, jurisdictional overlaps and regulatory gaps. The government may start by identifying, in consultation with businesses and relevant professionals, a few clusters of related laws and regulations, and subjecting these to review, followed by a roll-out of the review process to other important laws and regulations impacting on the private sector.
- Formulating necessary laws/acts/rules/SROs to reduce regulatory gaps.
- Establishing a "Notice and Comments" system that will include publication of a regulatory calendar at the beginning of a fiscal year indicating all upcoming laws for the year, and a structured mechanism to solicit comments on draft laws and regulations. In line with the government's Digital Bangladesh agenda, such a system may be technology-based.
- Introducing a system to automatically publish all new laws, regulatory amendments, and SROs on a dedicated website within a week of their coming into force. Since access to information is most problematic for regulatory orders, which are also often a major source of regulatory discretion, the government may initially focus this exercise on SROs.

- Introduce business-to-government feedback loops to identify gaps in service delivery and reform implementation. This may initially be piloted with selected government-to-business services through structured questionnaires and then gradually rolled out. Technology may be leveraged to ensure cost-effectiveness and sustainability of such efforts, for example, through an electronic feedback mechanism system for selected government-to-business service delivery.
- Introducing a systemic online grievance mechanism for all government-to-government, business and citizen services. This system may initially be piloted for select services identified through a survey of stakeholders. The grievance mechanism is intended to address specific cases and will complement the business-to-government feedback mechanisms that are aimed at identifying patterns and trends across respondents, ministries and thematic areas of regulation.

Annex I: Profile of surveyed enterprises

The surveyed enterprises include a variety in terms of firm age and size, and sectoral distribution. About a third of the enterprises are either in the process of being established or have been in operation for less than a year. At the other end of the spectrum, about 38 percent of the respondents are more than 10 years old. In the terms of firm size, the sample is almost equally distributed among small (between 5 and 19 employees), medium (between 20 and 99 employees) and large (over 100 employees). While all firms, irrespective of size and age, complain about regulatory unpredictability, there are some interesting differences in the response between different size and age groups, as discussed above.

As may be expected, the garment industry is represented the most in the sample, followed by IT, food, textiles, and electronics. Since the survey was done using survey-monkey, it is possible that these compositions also reflect differences in the propensity of different groups of enterprises to voluntarily respond to online surveys.

Figure I.1: Enterprise profile

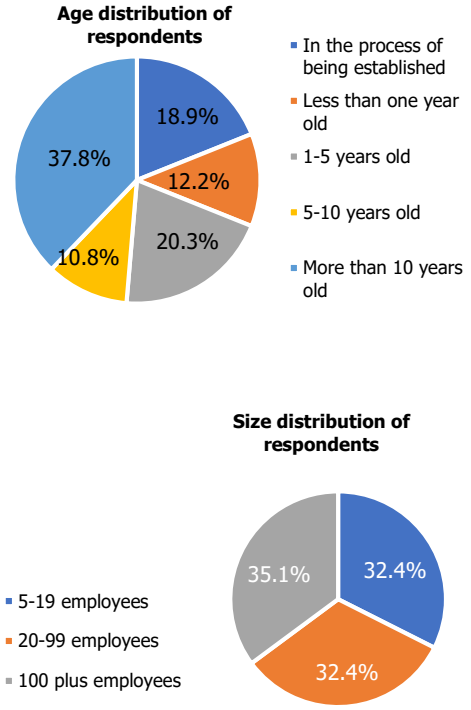
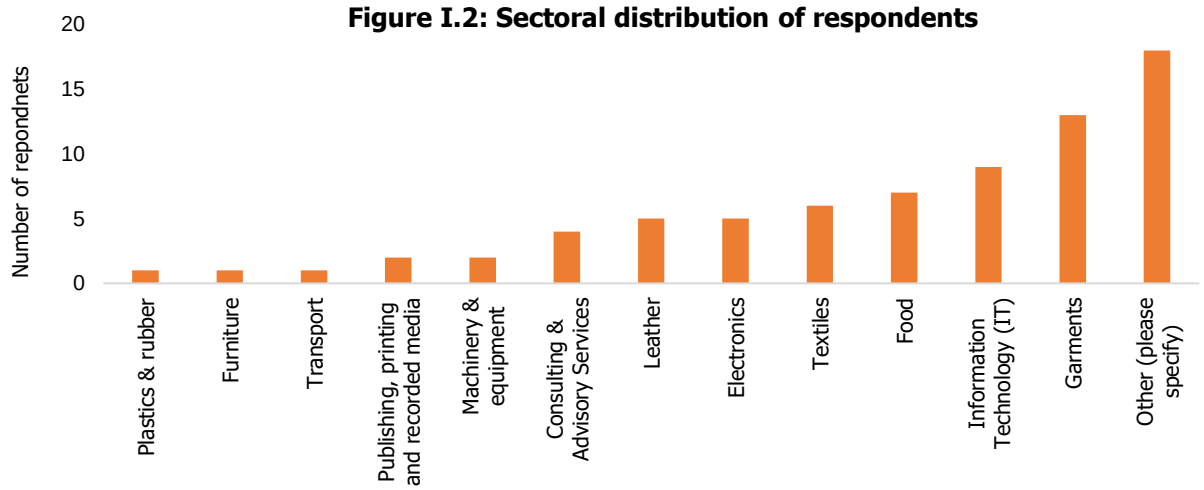


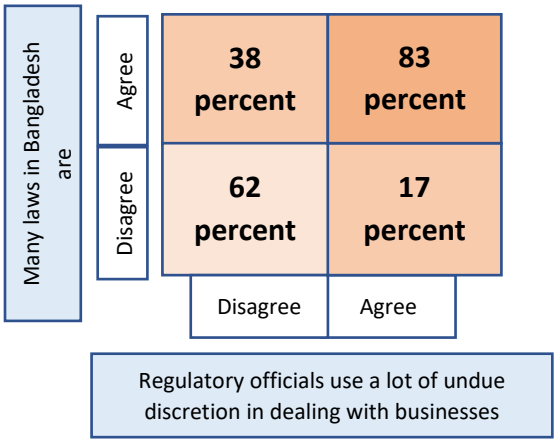
Figure I.2: Sectoral distribution of respondents



Annex II: Deeper correlates of regulatory unpredictability

Inconsistency in the legal framework creates fertile ground for discretionary behavior by officials. This problem is cited by more than two-thirds of businesses in Bangladesh. There appears to be a strong correlation between perceptions of discretionary behavior and inconsistency among laws in Bangladesh. Of the 41 firms (out of 72) which feel that that regulatory officials use a lot of undue discretion, 25 (or 83 percent) also believe that many laws in Bangladesh are inconsistent with each other, (Figure 1.3). The rest either disagree that laws are inconsistent or gave an indifferent answer. Of the firms that do not think there is undue use of discretion, 62 percent also do not think that laws are inconsistent with each. These responses suggest that legal and regulatory inconsistencies encourage discretion.

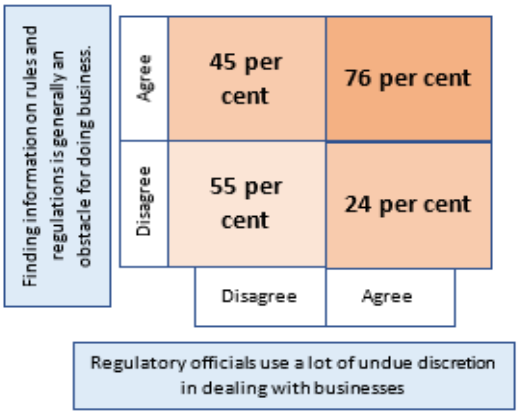
Figure II.1: Relationship between discretionary behavior and legal inconsistency



Discretionary behavior flourishes in the absence of effective grievance mechanisms. About 82 percent of the respondent firms which agree that regulatory officials use undue discretion in dealing with businesses also feel that the absence of effective grievance mechanisms is a concern. In contrast, 73 percent of businesses which do not complain about discretionary behavior by regulatory officials, also do not view the lack of effective grievance mechanisms as a problem. Such findings suggest a relationship between absence of effective grievance mechanisms and the prevalence of discretionary behavior. Two other observations: (a) regulatory officials may be encouraged to use undue discretion if they are immune from the accountability associated with grievance mechanisms, and (b) businesses who face discretionary treatment may feel the absence of grievance mechanisms more strongly than others.

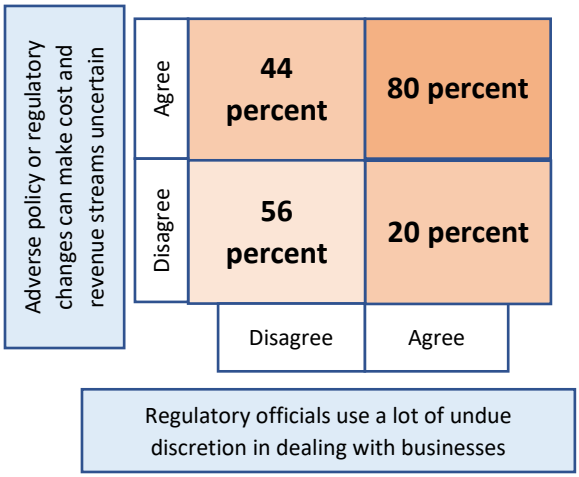
Poor access to information may also encourage use of undue discretion by officials. The survey findings show that inadequate knowledge about rules and regulations may make businesses more vulnerable to discretionary treatment by officials. 76 percent of respondent firms which agree that regulatory officers engage in undue discretionary behavior in dealing with businesses, also agree that finding information on rules and regulations is generally an obstacle for doing business (Figure 21). 55 percent of the surveyed firms which do not believe that regulatory officers use undue discretionary behavior also do not believe there is any obstacle in finding information on rules and regulations for doing business. However, 45 percent of the businesses which disagree on the use of undue discretion by regulatory officials, still agree that there is difficulty in obtaining such information.

Figure II.2 Relationship between discretionary behavior and access to information



Perceptions of discretionary behavior appear to be correlated with that of property rights insecurity. Four out of five firms which feel that regulatory officials use a lot of undue discretion also believe adverse policy and regulatory changes can make costs and revenues uncertain. Over half of the respondents (56 percent) who do not feel that regulatory officials use undue discretionary behavior, also disagree that adverse policy and regulatory changes are making business difficult in Bangladesh by creating uncertainty about cost and revenue streams. At the same time, while 44 percent of firms do not agree on the use of undue discretionary behavior by regulatory officials, they do indicate that adverse policy and regulatory changes may create uncertainty in costs and revenues (Figure 1.5). The above findings suggest that discretionary behavior has a strong potential to reduce security of property rights, although the latter may happen for other reasons as well.

Figure II.3 Relationship between discretionary behavior and insecurity of property rights



Annex III

Bangladesh Macroeconomic Indicators

Description	FY13	FY14	FY15	FY16	FY17	FY18
GDP Growth Rates and Per Capita Income						
GDP Growth (percent, 2005-06 base year)	6.0	6.1	6.6	7.1	7.3	7.9
GDP Growth Per Capita (percent)	4.8	4.8	5.4	5.9	6.2	6.5
Per Capita GDP (current US$)	954.8	1086.8	1212.2	1358.9	1516.7	1641.9
Per Capita GNI (current US$)	1031.6	1159.2	1290.9	1437.1	1581.9	1716.7
Per Capita GDP (US$, official estimate)	976.0	1110.0	1236.0	1385.0	1544.0	1675.0
Per Capita GNI (US$, official estimate)	1054.0	1184.0	1316.0	1465.0	1610.0	1751.0
Per Capita GDP Atlas Method (US$)	935.4	1009.3	1116.0	1255.4	1422.2	1589.0
Per Capita GNI Atlas Method (US$)	1010.7	1076.5	1188.4	1327.7	1483.4	1661.4
Inflation						
Rate of Inflation (CPI, percent) (year on year) **	6.8	7.3	6.4	5.9	5.4	5.8
Inflation (GDP deflator)	7.2	5.7	5.9	6.7	6.3	5.6
Saving & Investment (percent of GDP)						
Gross Domestic Saving	22.0	22.1	22.2	25.0	25.3	22.8
Gross National Saving	30.5	29.2	29.0	30.8	29.6	27.4
Private Investment	21.7	22.0	22.1	23.0	23.1	23.3
Of which: FDI	1.2	0.8	0.9	0.6	0.7	0.6
Public Investment	6.6	6.6	6.8	6.7	7.4	8.0
Central Govt. Budget (percent of GDP)						
Total Revenue	10.7	10.4	9.6	10.0	10.2	9.6
Total Expenditure	14.5	13.8	13.5	13.8	13.6	13.5
Overall Budget Deficit	3.8	3.6	3.9	3.8	3.5	3.9
Balance of Payments (percent of GDP)						
Trade (merchandize export + merchandize import)	40.1	38.4	35.0	33.1	31.0	32.9
Exports	17.7	17.2	15.7	15.1	13.6	13.1
Imports	22.4	21.2	19.3	18.0	17.4	19.7
Services & Income (net)	-3.7	-3.9	-3.1	-2.1	-2.1	-2.5
Current Transfers	9.9	8.6	8.1	6.9	5.3	5.6
Current Account Balance (including transfers)	1.6	0.8	1.5	1.9	-0.5	-3.5
Public Debt and official reserves						
Total Debt as percent of GDP	32.1	31.7	31.8	31.5	30.6	31.1
External Debt (US$ b.)	22.4	24.4	23.9	26.3	28.3	32.8
External Debt as percent of GDP	14.9	14.1	12.2	11.9	11.3	11.9
Gross Reserves (US$ b.) (end of period)	15.3	21.3	25.0	30.1	33.7	32.8
Gross Reserves (in months of imports)	5.5	5.8	7.0	7.9	8.0	6.2
Money and Credit						
M2 Growth (percent, year-on-year)	16.7	16.1	12.4	16.3	10.9	9.2
Net Domestic Asset Growth (percent, year-on-year)	11.8	10.3	10.7	14.2	9.8	12.8
Ratio of Private Sector Credit to GDP (percent)	37.7	37.8	37.9	38.7	39.3	40.3
Ratio of Total Deposits (Time+Demand) to GDP (percent)	44.7	46.4	46.1	45.8	44.4	43.0
Exchange Rate						
Nominal Period Average (TK/US$)	79.9	77.7	77.7	78.3	79.1	82.1
Nominal End of Period (TK/US$)	77.8	77.6	77.8	78.4	80.6	82.8
Real Effective Exchange Rate-REER Index, 2010=100	98.5	107.4	120.6	133.0	139.2	133.2
Memorandum Items						
GDP at Current. Prices (Taka bill.)	11989.2	13436.7	15158.0	17328.6	19758.2	22504.8
GNI at Current. Prices (Taka bill)	12953.5	14332.2	16142.0	18326.7	20607.2	23531.1
GNI at Current. Prices Atlas Method (US$ bill)	158.3	171.2	191.3	216.3	244.6	278.5
GDP at Current. Prices Atlas Method (US$ bill)	147.0	160.5	179.7	204.5	234.5	266.3
GDP at Current. Prices (US$ bill)	150.1	172.9	195.2	221.4	249.7	274.0
GNI at Current Prices (US$ bill)	162.1	184.4	207.8	234.1	260.5	286.5
Population (mill)*	157.2	159.1	161.0	162.9	164.6	166.9

Source: Bangladesh Bureau of Statistics, Bangladesh Bank, Ministry of Finance, The World Bank and IMF
**Population data is from DECPG.*

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