



Government of the
People's Republic of Bangladesh

Strengthening Finance for the 7th Five Year Plan and SDGs in Bangladesh

FINDINGS FROM AN INDEPENDENT DEVELOPMENT FINANCE ASSESSMENT

FINAL REPORT

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Australian Government

Department of Foreign Affairs and Trade



*Empowered lives.
Resilient nations.*



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A note on data sources: All sources for data are referenced in footnotes. All dates are provided for these sources.

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Disclaimer

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List of Acronyms

ADB	Asian Development Bank
ADP	Annual Development Programme
AF	Adaptation Fund
BCCRF	Bangladesh Climate Change Resilience Fund
BCCSAP	Bangladesh Climate Change Strategy and Action Plan
BCCTF	Bangladesh Climate Change Trust Fund
BIFFL	Bangladesh Infrastructure Finance Fund Limited
BOI	Board of Investment
CCM	Country Coordination Mechanism (of GFATM)
CFF	Climate Fiscal Framework
CIF	Climate Investment Fund
CPEIR	Climate Public Expenditure and Institutional Review
CSR	Corporate Social Responsibility
DAC	Development Assistance Committee (OECD)
DFA	Development Finance and Aid Assessment
DP	Development Partner
EEP	External Economic Policy
EPZ	Export Pricing Zone
ERD	Economic Relations Division
FDI	Foreign Direct Investment
GAVI	Global Alliance for Vaccine and Immunization
GCF	Green Climate Fund
GDP	Gross Domestic Product
GEF	Global Environment Facility
GFATM	Global Fund for Aids, Tuberculosis and Malaria
HDI	Human Development Index
IBAS	Integrated Budget and Accounting System

ICC	Inter-Agency Coordination Committee
ICCTF	Indonesia Climate Change Trust Fund
IDA	International Development Association
IFC	International Finance Corporation
INFS	Integrated National Financing Strategy
INGO	International Non-governmental Organization
JEC	Joint Economic Commission
LDC	Least Developed Country
LDCF	Least Developed Countries Fund
LMIC	Lower Middle Income Country
MDG	Millennium Development Goal
MIE	Multilateral Implementing Entity
MoEF	Ministry of Environment and Forestry
MRA	Microcredit Regulatory Authority
MSME	Micro, Small and Medium Enterprises
MTBF	Medium Term Budget Framework
MTDS	Medium Term Debt Strategy
MTSBP	Medium Term Strategy and Business Plan
NBFI	Non-Bank Financial Institution
NBR	National Board of Revenue
NGO	Non-governmental Organization
NIE	National Implementing Entity
NSD	National Savings Directorate
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PEFA	Public Expenditure and Financial Accountability
PKB	Probasi Kallyan Bank
PPCR	Pilot Programme of Climate Resilience
PPP	Public-Private Partnership

RIE	Regional Implementing Entity
RMG	Readymade Garments
SAARC	South Asian Association for Regional Cooperation
SDG	Sustainable Development Goal
SEZ	Special Economic Zone
SME	Small and Medium Enterprise
SSC	South-South Cooperation
SSTC	South-South and Triangular Cooperation
SWF	Sovereign Wealth Fund
TCS	Technical Cooperation Scheme
TOSSD	Total Official Support for Sustainable Development
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
VAT	Value-added Tax
WIPO	World Intellectual Property Organization
WRI	World Resources Institute

Foreword

This Independent Development Finance Assessment (DFA), commissioned by the Economic Relations Division, and supported by the United Nations Development Programme (UNDP) and the Asia Pacific Development Effectiveness Facility provides Bangladesh with a mapping of financing flows for development. The assessment can be a useful means to pursue our development priorities as articulated in Bangladesh's 7th Five Year Plan. It is the first assessment of its kind in Bangladesh – covering all development finance flows including private and public as well as external and domestic resources.

The unique value of the DFA is that not only delineates the contours of development financing landscape but assesses the strengths and weaknesses of the policy and institutional architecture to facilitate aligning finance with results. Its recommendations shed light on what reforms we need to undertake to help deliver a more integrated financing framework both to achieve our national development priorities, as well as the Sustainable Development Goals.

The assessment comes at a key moment after the agreement of the Addis Ababa Action Agenda at the Third International Conference on Financing for Development in July 2015, as well as the Sustainable Development Goals agreed at the Sustainable Development Summit in September 2015. The recommendations are far reaching and we look forward to working with all our partners across public and private, as well as international and domestic to prioritise and implement this agenda moving forward.

February 2016



Mohammad Mejbahuddin

Senior Secretary

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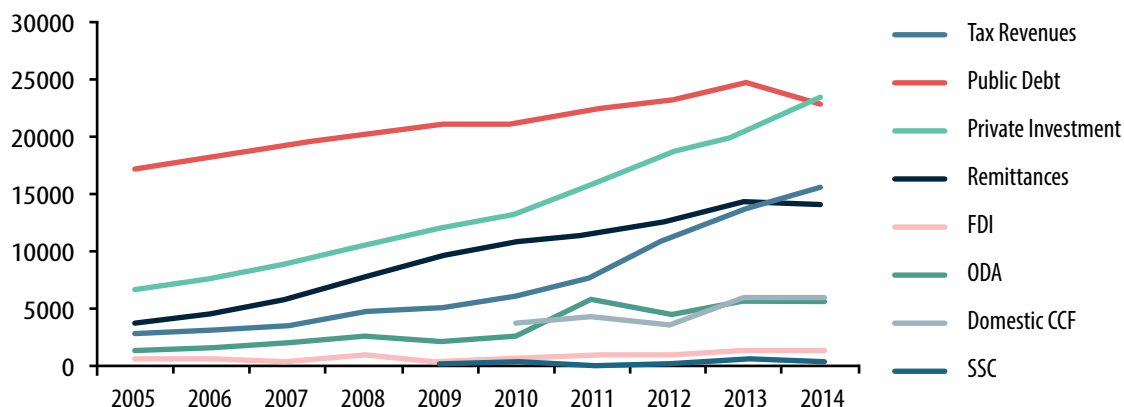
Facility (AP-DEF) Steering Committee

Executive Summary

Background

1. Bangladesh launched its 7th Five Year Plan (FYP) 2016–2020 in October 2015. The 7th FYP aims to develop strategies, policies and institutions that will allow Bangladesh to further accelerate job creation and reduce poverty as well as comply with new commitments to meet Sustainable Development Goal (SDG) targets. According to the Plan, the resource envelope needed will be Bangladeshi Taka 31.9 trillion (US\$ 409 billion) in FY2016 prices. An estimated 78 percent will come from private investment and 22 percent from public investment. The 7th FYP is ambitious from a financial perspective, particularly for the private sector. Bangladesh will face challenges to mobilize all of the resources needed to implement the Plan. However, it is a young and growing country and there is clearly scope to identify new ways of leveraging financing for development, which would not necessarily lead to a build-up of further debt.
2. The purpose of the analysis of the Development Finance Assessment (DFA) is thus to contribute to this policy discussion. The Government has placed a renewed emphasis on the role to be played by public-private partnerships, increasing the current rate of remittances, and foreign direct investment (FDI) from one percent to three percent of gross domestic product (GDP), as well as increased public and private savings, rapid income growth for the private sector, and increased revenue mobilization through reform and modernization of tax policy and tax administration. The Plan has also emphasized the need to increase total expenditures while increasing the value for money of public service delivery and subsidies and transfer programs as well improved efficiency and productivity of all public sector enterprises. These financial resources can, in the future, be captured in an Integrated National Financing Strategy that can help the country to articulate its complex and holistic financing structures, which are based on both domestic and foreign sources of funding.
3. Borrowing and revenue are the biggest sources of financing for the Government of Bangladesh. In 2015, borrowing was at 18 percent of GDP, and revenue, as a share of GDP, was around 10 percent, and official development assistance (ODA) was about 2 percent. Outside of the public sector, the most important development finance flows were: private investment \$23.3 billion in 2014 and remittances standing at \$14 billion in 2014.

Development Finance Flows in millions of US\$



Sources: Bangladesh Bank, World Development Indicators (World Bank), Ministry of Finance

4. The DFA will help provide an understanding of the potential resources needed for its future development initiatives. The DFA is a comprehensive mapping of past and current sources of development finance. It considers both domestic and external sources of development finance. On the domestic side, public sources include tax and non-tax revenue, resources from non-governmental organizations (NGOs), borrowing from private sources, and private investment, as well as resources from philanthropic organizations. On the external side, public sources include ODA, climate finance and South-South cooperation and private sources such as FDI and private borrowing.
5. The DFA includes an assessment of relevant policies, institutional arrangements, technical systems and tools, and human resource capacity to mobilize, manage, deliver, monitor and report on existing and future flows, together with recommendations on the way forward.

Socioeconomic and Political Context

6. The Bangladeshi economy is maintaining stability and moving forward in spite of recent challenges. The economy faced several key issues such as political uncertainty, global economic slow-down and a growing infrastructure deficit in recent years. Despite these challenges, advancements in the socio-economic sphere have been achieved.
7. Bangladesh is a Lower Middle Income Country (LMIC) according to World Bank classifications and a Least Developed Country (LDC) according to the United Nations.¹ Since independence, Bangladesh has experienced a steady increase in the growth rate of real GDP, accelerating from an average of less than 4 percent per year during 1974–1990 to 6.4 percent in 2010–2014. The 7th FYP forecasts a growth rate annually of 7 to 8 percent of GDP. The economy is increasingly based on export-led development. In particular, the textile industry is the second largest in the world. Other key sectors for Bangladesh include shipping, pharmaceuticals, ceramics and electronics. Agriculture also makes a key contribution, including for cash crops such as rice, jute, tea and wheat. Bangladesh is currently ranked fifth in the world in production of fish and seafood. International remittances in Bangladesh, mainly from overseas workers, have played an important role to boost the country's foreign exchange reserve. International remittances in Bangladesh in 2015 stood at around \$15 billion, covering almost 65 percent of the country's foreign exchange reserve for this period.

The Planning and Budget Process

8. With a clear focus on accelerating growth and reducing poverty, the 6th FYP made solid progress in increasing per capita income and reducing poverty focusing on several approaches of pro-poor economic growth. The plan also introduced the concept of results-based monitoring and evaluation in Bangladesh. The 7th FYP focuses on accelerating growth and empowering citizens, and does not deviate significantly from the 6th FYP, which similarly proposed ambitious social, economic and environmental targets. The 7th FYP also incorporates the key elements of the National Sustainable Development Strategy that was developed to address the challenge of mainstreaming the SDGs across sectors.
9. The introduction of a more strategic and performance/results orientated budget and the successful development and implementation of medium-term budget frameworks is a milestone for present

¹ See Annex B for full information on least developed countries and middle-income countries.

and future achievements in the public financial management reforms of Bangladesh. More important for the DFA analysis is that this introduction has initiated a strategic phase of budget development that focuses on the implications of strategic policy priorities for the allocation of resources across the budget. Once completely strengthened, this strategic process could allow the future analysis of other sources of finance that are also important to develop, but that are not necessarily under the direct control of the government. This strategic planning process could eventually lead to the development of more holistic Integrated National Financial Frameworks that will be necessary to mobilise the resources required to achieve the SDGs.

10. However, before that can happen, there are many aspects in this process that must be consolidated, further strengthened, or that need improvement, for example: (i) the weakness in the links between the Annual Development Programme (ADP) and the 7th FYP; (ii) remaining important disconnects between the ADP and the MTBF; (iii) the undertaking of public capital investment through two parallel streams: ADF and non-ADF; (iv) the medium term budget process in order to fulfil some of its strategic goals; and (v) there is room for improving the operational efficiency of the budget.

Domestic Finance: Institutional and Policy Context Flow Analysis

11. Bangladesh has one of the lowest revenue- to- GDP rates in the world. Implementation of the Tax Modernization Plan has not been as fast as expected. Tax administration improvements have been lower than expected because of capacity weaknesses, weak incentives for reform and delays in the computerization of the tax system. This has also resulted in strong discretionary powers of the National Board of Revenue. The present system involves person- to- person contact with taxpayers through 100 percent desk audits for income tax and physical inspection-based enforcement in the case of the value-added tax. The country is further challenged by its narrow tax base, and combined with monetary losses from exemptions and tax holidays, this has also further impeded the amount of tax which could be collected. Tax administration is however, increasingly moving towards a computerized system that can ultimately provide support for spot checks, automatic tax report generation and enforcement of tax compliance in the future. The National Board of Review seeks to revise the national income tax code and develop in its place a direct tax code for the country.
12. With regard to public domestic borrowing, the Government of Bangladesh could increase the duration of national saving instruments in order to attract more investors. At present, the maximum duration of savings instruments is five years, which is low in comparison to other countries where the duration is 20 to 30 years. Moreover, the government could make efforts to develop the long-term domestic bond market by issuing longer maturity government bonds and bills, and thereby reduce its dependence on borrowing through the national savings schemes and short-term treasury bills issued by the Bangladesh Bank. Implementation of these policies should also lead to better management of interest rate payments and reduce the risk of duration mismatch.
13. There has been some financial deepening in Bangladesh since 1980 with both broad money (M2) and bank credit to GDP growing steadily. Indicators such as the M2- to- GDP ratio, which is often used as an indicator of the depth of the financial sector, rose from 12 percent in 1980 to 57 percent in June 2012, along with total bank credit as a share of GDP growing from 14 percent to 55 percent over the same period. In the absence of a well-developed capital market, the growth in private credit has indeed played a role in supporting the expansion of the private sector in Bangladesh. Yet in comparison to

neighbouring countries, Bangladesh's financial markets can still be seen as underdeveloped, and overall the investment rates cannot compete with strong savers such as those in East Asia.

14. Although private borrowing is on the rise in Bangladesh, the government can do more to provide a supporting environment for private sector access to finance. Factors relating to private sector access to finance in Bangladesh include: (i) reducing the rate of interest charged to borrow from national banks in Bangladesh; (ii) the high spread between deposits and lending, a factor that discourages private sector and household investment; (iii) the efficiency of the banking system (e.g. high administrative costs, low efficiency in managing loan/investment portfolio without proper balance between risk and return, and low return on capital); and (iv) the limited access in rural areas and for small firms to access bank credit in Bangladesh. The government's domestic borrowing should be used in a wise way to avoid crowding out of the private sector investment and creating conflicts with strategic private sector development goals.
15. Bangladesh plans to form a sovereign wealth fund with its foreign currency reserves to invest in infrastructure. The initial size of the fund is likely to be between \$1 billion and \$2 billion, according to the Governor of the Bangladesh Bank. The foreign exchange reserves at the Central Bank were \$27.5 billion by end 2015, representing seven months of imports.
16. Promoting public-private partnerships (PPPs) has been more difficult than foreseen and results took much longer to be achieved than what was expected in the 6th FYP. However, after five years of accumulated experience and consistent efforts promoting PPPs, the future now looks promising. The government has navigated all the complexities around PPPs, ensuring credibility and transparency and delivering policies and measures that reflect internationally recognized good practices. Challenges remain that will require considerable attention during the 7th FYP, including the strengthening of the quality of infrastructure planning and consolidation of a national infrastructure development plan for PPPs, adequate international promotion campaigns, a strengthened technical and financial capacity of the domestic infrastructure financing market, and development of risk assessment strategies to find the right balance to stimulate private PPPs when social rates of return are high and private returns are low.
17. There are various options for inclusive businesses in Bangladesh. Lending from formal banks has increased, with Islamic Bank Bangladesh Limited as the largest lender. There are many microfinance institutions, with a significant total volume of lending. Non-bank financial institutions are relatively modest players. There are a number of funds that can offer equity or equity combined with debt. Some of these funds are defined as impact investment funds, which focus on businesses that seek combined social, commercial and environmental impact.
18. Bangladesh has a long tradition of partnership with NGOs, whose outreach has supported the government in the delivery of a wide range of services including in the areas of education, health, training, women's empowerment, micro-credits, agriculture, climate change and social protection. The 7th FYP defines a wide variety of key strategic areas for which the government will seek partnerships with NGOs. To achieve the full potential and contribution of NGOs' to achieve these goals, a number of issues must be addressed. These issues include increasing transparency of NGOs' use of public funds (domestic and external) and improving the quality of the services provided to the final beneficiaries. Addressing these issues will provide transparency of government funding to NGOs and help to design solutions to facilitate access to small- and medium-sized local NGOs.

19. Current corporate social responsibility (CSR) initiatives are aligned with international best practices and integrated with global business initiatives. There has been a measurable impact, both quantitative and qualitative, of how CSR can contribute towards sustainable profits and investment for business. The way forward in this area shows great potential, and the key element is to find the core business case and “win-win” approaches to integrate the interests of business, government and society. So far, the results achieved look promising. One of the main limitations to achieve more systemic approaches in this area is the lack of available data and information to inform the policy making process.
20. The Government of Bangladesh defines climate finance as “...the flow of funds toward activities that are aimed at reducing Greenhouse gas emission (‘mitigation’) or help societies in developing resilience to adapt to climate change impacts (‘adaptation’).” The Government of Bangladesh has implemented several climate change adaptations and disaster risk management projects. Attaching the highest importance to the issue, the Bangladesh Climate Change Strategy and Action Plan (BCCSAP) was formulated in 2009. The BCCSAP 2009 identified six thematic areas: (1) food security, social protection and health; (2) comprehensive disaster management; (3) infrastructure; (4) research and knowledge management; (5) mitigation and low-carbon development; and (6) capacity-building and institutional strengthening.

External Finance: Institutional and Policy Context Flow Analysis

21. Bangladesh transitioned to a lower middle-income country in 2015. However, at its earlier stage of development, the country was quite dependant on aid as a share of GDP. In the initial years after independence the country was dependent on food and commodity aid. During the first 10 years after independence, food and commodity aid accounted for 53–90 percent of total ODA. Commensurate with this nature of ODA, bilateral assistance accounted for 68–89 percent of total ODA. Over the years this pattern has changed as Bangladesh developed its agricultural sector with a strong focus on food production, with the share of food aid becoming negligent by FY2000.
22. The ODA in Bangladesh supports a wide variety of sectors, with changing patterns over time. Public administration, transport and power are the largest current recipients of ODA loans from multilaterals and now constitute the majority of ODA. However, budget support is limited. Almost all ODA is now characterized as project assistance, mainly to finance investment (e.g. 98 percent in FY2013). In line with this changing pattern of aid composition, the share of multilateral sources of ODA has increased to 63 percent while bilateral assistance declined to 37 percent over the same period. The share of ODA in GDP fell to only 2 percent by FY2009 and has hovered around 2 percent since. In a negative trend, disbursements as a share of total commitments have declined over time.
23. Bangladesh maintains strong development cooperation with many non-traditional donors such as China, India, Islamic Republic of Iran, Kuwait, Malaysia, Saudi Arabia, Turkey and United Arab Emirates. The overall picture of South-South cooperation is encouraging as this emerging source of finance has great potential for Bangladesh. There are, however, a number of issues that should be addressed for this type of financing to achieve its full potential and to better align with country priorities. The government is taking steps to improve value for money of South-South cooperation, but much work remains to be done, and as in many other countries, availability of quality data and information about South-South cooperation is sparse.

24. Most of the available vertical funds are being used in Bangladesh. The list includes the Global Environment Facility (GEF) and vertical funds in the health field, including the Global Alliance for Vaccines and Immunization (GAVI) and the Global Fund for AIDS, Tuberculosis and Malaria (GFATM). The GAVI funds approved for Bangladesh until March 2015 amounted to \$404,170,681 and the funds disbursed \$371,622,752.² As such, 94.5 percent of the committed funds have been disbursed. 52 percent is allotted to tuberculosis, 30 percent to HIV/AIDS and 18 percent to malaria. There were a total of 17 grants given under GFATM to Bangladesh, five of which are still active (two with the government, and three with international NGOs).
25. Since joining the GEF, Bangladesh received GEF grants totalling \$37 million that leveraged \$369 million in co-financing resources for 13 national projects. These include eight projects in climate change, three in biodiversity, one in persistent organic pollutants, and one in a multi-focal areas. Similarly, Bangladesh participated in nine regional and global projects financed by the GEF totalling \$62 million that leveraged \$761 million in co-financing resources. Bangladesh received \$110 million through the Pilot Program for Climate Resilience (PPCR) out of which \$50 million was grant funds and \$60 million was near zero interest concessional loans.
26. Bangladesh has large investment needs in power generation and other basic infrastructure that can be supported by external borrowing. However, Bangladesh has both a closed current and capital account, which has limited the scope for external borrowing. Although limited in relative size, external debt as a share of GDP has almost doubled since 2009 and there is a need to ensure that this debt build-up is sustainable and well managed. Looking to the future, external financing, primarily in the form of concessional loans from official multilateral and bilateral sources (but increasingly loans on non-concessional terms) will continue to supplement the public investment needs of the country. However, without a substantial liberalization of the current and capital accounts in Bangladesh, possibly gradual and partial, this source of finance will continued to be limited to the public sector. In addition, energy bonds, remittance bonds and the launch of a Bangladesh Eurobond could be introduced for generating funds.
27. The 7th FYP recognizes that public sector investment alone cannot bring about the increase in gross investment needed to achieve the 8 percent GDP growth target by FY2020. About 77–80 percent of investment is expected to come from the private sector. Without a significant increase in private investment from domestic and foreign sources, the planned increase in investment to more than 34 percent of GDP (from 25 percent in 2015) by the end of the 7th FYP will likely not be realizable. Although private sector borrowing from abroad is very limited it is still on the increase. In order to increase this type of borrowing, national policies need to be introduced to improve the overall environment for investment as well as a gradual opening of the current and capital account. The country has made progress in terms of developing a more favourable investment environment with good improving prospects for attracting productive FDI.
28. However, in comparative terms, Bangladesh's ability to attract FDI inflows is not as good as it could be. This may be related to the fact that by different international measurements, the investment climate for Bangladesh is not very open, or conducive to business. These measurements suggest that there are many areas where the country would need to make substantial improvements before becoming a more attractive destination for FDI. There are good short-term opportunities to increase FDI in specific niche areas (Export Processing Zones, Special Economic Zones, Shipbuilding), but

2 GAVI, the Vaccine Alliance, <http://www.gavi.org/country/bangladesh/>.

long-term measures to improve the business climate, together with a substantial empowerment and strengthening of the capacity of the Board of Investment are needed.

29. Migration and global diaspora resources are an integral component of the development process in Bangladesh and have been a key driver of social development. The economic performance of international remittances is indicative of the success achieved by a number of government policies and support services implemented during under the 6th FYP. However, success for achieving the 7th FYP target will require further coherence and improved coordination from the different ministries and agencies (i.e. policy, research, labour diplomacy, finance, skill development, welfare and social services) with a special focus on increasing the share of migrant workers from lagging economic regions, increasing the share of skilled and semi-skilled migrant workers, reducing remittance and migration costs, financial inclusion, promotion of the progressive bankarisation of remittance recipients and leveraging this source of finance to develop productive activities.

Conclusions and Recommendations

30. The Medium Term Macroeconomic Framework of the 7th FYP presents the main overall financial estimates to set the strategic discussion on the mobilisation of financial resources to achieve the objectives of the plan. These are summarised in Table 2.4 below. The 7th FYP makes it very clear that two important things must happen: (i) a large expansion of public investment, especially from domestic sources; and (ii) a similarly ambitious expansion of private investment, to reach almost 78 percent of the total finance needs of the 7th FYP.
31. In line with the recommendations of the 7th FYP, the DFA has found that there are three key preconditions to enable the Government of Bangladesh to make significant development progress over the next five years as well as to meet the development targets of the 7th FYP. These preconditions should become the main objectives of an Integrated Financial Strategy that should be implemented in parallel to the 7th FYP to ensure that adequate financing is available to support the achievement of the Plan's goals. The achievement of these objectives is a necessary but not sufficient condition for the final achievement of the objectives of the 7th FYP. In pursuing these three priority objectives, the government and its partners should adopt an integrated approach, working across concerned ministries and focusing on the comparative advantage and added value of different partners.
32. *The First Objective* relates to strengthening the quality of the budget, including the efficiency and effectiveness of public expenditures and their alignment with national priorities. According to the DFA analysis, a number of issues can be tackled under the 7th FYP. First, strategic resource allocation of the budget can be strengthened. While there is growing performance orientation of the budget, strengthening its results focus should continue to be a priority. Second, the current level of subsidization and refinancing of State-owned enterprises are major drains on public resources that can be reduced. Third, the balance between recurrent and development budgets could be more balanced. While 75 percent of the Government of Bangladesh's budget goes for recurrent expenditures in other high-growth countries such as China, the investment budget is around 55 percent. Fourth, there could be greater allocative efficiency within sectors, between sectors and in terms of the actual budgetary linkages with the 7th FYP. For example, although the Government of Bangladesh is strongly committed to social security and a concerted social protection strategy has been designed for supporting poverty reduction, the total allocation to this sector is roughly 2 percent of GDP, which is not large enough to cover the needs of the population. Fifth, although reforms to the MTBF are ongoing, developing more coherence between the recurrent and the ADP budget is the key factor in going forward.

33. *The Second Objective* pertains to addressing the challenge of deepening domestic resource mobilization with attention to its economic, social and environmental impact. Looking back at the 6th FYP, the Government of Bangladesh has recognized that the planned expansion in public expenditure as a percentage of GDP on health, education, rural development and social protection was limited by the weak expansion of tax resources. Revenue mobilization has had effects on inter-annual budget cuts and has led to increased levels of short-term borrowing, to narrow the financing gap left by lower than forecasted levels of revenue. The Government of Bangladesh supports a stronger implementation of the Tax Modernization Project with a special focus on strengthening income tax collection. Under the on-going reform of public finance, there is also a focus on increasing the equity of tax collection. There are also reforms underway to look at the way in which taxes and incentives can promote climate-compatible development. According to the DFA analysis, the Government of Bangladesh is further constrained by: the large size of the informal sector that falls out of the tax net; capacity gaps in the National Board of Review (NBR); computerization of the tax system, which needs to accelerate urgently; and other issues pertaining to tax incentives, tax evasion and the net loss from the outflow of illicit flows not captured by the NBR. These factors correspond to a challenge across the region, which is that many of the largest resource flows out of countries in the region are not productive investments in the rest of the world, but repatriated profits, repayments on loans or illicit financial outflows. The best available data estimates that the resources moved out of the region through trade mispricing alone are equivalent to almost 30 percent of inflows, totalling \$345 billion in 2011.
34. *The Third Objective* is the need for greater leverage of private sector resources behind national development priorities. As with the other priorities, an expanded role for the private sector will need to be promoted with a focus on the positive contribution that can be made to national priorities. As such, the quality of private investment in terms of its social and environmental impact will be a core concern along with GDP growth and resource mobilisation. According to the 7th FYP, 78 percent of investment for the plan should come from the private sector. However, there is still a closed capital account limiting foreign external borrowing and there is limited financial deepening in evidence in the domestic financial sector. There could be improved coherence between the different branches of the private sector strategy under the 7th FYP. A strengthened role for the Board of Investment is essential, especially for attracting and aligning FDI and national investment to the priority areas of the 7th FYP. There is a clear need to improve the business sector climate and to reduce the informality of the private sector. For this, a key element is to achieve improvements of national infrastructure (transportation and energy) for the main priority areas of the 7th FYP and to extend the access and quality of domestic finance to increase participation of national companies in PPPs and other modalities. Increased access and quality is also necessary to ensure inclusive finance and the further development of micro, small and medium enterprises (MSMEs).

Potential Contributions of the Financial Flows Analysed

35. Some of the financial flows studied with special attention in this DFA can also be instrumental for the achievement of these three objectives. Not all of these flows are under direct government control, and for some of them, the government can only aspire to influence their development to align them with national priorities. It is also important to highlight the inter-linkages between these flows and the potential synergies that can be achieved by promoting and influencing them with an integrated strategic approach.

36. The study included a particular focus on ODA, climate change finance and South-South cooperation as key resources from which to begin to build an integrated financing strategy. The contribution of the resources and the modalities for their delivery must also be considered in relation to progressing the three top strategic priorities articulated above: strengthening the budget, domestic resource mobilisation and leveraging private sector contributions to the 7th FYP. Alongside ODA, climate change finance and South-South cooperation, the report also makes specific recommendations in relation to: (i) achieving success in FDI promotion; (ii) success in the PPP strategy as a precondition to achieve long-term success for the country and for FDI promotion; (iii) the possible good opportunities of corporate social responsibility for improving the quantity and quality of private investment; and (iv) the potential importance of remittances for extending inclusive finance and promoting expansion of MSMEs.

The Way Forward: Key Challenges and Main Recommendations

37. An important observation is that the implementation of the recommendations of this DFA may require high-level political and institutional discussions to find a solution that can work in Bangladesh. Significant institutional reforms are proposed and these will need to bring together coherent policies for the different development finance flows and to align them with national priorities and results frameworks. Most of them are away from the mandate of a single ministry or government agency. It seems to be clear that during implementation, strong and coordinated leadership will be needed from the Ministry of Finance and the Planning Commission as well as from Economic Relations Division (ERD). The DFA oversight team already provides a well suited core group for such a discussion. However, this will not be enough. The agenda proposed here demands systemic reforms and involve a wide range of areas, from public administration reforms to good governance and the strengthening of the management capacity of the central government and line ministries and sub-regional governments, to name some. For all of them, a realistic test of the political will to implement them is mandatory and a realistic discussion of the best possible solution is necessary.

38. Aligning and developing non-public flows will present some of the biggest challenges to the government. The experience of the DFA has been that (i) it has been proven to be very difficult to access and collate reliable data and evidence for many of the flows for the private sector; (ii) the task of aligning private sector interests with country priorities is not always easy as some of these flows also undermine the SDGs; (iii) the government must be able to manage the social and environmental risks and opportunities that come with private sector development.

39. The government will also need to develop better tools, data and analysis – including in respect to promoting more open data. Managing resources with this new perspective will also require more holistic tools and analysis. The DFA revealed that there are still several gaps that will need some more work to resolve: (i) key data is usually confined in different government areas and hard to find or not collected at all; (ii) silo production of knowledge and analysis that obstructs its effective use and integration at more general levels is common; and (iii) a complex integration of information is needed to effectively use knowledge achieved with more traditional PFM analysis and tools. Integration of existing data systems in government, starting with the various financial data systems (aid, debt, budget, accounting) is essential.

40. While the agenda of promoting an integrated financing strategy for implementing the 7th FYP is a long-term and ambitious agenda, there are some immediate next steps that the DFA envisages. First focusing on ODA, climate finance and South-South cooperation, it is proposed that the upcoming

National Policy on Development Cooperation, as well as the proposed Joint Cooperation Strategy, integrate a concern with the three strategic objectives of: strengthening the quality of the budget; expanding domestic resource mobilisation; and leveraging private resources for the 7th FYP. Secondly, as a part of implementing these policies, ERD should work with its development partners, as well as key government ministries and departments, to build evidence from which to strengthen the contribution of ODA, climate change finance and South-South cooperation to these strategic priorities. This process will necessarily involve further data collection, case study development, analysis and dialogue. The ambition is for government and its partners to develop a common narrative of their contribution to the three strategic priorities.

41. In addition to these recommendations focused on ODA, climate change finance and South-South cooperation, which can provide the building blocks for a more integrated financing strategy, the DFA also presents a summary of the key challenges by different financial flow, as well as the expected impact of the flow on performance and potential recommendations for moving forward.

1. Background

1.1 Overview

42. Bangladesh launched its 7th Five-Year Plan 2016–2020 (7th FYP) in October 2015. The Plan aims to develop strategies, policies and institutions that will allow Bangladesh to accelerate further job creation and reduce poverty as well as comply with new commitments to meet the targets of the Sustainable Development Goals (SDGs). According to the 7th FYP, the resource envelope needed will be Bangladeshi Taka 31.9 trillion (or US\$ 409 billion) in FY2016 prices. An estimated 78 percent will come from private investment and 22 percent from public investment. The 7th FYP is ambitious from a financial perspective, particularly for the private sector. Bangladesh will face challenges to mobilize all of the resources needed to implement the 7th FYP. Although Bangladesh faces financial challenges, it is a young and growing country and there is clearly scope to identify new ways of leveraging financing for development, which would not necessarily lead to an unsustainable build-up of further debt.
43. The purpose of this analysis is thus to contribute to the policy discussion. The Government has placed a renewed emphasis on the role to be played by public-private partnerships (PPPs), increasing the current rate of remittances and foreign direct investment (FDI), as well as increased public and private savings, rapid income growth for the private sector, and increased revenue mobilization through reform and modernization of tax policy and tax administration. The new plan has also emphasized the need to increase total expenditures while increasing the value for money of public service delivery, reduction of unnecessary subsidies and transfer programmes as well as improved efficiency and productivity of state-owned enterprises.
44. A strategic approach to developing this broad diversity of financial resources can in future be captured in an Integrated National Financing Strategy (INFS), which should help the country to articulate its complex and holistic financing structures, which are based on both domestic and foreign sources of funding. The development of an INFS is a key recommendation from the Addis Ababa Action Agenda, adopted at the Third International Conference on Financing for Development (Addis Ababa, 13–16 July 2015). According to paragraph 9 of the Action Agenda:

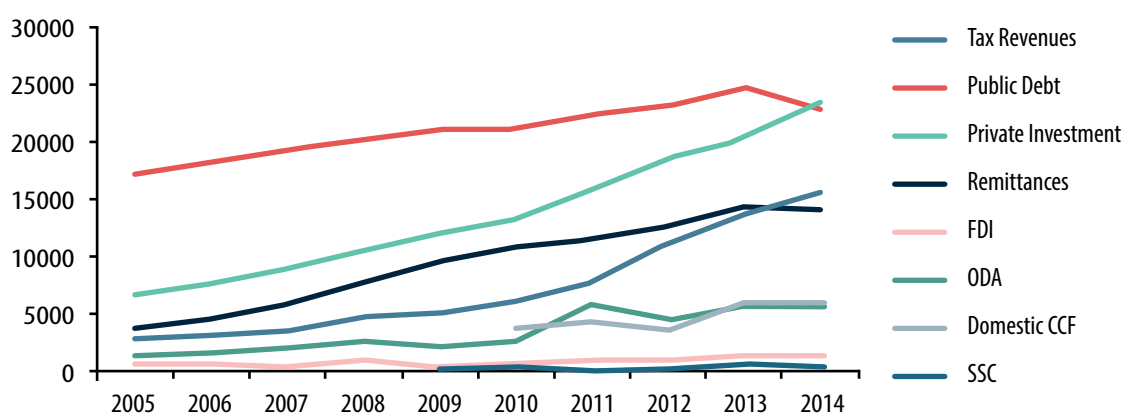
“Cohesive nationally-owned sustainable development strategies, supported by integrated national financing frameworks, will be at the heart of our efforts. We reiterate that each country has primary responsibility for its own economic and social development and that the role of national policies and development strategies cannot be overemphasized.”

Table 1.1: Financial Flows 2005–2014 in millions of US\$

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Tax Revenues	3,048	3,397	3,803	4,813	5,287	6,249	7,955	11,481	13,961	15,661
Public Debt	17,385	18,380	19,428	20,300	21,210	21,400	22,350	23,251	24,850	23,000
Private Investment	6,835	7,817	9,128	10,744	12,152	13,547	15,983	18,695	20,531	23,307
Remittances	3,848	4,802	5,978	7,915	9,689	10,987	11,650	12,843	14,461	14,942
FDI	845	793	666	1,086	700	913	1,136	1,293	1,599	1,527
ODA Commitments	1,552	1,787	2,256	2,842	2,444	2,984	5,969	4,765	5,855	5,844
Domestic CCF						3,875	4,508	3,915	5,938	6,170
SSC					507	511	249	436	813	746

Source: Bangladesh Bank, World Development Indicators (World Bank), and Ministry of Finance

45. The sources of development finance that can be directly programmed by the Government of Bangladesh are as follows: revenue, official development assistance (ODA) and borrowing/debt. It can be seen from Table 1.1 and Figure 1.1 that all of these resources have been increasing over time with a dip in performance for some flows in 2013 and 2014. Borrowing and revenue are the biggest sources of financing for the Government. In 2015, borrowing was at 18 percent of gross domestic product (GDP) and revenue as a share of GDP was around 10 percent. The ODA commitments stood at about 4 percent of GDP. Outside of the public sector, the most important development finance flows are: private investment \$23.3 billion (2014) and remittances at almost \$15 billion (2014).

Figure 1.1: Development Finance Flows in millions of US\$

Source: Bangladesh Bank, World Development Indicators (World Bank), Ministry of Finance, estimates by DFA

1.2 Objectives of the DFA

46. The objective of the DFA is to measure recent trends in development finance flows – public and private flows, external and domestic flows and evaluate policies and institutional capacity in government to manage such flows in a more coherent, complementary, and catalytic way.
47. The DFA should help provide a clear understanding of the potential sources of resources needed for its future development initiatives. The DFA is a comprehensive mapping of past and current sources of development finance. It considers domestic and public sources of development finance. On the domestic side, public sources are tax and non-tax revenue, and private sources are private investment and sources from philanthropic organizations. On the external side, public sources include ODA, climate finance and South-South cooperation (SSC) and private sources such as FDI remittances and private borrowing. The DFA includes an assessment of relevant policies, institutional arrangements, technical systems and tools and human resource capacity to mobilize, manage, deliver, monitor and report on existing and future flows, together with recommendations on the way forward.
48. The findings and recommendations of the DFA are also expected to inform the implementation of the 7th FYP. It will also inform the Development Cooperation Policy and Joint Cooperation Strategy, as well as the institutional arrangements necessary to implement the Policy. Importantly, the DFA will also inform the institutional restructuring of the Economic Relations Division (ERD), in the Ministry of Finance. While the ERD has in the past concentrated its work on the management of traditional ODA, the proposed new Development Effectiveness Wing will have responsibility for the effectiveness of ODA as well as SSC, innovative finance, and climate change finance.
49. The DFA will:
 - Measure recent trends in development finance flows and their allocation to national priorities. This includes ODA and non-ODA, public and private flows, and other external and domestic flows.
 - Attempt to analyse the interface between different flows and the overlapping complementarities between the different sources of development finance.
 - Analyse institutional capacity and coherence in the government to manage such flows and make recommendations for improvements.
 - Serve as a starting point to strengthen cross-government coordination, especially ensuring the engagement of the Ministries of Finance and Planning as well as the involvement of the private sector, civil society and development partners.

50. The flows analysed under the current DFA are:

	Public	Private
External	ODA Grants and Loans	Foreign Direct Investment
	Public Borrowing from K-Markets	Overseas Remittances
	South-South and Triangular Cooperation	International Non-governmental Organizations (INGOs)
	Climate Change Finance	Private Borrowing from K-Markets
	Vertical Funds (GAVI and GFATM)	
Domestic	Tax and Non-tax Revenues	Private Borrowing
	Public-Private Partnerships	Inclusive Business Finance
	Public Domestic Borrowing	Domestic Philanthropy and Non-governmental Organizations
	Sovereign Wealth Funds	Corporate Social Responsibility Linked to Development
	Climate Change Finance	

51. In addition to providing the overview of the development finance flows listed in the dashboard above, the DFA will look more in depth at the following “focus flows” selected by ERD: (i) ODA; (ii) climate change finance; (iii) South-South and Triangular Cooperation (SSTC); (iv) PPPs; (v) remittances; and (vi) FDI.

52. The DFA was requested by the Government of Bangladesh, with UNDP support. A DFA oversight team was responsible for quality assurance of the DFA. The oversight team was composed of a wide range of government officials who were responsible for providing information, data and feedback on briefings and draft reports of the DFA. A list of members of the oversight team is contained in Annex E. Consultative meetings with the oversight team were held in May and October 2015. The oversight team provided a complete set of comments on the draft assessment, which were then incorporated into the final report. The remainder of the report is structured as follows: chapter 2 will reflect on the socioeconomic and political context of Bangladesh; chapter 3 will focus on domestic finance and policy context flow analysis; chapter 4 will focus on external finance and policy context flow analysis; and chapter 5 will provide key findings and recommendations from the DFA. There are seven annexes included in the document: Annex A, a glossary explaining the meaning of all the flows assessed in the assessment; Annex B, the bibliography; Annex C, an explanation of the importance of Bangladesh transitioning to a Lower Middle-Income Country (LMIC); Annex D, an overview of the progress of Bangladesh in meeting the Millennium Development Goals (MDGs); Annex E, a list of DFA Advisory Committee for Bangladesh; Annex F, key challenges and impacts of key flows and areas for the DFA; and Annex G, key recommendations for Bangladesh 2015-2020.

2. Socioeconomic and Political Context

2.1 Socioeconomic Context

53. The economy of Bangladesh is maintaining stability and moving forward, in spite of recent challenges. The economy faced several key challenges such as political uncertainty, global economic slow-down and a growing infrastructure deficit in recent years. Despite these challenges, advancements in the socioeconomic sphere have been achieved.
54. The 6th FYP sought to reduce head-count poverty from 31.5 percent in 2010 to 22.5 percent by 2015. The incidences of poverty and extreme poverty have both exhibited considerable reduction since 1990. The incidence of poverty has fallen below 25 percent while that of extreme poverty has declined to around 12 percent. Importantly, Bangladesh has achieved the MDG target of halving the incidence of poverty between 1990 and 2015.

Table 2.1: Poverty Head-Count Rates (percentage)

	Upper Poverty Lines					Lower Poverty Lines				
	1991/92	1995	2000	2005	2010	1991/92	1995	2000	2005	2010
National	56.8	53.1	49.8	40	31.5	41.3	34.4	33.7	25.1	17.6
Urban	42.6	35.0	36.6	28.4	21.3	23.6	13.7	19.1	14.6	7.7
Rural	58.7	56.7	53.1	43.8	35.2	43.7	38.5	37.4	28.6	21.1

Source: Household income and expenditure survey, Bangladesh Bureau of Statistics (BBS)

55. The 7th FYP seeks to reduce the poverty rate to below 19 percent and extreme poverty to around eight percent by FY2020. Along with growth, the 7th FYP will emphasize human development, social protection and social inclusion as essential elements of a comprehensive poverty reduction strategy. According to the 2014 United Nations Development Programme Human Development Index (HDI), Bangladesh is ranked 142 among 187 countries with an HDI score of 0.558.³ Domestic employment increased from 54.1 million in 2010 to 58.1 million in 2013. The domestic economy has added about 1.3 million jobs per year on average.⁴

Table 2.2: Sixth Five Year Plan Key Targets of the Macroeconomic Framework

Policy Area	Performance Indicators	Baseline (FY2010)	Plan (FY2015)	Actual (FY2015)
Fiscal Policy	Tax to GDP ratio (%)	7.8	12.4	9.3
	Fiscal Deficit (% of GDP)	3.7	5.0	4.7

³ The Human Development Index (HDI) is a composite statistic of life expectancy, education, and per capita income indicators, which are used to rank countries into four tiers of human development.

⁴ The World Bank 'Bangladesh Development Updates,' April 2015

Policy Area	Performance Indicators	Baseline (FY2010)	Plan (FY2015)	Actual (FY2015)
Balance of Payments	Average growth rate of Exports (%)	-	17.5	14.0
	Current account balance (% of GDP)	3.7	(-) 0.4	0.8
	Remittance (billions of US\$)	10.9	17.8	14.9
	Foreign Reserves (month of imports)	3.0	3.3	6.3
Inflation Management	Rate of CPI inflation (%)	7.3	6.0	6.5
	Growth of M2 (%) (end of year)	22.0	16.0	16.2

Source: 6th FYP and GED Estimates

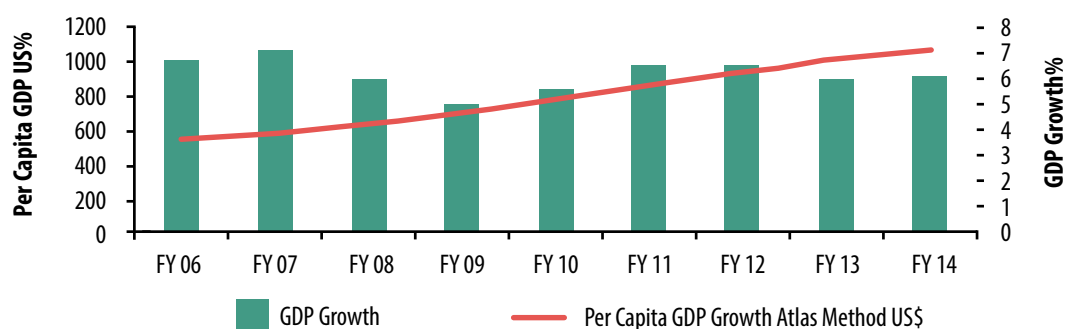
56. Bangladesh has made significant progress against the MDGs. Please see Annex D for a full overview of Bangladesh's progress in meeting MDG targets. Given the notable successes achieved in relation to the MDGs and also in the context of various other developments, Bangladesh is set to make progress against the Sustainable Development Goals (SDGs). However, environmental pressures, exacerbated by climate change, will remain significant. Better social service provision, especially in health and education, is also key to Bangladesh's continuing development agenda.

2.2 Economy

57. Bangladesh is a LMIC according to World Bank classifications and a least developed country (LDC), according to the United Nations.⁵ Between 2010 and 2015, GDP growth averaged 6 percent. The economy is increasingly based on export-led development. In particular, the textile industry is the second largest in the world. Other key sectors for Bangladesh include shipping, pharmaceuticals, ceramics and electronics. Agriculture also makes a key contribution, including for cash crops such as rice, jute, tea and wheat. Bangladesh is currently ranked fifth in the world in terms of its production of fish and seafood. Remittances from overseas workers reached \$15 billion in 2014 (Government of Bangladesh, 2015).

58. Since gaining independence in 1971, Bangladesh has experienced a steady increase in the growth rate of real GDP, accelerating from an average of less than 4 percent per year during 1974–1990 to 6.4 percent in 2010–14. The 7th FYP forecasts a growth rate annually of 7 to 8 percent of GDP.

Figure 2.1: Growth and Per Capita GDP



Source: Ministry of Finance

⁵ See Annex B for information on LDCs and MICs

59. Government policy has been engaged in structural change of the economy and economic transformation. Policy is focused on shifting the economy from a traditional agrarian based economy to a modern manufacturing and service focused country. The expansion of non-farm rural enterprises into light manufacturing particularly in the textile sector and modern services such as banking, and information technology has done particularly well. GDP share of industry increased from 26 to 28 percent, with the share of manufacturing growing to 17 percent from 18 percent during the 6th FYP.

Table 2.3: Structural Change in the Economy during the Sixth Five Year Plan (percentage of GDP)

Structure of the Economy	FY2010	FY2015
Agriculture	18	16
Industry	26	24
Manufacturing	17	18
Services	56	56

Source: Bangladesh Bureau of Statistics

Private Sector Economic Trends

60. External factors such as exports, imports, remittances and foreign aid have always played important roles in the economy of Bangladesh. However, the relative importance of the various external factors has changed over time. In the 1970s, the growth of the economy was sluggish and growth of exports was insignificant. Both the balance of trade deficit and the current account deficit as a proportion of GDP almost doubled between FY1973 and FY1980. During that period the country was following an import substitution industrial policy and the global economy had a protectionist approach to trade. In addition, the country was recovering from the losses of the Bangladesh War of Independence in 1971, domestic real shocks from consecutive droughts in 1972 and 1973 and floods in 1974. The country faced a number of international shocks such as the oil price shock of 1973, the food price shock as a consequence of the bad weather of 1972 and 1973, and a demand shock for exportable jute products originating from synthetic substitutes of jute and the oil price shock of 1979. As a result, the economy had to depend heavily on foreign aid to meet its demand for foreign currencies in the 1970s.

61. During the 1980s, Bangladesh began to shift from import substitution and industrial and protectionist trade policies, to export-oriented industrial policies. The country initiated important reforms in domestic policies. Bangladesh experienced an accelerated pace of global integration of its economy in the 1990s. Economic reforms gained momentum in the 1990s and successive governments pursued an export-led growth strategy. In addition, Bangladesh was able to get increased market access with reduced tariff rates provided by some developed countries to export commodities. The volume of FDI gradually increased, and participation of Bangladeshi workers in the global labour market also increased, which resulted in increased remittances to the country.

62. Currently, remittances and exports are the key drivers of the economy of Bangladesh. On the demand side, domestic consumption, fed by strong growth in remittances, has contributed to 70 to 80 percent of the growth in the past decade. Remittances, combined with growth of readymade garment (RMG) exports, which now account for over two-thirds of export earnings, have been the major contributors

to current account inflows, leading to a positive current account balance in recent years. In FY2010, while the global slowdown dampened the growth of exports, remittances continued to be robust, keeping the current account in surplus.

63. The performance of the external sector since 2010 is satisfactory with both exports and imports registering higher growth despite the political unrest in the country. Bangladesh has maintained export competitiveness in her major export items, and exports-maintained growth rates of above 10 percent while imports remained production and growth oriented. Only about one seventh of total imports were for food grains and other food items, the rest were petroleum products, raw materials and capital goods. The trade deficit has been on the decline with strong export growth from a narrow base. Lower growth of import payments, compared to export receipts coupled with remittances, resulted in a significant increase of foreign exchange reserve. The Bangladeshi Taka to United States Dollar exchange rate has remained almost stable since 2010.
64. Merchandise exports (free on board) increased by \$3159.26 million (or 12 percent) in FY2014, totalling to \$30,186.62 million. Despite the negative growth of petroleum by product, raw jute, jute goods and specialized textile, other major exportable items showed positive growth. Exports of tea, leather and leather products, frozen shrimp and fish, knitwear and woven garments contributed significantly to increase the growth of merchandise exports in FY2014 over FY2013. The export of miscellaneous products, summed as the "others" category, showed a positive growth of 6.09 percent in value terms during FY2014. However, as a percentage of GDP, exports decreased by 0.16 percent points from 17.53 percent in FY2013 to 17.37 percent in FY2014. Merchandise imports increased by \$6,609 million (19.39 percent) in FY2014 to \$40,692 million over FY2013.
65. Export earnings are growing at an increasing rate over the years because of the increasing exports to the traditional and non-traditional markets. In FYs 2013 and 2014, major exports by country went to the United States equivalent to \$5,583.62 million which was 18.50 percent of total exports as compared to 20.1 and 21 percent in the same period of FY2012/2013 and FY2011/2012 respectively. Various commodities such as fish and shrimp, jute goods, leather, raw jute, RMG were the highest contributor to increase export of Bangladesh. The second largest buyer was Germany which amounted to \$4,721 million having the share of 15.6 percent in FY2013/2014 as compared to 14.7 percent in the previous fiscal year. The RMG exports to Germany were \$4,720.5 million in FY2013/2014 having a growth of 19.13 million over the previous FY2 2012-2013. In addition, total exports to Canada, France, Italy, the Netherlands, Spain, Turkey and the United Kingdom increased in FYs 2013 to 2014, but the total exports to India has decreased.
66. There has been a significant growth of imports of oil seeds, food grain, tanning and dyeing extracts, milk and cream, plastics and rubber articles thereof, clinker, edible oil, capital machinery and sugar etc. induced to increase overall import during the year, despite negative import growth of crude petroleum and fertilizer. Imports (f.o.b.) as a percentage of GDP decreased by 1.3 percentage point from 22.4 percent in FY2013 to 21.0 percent in FY2014. Satisfactory growth of gross imports along with strong export growth led to a lower trade deficit during FY2014 compared with FY2013. The trade deficit came down from \$7,009 million in FY2013 to \$6,800 million in FY2014.

2.3 National Framework for Planning and Budgeting in Bangladesh

67. The Government of Bangladesh developed “Vision 2021” in 2010, a general strategy that delineates economic and social outcomes to be achieved by the year that marks the 50th anniversary of the country’s independence. An associated “Perspective Plan 2010–2021” was also developed to transform this vision into long-term development targets. The goals of the Perspective Plan 2010–2021 were to be achieved through the implementation of two five-year plans, the 6th FYP (2011–15) and the 7th FYP (2015–2020).
68. With a clear focus on accelerating growth and reducing poverty, the 6th FYP made solid progress in increasing per capita income and reducing poverty focusing on several approaches of pro-poor economic growth. The plan also introduced the concept of results-based monitoring and evaluation in Bangladesh. It was conceived as a living document that would be monitored for results, using the Results Framework provided, and changed and adapted in light of these outcomes and changing global and domestic economic environment.
69. The 7th FYP focused on accelerating growth and empowering citizens does not deviate significantly from the previous one and aims to complete the remaining agenda of achieving the outcomes of the Vision 2021. The Plan proposes ambitious social, economic and environmental targets to be achieved by 2020 and incorporates the key elements of the National Sustainable Development Strategy that was developed to address the challenge of mainstreaming the SDGs across all sectors.
70. Financial estimates of the 7th FYP are provided in the Medium Term Macroeconomic Framework that presents the main growth projections for key variables and analyses the necessary investments that will be required to achieve the objectives of the plan. These projections include detailed targets for the mobilization of domestic and external, public and private resources (Table 2.4 below).
71. A significant aspect of these financial projections is that from the total estimated envelope of the plan of Tk 31.9 trillion or \$409 billion, almost 22 percent (Tk 7.25b) should be financed by the public sector and 78 percent (Tk 24.7b) by the private sector. This will require substantial expansions of private and public investment, which are expected to be driven by:

Table 2.4: Financing of Seventh Five Year Plan Investment (FY2016 prices)

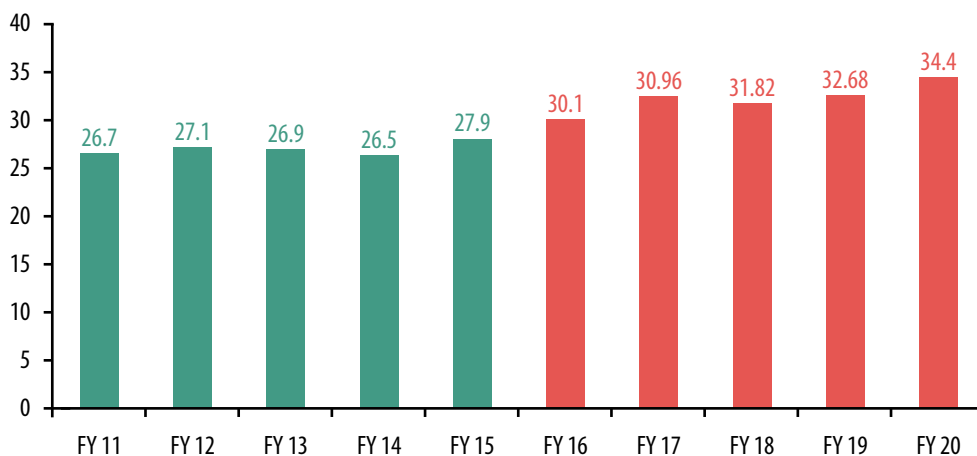
Item: BDT in Billions	Total	Share (%)	Public	Share (%)	Private	(Share %)
Total Investment	31,902.8	100.0	7,252.3	100.0	24,650.5	100.0
Domestic Resources	28,851.0	90.4	6,384.6	88.0	22,466.4	91.1
External Resources	3,051.8	9.6	867.6	12.0	2,184.1	8.9

Source Government of Bangladesh: Planning Commission – GED 7th Five Year Plan, 2015

- An increase of the overall growth rate of 7.4 percent of GDP from the average level of 6.3 percent recorded under the 6th FYP. Forecasted increase to 8 percent by 2010 according to the 7th FYP;

- Total government revenue to be raised from 10.7 percent of GDP to 16.1 percent (from Tk 1.690 to Tk 4.728 trillion in 2020);
- A marked expansion of tax revenue from 9.3 percent to 14.1 percent of GDP almost tripling current revenues from Tk 1.406 to Tk 4.052 trillion;
- A substantial growth of FDI from 0.9 percent to three percent of GDP, which will demand an almost six-fold expansion of the present volume (from \$ 1.7 billion to \$9.6 billion);
- An overall expansion of the manufacturing sector to 21 percent of GDP by FY2020;
- A steady share of remittances to 8 percent of GDP, which will require these flows to grow from \$ 15 billion in 2015 to \$25 billion in 2020; and
- A substantial increase of private sector infrastructure investment driven by PPPs, which in the infrastructure sector alone should grow from 0.2 percent to 1 percent of GDP.

Figure 2.2: Seventh Five Year Plan Investment Requirements (as percentage of GDP)



Source: Government of Bangladesh Planning Commission – GED 7th FYP, 2015

2.4 Public Financing of Development: the Planning and Budget Processes

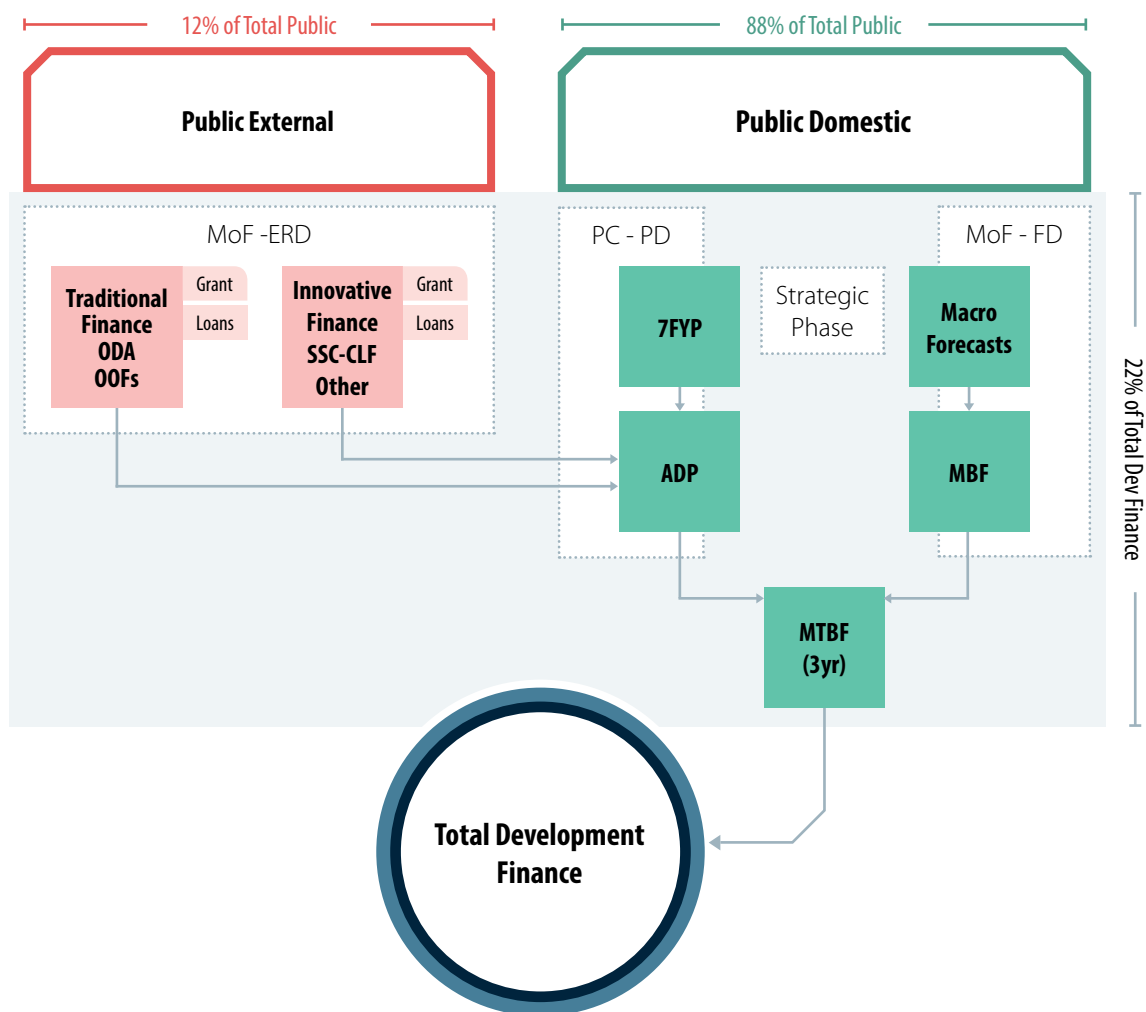
72. The budget process is built around the preparation of a three-year Medium Term Budget Framework (MTBF). The MTBF proposes the programming of development and recurrent expenditures and has been rolled out across all government to improve the efficiency and effectiveness of public expenditure and ensure the attainment of the strategic goals and objectives of the Government. Under the MTBF, the budget preparation process is completed in three phases: (i) strategic phase (ii) estimating phase and (iii) budget approval phase. The MTBF encourages LMs to allocate resources for programs integrating recurrent and capital spending and medium-term expenditure plans in line with FYP priorities. This process is led by the Finance Division of the Ministry of Finance.

73. For the line ministries, the budget process starts in November, when the Finance Division sends the Budget Call Circular 1 (BCC1). This document provides estimates of the preliminary indicative expenditure ceilings and revenue targets⁶ and requests them to provide their draft Ministry Budget

⁶ These indicative resource ceilings are based on the outer-year forecasts from the previous MTBF rolled forward for a further year.

Frameworks (MBFs) by January. A Second Budget Call Circular (BCC2) is sent in April and provides Indicative Expenditure Ceilings and requests the preparation of detailed annual budget proposals. These ceilings take into account the updated macroeconomic and fiscal frameworks and the conclusions from the evaluation of the draft MBF submissions in tripartite meetings between the Finance Division, Planning Commission and individual ministries.

Figure 2.3: Simplified Integration of Planning and Budget Process



74. The planning process is led by the Planning Commission that has the mandate for developing and managing the implementation of the long-term vision and FYPs and for ensuring coherence of the annual planning process with longer-term goals. The Planning Commission acts as the central planning organization of the country. The Prime Minister is the Chairperson and the Minister for Planning is the Vice-Chairperson of the Commission. There are six Divisions under the Planning Commission: two of the Divisions (The General Economics Division and Programming Division) deal with the general macro issues of the economy and the other four Divisions deal with the planning and policy issues of different sectors of the economy. While the Planning Commission does not have direct responsibility for ministry-level planning, it has an important role in supporting the policy development process, in reviewing policy and strategy proposals and in ensuring their consistency

with overall macro-level policies and strategies. The Planning Commission also has the responsibility for developing cross-sector policies and strategies (e.g. environment and climate change, inclusive and resilient development, and gender and inequality) and to ensure coherence of line ministry annual plans with these goals.

75. The main contribution of the planning process to the budget is the preparation of the Annual Development Programme (ADP), led by the Programming Division of the Planning Commission. The ADP is a list of public investment and technical assistance projects that are financed through the annual development budget. Around February each year, the Programming Division issues the ADP Call Circular 1 (ACC1) providing guidelines for ADP preparation and instructions for line ministries to allocate resources among various development programmes and projects detailing sector priorities, aligned with the national development plan priorities. The guidelines are based on national plans and strategies and are informed by the budgetary ceilings and provisions established in the Budget Circular 1. The ADPs are structured across an ad hoc categorization of 17 sectors and 31 subsectors defined by the Programming Division. All ADP submissions are scrutinized by the Planning Commission, which has the final say in ADP allocations.
76. Coherence for the usage of public external finance in the budget process is provided by the participation of the Economic Relations Division (ERD) of the Ministry of Finance. The ERD leads as the focal point of the government for interfacing with development partners as well as for co-ordination of all public external assistance inflows to the country. The Government of Bangladesh budget includes ERD's estimates of project expenditure funded by development partners and government counterpart contributions for all projects for which agreements have been signed before the start of the fiscal year. A further estimate is undertaken to capture projects, which may start after the annual budget process. The ERD participates both in the Medium Term Budget Co-ordination and Technical Committee Working Group for the Macroeconomic Framework that are key in this process. The estimates/projections for ADP expenditure sent by the line ministries must be in line with the projections of foreign assistance prepared by the ERD for five years. The estimates of foreign-aided projects must ensure the reflection of the estimates of aid and reimbursable project aid as prepared by the ERD.
77. While the traditional focus of the work of ERD was mainly on ODA management (grants and loans), recent institutional changes will allow ERD to step up in the mobilization of other, less traditional flows of development finance, building on the lessons learned from ODA management and effectiveness of traditional aid. A new wing for development effectiveness was recently approved and will initially focus on achieving better coordination and usage of South-South cooperation (SSC) and climate finance and explore other types of development finance to ensure maximum development impact of emerging finance flows.
78. The introduction of a more strategic and performance orientation in budgeting and the successful development and implementation of MTBFs is a milestone for present and future achievements in Bangladesh's public financial management reforms. The introduction of the MTBF has recorded a number of achievements: (i) sectors have improved considerably their budgeting accuracy and the near elimination of overexpenditure;⁷ (ii) assisting to shape inter-sector budgetary resource allocations that

⁷ However, the high budgeting accuracy is not fully working for all line ministries. Overall accuracy is achieved partly due to the fact that overspending in some sectors is compensated by underspending in others.

are broadly in accordance with strategic policy priorities; (iii) introduction of demand side discussions for better budgeting within the executive motivating line ministries to prepare better budget submissions; and (iv) highlighted the need for better budget execution and procurement systems.

79. More importantly for the DFA analysis is that this introduction has initiated a strategic phase to budget development that focuses on the implications of strategic policy priorities for the allocation of resources under the budget. Once completely strengthened, this strategic process could allow the future analysis of other sources of finance that are also important to develop, but not necessarily under the direct control of the government. This strategic planning process could eventually lead to the development of more holistic Integrated National Financial Frameworks that will be necessary to mobilise the resources required to achieve the SDGs. However, before that can happen there are many aspects in this process that must be consolidated, further strengthened or that need improvement.
80. The budget, in particular ADP, should be a vehicle for attaining medium-term and long-term development aspirations of Bangladesh. But the links between the ADPs and the FYPs are weak: (i) the budget under MTBF is prepared on three-year basis whereas the ADP is prepared on annual basis, which leads to a mismatch in resource allocation; and (ii) the sector categorization structure of 17 sectors and 31 sub-sectors used by the Programming Division in the ADP planning process does not match the broader sector categorization defined in the FYP. On the other hand, the budget is prepared by dividing the economy into 13 sectors. This warrants not only sector alignment but also synchronization in resource allocation to ensure coherence.⁸ The ADP circular does not provide clear instructions to line ministries and agencies on how to prioritize and propose development projects. In such situation, projects can be justified within very broad criteria, leading to the proliferation of a large number of projects in the ADP that are not aligned with the country's long-term development objectives. The ADP tends to underspend by a greater amount than the non-development budget.
81. (i) *There are still important disconnects between the ADP and the MTBF.* The BCC1 is issued around November and it requests line ministry submission in December or January. However, the ADP Circular is only issued to the line ministries around February. This creates a situation in which the line ministries are requested to present to the FD their medium-term Ministry Budget Frameworks (which include estimates of expenditure, strategic objectives and activities and priority spending areas/programmes) before they received the indicative guidelines from the detailing annual sector priorities and their alignment with the national development plan priorities. This situation not only complicates the work of the line ministries but also undermines the accuracy of the following tripartite negotiations.
82. (ii) *Public capital investment is undertaken through two parallel streams: Annual Development Planning (ADP) and non-Annual Development Planning.* Most public investments are financed through the ADP. However, it has been recently noted that an increasing proportion of public investment (mainly "net lending" to state-owned enterprises) is financed outside the ADP.⁹ Development expenditure was worth 33 percent of expenditure excluding net lending, and 40 percent of expenditure including net lending in FY2014, much of which is investment funneled through state-owned enterprises. In both cases, it represents an increase of 7 percent points since FY2010.¹⁰ This provides some benefits and poses some challenges. This practice may provide flexibility to the government, but it also creates fragmentation and poses questions for planning and execution efficiency.

8 Ashan, F. "Importance of Linking MTBF and ADP (PIP): Use of MTBF as an Instrument for Achieving country's Long and Medium Term Economic and Social Development objectives" Planning Commission GED, 2015

9 World Bank, "Bangladesh Public Expenditure Report," 4 August 2015, pp. 1–62.

10 Ibid.

83. (iii) *The medium-term budget process still needs further improvement to fulfil some of its strategic goals.* The MTBF still needs improvement to be able to achieve its goal of strengthening the linkage between policy priorities and resource allocations. The budget is presented in a format that does not yet clearly highlight policies and programs that are being financed and thus does not facilitate policy analysis and allow cabinet or parliament to have more informed discussions of intra-sector allocations. A recent Climate Public Expenditure and Institutional Review (CPEIR)¹¹ study in Bangladesh reviewed the MBFs of all 37 line ministries involved in the delivery of climate spending and noted that almost 45 percent of planned climate sensitive expenditure was not referenced in the MBF. Hence, most ministries involved in climate-sensitive activity made no reference to climate in the key performance frameworks or KPIs delivered in their MBFs.
84. (iv) *There is room for improving the operational efficiency of the budget.* The introduction of the MTEB established a framework for performance monitoring of the budget, but this function is yet to be perfected. Recent analysis by Public Expenditure and Financial Accountability (PEFA) (a multi-donor partnership) concluded that notwithstanding recent developments, budget management continues to suffer from fragmentation between the revenue and development budgets, as well as from weak financial systems and controls.¹² Overall performance of the ADP portfolio, in terms of planning and execution, has been less than desirable, notably owing to: (i) more than 80 percent of projects take more time than envisaged at the time of planning; and (ii) there are cost overruns in about a quarter of the completed projects.¹³ These cost overruns and delays undermine the economic returns to investment and postpone the envisioned benefits further into the future. This problem is partly caused by allocative inefficiencies visible through the systematic addition of significant numbers of small projects (through a revised ADP) just a few months after the budget is approved, which is not in line with best budgetary practices.

2.5 Governance

85. Bangladesh has made significant progress in building and consolidating on key institutions to safeguard its democracy and rule of law since its independence in 1971. A number of notable acts and policy passed by parliament towards good governance which include *The Citizenship (Amendment) Act, 2009; Money-laundering Prevention Act, 2009; Anti-Terrorism Act, 2009; Right to Information Act, 2009; Consumer Protection Act, 2009; the Overseas Employment Migrants' Act, 2013* and the *Code of Criminal Procedure (Amendment) Act, 2009* (Sangshad Bulletin, 2012). The *National Human Rights Commission and Right to Information Act 2009* and the National Integrity Strategy not only enhances the ability of citizens to participate in government programmes but also enhances the power of civil society to ensure accountability of government officials towards its citizens.
86. Local government in Bangladesh is enshrined in the constitution and the main legislative texts include *Local government Ordinances, 2008; the Zila Parishad Act 2000 and the Hill District Local Government Parishad Act 1989*. Recently, *Local Government (Union Parishad) Act 2009, Local Government (City Corporation) Act 2009 and the Local Government (Pourashavas) (Amendment) Act 2010* were passed, which further enhanced transparency, accountability and good governance. Local governments also have the power to levy taxes and rates and the range of functions for which local authority is responsible.

11 Planning Commission, GED, "Bangladesh: Climate Public Expenditure and Institutional Review (CPEIR)," 16 November 2012

12 Government of Bangladesh, Public Expenditure and Financial Accountability 2015 draft Assessment

13 Ibid, World Bank, 2015

87. Vision 2021 recognises a key role for governance institutions in implementing the plan and highlights reform of the civil service and other central institutions as well as combating corruption. Vision 2021 commits to: 1) guarantee the rule of law; 2) avoid political partisanship; and 3) build a society free of corruption (Vision 2021). The plan outlines the need to develop civic participation as a key constituent part of stability and middle income status with the development of a “culture of democracy [...] a primary focus of governance.”
88. Tools for realising Vision 2021 include strengthened oversight and accountability of government, wide participation and better access to information, as well as capacity building of the judiciary to ensure it is independent from the executive branch of the state. In addition, Vision 2021 focuses on increased gender balance in public life, law and order, and reform of the civil service, as well an increase in local governance with devolved powers.
89. As in all countries, judiciary is one of the crucial mechanisms to ensure accountability of government officials as well as human rights in their respective countries. In Bangladesh, there are extensive pressures on the judiciary, which currently lacks capacity and is confronted with 3.1 million pending cases across the higher and district courts (Supreme Court, 2015). Access to justice in Bangladesh is considered to be limited, particularly for the poor, with lengthy court cases that can take on average five years to be concluded and which may incur prohibitive costs (UNDP, 2014a). In addition, the justice sector lacks capacity and resources to carry out their mandate (World Justice Project, 2015b).
90. Participation of the private sector, NGOs, civil society and media have been very proactive in Bangladesh. The NGOs and human rights defence organizations are valuably working to increase empowerment of communities, protecting the rights and interest of the poor, and also for protection of vulnerable citizens through various educational, awareness-raising and litigation aid programmes. However, obstacles are still there in terms of implementing major reform policies.

3. Domestic Finance: Institutional and Policy Context Flow Analysis

3.1 Overview

91. The availability and quality of domestic finance will be a decisive element to support the rollout of the 7th FYP for development and for the implementation of the Post-2015 Development Agenda. Domestic resource mobilization should be a top priority for every country in the context of the INFF financing strategy. Increasing domestic resources is a key issue for Bangladesh both because it has one of the lowest revenue-to-GDP ratios in the world and because as the country transitions to an LMIC it will have less access to International Development Association grant flows and to non-concessional borrowing. Sustainable development will depend not just on the expansion of domestic finance but also on the achievement of substantial improvements in the efficiency of public expenditures. This section will focus on the following issues: (i) taxation; (ii) borrowing; (iii) PPPs; (iv) sovereign wealth funds (SWFs); (v) domestic climate finance; (vi) inclusive business finance; (vii) domestic philanthropy and NGOs; and (viii) corporate social responsibility linked to development.

3.2 Tax Revenues

92. Bangladesh's performance for NBR revenue, income tax and value-added tax (VAT) performance as compared with targets from the 6th FYP has been somewhat erratic. Revenues did grow by almost 1 percent of real GDP, under the 6th FYP and tax to GDP ratios are around than 10 percent of GDP per annum. In nominal terms, total revenue has also been growing steadily on annual basis. However, in most cases the real achievements for individual tax categories have fallen short of expectations of the 6th FYP.

Table 3.1: Growth in Tax Revenue in Recent Years

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Tax Revenue share of GDP (%)	9.3	9.0	9.6	9.8	10.0	10.4	10.9	11.6	10.4	10.8

Source: National Board of Revenue

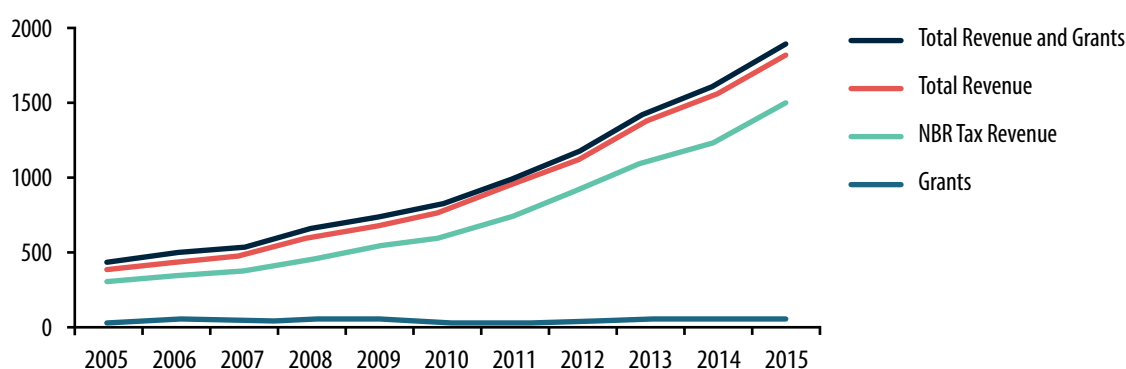
93. The major shortfall in terms of GDP ratios are to some extent, attributable to the upwards revision of GDP with a rebasing of GDP to FY2005 from the previous base of FY1995. The upward revision of GDP amounted to a 1.2 percent point of GDP discrepancy. With the revision, the shortfall for end FY2015 target is about 1.5 percent, given actual turnout was 10.8 percent versus a target of 12.3 percent.

Table 3.2: Comparing Bangladesh Tax/GDP to its Regional Partners

Country	FY 11	FY 12	FY 13	FY 14
Bangladesh	10.1	10.4	11.6	10.4
India	16.3	16.3	17.2	17.9
Nepal	13	13.9	15.3	16.3
Pakistan	9.3	10.2	9.8	14.0
Sri Lanka	12.9	12.0	11.6	-

Source: Ministries of Finance of Pakistan, Nepal, and India, Central Bank of Sri Lanka, NBR Bangladesh

94. Non-tax revenues at 2 percent of GDP have not shown any sign of improvement over many decades. With the starting of trade reforms and the introduction of VAT, dependence on customs, duty has also declined and the relative importance of domestic taxes like VAT and direct taxes has increased. The expected target for 2020 is to raise revenue to GDP to 16 percent.

Figure 3.1: Breakdown of Sources of Revenue 2005–2015 in billions of Taka

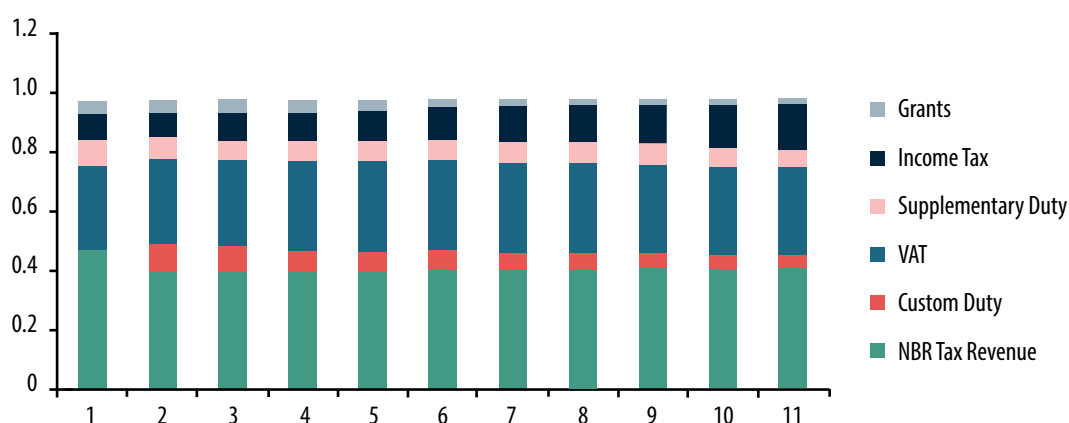
Source: NBR

95. Implementation of the Tax Modernization Plan has not been as fast as expected. Tax administration improvements have been lower than expected because of delays in the computerization of the tax system. This has also resulted in overly strong discretionary powers of the NBR to grant tax incentives and to support tax evasion. The present system involves person-to-person contact with taxpayers through 100 percent desk audits in the case of income tax and physical inspection based enforcement in the case of VAT. The country is further challenged by its narrow tax base, and combined with the monetary waste for exemptions and tax holidays, this has also further impeded the amount of tax which can be collected. Tax administration is, however, increasingly moving towards a computerized system that can ultimately provide support for spot checks, automatic tax report generation, and enforcement of tax compliance in the future. The NBR is also looking to revise the national income tax code to developing a direct tax code for the country.

96. Looking forward, the main sources of tax should be derived from domestic sources to ensure sustainability of finance for development, mainly from income tax and VAT. Expansion of the tax base would enable the taxation of more individuals and companies. However, since a major part of

the Bangladesh economy is informal, the Government of Bangladesh needs to work on registering informal individuals and companies to bring them into the NBR net. Expansion of the income tax base and bringing more individuals and companies under the tax net and under the withholding mechanism would certainly help to drive revenue growth and to achieve levels enjoyed by neighbouring countries. Initiatives and incentives that could be provided by the government to formalize these activities would greatly enhance the tax potential on the domestic side while making it possible to achieve the targets set under the 7th FYP.

Figure 3.2: Share of Tax and Non-tax Revenue in Total Taxes 2005–2015



Source: National Board of Revenue

97. Bangladesh's tariff regime would also need to be restructured in order to reduce effective protection levels and the consequent anti-export bias. In order for the government to continue on a path of sustainable export growth with a diversified basket of goods, trade and industrial policies have to be geared more towards a dynamic and globally-competitive manufacturing sector. Bangladesh would have to restructure its tariff regime in order to reduce gradually effective protection levels and consequent anti-export bias. In view of the currently high levels of tariffs on final consumer goods, the proposed structure calls for a gradual but significant reduction of tariffs on these goods while making modest adjustments to input tariffs along the way. According to the Government of Bangladesh (2015), this trend in the structure of output-input tariffs seems to be the right path, if Bangladesh is to undergo transformative change in its structure of production where production, jobs and income hinge on the success of exports, which by FY2020, could reach \$59 billion and constitute 30% of the GDP, from 17% in FY2015.

Table 3.3: Revenue Structure in the Seventh Five Year Plan Period (FY2016-FY2020)

As percentage of GDP	FY14	FY15	FY16	FY17	FY18	FY19	FY20
	Actual	Revised Budget	7th FYP Period				
Total Revenue	10.4	10.8	12.1	13.5	14.3	15.1	16.1
Total Tax Revenue	8.6	9.3	10.6	11.5	12.3	13.1	14.1
NBR Tax Revenue	8.3	8.9	10.3	11.1	11.9	12.7	13.7

Table 3.4: Major Components of Revenue under the Seventh Five Year Plan Period (FY2016-FY2020)

As percentage of GDP	FY14	FY15	FY16	FY17	FY18	FY19	FY20
	Actual	Revised Budget	7th FYP Period				
Customs Duty	1.0	1.0	1.1	1.2	1.2	1.2	1.3
VAT+SD	4.5	4.6	5.4	5.7	6.4	6.6	7.0
Income Tax	2.6	3.2	3.7	4.1	4.3	4.9	5.4
Others	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Non-NBR Tax	0.3	0.4	0.3	0.4	0.4	0.4	0.4
Non-Tax Revenue	1.8	1.5	1.5	2.0	2.0	2.0	2.0

Source: National Board of Revenue and Seventh FYP Projections

98. In light of these considerations, achieving the tax revenue target under the Plan will require prioritization in relation to some other reforms as well. The required growth rate of taxes would be about 24 percent per annum over the entire 7th FYP period, which will require significant efforts on the side of the NBR, Bangladesh Bank and Ministry of Finance. In order to achieve this target, the authorities should press ahead with further automation of the tax administration system, including the ongoing online taxpayer registration, and increased staffing levels and training at the NBR. In addition, the NBR should be held more directly accountable for tax revenue performance. These changes also involve setting realistic revenue targets that are agreed upon by the NBR (International Monetary Fund, 2014). Finally, a review of the existing tariff policy will be essential for boosting and diversifying exports.

99. Also linked to the challenge of domestic resource mobilisation is the of capital flight and illicit financial flows. The Asia and Pacific region loses significant resources through illicit flows and tax evasion, an estimate of over \$400 billion lost in 2011 alone.¹⁴ The largest majority of illicit flows take place through trade mis-invoicing. Data is very difficult to gather in this area but the losses for Bangladesh are likely to be in the hundreds of millions of dollars from these outflows.

3.3 Public Domestic Borrowing

100. The Bangladesh Bank formulated a strategic plan for the first time in 2010 to support the sustainable development of the economy with the goal of achieving a dynamic, efficient and resilient financial system combined with large-scale digitalization of its activities. The first strategy comprised 17 different areas that have been pursued by the Bangladesh Bank over the course of the 6th FYP. Looking to the future, the Bangladesh Bank has now developed a strategic plan for 2015–2019. The strategic plan has six strategic areas of focus: (i) balanced and coordinated monetary policy; (ii) supervision and regulation for ensuring financial stability; (iii) optimization of human capital; (iv) promoting a more liberalized foreign exchange market; (v) socially responsible (sustainable) financing and inclusive growth; and (vi) enterprise resource management, effective communication and image building. Although this section is focused on domestic borrowing, it is important to note

¹⁴ Asia-Pacific Effective Development Cooperation Report 2014. See http://www.asia-pacific.undp.org/content/rbap/en/home/library/democratic_governance/effective-dev-cooperation-report-2014.html.

that the Bangladesh Bank is supporting the country's development through a number of routes, including effective macro management and private sector promotion.

101. Historically speaking, Bangladesh can be seen to have experienced a sharp reversal since the early years following independence in terms of how it has managed its fiscal deficit financing. For the first twenty years after independence, borrowing was heavily tilted towards external borrowing and actual recourse to domestic borrowing was quite limited. This financing structure resulted in a rapid build-up of external debt while the domestic debt burden was extremely low. This strategy has been reversed starting in the mid-1990s.
102. The trend to rely more on domestic borrowing, has partially been driven by the development of Bangladesh itself in terms of expansion of RMG based manufacturing exports and growing inflows of remittances from Bangladeshi workers abroad, which have helped to finance domestic development. This shift in financing has on the other hand now led to the build-up of domestic issued debt, as well as increased public debt interest payments to support the rise in domestically-generated borrowing (Mansur, 2015), though overall interest rate payments have been on the decline (see Figure 3.3 below) and the International Monetary Fund considers the current debt levels of Bangladesh to be sustainable.

Table 3.5: Bangladesh: Public Domestic Debt at Year End of 2013

	In Billions of Taka	In % of Total Debt
Treasury Bonds	1,013	46.3
National Savings Directorate	644	29.4
Treasury Bills	294	13.4
Overdraft	219	10.9
Ways and Means of Advance	20	0.9
Total	2,190	
Percentage of GDP	21.0	
General Provident Fund	244	

Source: Bangladesh Bank and International Monetary Fund staff estimates

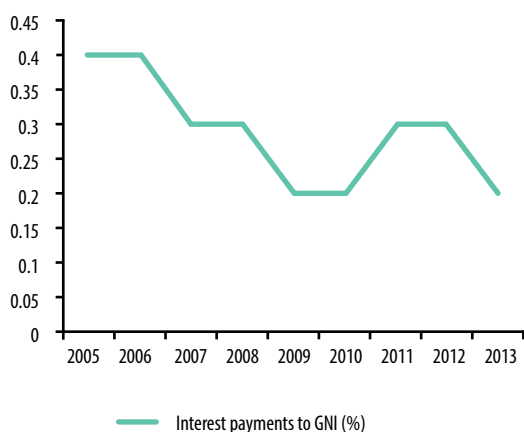
103. From Figures 3.4 and 3.5 below, domestic bank borrowing far exceeds non-bank borrowing in Bangladesh although they are both important sources of finance. The cost of financing the total debt of the country on average has been on the decline although there was a spike in interest rate costs in 2011 and 2012. Domestic debt in 2013 amounted to 21 percent of GDP and fell to 18 percent in 2014 and 2015. Treasury bills and bonds comprised 17.6 percent and 52.9 percent of the total central government's domestic debt stock respectively in 2013. The rest of the debt stock, or 29.4 percent of the stock, was composed of the National Savings Directorate (NSD) instruments.¹⁵ Marketable treasury bonds with maturity of 10 years or more comprised more than 32 percent of

¹⁵ NSD instruments can broadly be classified into two categories: savings schemes for resident Bangladeshis; and savings schemes for non-resident Bangladeshis. Ninety point eight percent of the total NSD instruments are subscribed by the residents and the remaining 9.2 percent are subscribed by non-residents. It is important to note that although more than 30 percent of the total outstanding domestic debt stock is composed of NSD instruments, the growth rate of gross sales of these instruments showed volatile trends from 2010-2015.

the domestic debt stock (BoB, 2014). Domestic debt is composed of 83 percent medium to longer term and 17 percent short term (Bangladesh Bank, 2014).

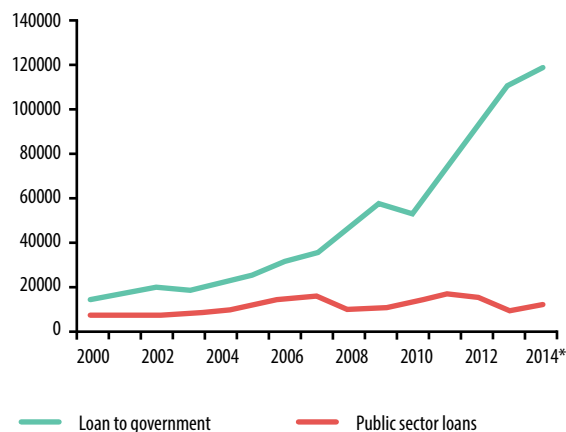
104. There is no single database at present in which all public debt data are consolidated. Moreover, at present there is no system in which a comprehensive database on contingent liabilities is recorded and updated. As of 30 June 2013, the stock of outstanding central government debt was \$50,545.40 million, of which \$22,586.40 million was external and \$27,959 million was domestic. Thus the government’s current external debt comprises about 45 percent and domestic central government debt comprises about 55 percent of the total nominal debt stock to date.

Figure 3.3: Interest Payments on Debt as a Share of GNI



Source: Bangladesh Bank

Figure 3.4: Breakdown of Public Borrowing in billions of Taka

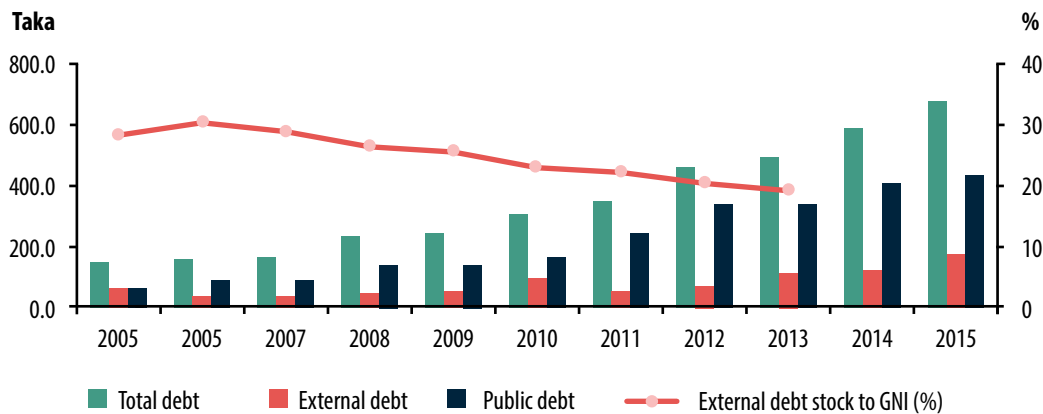


Source: Bangladesh Bank

105. Of the outstanding debt stock, 98.2 percent was fixed rate debt, because all the domestic debt instruments (e.g. treasury bills, bonds, and savings instruments) and 96 percent of the central government’s external debt are available at fixed rate terms (Medium Term Debt Strategy (MTDS), 2014).

106. As noted above, the International Monetary Fund debt sustainability analysis considers the current debt scenario to be sustainable for Bangladesh. Still, it is considered that the government can further diversify its sources of long-term public borrowing and identify market based additional sources of financing. For short-term debt, they note the current dependence on National Savings Schemes and short-term treasury bills, which should give way to long-term treasury bills and longer-term government bonds, including infrastructure bonds.

Figure 3.5: Total Debt Domestic and External in billions of Taka and Debt Share of GNI, 2005–2015



Source: Bangladesh Bank

107. The Government has a draft MTDS, which was approved by the Minister of Finance in 2014. Having a debt strategy is important because the MTDS helps to identify the appropriate borrowing mix required to minimize cost and risk to the debt portfolio. It also gives the country a clear indication to the financial market about the borrowing plan of the Government, which in turn helps to ensure efficient allocation of financial resources.

108. However, public debt data recording and management in Bangladesh is highly fragmented among various debt offices. Currently, the ERD maintains a record of public external debt data while the Bangladesh Bank and the NSD maintain records of wholesale and retail domestic public debt data, respectively. The objectives of the MTDs are to:

- Minimize cost and risk of the central government debt portfolio;
- Meet the borrowing requirement of the government in time; and
- Develop domestic debt market in the country.

109. The 7th FYP predicts that 90.4 percent of the plan will be financed from domestic sources that will include fiscal savings, but also public and private borrowing from the domestic banking and non-bank sources as well as from capital markets, as discussed in chapter 4. Looking forward, the government's fiscal deficit level should still remain at about 5 percent of GDP so that with 7 to 8 percent GDP growth per annum, Bangladesh's current public debt levels will continue to remain sustainable. However, there is an urgent need to restructure the sources and conditions attached to public domestic borrowing under the 7th FYP. Ideally, further investment would be sourced through stronger rates of savings. In the meantime, there are other alternatives for Bangladesh to reduce its short-term borrowing costs and make longer-term borrowing and investment decisions more effective moving forward.

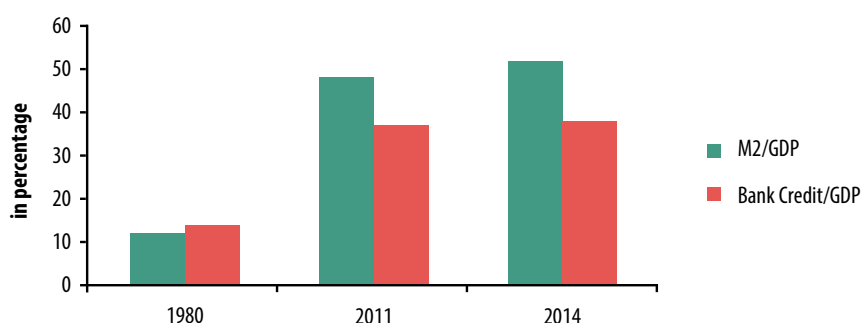
110. In sum, the Government of Bangladesh should initially increase the duration of national savings instruments, so as to attract more investors. In 2015, the maximum duration of savings instruments was five years, which is low in comparison to other countries where the duration goes up to 20 to 30 years. Moreover, the Government could make efforts to develop the long-term domestic bond market by issuing longer maturity Government bonds and bills, and thereby reduce its dependence on borrowing through the National Savings Schemes and short-term treasury bills issued by the Bangladesh Bank. Implementation of these policies should also lead to better management of interest rate payments and reduce the risk of duration mismatch.

3.4 Private Domestic Borrowing

111. After the independence of Bangladesh, there was an expansion of investment, which was primarily facilitated by foreign savings, mainly in the form of concessional aid. However, as noted above, since the mid-1990s the situation has changed with the majority (55 percent) of investment coming from domestic sources. The expansion of savings, including the large role played by remittances, has exceeded the investment rate and contributed to a current account surplus. On the other hand, this expansion of savings suggests that there may be demand side reasons why savings are not fully utilized for investment purposes in the country.

112. From Figure 3.6 below, there has been some financial deepening in Bangladesh since 1980 with both broad money (M2) and bank credit to steady growth of GDP. M2-GDP ratio, an indicator often used to indicate the depth of the financial sector, has risen from 12 percent in 1980 to 57 percent in June 2012 and the total bank credit as a share of GDP has grown from 14 percent to 55 percent over the same period. In the absence of a well-developed capital market, the growth in private credit still played a role in supporting the expansion of private investment in Bangladesh.

Figure 3.6: Indicators of Growth of Banking Activities



Source: Bangladesh Bank

113. In comparison to neighbouring countries, Bangladesh's financial markets can still be seen to be underdeveloped when compared to the overall investment rates in strong saver countries in East Asia (see Table 3.6).

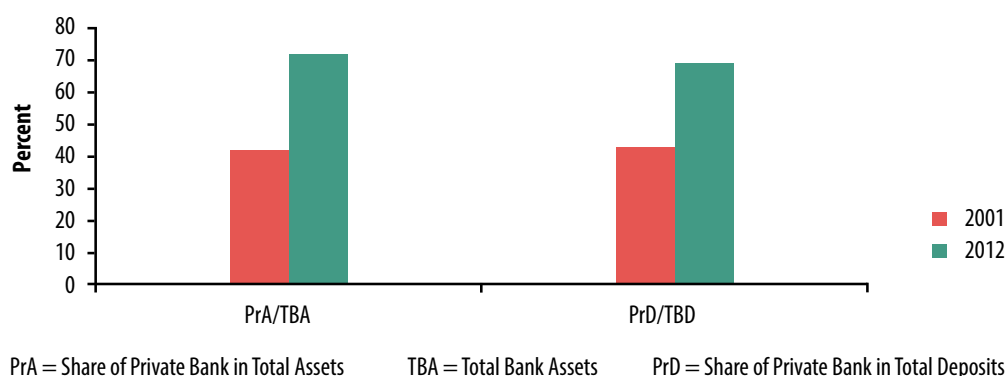
Table 3.6: Indicators of Banking Activities for Selected Countries (2013)

Country	M2/GDP	Bank Credit/GDP
China	194.5	140.0
India	77.4	51.8
Pakistan	40.2	15.6
Viet Nam	117.0	96.8
Bangladesh	70.8	48.0

Source: World Development Indicators, World Bank/Financial Soundness Indicators, International Monetary Fund

114. At the same time that we can observe a nascent process of financial deepening in the country, there has also been an increase in private bank assets and total bank deposits over time (see Figure 3.7).
115. Although private borrowing is on the rise in Bangladesh, the government can do more to provide a supporting environment for private sector access to finance. According to a study by the Bangladesh Bank, it is reported that the rate of interest charged to borrow from Bangladeshi banks is high. The spread between deposits and lending is also high, which discourages private sector and household investment. Other structural issues that impact the development of the commercial banking sector relate to the efficiency of the banking system (e.g. high administrative costs, low efficiency in managing loan and investment portfolios without a proper balance between risk and return, and a low return on capital).
116. A further issue with private sector borrowing is the limited access of rural people and small firms to access bank credit in Bangladesh. The country has a very strong microcredit industry, which will be discussed in more depth in this chapter. It is worth mentioning that the Bangladesh Bank has taken a number of measures to support access to credit for micro, small and medium enterprises. These measures include new financial instruments such as mobile banking. In the area of microcredit, rules have been developed for the Microcredit Regulatory Authority (MRA) in 2010 to supervise microcredit finance institutions and protect both borrowers and lenders using these types of schemes. The number of registered microcredit finance institutions, as well as the number of borrowers and savings per borrowers has been steadily increasing throughout the 6th FYP. The Government of Bangladesh has provided microcredit financing through 272 partner NGOs. So far, through the Palli Karma Sahayak Foundation programme, about eight million borrowers have received microcredit, of which 91 percent are women. Given the important role that the private sector is expected to play under the 7th FYP, it will be important for the Government of Bangladesh to support more credit lending for informal, rural and microcredit agencies.

Figure 3.7. Growth of Private Banking, 2001–2012



Source: Bangladesh Bank

117. With the expected reduction in the reliance on external financing of the government's budget, the government's reliance on domestic financing is expected to increase and the level of outstanding domestic public debt will grow. The amount of domestic government borrowing must be correctly planned and synchronized with monetary policy and the expected rapid growth of the private sector credit demand. Government's domestic borrowing should avoid crowding out private sector investment and creation of conflicts with strategic private sector development goals.

3.5 Sovereign Wealth Funds

118. A sovereign wealth fund (SWF) is a state-owned investment fund that is commonly established from balance of payment surpluses, official foreign currency operations, the proceeds of privatisation, government transfer payments, fiscal surpluses and/or receipts resulting from exports.¹⁶ Most SWFs are created to diversify the total revenue base and hedge export revenues from energy and commodity price volatility, as well as to accumulate savings for future generations.
119. Bangladesh plans to form a SWF with its foreign currency reserves to invest in infrastructure. The initial size of the fund is likely to be between \$1 billion and \$2 billion, according to the Bangladesh Bank Governor. The foreign exchange reserves at the Central Bank had reached over \$25 billion by September 2015. By the end of 2015, they were expected to cross the \$26-billion mark,¹⁷ representing seven months of imports. The Government of Bangladesh has formed a seven-member committee headed by Bangladesh Bank Deputy Governor to explore SWF prospects. The committee, which comprises economists and representatives from the Ministry of Finance, will examine similar funds in other countries at its upcoming meetings, after which it will submit its recommendations to the government, including on an optimal legal and economic structure of the SWF and specification of spending rules.
120. In September 2015, the Sovereign Wealth Fund Institute suggested that SWFs around the world stood at \$7.23 trillion in assets under management, a more than doubling since September 2007 (\$3.265 trillion). The SWFs that have been funded by oil and gas revenues accounted for 57.2 percent of the total, while non-commodity and other SWFs comprised the 42.8 percent balance as of September 2015. Most SWFs have a number of common elements – they are almost always state-owned, generally have few liabilities and are either heavily or entirely invested in foreign assets. Most SWFs have unusually long investment horizons (since they are investing for future generations). Low or no specific liabilities means they can also take higher risk than any other investment vehicle. Some key observations on SWF composition are:
- While total SWFs were 79 as of September 2015, most of their assets were concentrated in a few funds. The top five SWFs accounted for more than 50 percent of total SWF assets;
 - The SWFs vary widely in size, ranging from the Government Pension Fund of Norway, which is global with almost \$873 billion in assets, to small SWFs operated by Equatorial Guinea and Mongolia, that have less than \$100 million in assets;
 - Major trends are reflected by observing the year in which the SWFs were established. For example, in the 1970s and 1980s, as well as in the first decade of this millennium, a number of SWFs were formed in the Middle East, most likely due to the surging of oil revenues. In the 1990s and 2000s, China set up a number of SWFs as export revenues and its foreign currency reserves soared; and
 - Asia accounted for 40 percent of SWFs by assets, while the Middle East made up 35 percent and Europe 17 percent. The Americas and Africa comprised 3 percent each.
121. There are various ways through which funds from the non-commodity sector can be mobilized for establishing Bangladesh SWFs to meet the government's future liabilities, create infrastructure, diversify the revenue base or manage state-owned enterprises. A prime example of positive SWF

¹⁶ <http://www.swfinstitute.org/sovereign-wealth-fund/>.

¹⁷ <http://www.thedailystar.net/business/sovereign-wealth-fund-the-offing-fix-infrastructure-122107>.

involvement is the use of funds that were pumped into reviving financial giants such as Citigroup and Merrill Lynch from China and Kuwait during the global credit crunch of 2008. The SWFs can also help develop assets that require substantial capital. In a world where investment capital is getting increasingly scarce, SWF funds remain an attractive investment source.

122. Nevertheless, there are some challenges for SWFs in going forward with lack of transparency being the biggest major concern. Many SWFs do not divulge key information such as their holdings, investment objectives, and performance. A related issue is vulnerability owing to foreign government control. The threat of critical know-how and knowledge being exported to unfriendly nations is a real one, since SWFs can exploit their position as large or majority shareholders.

Box 3.1: Institutional Framework of Sovereign Wealth Funds

The Sovereign Wealth Funds have two of the most popular institutional frameworks – the company-development model and the manager model.

1. Company-development model:

The government elects to create an investment company that will manage government assets. This investment entity may also have strategic development objectives. Company-development models tend to act similarly to large state-owned conglomerates. In addition, this model often permits the investment company the ability to raise debt and manage third-party assets.

2. Manager model:

In this model, the owner of the assets is a branch of the government such as the Ministry of Finance or Treasury. The government branch then gives investment mandates to an asset manager. The manager model can be broken down into three sub-categories:

- i. Central Bank Manager Model: The Central Bank manages the assets and has direction from the Treasury or Ministry of finance.
- ii. Ministry of Finance direct model: The Treasury or Ministry of Finance extends mandates to an asset manager.
- iii. Investment company model: This model entails the creation of a separate fund management entity that is owned by the government to manage the assets.

3.6 Public-Private Partnerships (PPPs)

123. Over the years, the infrastructure gap has been hindering Bangladesh's economic growth potential. It has also become clear that the government's development budget is not going to be sufficient to satisfy these needs. Indicative infrastructure requirements estimated in the 7th FYP foresee an increased demand for transport investment from 1.6 percent of GDP in the baseline year (FY2015) to a yearly average of 3 percent during the following years of the 7th FYP.¹⁸ The list of areas that need attention is vast and includes roads, highways and bridges, railways, urban and rural transport quality and safety, ports, civil aviation airports, inland water transportation, and port infrastructure.

124. A similar situation has been detected in the demand for energy. Although the 6th FYP achieved substantial progress in generation capacity along with expansion of transmission and distribution

¹⁸ Source: Bangladesh 7th FYP, p. 403

networks, the gap remains large and the investment needs are challenging. Total investment requirements in energy (power plus primary energy) add up to 2.5 percent of GDP per year, of which it is estimated that the public sector will only cover 1.7 percent per year on average.¹⁹ Private sector investments in the energy sector for 2015–2020 will be mainly pursued through PPPs and should account for at least 1 percent of GDP per year in this period.

125. Achieving visible progress in all these areas is challenging and a substantial part of the additional financing, technology and operational management will have to have come from private sector investment through PPP arrangements. Although no specific targets are specified for PPPs, the 7th FYP aims to substantially increase the amount of PPP investment from an average of about 0.2 percent of GDP in FY2015 to somewhere between 1 and 2 percent of GDP per year during the 7th FYP. Given these large financing requirements and the multiple claims on the budget, a sound financing strategy for the infrastructure sector is essential.
126. Results from promoting PPPs under the 6th FYP took much longer to be achieved than what was expected. The government faced several obstacles that slowed down the rate at which the results could be delivered: (i) the market was not known for potential investors; (ii) the same limitations of the business climate that are hindering FDI explained later in chapter 4 also apply to PPPs; (iii) a lack of institutional history of infrastructure financing with the private sector slowed down project identification and development; (iv) lack of standardised documentation and bureaucratic restrictions; (v) lack of availability of qualified advisory services with a credible reputation to advise potential international investors, especially in PPP project appraisal and tendering phases; and (vi) no exit strategies to allow shareholders to send capital gains out of the country.
127. Several steps and policy and institutional reforms were introduced in this period. In 2010, the Government issued the Policy and Strategy for Public-Private Partnerships²⁰ to facilitate the development of core sector public infrastructure and services. The policy prioritizes increased investment in infrastructure and provides a framework to attract national and international private sector investors to join in partnership with the government in building and upgrading core infrastructure assets.
128. Under this new national policy, a Public-Private Partnership Office was established under the Prime Minister's Office to support sector line ministries to facilitate identification, development, tendering and finance of PPP projects. For interested investors and lenders, the PPP Office provides centralized support to line ministry project development efforts with external PPP resources. A wide range of powers has been provided to the PPP Office to ensure an efficient and comprehensive development of the PPP programme. The PPP Office is charged with: development of policy, regulations and guidelines; development of standard documentation; appointment of consultants and advisors; providing consent and opinions in relation to PPP projects; and organizing seminars and training sessions. A PPP Unit under the Ministry of Finance was also established to foster an environment of fiscal responsibility and sustainability in PPP projects. In order to address the many obstacles mentioned above, the government has also developed a number of additional measures, incentives and financial benefits for PPP investors. These include:

¹⁹ Ibid, p. 370

²⁰ Policy and Strategy for Public-Private Partnership, 2010.

- *Fiscal Incentives*: There are provisions permitting PPP investors to benefit from various fiscal incentives (e.g. reduced import tax on capital goods, tax holidays) to reduce the cost of implementing the project and to enhance the viability of the project;
 - *Special Incentives (non-fiscal)*: Any specific project may get special incentives or other non-fiscal incentives to support the implementation of policy objectives or to enhance the ease and efficiency of delivering the project. These may include exemption from specific provisions related to insurance regulations, banking regulations, and foreign exchange regulations;
 - *Viability Gap Financing*: A budgetary fund may be created to provide a financial subsidy for PPP projects that have high socioeconomic value but are not sufficiently commercially viable to be delivered on a PPP basis. Up to 30 percent of the total project cost can be subsidised either as part of a capital contribution during construction or in the form of annuity payments during operation;
 - *A PPP Technical Assistance Fund* with an initial endowment of approximately \$12 million will be established to provide early stage project development funding support to sanctioned PPP projects. The PPP Technical Assistance Fund will help defray the cost of professional consultants and advisors needed to assure that the government achieves appropriate risk allocation in PPP projects and pre-develops projects to a standard that attracts maximum interest from investors and lenders; and
 - *The Bangladesh Infrastructure Finance Fund Limited (BIFFL)*, was incorporated by the Ministry of Finance in 2011 to provide long-term financing in the local currency to infrastructure projects that meet BIFFL investment criteria. The BIFFL seeks to attract investment from both institutional and retail investors (including non-resident Bangladeshis and overseas foreign workers) to provide an alternative savings/investment vehicle in the Bangladesh market. The BIFFL is managed independently following objective investment criteria.
129. Two government organizations, the Infrastructure Development Company Limited and the BIFFL, will be the main agents to provide specialized finance to the private sector under PPPs. So far PPP projects have already been delivered or are being developed in wide range of sectors which includes transport (e.g. port, airport, highway, railway, bridge); energy (e.g. power plants, transmission lines); civil accommodation (e.g. economic zones, public buildings, convention centres, sports facilities, commercial development, residential housing, education buildings); health (e.g. hospitals, health care, dialysis and diagnostics); tourism and hospitality; water, sewerage and waste; information technology infrastructure and agriculture. Currently, the PPP Office has a pipeline of 45 projects, which are under various stages of project development activities, and also includes a few successfully closed projects.
130. After five years of accumulated experience and consistent efforts promoting PPPs, the future looks promising as the government has managed to navigate all the complexities ensuring credibility and transparency and delivering policies and measures that reflect internationally recognized good practices. There are still many challenges that will require considerable attention during the 7th FYP.
131. (i) *Strengthening the quality of infrastructure planning and consolidation of a national infrastructure development plan for PPPs*. The financial and technical ability of the public sector to plan and build large infrastructure projects is limited. There is a dispersion in planning quality between sectors (i.e. energy, infrastructure) and subsectors and investment opportunities. Financial estimates for PPP potential are scattered across different ministries and agencies. The government will need to level up

the overall quality of this scattered supply of plans, and produce a comprehensive, costed package for infrastructure development that could be used to attract PPPs internationally. Such a plan should show that there is a long-term view and overall coherence for the list of projects that are proposed in the short term. It is also a fundamental “selling tool” for the government as PPP is a market for mature investors and they usually require these types of assurances from the government side.

132. (ii) *The technical capacity of the domestic infrastructure financing market may still need substantial development.* The banking sector in Bangladesh views the infrastructure financing space as one with plenty of opportunity given the considerable infrastructure needs but equally risky as well. Except for infrastructure projects in the power sector where there is more experience and development in terms of contracts guaranteeing a sustainable revenue stream, banks are not fully experienced in lending to infrastructure development projects. They seem especially wary of resettlement issues potentially arising from projects where land is a big concern (e.g. roads/toll projects). There is a mixed picture in terms of the banking sector’s ability to engage more aggressively in infrastructure financing. The key barriers to lending to infrastructure PPPs seems to be emanating from: (i) capacity of domestic banks to select, analyse risks and structure project financing; (ii) asset liability mismatch and balance sheet management from their existing portfolio; and (iii) complexity and the long-term nature of infrastructure PPP projects and limited experience in managing such assets; and (iv) a lack of experience in committed (indicative) financing from the lenders of a bidding consortium (who generally demand more rigorous investigations into the likely costs and revenues of an underlying project) to bring those lenders into the bidding process in the early stages.²¹
133. (iii) *Domestic financial institutions may not have the size to finance the PPP investments to implement the 7th FYP agenda.* Translating the estimates established for PPPs in the 7th FYP of one percent of GDP to nominal terms using the same projections of the plan, will show that the overall size of these investments should be in the range of \$1 billion/year and an PPP accumulated investment of at least \$5.5 billion over five years. The initial capitalization of the institutions created by the government is far more modest (the initial capitalization of the IPEF was of \$250 million). To ensure an adequate participation of national companies in the PPP expansion, other countries developed more aggressive strategies to strengthen the capacity of national banking system.²² This may be needed in Bangladesh if the PPP promotion activities are to succeed in attracting more investors.
134. (iv) *The government will have to develop risk assessment strategies to find the right balance to stimulate private PPPs when social rates of return are high and private returns are low.* Many infrastructure projects with high socioeconomic rates of return are often not financially viable and expected revenues are frequently unable to cover project costs. This could be the case, for example of building schools and public health facilities, where governments would still want to stimulate private investment. For these cases, the government should measure the risks and find adequate ways to align regulatory frameworks to sustainable development objectives and lift barriers to ensure business participation. There are some encouraging experiences in the health sector and opportunities for expanding the equipment-based service sector in health, but PPPs may not be applicable for every project, and

21 World Bank: *Study on financing Bangladesh PPPs: exploring options for introducing indicative or committed financing, September 2015.*

22 For example, Indonesia transformed the state-owned financing firm PT Sarana Multi Infrastruktur (SMI) into an infrastructure bank with a six-fold increase in SMI capital to \$2.05 billion. The SMI was transformed into an institution with sovereign status, so that it would be eligible for cheap loans from multinational banks. Reforms also included a substantial increase of the capital of state-owned PT Bank Mandiri Tbk, Indonesia’s biggest bank to improve the lender’s capacity for infrastructure financing (Stratta, 2015).

not without careful management and consideration of risks. Critics of this modality argue that risks and problems linked with PPPs, including the lack of transparency, efficiency, and the risk of strong negative financial impacts on the public sector are likely to increase further as a result of the recent revamping of large infrastructure programmes.

3.7 Inclusive Business Finance

135. Inclusive business finance refers to capital that supports the creation, growth, and sustainability of entrepreneurs, small holders, and small enterprises that were previously excluded from the financial markets. The Netherlands Platform for Inclusive Finance²³ states that “.....through what is called inclusive finance, people living in poverty are offered a diverse range of financial instruments to run their businesses, build assets, stabilise consumption and shield themselves against risks.”
136. There are various options for inclusive businesses in Bangladesh. Lending from formal banks has increased, with the Islamic Bank Bangladesh Limited the largest lender. There are many microfinance institutions, with a significant total volume of lending. Non-bank financial institutions are relatively modest players. There are a number of funds that can offer equity or equity combined with debt. Some of these are defined as impact investment funds, which focus on businesses that seek combined social, commercial and/or environmental impact.
137. The economic importance of non-formal sectors and micro, small and medium enterprises (MSMEs) is well recognised in Bangladesh. The MSME financing in Bangladesh is receiving increased attention given the importance of small and medium enterprises (SMEs) in the economy, especially in employment generation. They are seen as critical to increase economic output, broaden employment opportunities and help improve wealth distribution. A World Bank study²⁴ examined access to finance specifically for SMEs and ranked Bangladesh ahead of other South Asian countries, in terms of SME lending as a percentage of GDP, and as a percentage of total lending. In 2009, the Bangladesh Bank initiated SME lending targets to boost formal credit for MSMEs:
- The initial Bangladesh Bank target for all banks and financial institutions was Tk 240 billion (\$3 billion) in SME loans for 2010;
 - The target for 2012 was nearly two and half times the original at Tk 590 billion (\$7.37 billion);
 - The Bangladesh Bank also initiated subsidised programmes with a specific focus, such as agriculture and women, with a target of Tk 138 billion (\$1.725 billion) for the former in the financial year to 30 June 2012 and Tk 10 billion (\$125 million) for women entrepreneurs in 2013;
 - The Bangladesh Bank set the SME loan disbursement target at over Tk 1,00,000 crore through all the commercial banks in 2015;²⁵
 - The target is 16.35 percent higher than the earlier target of Tk 89,000 crore for the year 2014; and
 - The largest lender to SMEs by far is the Islamic Bank Bangladesh Limited, followed by BRAC Bank. Others with an SME focus include Sonali Bank, Eastern Bank and Mutual Trust Bank.
138. Banks provide a range of working capital loans, term loans and overdrafts, together with a limited range of non-lending services. All banks require collateral for SME loans above a certain amount,

²³ <http://www.inclusivefinanceplatform.nl/inclusive-finance/inclusive-finance>

²⁴ The World Bank, ‘Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises,’ Washington D.C., 2006.

²⁵ <http://www.dhakatribune.com/banks/2015/jan/29/bb-sets-sme-loan-target-tk100000-crore>.

while below the threshold personal guarantees are invariably demanded. The cut-off varies greatly between the banks, with some as low as Tk 100,000 (\$1,250) and others requiring collateral once the loan size reaches Tk 2.5 million (\$31,000). The other key requirement is a business history of at least one year, and for many banks it is three years.

139. There are 31 non-bank financial institutions (NBFIs) operating in Bangladesh. The NBFIs are organizations that offer financial services, such as insurance or loans, but are not licensed and regulated as banks. With relatively limited funding bases, they are modest players holding SME assets of just Tk 22 billion (\$271 million) as at 31 March 2012.²⁶ The NBFIs can provide syndicated financing, bridge financing, lease financing, securitisations and private placements of equity.
140. Lease financing has been shown in other countries to be an effective way to overcome issues for SMEs, such as sufficient collateral, since the asset title remains with the lender. The largest participant in this market by far is United Leasing Corporation in Bangladesh, which provides asset finance, syndicate finance, term finance, channel finance and investment. For projects requiring large-scale investment, it brings other financial institutions to raise funds through syndication where United Lease Corporation acts as the lead arranger for the financing. The channel finance includes financing for work order, distributor finance and factoring, which is a mode of financing receivables arising out of supply of goods or delivery of services on credit. The Bangladeshi microfinance sector is mature and there are thousands of MFIs working in the country. There are mainly four types of institutions involved in microfinance activities. These are:
- Grameen Bank, a member-owned specialized institution;
 - Around 1,500 NGOs, including BRAC, Proshika, ASA, BURO-Tangail, BEES, CODEC, SUS, TMSS, Action-Aid;
 - Commercial and specialized banks, including Bangladesh Krishi Bank, and Rajshahi Krishi Unnayan Bank; and
 - Government-sponsored microfinance projects/programmes such as BRDB, Swanirvar Bangladesh, RD-12 and others, which are run through several ministries viz., Ministry of Women and Children Affairs, Ministry of Youth and Sports, and Ministry of Social Welfare. All of the programmes are targeted at the functionally landless rural poor.
141. All the MFIs provide mostly small, un-collateralized short-term loans, and they use similar on-site loan disbursement and weekly collection methods by forming village organizations or self-help groups. Credit services by MFIs include general microcredit, microenterprise loans, seasonal loans and loans for disaster management. Many MFIs do offer other services to customers, e.g. micro-insurance and remittances, plus some non-financial assistance or advice that reflects their NGO base. Non-financial assistance is deemed as being important to nurturing SME sector growth. Interest rates vary among MFIs, but are capped at 27 percent per annum.
142. The concept of equity to outside investors is not widely used in Bangladesh. But there are avenues available through Small Enterprise Assistance Funds (SEAF), International Finance Corporation (IFC) SME Venture and others. There are also many impact investment funds active in the region, in two main categories: (i) development finance institutions (DFIs) and (ii) private equity/venture capital funds.

²⁶ <http://bit.ly/TLgjlj>.

143. DFIs are government-controlled institutions that invest in sustainable private sector projects and are either multilateral institutions such as the IFC or the Asian Development Bank (ADB), or bilateral institutions such as CDC (United Kingdom), Overseas Private Investment Corporation (United States) or the Netherlands Development Finance Company (FMO).
144. There are many international private equity and venture capital funds that invest in inclusive businesses. They aim to achieve a financial return on their investments together with social and environmental benefits for the communities in which they are based.
145. In Bangladesh, the SME Foundation is set up specifically to provide advice to MSMEs. Businesses can approach the SME Foundation for advice on matters relating to SMEs and entrepreneur capacity building. This advice can include promotion and market expansion for SME products, linkages between buyers and sellers guidelines on establishing a new business and/or SME business manuals and specific product fairs.
146. Other donor agencies working in the field of advice/assistance to SMEs include KfW/DEG (German development bank/investment corporation), USAID, the Swiss Development Agency and the Bill and Melinda Gates Foundation. International development agencies such as Action Aid UK, CARE and Oxfam have also made substantial contributions to the sector, in terms of grants, technical assistance (including financing research) and model documentation.
147. Social enterprises are also emerging as an innovative inclusive finance source in Bangladesh. They employ business approaches to address social and environmental problems and enhance their communities.²⁷ Bangladesh has a strong history of social enterprise, with national-level organizations such as BRAC and the Grameen Foundation having used social enterprise as an effective tool to alleviate poverty. Social enterprises mobilize finance from high net worth individuals; private equity, development finance institutions (ADB, IFC); and debt financing from public and private banks. Several investment funds like Acumen, Grassroots Business Fund, Navis Capital and others provide investment support to social enterprises in Bangladesh.

3.8 Domestic Philanthropy and Non-Governmental Organizations (NGOs)

148. Bangladesh has a long tradition of partnership with NGOs. The outreach of NGOs has supported the government in the delivery of a wide range of services including education, health, training, women's empowerment, microcredit, agriculture, climate change and social protection. Each year, more than 1,000 projects receive foreign grants amounting to over half a billion dollars but these funds are not accounted for in the budget preparation process. Current data constraints do not allow estimations of the volume of investment made by philanthropic and other domestic sources. However, based on discussions with the government and NGOs in Bangladesh it was pointed out that domestic funding for national NGOs is limited.
149. The 7th FYP defines a wide variety of key strategic areas for which the government will seek partnerships with NGOs to: (i) deliver health and education services in the hard-to-reach areas as

27 <http://www.britishcouncil.org.bd/en/programmes/society/social-enterprise>.

well as reaching out the socially-excluded groups; (ii) provide outreach for nutrition programmes; (iii) promote access to justice and the provision of quality legal aid, especially for the poor, women and marginalized groups; (iv) provide various technical and vocational education and training programmes; (v) provide credit for small- and micro-enterprises; (vi) roll out broadband connectivity in rural areas especially for reaching the last mile, where there is already vibrant NGO presence; (vii) improve agricultural and livestock extension services; (viii) monitor the operation of hatcheries, nurseries and supply of spawn and fry, in which private sector is the key player; (ix) assist the Forest Department to implement the social forestry programme and motivate people through informal training and other extension services; (x) strengthen local governance in both rural and urban contexts; (xi) support the implementation of the social safety net programme; and (xii) support climate change resilience conducting small-scale community-based projects to build local level adaptive capacity. In the 7th FYP NGOs are recognized as key policy actors as well as implementing agencies.

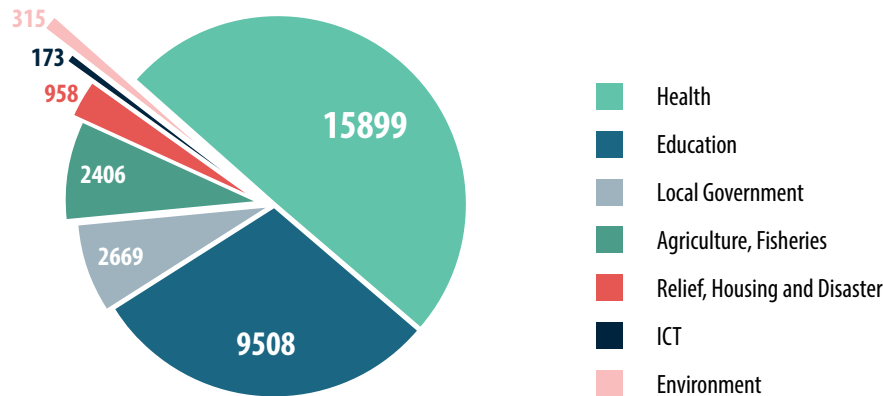
Table 3.7: Projects and Funds for INGOs in millions of US\$

Year	Approved project numbers	Cumulative approved Projects	Released USD	Cumulative amount Released (USD)
2005	930	12251	34.8	316.0
2006	908	13159	32.3	289.6
2007	1462	14621	52.3	341.9
2008	1042	15663	48.6	390.5
2009	1172	16835	51.6	442.1
2010	1120	17955	65.9	508.0
2011	1077	19032	58.0	532.1
2012	1048	20080	67.8	599.9
2013	1116	21196	71.9	656.2
2014	1035	22231	75.0	731.2
2015 (p)	82	22313	3.8	735.0

Source: NGO Affairs Bureau

150. The above list exemplifies the great potential and variety of opportunities for the interaction of NGOs with government agencies. The NGO Affairs Bureau in Bangladesh coordinates the allocation of public funds (domestic and external) on a project basis. The Bureau registers NGOs, approves and releases project funds for NGOs, allows permission for appointment of expatriate consultants, examines and evaluates reports/returns submitted by NGOs, monitors implementation, evaluates and inspects of NGO activities; and enlists chartered accounting firms for auditing of accounts of NGOs. Figure 3.8 below shows the current allocation of NGO spending to main areas of the 6th FYP.

Figure 3.8: Distribution of Released Funds to NGOs according to 6th FYP priorities (in millions of US\$)²⁸



151. To achieve the full potential and contribution of NGOs to achieve the goals of the 7th FYP, a number of issues must be addressed:
152. (i) *Increase Transparency of NGO Activities.* The government demands more transparency on the usage of the public funds (domestic and external) allocated to NGOs and of the quality of the services provided to the final beneficiaries. The new *Foreign Donations Act* aims to increase this transparency but needs to be carefully drafted and implemented to avoid undermining the work of NGOs and generate negative effects.
153. (ii) *Reduce bureaucracy and provide transparency of government funding to NGOs.* Although the establishment of the NGO Affairs Bureau has considerably cut down on the bureaucratic complexities, the process can still be substantially improved. Providing more transparency about NGO fund allocation and cutting corruption is a key priority claimed by NGO associations.
154. (iii) *Design solutions to facilitate access to small- and medium- sized and local NGOs.* Project fragmentation is a burden for the government, but the present system tends to favour access to funds to large-scale international NGOs. This uncoordinated vertical integration that is emerging has several negative effects including: (i) relegating small NGOs as sub-contractors of large ones, developing local patron- client dynamics; (ii) producing a centralization of decision-making, policy setting and project formulation; and (iii) fostering an unfair distribution of project costs and overheads, where a large portion of the funds used remained in the INGOs (to finance high salaries, vehicles and other office operating costs) while the small NGOs can barely cover their overhead costs. This situation could be improved by promoting consortiums of small and local NGOs, but these practices are still in a pilot phase.

²⁸ Source: NGO Affairs Bureau, figures correspond to FY 2014–2015.

3.9 Corporate Social Responsibility Linked to Development

155. Corporate social responsibility (CSR) started in Bangladesh in the early 1980s and gained momentum in 2007 with the establishment of the CSR Centre. The Centre has wide access to different business sectors and a strong local and international network to promote responsible business practices.
156. Bangladesh CSR initiatives are aligned with international best practices. Along with the Bangladesh Enterprise Institute, the Centre is the focal point for the Global Compact Network in Bangladesh. The GCN contributes to achieve the objectives set in the SDGs in Bangladesh through private sector led growth. The Centre is also a founding member of the South Asian Network on Sustainability and Responsibility (SANSAR), a regional network working collaboratively for long-term development of economy at national levels.
157. The disaster of the Savar building collapse in 2013 led to widespread discussions about CSR across global supply chains and accelerated the path for the implementation of further CSR reforms in Bangladesh. Globally and in Bangladesh, international development partners are signing up with relevant brands specifically in the RMG sector to implement CSR in line with social, environmental and economic aspects in order to build ethical supply chains.
158. There has been measurable impact, both quantitative and qualitative, of how CSR can contribute towards sustainable profits and investment for business in Bangladesh. Many accomplishments were achieved in this area in recent years, all of them through a multi-stakeholder approach and integrating the views of business, government, NGOs and a multiplicity of development partners.
159. One of the most remarkable achievements was the development of a National CSR Policy for Children in Bangladesh, which was developed in close collaboration among the CSR Centre, the Ministry of Labour and Employment and NGOs, such as Save the Children. This policy aims to withdraw children from hazardous jobs, improve income-generating opportunities for parents so they are not so reliant on child income, offer incentives for working children to attend school, and enact laws and improve law enforcement to eliminate child labour. The National CSR Policy for Children is the final step for approval and a joint action plan is being designed to support this policy implementation, awareness, information and motivation in the business communities.
160. There are also on-going initiatives for improving working conditions for women, in close collaboration with the Ministry of Women and Children Affairs. A National Women Development Policy was developed in 2011 to create the framework to help attain these goals. The Women's Empowerment Principles team, a joint initiative between the United Nations Global Compact and UN Women is being promoted by the Global Compact Network Bangladesh at the country level. Current initiatives in the RMG sector, which is a main employer for women in the country, expect to support 300 garment factories in achieving a safe and healthy working environment for workers and inspect almost 1,700 exporting factories for fire, electrical and structural safety under this programme.
161. There is also an initiative with the Ministry of Industry to include the CSR agenda in the development of a new Industrial Policy to ensure workers' interest, safety and employment security and to give emphasis on skills development, education, curricula and training. Protection of the environment

is also an important issue to be addressed by the policy. While there is no dedicated chapter on CSR in the policy, the CSR dimension is embedded in all chapters to a certain extent. A National CSR Guideline is being drafted in collaboration with several ministries, NGOs and development partners. The purpose of these guidelines is to streamline the framework of CSR. This may lead to the adoption of voluntary social certification standard for workplaces (as the Social Fingerprint SA8000) and it takes into account lessons learned in several countries in the region, particularly China, India, Indonesia, Pakistan and Singapore.

162. The CSR good practices are being introduced in a variety of areas and with very encouraging results. The following are some examples of the multiple initiatives that are happening:

- Scholarship programmes for the meritorious children of employees;
- Economic support for the adoption and implementation of UNICEF Child-Friendly Schools;
- Programmes designed to strengthen and re-orient agricultural production systems to improve food security and accelerate income growth in rural areas (promotes use of good quality seed, judicious application of balanced fertilizer and better water management practices);
- Improved Rice Parboiling System for 50,000 small and medium-sized steam-generating boilers that parboil 90 percent of the Bangladesh rice harvest right at the mills;
- Introduction of small solar photovoltaic systems that transform solar energy into electricity, providing a decentralized power supply to individual users who are not usually connected to the national grid, replacing kerosene lamps (which provide poor illumination and produce emissions that cause respiratory problems); and
- Projects to provide rural farmers with access to information and communication technologies

163. All of these initiatives were developed with the collaborative involvement of different government bodies, NGOs and multilateral and bilateral donors. On a different line of work, the Bangladesh Bank has been able to get large amounts of funding from the banks in the form of “CSR Funds”, which are one-time donations for national events or disasters. The Bangladesh Bank stands as the sole authority in the sector, which makes it mandatory for all financial institutions to support their causes through monetary disbursements (see Table 3.8 below).

Table 3.8: CSR Expenditures of Banks in millions of US\$

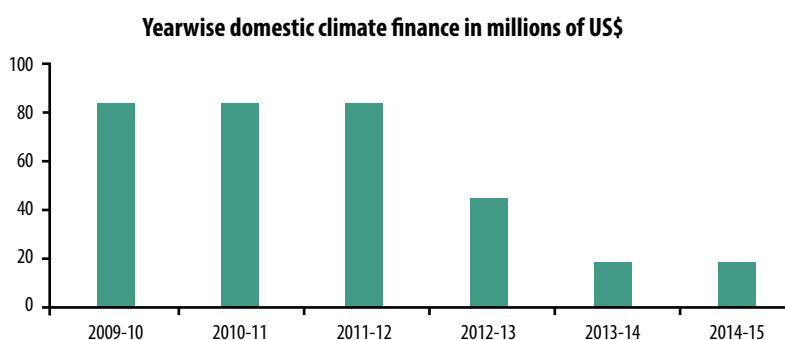
Sector	2011	2012	2013	2014	2015 (Up to June)
Relief and Disaster Management	18.8	78.84	138.58	94.95	64.27
Education	61.25	98.37	129.52	150.8	81.26
Health	52.04	43.54	48.17	138.37	53.13
Sports	35.91	18.38	38.40	20.74	
Art and Culture	17.15	21.33	12.47	40.71	24.75
Environment Friendly	13.81	14.02	10.66	16.45	7.45
Infrastructural Development	-				2.70
Others	19.87	30.18	69.34	48.52	21.09
Total	218.83	304.67	447.15	510.55	254.65

Source: Bangladesh Bank

164. The way forward in this area shows great potential, and the key element is to find the core business case and “win-win” approaches to integrate the interests of business, government and society. So far, the results achieved look promising. One of the main limitations to achieving more systemic approaches in this area is the lack of available data and information to inform the policy-making process.

3.10 Domestic Climate Change Finance

165. Following the Organisation for Economic Co-operation and Development (OECD) definition of “climate marker”, the Government of Bangladesh defines climate finance as “...the flow of funds toward activities that are aimed at reducing Greenhouse gas emission (‘mitigation’) or help societies in developing resilience to adapt to climate change impacts (‘adaptation’)”



166. The Government of Bangladesh has implemented several climate change adaptations and disaster risk management projects. Attaching the highest importance to the issue, the BCCSAP was formulated in 2009. The BCCSAP 2009 identified six thematic areas: (1) food security, social protection and health; (2) comprehensive disaster management; (3) infrastructure; (4) research and knowledge management; (5) mitigation and low-carbon development; and (6) capacity building and institutional strengthening.

167. Subsequently, in FY2009-FY2010, the Bangladesh Climate Change Trust Fund (BCCTF) was created by the Government from its own resources to finance projects for implementation of BCCSAP 2009. The aim of these projects is to reduce the vulnerabilities caused by the adverse effects of climate change. To set up institutional arrangements for management of the BCCTF, the Climate Change Trust Act of 2010 was enacted. Under the framework of this Act, the Bangladesh Climate Change Trust was constituted. The diagram above highlights the annual allocation by the government to climate finance through BCCTF.

Indonesia Climate Change Trust Fund

Jointly launched by the Ministry of National Development Planning and the Ministry of Finance in September 2009, the Indonesia Climate Change Trust Fund (ICCTF) is designed as a national trust fund to attract, manage and mobilize financial investments in climate change mitigation and adaptation. The ICCTF acts as a financial portal to receive and distribute funds from international funds, other governments, development partners and other climate change funding mechanisms.

In first two phases, the ICCTF issued grants only to line ministers to build capacities and technical know-how. Under the third phase and within the revolving Transformation Fund, the ICCTF issues loans and intends to tap PPPs, CSR and carbon trading markets. Though the ICCTF was established by the government, it is independently governed by the Steering Committee comprising members of line ministries and development partners.

Source: <http://fs-uneep-centre.org/publications/case-study-indonesia-climate-change-trust-fund-icctf>

168. The Government of Indonesia has also established Indonesia Climate Change Trust Fund (ICCTF). However, as highlighted in the box above the structure, sources of finance and fund management are different than the BCCTF. In discussions with government officials in the Ministry of Finance, it was understood that Bangladesh had a similar plan of merging both external and internal finances into one at BCCTF. As Bangladesh is likely to follow similar path, the experience and learning from ICCTF could be very relevant for the relevant Bangladeshi government officials.

169. Building on the results of the Climate Public Expenditure and Institutional Review (CPEIR) carried out in June 2014, the Government of Bangladesh developed and approved a Climate Fiscal Framework (CFF) to ensure the effective use of domestic and international climate finance within the national budget process. The CFF identifies the demand and supply of national climate finance and forecasts future climate financing needs for Bangladesh. The CFF designed the Climate Expenditure Tracking Framework, which enables tracking and monitoring climate-related expenditures in a systemic and transparent way.

Climate Risk Fund

The Bangladesh Bank finances the economic activities of the flood, cyclone and drought prone areas at the regular interest rate without charging additional risk premium. However, banks should assess their environmental risks for financing the sectors in different areas for creating a Climate Change Risk Fund to be used in case of emergency. The Bank would ensure regular financing flows in these vulnerable areas and sectors. The fund could be created as part of banks' CSR expenses.

Source: Bangladesh Bank Policy Guidelines on Green Financing, 2011

170. The CFF introduces a climate marker in the MTBF and climate dimension for the preparation of capital development projects, linking climate change with planning and budgeting management plan, the national biodiversity strategy and action plan, and national environmental management plan.

171. The government has three main operational mechanisms to deliver domestic climate finance: (i) the non-development budget; (ii) Annual Development Programme (ADP); and (iii) BCCTF. Over 60 percent of government climate expenditure comes from the ADP.

172. Since climate change is a cross-cutting issue, a wide range of relevant institutions contribute to the national and local response to climate change. The Finance Division of the Ministry of Finance is mainly responsible for preparation and analysis of fiscal policy, budget and budget proposals as well as research and analysis on economic policy, which are highly relevant to the implementation of the National Climate Fiscal Framework.

173. The Bangladesh Planning Commission acts as the central planning organization of the country. It determines goals and strategies of short, medium and long term plans and formulates policy measures for the achievement of those goals, playing a crucial role in the interface between policy and allocation of resources at sector level. The Ministry of Environment and Forestry (MoEF) is responsible for formulation of policy for climate change adaptation and mitigation, performing national and international negotiations, climate change funds management and related administrative activities. The MoEF plays an important role in mainstreaming climate change in sectoral activities performed by different ministries and departments. The Ministry of Local Government, Rural Development and Cooperatives is an important channel through which allocations are made to address climate change impacts at the local level in climate sensitive areas, especially for the poor and vulnerable populations. All local elected bodies are under the responsibility of the Ministry and receive allocations through the Local Government Division of the Ministry. Climate expenditure data from 2009 to 2014 are summarized in Table 3.9.

Table 3.9: Climate Expenditures in Bangladesh in millions of US\$ (FY2009–2014)

Item	Revised 2009–10	Revised 2010–11	Revised 2011–12	Revised 2012–13	Original 2013–14
Climate Dimension Expenditure	3,875	4,508	3,915	5,938	6,170
% of Total Government Budget	23.61%	24.15%	18.01%	25.67%	21.66%
% of GDP	4.35	3.99	3.17	4.68	4.05
Climate-Relevant Expenditures	1,082	1,272	1,154	1,734	1,813
% of Total Government Budget	6.59%	6.81%	5.31%	7.50%	6.36%
% of GDP	1.22%	1.12%	0.94%	1.37%	1.19%

Source: Bangladesh CPEIR (2012), Bangladesh Climate Fiscal Framework (2014)

174. Climate dimension expenditures and climate-relevant expenditures in Bangladesh amount up to \$24.4 billion over five years (2009–2014). It is to be noted that climate dimension expenditure is the total sum of expenditures of any programmes that include climate elements, while the climate-relevant expenditure is weighted average climate dimension expenditures, adjusted based on the level of relevance to climate change of each programme. While there is little reference to climate change in the budget documents, the climate dimension expenditures actually represent 22 percent of the total government budget and 6.51 percent of GDP on average (and 4.05 percent and 1.17 percent for climate-relevant expenditures).

175. The Government spends around 6 to 7 percent of its annual combined development and non-development budget on climate-sensitive activity. It is noted that while the spending on climate-sensitive activity increased from 6.6 percent to 7.2 percent of the total budget between 2009/2010 and 2010/2011, it fell back to 5.5 percent of the budget in 2011/2012. Notably, Bangladesh climate expenditures have increased over the years, featuring a small dip in 2011/2012 followed by a sharp increase of over 50 percent in the year after. As shown in Table 3.7, the Government of Bangladesh is the main funder of the climate expenditures in the Bangladesh budget system, financing 80 percent of the total climate expenditures on average.

176. On average, 14 percent of the local government's budgets are inclusive of climate change. In addition to these funds, household and individuals spend their own financial resources on addressing climate change impacts. Central government funds are usually allocated to *zilas* and *upazilas* (districts and sub-districts) for further allocation to lower levels at Union Parishads. Some donor funds use the national system to channel funds local government, but most channel funds directly to NGOs. Given the significant number and types of institutions involved in climate change in Bangladesh, formulation and effective implementation of climate activities require complex coordination mechanisms.
177. The central Bangladesh Bank has also earmarked \$500 million of low-cost green funds for the textile sector. The IFC is taking a lead role in structuring this green fund, available to textile industries as a concessional loan for promoting environmentally-friendly practices. The Bangladesh Bank has identified 47 green products under the refinancing scheme, including in the garment sector.²⁹
178. The Bangladesh Bank launched the green banking refinance scheme in August 2009. The green banking initiatives have three aspects: policy initiatives, monitoring of green banking activities, and refinance support for green sectors. Policy guidelines for green banking were issued for the first time in 2011. A total of Tk 398.2 billion was disbursed in FY2014 for green finance.
179. The coordination between different departments for climate finance has been a complex issue. In the central government alone at least 37 ministries (plus their departments and autonomous bodies) have at least one climate-sensitive programme. In addition to intra-government co-ordination, the co-ordination between institutions (i.e. national, regional and local governments) are limited. The involvement of the private sector is at its initial stage and offers a lot of potential opportunities. While, local stakeholders are not always able to distinguish between development expenditure and climate-related expenditure, experiences of flooding, cyclones and other climate-related impacts have raised significant awareness of the challenges that Bangladesh faces.
180. The two most popular strategies for addressing climate change are infrastructure development and sustainable and alternative livelihoods. There are several sources of climate-related finance found at the local level: central government funds, donor funds, private sector donations, household spending and local government internally-generated revenue.

29 <http://www.dhakatribune.com/business/2015/feb/14/bb-launch-550m-fund-green-business>.

4. External Finance: Institutional and Policy Context Flow Analysis

4.1 Introduction

181. This section will analyse fundamental elements that can be used towards building an INFF and for implementation of the 7th FYP. External finance includes a variety of private and public sources of external financing. In this section we will observe how ODA may not continue to be a main resource to finance the Post-2015 Development Agenda, but that it can be used to achieve key strategic results in Bangladesh. Important changes are also happening in the area of international climate finance, which until recently was marked by a number of vertical funds established by the United Nations Framework Convention on Climate Change.³⁰ Climate finance is expected to significantly increase in the coming years with the creation of the Green Climate Fund (GCF). This new mechanism is committed to providing up to \$100 billion per year by 2020. The following flows are covered under chapter 4: (i) ODA; (ii) vertical funds; (iii) public and private external borrowing; (iv) external climate change finance; (v) INGOs; (vi) remittances; and (vii) FDI.

4.2 Official Development Assistance (ODA)

182. Bangladesh transitioned to an LMIC country in 2015. However, at its earlier stage of development the country was quite dependant on aid as a share of GDP. In the initial years after independence the country was dependent on food and commodity aid. During the first 10 years after independence, food and commodity aid accounted for 53 to 90 percent of total ODA. Commensurate with this nature of ODA, bilateral assistance accounted for 68 to 89 percent of total ODA. Over the years this pattern has changed. As Bangladesh developed its agricultural sector with a strong focus on food production, the share of food aid declined rapidly and by FY 2000 it had become negligible. Similarly, the recovery of the economy and progress with industrialization saw the end of commodity aid, which vanished altogether in 2006.

183. Almost all ODA is now characterized as project assistance, mostly to finance investment (98 percent in FY 2013). In line with this changing pattern of aid composition, the share of multilateral sources of ODA has increased to 63 percent while bilateral assistance declined to 37 percent over the same period. The share of ODA in GDP fell to only 2 percent by FY2009 and has hovered around 2 percent since.

184. At times multilateral agencies have provided direct budget support through development support credits to coincide with the budget cycle, but this support has been erratic. A more successful example can be found in the example of the Primary Education Development Programme (PEDP), which uses performance-based budget support as a way to build institutional capacity. Direct budget support is expected to provide the most timely and predictable source of assistance since these are timed to disburse at the beginning of the government's budget cycle and commitments are based on conditions agreed and met by the government in advance. The Government of Bangladesh's *Flow of External Resources into Bangladesh* documents show considerable variation between amounts committed,

³⁰ The Global Environment Facility Trust Fund, the Least Developed Countries Fund, the Special Climate Change Fund and the Adaptation Fund.

budgeted and then received for budget support programmes over the years (ERD, 2014). The World Bank has recently announced that they may resume direct budget support.

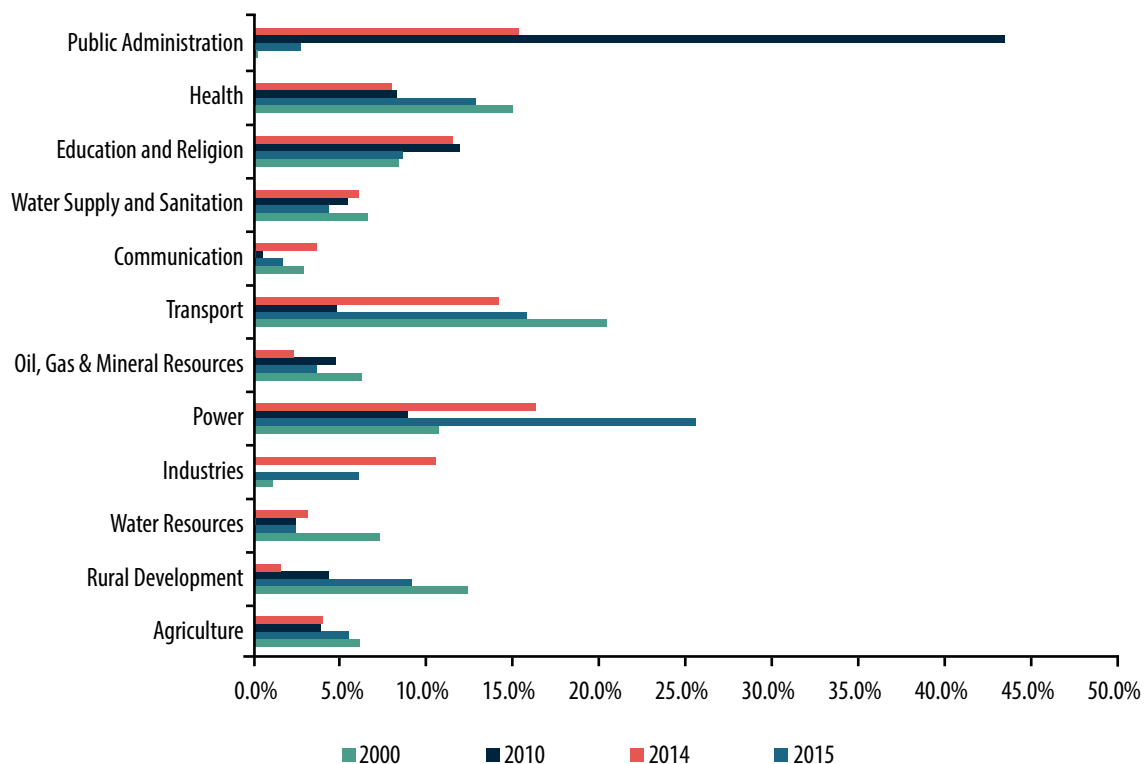
From Figures 4.1 to 4.4 below, it can be seen that:

- ODA in Bangladesh supports a wide variety of sectors and this pattern has changed over time;
- Public administration, transport and power are the largest current recipients of ODA;
- Loans from multilaterals now constitute the majority of ODA, but budget support is limited; and
- Disbursements as a share of total commitments have declined over time.

185. From this viewpoint there are a number of key issues for Bangladesh moving forward that can ensure a more effective use of its existing ODA pipeline.

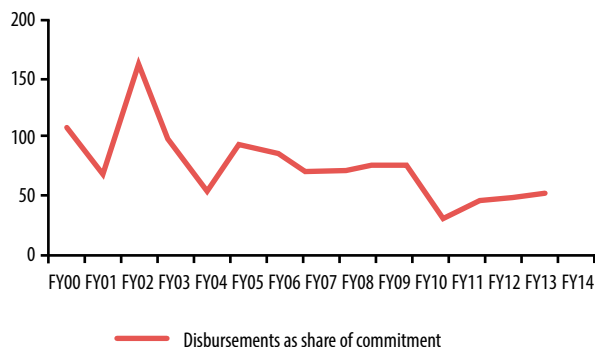
186. (i) A key policy concern is related to the low level of disbursement as a share of commitments, which fell below 80 percent in 2003 and now hovers between 40 and 60 percent. This has affected disbursements particularly in the ADP area of Government of Bangladesh spending. Given the major investment needs of the country and since growth is constrained by investment, there is space for the Government of Bangladesh to make better use of its ODA resources. Still the issue is not as straightforward as one observes from current trend analysis of commitments versus disbursement. According to analysis conducted by ERD, disbursement rates as a share of actual allocations is around 90 percent per annum. The challenge therefore appears to be the long time-gap between donors making commitments, and allocations being agreed for actual activities, by line ministries. There is scope for accelerating the pace of donor funded project implementation and to reduce the large aid pipeline which currently stands at more than \$19 billion (about six years of aid utilization).

Figure 4.1: Breakdown of Aid Commitments by Sector 2000–2014



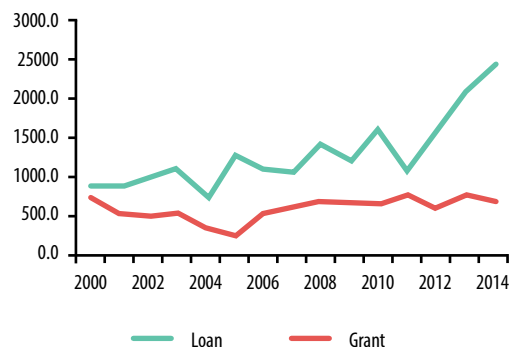
Source: ERD ("Public Administration" includes development policy loans.)

Figure 4.2: Disbursements as a Share of ODA Commitments 2000–2014



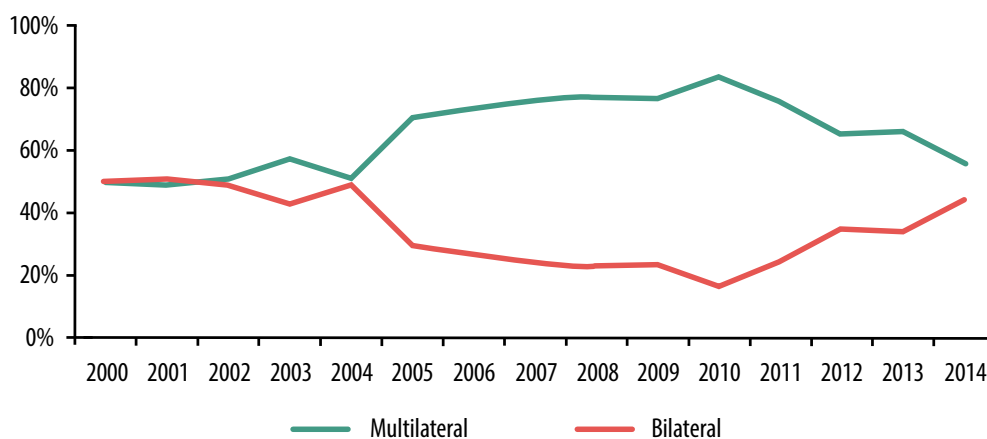
Source: Ministry of Finance

Figure 4.3: Loans versus Grants (in millions of US\$)



Source: ERD

Figure 4.4: Multilateral versus Bilateral Share of ODA



Source: ERD

187. Notwithstanding this key challenge, there are other explanations for the rising rate of low disbursement, which relate to concerns of development partners (DPs) in Bangladesh. According to DPs interviewed under a focus group discussion for the DFA, donors perceived a high level of fiduciary risk in the country. The DPs are concerned about governance and the recent political violence. There is similarly strong concern from DPs with regard to financing for large infrastructure projects. It is felt that there is currently too limited oversight during the procurement process.

188. (ii) A second policy issue for Bangladesh is that the current value and effectiveness of foreign assistance is being undermined by the high degree of aid fragmentation on the donor side, owing partially to the high degree of traditional and non-traditional donors who operate in the country and do not necessarily adopt best practices for donor behaviour as outlined in the Paris Declaration on Aid Effectiveness and successor international agreements. This creates problems for the Government of Bangladesh in terms of ownership and its ability to ensure that aid delivered is linked to national development plans and priorities. The ODA environment is becoming ever more complex due to the growing importance and role of non-DAC emerging DPs. This rise of non-DAC donors presents many benefits for the country (discussed under the SSC section), but also some challenges in terms

of harmonizing and aligning aid. This is because DAC and non-DAC donors have different strategic approaches and systems for planning and executing their aid in Bangladesh. This appears to have resulted in increasing transaction costs for both DPs and Government of Bangladesh in terms of project duplication in service delivery as well as in other areas. If there continues to be increasing fragmentation across sectors, this may also lead to rising competition between DPs. In other countries, this has at times led to greater focus on results of DP projects rather than on alignment to national priorities, posing coordination and efficiency problems for the Government.

189. *(iii) The Government of Bangladesh can use ODA to develop more catalytic ways, including to sharpen its focus on poverty reduction and equity issues, to leverage private finance and to support key public sector reforms such as for the reform of the NBR or the Board of Investment (BoI). It is clear that building strong domestic institutions to support the effective use of ODA at the national level will be key to achieving a sustainable and lasting development impact for all.*
190. *(iv) The composition between the net long-term concessional foreign borrowing (foreign aid) and other long-term borrowing may change depending on government's ability to utilize the new aid commitments as well as the existing pipeline. The external financing strategy under the plan essentially maintains the current strategy of prudent external borrowing on the best possible terms with maximum utilization of concessional official bilateral and multilateral borrowing. Many of the key infrastructure projects in the transport and energy sector (e.g. Matarbari Power Hub, Dhaka Metro Rail, and the Karnaphuli River Tunnel) can also be financed through concessional borrowing (Government of Bangladesh, 2015).*
191. *(iv) There is a renewed vision for Bangladesh under the plan to implement projects that can mitigate the adverse effects of climate change that can be funded under relevant multilateral initiatives. However the development of external climate change finance to support local initiatives has been slower than expected to take off the ground in Bangladesh (see section on external climate change finance).*

Table 4.1: Forecasted Net ODA for the 7th Five Year Plan in millions of US\$

	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	Average (FY2016–2020)
Net ODA	1534	3053.5	2937.0	3069.0	3124.9	3164.6	3069.8

Source: Government of Bangladesh

192. Bangladesh is aware of the challenges it faces with regard to ODA and is moving forward with tackling challenges. Bangladesh participated in the former OECD DAC Working Party on Aid Effectiveness and is a member of the Steering Committee of the Global Partnership on Effective Development Cooperation. Bangladesh was part of the negotiations of the Paris Declaration on Aid Effectiveness (2005), the Accra Agenda for Action (2008) and the Busan Partnership on Effective Development Cooperation (2011). The ERD has a dedicated wing to work on these issues.
193. The Government of Bangladesh established the Joint Cooperation Strategy in 2010, which serves as a formal mechanism of partnership with DPs working in Bangladesh. Its primary aim is to help implement international commitments on aid effectiveness. The local consultative group, which is anchored in the Joint Cooperation Strategy, is the main coordination platform between 18 DPs and the Government of Bangladesh. To strengthen aid coordination and effectiveness, the local

consultative group includes 18 working groups focused on a specific development priority. However, in order to function more effectively, a more prioritized and focused work environment should be established, including the development of a strategy and action plan for DPs to address concerns of the Government of Bangladesh that aid is delinked from national priorities.

194. The ERD identified the following continuing challenges during interviews: (i) proliferation of stand-alone projects and aid fragmentation; (ii) inadequate aid coordination at the sectoral level; (iii) weak progress with harmonization of policies and procedures and low use of country systems; (iv) low aid predictability; and (v) weak coordination between government agencies.

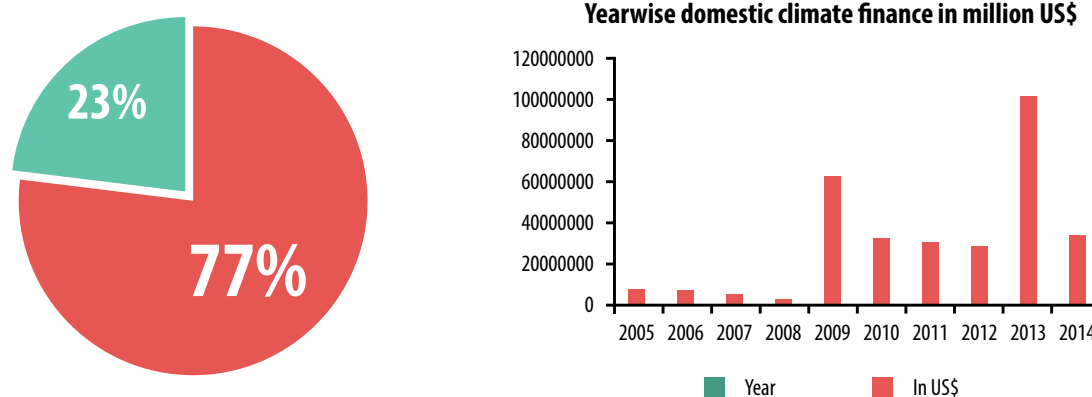
195. A further issue from the DFA analysis points to the need to develop a very strong sovereign aid policy that can help the country manage their expectations vis-à-vis activities on the group by DPs. Typically DPs can sign an Memorandum of Understanding with the Government of Bangladesh once the policy has been approved to ensure that there is mutual accountability under the new aid policy. Work is ongoing in this area.

4.3 Vertical Funds

196. Most of the available vertical funds are being used in Bangladesh. The list includes the Global Environment Facility (GEF), analysed in detail in Section 4.7, and vertical funds in the health field, including GAVI and GFATM). Although vertical funds are considered to be an effective development in the aid modality forums there are some concerns that it inhibits effective prioritization by the Government of Bangladesh and undermines government ownership over the development agenda, creating distortions in service delivery.

197. GAVI funds approved for Bangladesh until March 2015 were of \$404,170,681 and the fund disbursed \$ 371,622,752.³¹ As such, about 92 percent of the approved fund has already been disbursed. Out of total fund distributed, 77 percent was for vaccine support and 23 percent was non-vaccine support. The diagrams below indicate GAVI support to Bangladesh.

Figure 4.5: GAVI Operations in Bangladesh

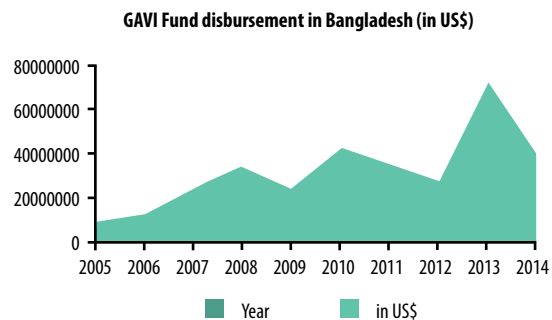


Source: <http://www.gavi.org/results/disbursements/>

³¹ <http://www.gavi.org/country/bangladesh/>

198. As per funding criteria, countries with their Gross National Income (GNI) per capita below or equal to \$1,580 are eligible for GAVI support.³² Countries whose GNI per capita crosses the GAVI eligibility thresholds have a graduation process before the phasing out of GAVI support. GAVI funding support to Bangladesh is likely to be phased out once Bangladesh achieves MIC status.

199. The diagrams also indicate GAVI fund disbursement to Bangladesh from 2005 to 2014, and show a varying disbursement pattern, related to funding cycle. The Inter-Agency Coordinating Committee (ICC), the GAVI coordinating mechanism at the country level, is chaired at a high level by Minister of Health and Family Welfare. Membership includes civil society and bilateral and multilateral representation.



200. The GFATM is a partnership between governments, civil society, the private sector and people affected by the diseases. The GFATM Country Coordination Mechanism (CCM) in Bangladesh coordinates funding between the government and other national stakeholders. The CCM develops and submits grant proposals to the Global Fund based on priority needs at the national level. After grant approval, it oversees progress during implementation. The CCM members include representatives from government ministries, NGOs, civil society, academia and the private sector.

201. The funding commitment signed under GFATM for Bangladesh until September 2015 is \$ 358,485,776 and actual disbursements of \$338,548,478.³³ As such, 94.5 percent of the committed fund has been disbursed to date. Fifty-two percent is allotted to tuberculosis, 30 percent to HIV/AIDS and 18 percent to malaria. There were a total of 17 grants given under GFATM to Bangladesh, five of which are still active (two with the government, and three with INGOs).

202. The GAVI disbursement diagram shows the varying trend in fund disbursement, which indicates variation in different rounds of the funding cycle. The main difference between GFATM CCM and the GAVI ICC is the governance mechanism. Whereas the ICC is more of an information sharing and coordinating body, the GFATM CCM is an executing body that constitutes decision-making by committee members. The GFATM CCM model is known for its governance procedures and higher level representation.

203. Civil society and the private sector are taking active part in Bangladesh in advocacy and service delivery, and the academic and scientific communities in research and policy development. The essential packages of services and health system strengthening programmes are contributing towards closer link with health sector development. Support to health systems development, greater flexibility in allocating health spending in line with national priorities, and ensuring that disease-specific interventions strengthen national systems are providing broader and more sustainable health improvements in Bangladesh though country stills lag behind achieving MDG targets on health and combating malaria, tuberculosis and other diseases (MDG Goals 5 and 6).

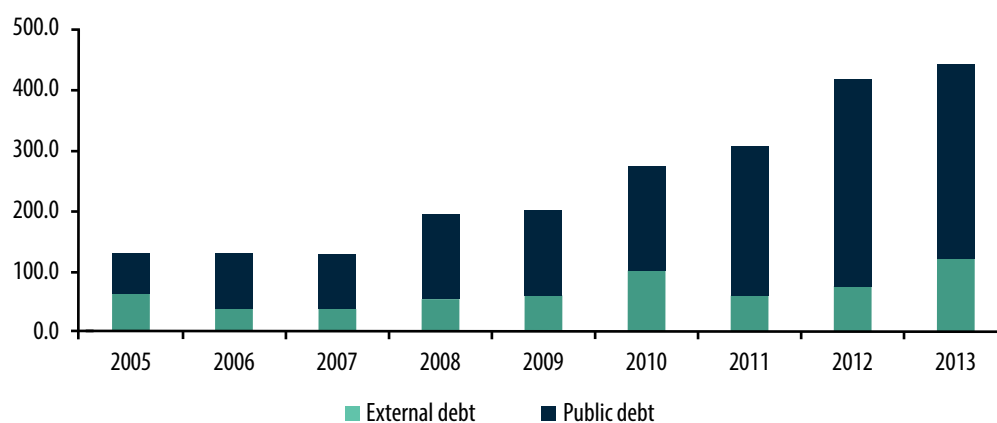
32 <http://www.gavi.org>

33 <http://portfolio.theglobalfund.org/en/Grant/List/BGD>.

4.4 Public Borrowing from Capital Markets

204. Bangladesh has large investment needs in power generation and other basic infrastructure that can be supported by external borrowing. Although limited in relative size, external debt as a share of GDP has almost doubled since 2009 and there is a need to ensure this debt build-up is sustainable and well managed.
205. On balance, domestic external borrowing has declined in importance since the mid-1990s, but external financing, primarily in the form of non-concessional loans from official multilateral and bilateral sources has continued to grow nominally in size over the years. The total amount of external public borrowing could also now increase given broader access to lenders, now that Bangladesh has reached LMIC status.
206. Bangladesh mainly borrows from external sources either as grants on highly concessional terms (grant element is 35 percent or more) or semi-concessional financing at a low interest rate with significantly longer maturities rates than grant financing. Bangladesh also obtains foreign loans at market-based interest rates. In the medium term, the target for deficit financing of the budget is to allow for borrowing of 1.7 percent of GDP (up from 1 percent in the previous FYP) where the expected contribution of loan and grants will be on average 1.2 and 0.5 percent of GDP respectively. A further 0.5 percent of GDP will be needed on an annual basis for amortization on foreign debt.
207. In line with the provision made in the Public Money and Budget Management Act (2009), the government is required to follow a specified procedure for borrowing with a view to ensuring sound debt management. The use of appropriate debt strategies is a priority of the Bangladesh Bank to help determine a borrowing mix, which also ensures minimization of costs and risks to its debt portfolio.
208. The Government of Bangladesh is committed to provide guarantees to the sector that have the most impact on growth. These guarantees enable borrowers to obtain loans at much more favourable rates of financing for specific growth promoting projects which are mainly in the area of power, energy and agriculture. At present, power and energy sector guarantees constitute 65 percent of total contingent liabilities of the Government of Bangladesh. The Government of Bangladesh has developed a monitoring system under a risk framework to check that guarantees do not turn into liabilities and Sovereign Guarantee/Counter guarantee guidelines.

Figure 4.6: Domestic Debt versus External Debt



Source: Bangladesh Bank

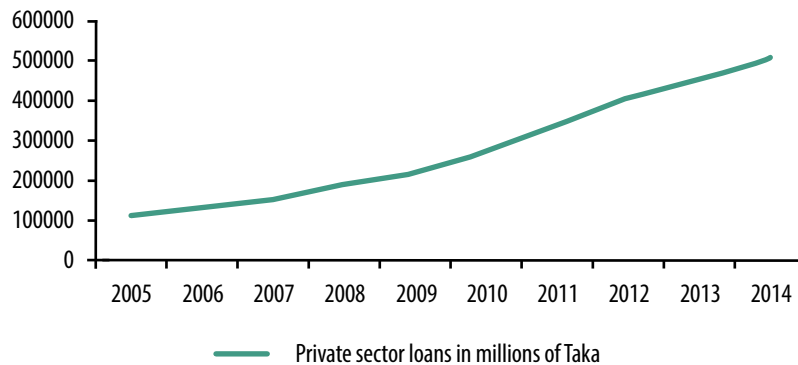
209. The International Monetary Fund (2014) has pointed to the need to manage the total size of non-concessional borrowing as a share of domestic external borrowing in terms of improving the overall quality of spending in the public sector. In view of the relatively high cost of non-concessional resources, which will likely increase in future, all projects tied to this type of borrowing should be closely vetted, properly evaluated, and carefully monitored to ensure sound governance and oversight in the contracting and use of these funds. Furthermore, the International Monetary Fund and other partners urge the government to continue to avail the large pool of existing commitments (mainly concessional) and undertake additional external borrowing mainly on concessional terms, if it can, which would be consistent with Bangladesh's debt management capacity.
210. According the 7th FYP, access to traditional concessional borrowing from official bilateral and multilateral sources should be increased and complemented with additional borrowing in the form of sovereign bonds of various maturities (with preference for a longer maturity period as is the case in Indonesia and Philippines) and other sources of financing. In addition to the traditional access to multilateral institutions such as the World Bank and the ADB, the new Asian Infrastructure Bank is also expected to help mobilize concessional external financing for infrastructure investment in Bangladesh. The government could also build up its relations with the international capital market by launching its second sovereign bond. These strategic transformations should be done on the basis of a comprehensive new Government Financing and Debt Management Strategy to be prepared by the Debt Management Wing of the Ministry of Finance (Government of Bangladesh, 2015).
211. As regards accessing capital finance for the public sector by issuing sovereign bonds – progress is being made on the ground. For example, the Government of Bangladesh has now approved the IFC proposal for the second-ever offshore taka bond program worth \$1 billion, which aims to strengthen capital markets and increase foreign investment in Bangladesh. The bonds will be listed in the London Stock Exchange. This programme follows the development of the Masala bond programme launched in 2013. To date \$1.7 billion have been sold through international investors. Without question exploring options to access external capital markets through sovereign debt bonds with long-term maturities is critical to providing long-term financing for the private sector, which plays an essential role in job creation.
212. Looking to the future, external financing, primarily in the form of concessional loans from official multilateral and bilateral sources, but increasingly loans on non-concessional terms will continue to supplement public investment needs of the country.

4.5 Private Borrowing from Capital Markets

213. The 7th FYP recognizes that public sector investment alone cannot bring about the increase in gross investment needed for achieving the eight percent GDP growth target by FY2020. About 77–80 percent of investment is expected to come from the private sector and without a significant increase in private investment from domestic and foreign sources, the planned increase in investment to more than 34 percent of GDP (from 25 percent of GDP in FY2015) by the end of the 7th FYP will likely not be realizable.
214. In order to obtain loans from external sources a private company in Bangladesh needs approval from the Scrutiny Committee of the Board of Investment, chaired by the Governor of the Bangladesh

Bank. Loans are approved only if they are provided by a list of eligible lenders, which include international banks, international capital markets, multilateral financial institutions (International Finance Corporation, World Bank, ADB, Organization of the Petroleum Exporting Countries Fund, etc.); export credit agencies and suppliers of equipment; and borrowing from foreign equity holders for short-term bridge financing. The range of acceptable loans covers financial loans, bank loans, and buyer's credit, as well as supplier's credit from institutions or individuals. These loans can be used for investment in the industrial sector including small and medium enterprises, infrastructure and other priority sectors as defined in the Industrial Policy but not for working capital purposes or for investments in the capital market.

215. The amount of loans taken by the private sector has expanded although not to the extent that they are able to fill fully the financing gaps for public sector investment. The Bangladesh Bank recently conducted a study on foreign borrowing by the private sector. The Bank surveyed a representative sample of 13 firms from different sectors that had taken loans from external sources. The findings of the study suggested that the main reasons for borrowing from foreign sources were the lower interest rates than could be accommodated domestically (i.e. external: LIBOR (London Interbank Offered Rate) +3 to 4.5 percent and domestic: 14 percent to 18 percent), but also because most local banks could not finance such large projects owing to their limited capital base.
216. According to the Bangladesh Bank study, about 20 private enterprises received approval for \$936.30 million loans in 2011, which increased to \$1,579.57 million (among 81 enterprises) in 2012 and further to \$1,555.33 million (among 116 enterprises) in 2013. According to the same study, the highest amount of borrowing from external sources was approved for the telecommunication sector, followed by the power sector. Together they constituted more than 61 percent of total approved loans.
217. Although private sector borrowing from abroad is very limited it is still on the increase. In order to increase this type of borrowing, in particular for nationally important mega projects, national policies need to be introduced to improve the overall environment for investment (as reflected through indicators such as Doing Business Indicators [World Bank] and Productivity Indicators [OECD]) as well as a gradual opening, possibly partial opening of the current and capital account. In addition a gradual liberalization of the capital and current account will be needed to accommodate a growing market for private sector borrowing.
218. A review of past experience indicates that, the secular increase in the share of private investment in total investment was the result of reforms initiated in 1980s and 1990s by liberalizing trade and domestic investment, initiating privatization of public enterprises, financial sector reform and liberalization, and access to power and gas at cheaper prices. Private investment in the economy in the post-2000 period has faced challenges such as infrastructure constraints including power shortages due to cuts in public investment spending and the inability of the government to implement large infrastructure projects. Although the power situation has significantly improved during the 6th FYP, problems with transportation, availability of serviced land for industrial projects, and the overall political environment have worsened the investment climate over time. Improving these key-binding constraints will be a challenge under the 7th FYP (GoM, 7th FYP).

Figure 4.7: Private Sector Loans in millions of Taka, 2005–2014

Source: Bangladesh Bank

4.6 South-South Cooperation (SSC)

219. Bangladesh maintains strong development cooperation with many non-traditional donors such as China, India, Islamic Republic of Iran, Kuwait, Malaysia, Saudi Arabia, Turkey and United Arab Emirates. It has also developed strong relations from traditional donors or Development Assistance Committee (DAC) member countries, namely Japan and Republic of Korea. Since 2001, Bangladesh has mobilized \$2.16 billion through official assistance from non-traditional donors out of which \$1.34 billion is loan and \$819 million are grants. The table below indicates types of SSC support.

Table 4.2: Types of South-South Cooperation in Bangladesh

Country	Type of Support
China	Most aid in form of projects in-kind, government concessional loan, preferential buyer's credit, technical cooperation and scholarships.
India	Project-oriented technical cooperation, line of credit, scholarships.
UAE	Aid in the form of projects and technical cooperation. Direct bilateral support, which sometimes may include budget support.
Kuwait	Mainly project and technical cooperation, sometimes budget support. Also provides debt relief.
Saudi Arabia	Mainly project-type assistance (but not technical co-operation), with programme aid, sometime budget support and debt relief.
Pakistan	Line of credit, technical assistance.
Malaysia	Concessional loan, technical collaboration, scholarships.

220. Effective SSC is part of the mandate of the new Development Effectiveness Wing. The Economic Relations Division (ERD), through its ten wings, maintains external economic relations and resources, including with countries from the Global South. The ERD has been working on South-South and Triangular Cooperation (SSTC) but there is no separate unit yet for SSTC. Bangladesh is pursuing SSC through the following mechanisms:

Regional Trading Arrangements

221. The South Asian Association for Regional Cooperation (SAARC) is one of the first few major regional integration initiatives in South Asia. The Preferential Trading Arrangement (SAPTA, 1995) and South Asian Free Trade Area (2004) offers capacity building in trade-related issues through training, export promotions, trade policy formulation and others.
222. The Asia Pacific Trade Agreement offers tariff concessions on specified products by member countries (Bangladesh, China, India, Lao People's Democratic Republic, Mongolia, Nepal, Philippines, Republic of Korea and Sri Lanka). Under this agreement Bangladesh has received 100 percent tariff concessions to 83 items from China and to 139 items from the Republic of Korea.
223. Under the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, in the case of First Track products, non-LDCs will open up their markets for the products of LDCs in one year and LDCs will do the same for non-LDCs in five years. Bangladesh, being an LDC, still enjoys special and differential treatment.
224. The Preferential Trade Agreement (PTA) among the D-8 Organization for Economic Cooperation countries is an arrangement for development cooperation among the following eight member countries: Bangladesh, Egypt, Indonesia, Islamic Republic of Iran, Malaysia, Nigeria, Pakistan and Turkey. The D-8 was established by the Summit of Heads of State/Government in Istanbul on 15 June 1997. Through PTA, Bangladesh is able to improve its position in the world economy and diversify and create new opportunities in trade.

Bangladesh has **Joint Economic Commission (JEC)/ Joint Commission (JC)** agreements with 18 counterparts: China, India, Indonesia, Islamic Republic of Iran, Kuwait, Malaysia, Nepal, Pakistan, Philippines, Republic of Korea, Romania, Saudi Arabia, Sri Lanka, Thailand, Turkey, Viet Nam, United Arab Emirates, and the European Union. The prime objective of JEC/JC meetings is to enhance bi-lateral cooperation and instil effective measures in order to achieve a comparative advantage in each country. Bilateral relations such as political, economic, trade, industrial, investment, civil aviation, cultural, shipping, education, health, labour force are discussed during JEC meetings.

Source: <http://www.erd.gov.bd>

225. Impacts of regional trading arrangements are well reflected in the levels of FDI flows from countries from the Global South, which has doubled from \$518 million in 2008–2009 to \$963 million in 2012–2013.³⁴
226. Table 4.3 below indicates that the highest levels of FDI flows have been from Egypt, followed by China (Hong Kong), Malaysia, Pakistan and Singapore.

Table 4.3: Top 10 Countries with FDI Flow to Bangladesh from 2008–2014 (in millions of US\$)

No.	Country	2008–09	2009–10	2010–11	2011–12	2012–13	2013–14	Total
1	Egypt	309.70	20.00	37.30	146.86	138.14	0.41	652.41
2	Singapore	14.75	311.86	22.77	15.59	103.60	140.63	609.20

³⁴ Flow of External Resources in Bangladesh, ERD, PR of Bangladesh, table no. 3.11, 2015

No.	Country	2008–09	2009–10	2010–11	2011–12	2012–13	2013–14	Total
3	Malaysia	79.15	40.17	2.00	7.72	337.97	59.23	526.24
4	China (Hong Kong)	47.55	72.95	93.58	68.07	86.34	119.76	488.25
5	Pakistan	22.96	13.14	24.59	63.19	27.37	131.96	283.21
6	Sudan	21.84	38.06	21.21	80.19	0.67	0.00	161.97
7	Sri Lanka	8.54	7.13	16.08	27.15	24.96	63.24	147.10
8	Republic of Korea	N.A	N.A	N.A	N.A	N.A	140.35	140.35
9	British Virgin Islands	0.00	2.35	13.38	12.51	68.24	43.24	139.72
10	China	2.54	5.17	18.57	14.35	26.01	46.70	113.34

Source: Bangladesh Bank FDI Survey Reports from 2008 to 2014

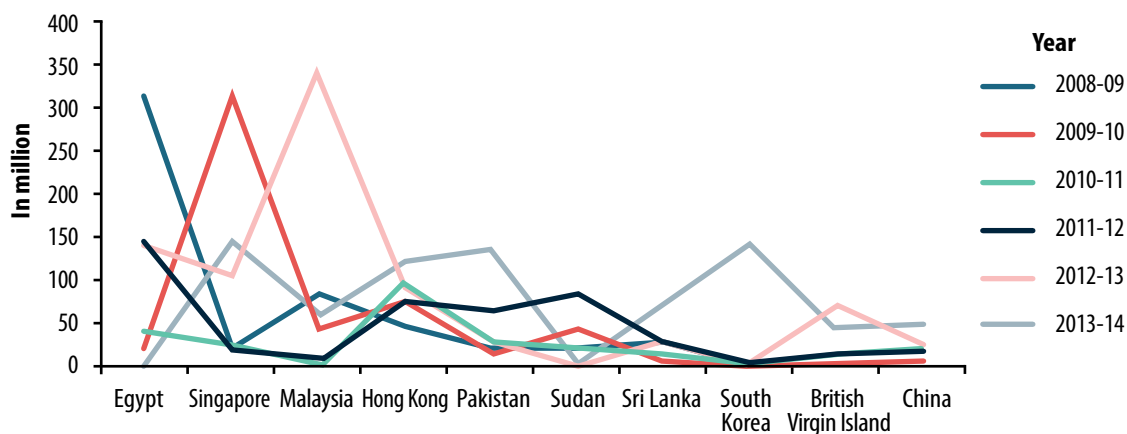
Bilateral Trade Relations among countries from the Global South

227. Bangladesh has established bilateral trade relations with about 40 countries of the Global South. The share of Bangladesh's exports to all countries of the Global South increased from 10 percent in 2000 to 16.2 percent in 2010 though the share of exports to the top 10 countries of the Global South in the total exports fluctuated. It was 77.2 percent in 2000, declined to 73.7 percent in 2005 and increased to 74.5 percent in 2010.

Bilateral Financial Assistance from the Global South:

228. Top partners from the Global South for bilateral financial assistance include China, India, Kuwait, Russia, Saudi Arabia, Turkey and the United Arab Emirates. Figure 4.8 below indicates the fund flow from these countries. China supports Bangladesh through in-kind support. India has been providing support mainly through a line of credit. Japan has disbursed \$4,860 million as its ODA support to Bangladesh.³⁵

Figure 4.8: Foreign Direct Investment from the Global South



Source: Bangladesh Bank FDI Survey Reports from 2008 to 2014

³⁵ <http://www.bd.emb-japan.go.jp/en/bilateral/overview.html>

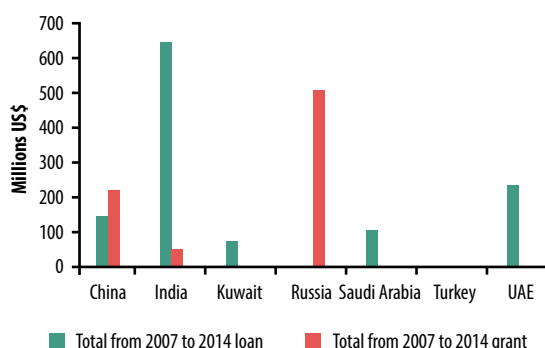
SSC Technical Assistance

229. Bangladesh receives technical assistance mainly from China, India and Malaysia through scholarships and training programmes under Technical and Economic Cooperation (TEC), the Technical Cooperation Scheme (TCS) of the Colombo Plan, SAARC and the Indian Ocean Rim Association.³⁶
230. China provides 70 scholarships of various kinds to Bangladesh nationals each year. India³⁷ offers 185 fellowship under ITEC and 35 fellowships under TCS of the Colombo Plan every year to Bangladesh. India also extended 200 scholarships for Higher Secondary-level students and 500 scholarships to Graduate-level students on an annual basis. Malaysia, through the Malaysian Technical Cooperation Programme, shares its development experiences and expertise with Bangladesh. It also provides fellowships to Bangladeshi students under the Malaysia International Scholarship for Postgraduate and Postdoctoral Studies.

Multilateral Financial Institutions from the South:

231. Bangladesh receives concessional loans and grants from Southern multilateral institutions, mainly from Abu Dhabi Fund for Development, Kuwait Fund for Arab Economic Development, Islamic Development Bank, SAARC Development Fund and others.

No.	Country	Total Fund Flow from 2007 to 2014 (in millions of US\$)	
		Loan	Grant
1	China	140.70	217.70
2	India	638.40	50.00
3	Kuwait	71.22	0.00
4	Russia	0.00	500.00
5	Saudi Arabia	98.33	0.00
6	Turkey	0.00	0.43
7	UAE	225.30	0.00



Source: *Flow of External Resources in Bangladesh, ERD, PR of Bangladesh, table no.3.11, 2015*

232. Abu Dhabi Fund for Development's³⁸ involvement in Bangladesh goes back to 1976. The Fund has since then offered and managed loans and grants totalling around \$104 million for small- and medium-sized industrial enterprises across all economic sectors. The Kuwait Fund for Arab Economic Development³⁹ provided 23 loans to Bangladesh to date, totalling about \$556.7 million. The Fund also extended three technical assistances of about \$1.44 million for the financing of feasibility studies in the transport sector. Similarly, the SAARC Development Fund has provided a \$2.6 million grant to Bangladesh.

36 Please refer to the Annex on SSC for details on these institutions

37 www.mea.gov.in/Portal/ForeignRelation/Bangladesh_Brief.pdf

38 <http://www.adfd.ae>

39 <https://www.kuwait-fund.org/en>

233. Bangladesh has sought \$1.8 billion in assistance from the Islamic Development Bank under its second Members Country Planning Strategy on rural development, agriculture, power, health and small enterprises to be implemented from 2017 to 2019. Assistance from the Islamic Development Bank will be in the form of mixed credit as some of the loans will be soft in nature. During the previous fund cycle, the Islamic Development Bank provided \$874 million to Bangladesh with less than 2 percent interest and a seven-year grace period.⁴⁰
234. The overall picture from SSC is encouraging as this emerging source of finance has great potential for Bangladesh. There are, however, a number of issues that should be addressed to achieve their full potential and a better alignment with country priorities:
235. (i) *It has not been easy for the Government of Bangladesh to align some of the main sources of SSC with country priorities.* A large proportion of SSC is supply driven. In fact, most of the investment is concentrated manufacturing and infrastructure development and other key national development goals, like education, skill development, health and others are likely to be ignored. This is less of a problem for grants, as some countries like India provide absolute freedom to the government to spend the grant funds in any area or project. When it comes to loans, the government has the perception that many of the initiatives are donor-driven and sometimes that there are also vested interests from the middlemen who champion these projects all the way from line ministries and agencies to the top.
236. (ii) *Government is taking steps to improve value for money of SSC, but there is still some way to go.* Value for money has been an issue that also concerned the government, especially for loan-based support from SSC suppliers. This is not a big issue anymore for the cooperation that comes from some countries, like India, where the Government of Bangladesh has achieved some freedom for tendering among suppliers, in that they are free to choose the supplier as long as they are from India. The availability of a large and competitive market of quality suppliers in the country ensures that a reasonable degree of value for money can be achieved for all projects. China, however, has been a much more complex partner to manage as their approval process linked the designation of the supplier firm together with the approval of the project finance. Recent diplomatic agreements with China are aiming to achieve a similar system as the one used with India, but this still needs to be translated in operational terms to current practice.
237. (iii) *As in many other countries, availability of quality data and information about SSCs is a problem.* Lack of systematic analysis and data collection for SSC undermine the government's capacity to manage these funds properly. This has also the negative consequences for development partners as it is difficult for them to have an informed perspective of the results obtained with their cooperation.

40 *The Independent Daily*, 15 October 2015, pp 2.

4.7 External Climate Change Finance

238. Bangladesh remains exempted from internationally agreed obligations to pursue mitigation efforts. Bangladeshi climate-related activities are generally geared towards developing resilience in the face of climate-related impacts. As such, climate finance in the Bangladeshi context mostly refers to flow of funds, from both internal and external sources, toward adaptation measures. Bangladesh has set Intended Nationally Determined Contributions (INDC) of emission reduction to 5 percent conditional and 15 percent unconditional by 2030 under the COP21⁴¹.
239. Established in 2010, the Bangladesh Climate Change Resilience Fund (BCCRF) aims to build a medium- to long-term programme for enhancing climate resilience and facilitate sustainable growth, financially supported by the development partners of the Government of Bangladesh. In 2012, the support reached \$188.2 million. As of 2014, 83 percent of the fund has been allocated to 13 projects. Continuation of the fund is currently being discussed. With the World Bank's decision to quit its trustee role after 2017, the BCCRF Secretariat is likely to be closed after December 2015.
240. Since joining the GEF, Bangladesh has received GEF grants totalling \$37 million that leveraged \$369 million in co-financing resources for 13 national projects. These include eight projects in climate change, three in biodiversity, one in persistent organic pollutants, and one in multi-focal areas. Similarly, Bangladesh participated in nine regional and global projects financed by the GEF totalling \$62 million that leveraged \$761 million in co-financing resources. These include six projects in climate change, one in biodiversity, one in land degradation, and one in international waters. During GEF-5 replenishment period (July 2010 to June 2014), Bangladesh received an indicative allocation to formulate and execute projects for \$1.8 million in biodiversity, \$9.6 million in climate change, and \$1.1 million in land degradation.⁴²
241. Bangladesh's Least Developed Countries Fund ceiling currently is \$30 million and the country so far accessed around \$23.5 million (adding all projects implemented, ongoing and agreed concept notes under design phase). A project of \$6.5 million has been submitted to GEF and if approved; Bangladesh will almost utilize the country quota of GEF/Least Developed Countries Fund (\$29.5 million out of \$30 million).
242. The Adaptation Fund (AF) had provisions such as the GEF for direct access by National Implementing Entities (NIEs) as well as access by Multilateral Implementing Entities (MIEs) [a total of 11, including UNDP, United Nations Environment Programme, ADB, International Fund for Agricultural Development, World Food Programme and others] and Regional Implementing Entities (RIEs) such as the West African Development Bank. Bangladesh opted for direct access through NIEs and no project was submitted through MIEs/RIEs. The Government of Bangladesh had applied for NIE status with AF, but it was not approved. Recently, it has again applied for accreditation, and if it is successful this time then Bangladesh can access AF directly.
243. The Climate Investment Fund (CIF) includes four key programmes that help 63 developing countries pilot low emissions and climate resilient development:
- Clean Technology Fund Forest Investment Programme (FIP)

41 <http://climateobserver.org/open-and-shut/indc/>

42 https://www.thegef.org/gef/country_fact_sheet/bangladesh-and-gef-0.

- Pilot Programme of Climate Resilience (PPCR), and
 - Scaling Up Renewable Energy Programme (SREP)
244. Bangladesh received \$110 million through the PPCR programme, out of which \$50 million was grant and \$60 million was near zero interest concessional loans. The World Bank, IFC and ADB manage the fund, with the ADB managing the majority share of \$71.5 million and the rest by the World Bank and IFC. The fund managers informed that a total of \$572 million had been injected as co-financing to the PPCR amount of \$110 million from ADB, World Bank, International Fund for Agricultural Development, KfW (German development bank) and the Bill and Melinda Gates Foundation.
245. Apart from these funds, the UN-REDD Readiness Programme (United Nations Programme on Reducing Emissions from Deforestation and Forest Degradation) is also a funding source for climate change mitigation through forestry and land use change. Bangladesh has accessed \$2.3 million from UN-REDD. Bangladesh is highly likely to receive \$30 million as a grant from the CIF.
246. A new development in climate finance has been the Green Climate Fund (GCF). The GCF was established in 2010 under the United Nations Framework Convention on Climate Change as a legally-independent institution. The fund headquarters was established in December 2013 in Songdo, Republic of Korea. Its target is to mobilize \$200 billion by 2020, however by September 2015, only \$10.2 million had been mobilized.⁴³
247. The ERD is selected as the National Designated Authority (NDA) for the GCF, and UNFCCC together with GIZ and UNDP, is working with the Government of Bangladesh to establish a National Designated Authority (NDA) secretariat. The NDAs are the interface between each individual country and the Fund. These focal points communicate the country's strategic priorities for financing low-emission and climate-resilient development across their economy. In general, there are two different ways to access the GCF. One is 'Indirect Access', which is through the Multilateral Implementing Entity (MIE) that includes multilateral development banks and the United Nations agencies accredited by GCF. The other is by 'Direct Access', which is through a National Implementing Entity (NIE) that includes any national institution accredited by the GCF.
248. The GCF will provide financing in the form of grants and concessional lending, and through other modalities, instruments or facilities as may be approved by the Board. National Implementing Entities (NIE) can access the fund directly when accredited by the Board, Specific accreditation criteria include the Fund's fiduciary principles and standards and environmental and social safeguards.
249. Bangladesh is working on six proposals to put to GCF through Multilateral Implementing Entities (MIE). The three MIEs which are working with the Bangladesh government on the proposals are UNDP, ADB and KfW. The ERD is the National Designated Authority (NDA) of Bangladesh. Recently, GCF approved two for \$40 million (with UNDP as MIE) and \$80 million (with KfW as MIE).⁴⁴
250. As highlighted by the Senior Secretary, ERD and NDA of Bangladesh to the GCF,⁴⁵ Bangladesh faces a few challenges in accessing GCF. These include improving institutional capacity in the

43 http://issuu.com/greenclimatefund/docs/gcf_dispatch_-_October_2015.

44 Based on discussions with ERD and UNDP staff.

45 [https://www.dropbox.com/home/DFAA%20UNDP/climate?preview=Accessing+Green+Climate+Fund+_+Challenges+and+opportunities.pdf.\(available+to+Dropbox+members\)](https://www.dropbox.com/home/DFAA%20UNDP/climate?preview=Accessing+Green+Climate+Fund+_+Challenges+and+opportunities.pdf.(available+to+Dropbox+members))

area of environmental and social safeguard policy and practices, particularly Environment Impact Assessment practices at both project and programme level; enhancing fiduciary standards and project management capacities; and design credible bankable projects or programmes for GCF funding.

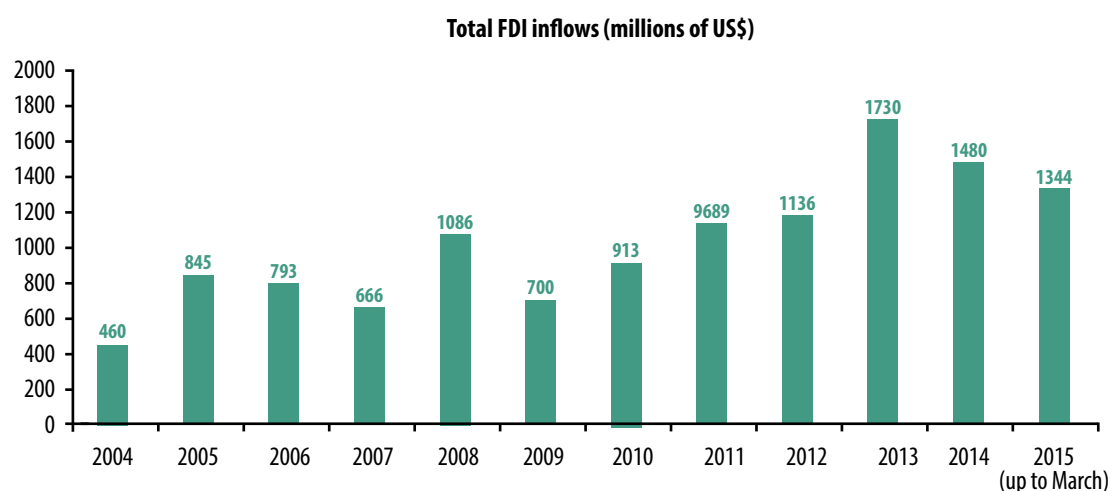
251. As the multi-donor trust fund BCCRF does not look promising and other external sources on climate finance (CIF, GCF, GEF, etc.) to Bangladesh are also not significant, it appears that the country will have to make a greater emphasis on mobilizing climate finance from bilateral donors or through domestic sources.

4.8 Foreign Direct Investment (FDI)

252. One of the most ambitious goals of the 7th FYP aims to achieve a radical increase of FDI inflows from 0.9 percent to three percent of GDP, which in nominal terms will mean an almost six-fold expansion of the present volume, from approximately \$1.7 to \$9.6 billion in 2020. Recent trends show that volume of FDI has been increasing, but not at the pace that would be required to achieve the targets of the plan.

253. In principle, the country presents what is mainly a favourable investment regime and has good perspectives for attracting productive FDI: (i) all Bangladeshi products (other than armaments) enjoy complete duty and quota free access to markets such as Australia, Canada, Japan and the European Union; (ii) the country is strategically positioned next to China, India, and key Association of South-East Asian Nations markets; (iii) the country offers legal protection against nationalization and expropriation by Foreign Private Investment;⁴⁶ (iv) Bangladesh is also a signatory of treaties as the Multilateral Investment Guaranty Agency, United States Overseas Private Investment Corporation, International Center for Settlement of Investment Disputes and World Intellectual Property Organization; (v) bilateral agreements to avoid double taxation have been signed with many countries; (viii) there are no limits on income and profit repatriation for foreign investors; (ix) 100 percent foreign ownership and joint ventures without restrictions on shareholding are allowed; and (x) all sectors are open to FDI except few restricted on national security grounds.

Figure 4.9: Total Foreign Direct Investment Inflows 2004–2015



Source: Foreign Investment and External Debt (FIED) Division, Statistics Department, Bangladesh Bank

46 (Promotion & Protection) Act 1980.

254. However, in comparative terms, the performance of Bangladesh for attracting FDI inflows has been, disappointing. Current FDI/GDP rates are in range with the South and Southwest Asian region average (1.3 percent), but these levels are quite low when compared with other emerging and dynamic economies of the region that are attracting much larger volumes of FDI (Cambodia, Fiji, Mongolia, Myanmar and Viet Nam), (see Table 4.4 below). Bangladesh is also outperformed by other economies like Bhutan, Democratic People's Republic of Korea and Sri Lanka. The list of regional economies with lower levels of FDI/GDP than Bangladesh includes Afghanistan, Islamic Republic of Iran, Nepal, Pakistan and Timor-Leste.

Table 4.4: FDI Inflows as a Percentage of GDP of Selected Countries and Regions

Regional Benchmarks		Similar Ratio Countries		High Performing countries	
South and Southwest Asia	1.3	Nepal	0.4	Bangladesh	0.9
East and Northeast Asia	1.4	Iran	0.6	Myanmar	4.2
Bangladesh	0.9	Bangladesh	0.9	Viet Nam	5.2
North and Central Asia	3.9	Bhutan	1.2	Fiji	6.0
Pacific	3.0	Sri Lanka	1.4	Cambodia	9.2
South-East Asia	5.1	DPR Korea	1.5	Mongolia	17.2

Source UNESCAP Database (data for 2013)

255. On the other hand, by different international measurements, the investment climate for Bangladesh does not appear to be quite so attractive. The World Bank 2015 *Doing Business Report* ranks Bangladesh 173 out of 189 countries. The survey measures a comprehensive sample of 31 indicators for 10 Doing Business topics⁴⁷ and also provides a score that estimates the gap between national performance for each indicator and best practice measures. The overall score for Bangladesh is 46.84 percent, which means that there is still a long way to go make many things work. The Doing Business methodology may have limitations but the score of all the countries compared above are higher than that of Bangladesh.⁴⁸

256. The *Global Competitiveness Report*, produced by the World Economic Forum, also portrays a not so positive overview of the competitiveness performance of Bangladesh. Out of 144 economies measured, the country ranks in the 109th position. The competitiveness factors measured are broader⁴⁹ and complementary to the ones presented above. The study also presents results of a survey that captures the opinions of business leaders around the world and their perception of the most problematic factors for doing business. Weighted results for Bangladesh include: inadequate supply of infrastructure (21 percent); corruption (20.7 percent), inefficient government bureaucracy (15.3 percent), Government instability (9.3 percent), access to financing (7.5 percent), inadequately educated workforce (4.3 percent), crime and theft (3.2 percent) and tax regulation (2.9 percent), among many others.

47 Measured topics are: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency, and labour market regulation.

48 Mongolia (72), Viet Nam (78), Fiji (81) Sri Lanka 99, Bhutan (125), Iran (130), Cambodia (135), and Myanmar (177).

49 Institutions, infrastructure, macroeconomic environment, Health and primary education, efficiency enhancers, higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size, innovation and sophistication factors.

257. These measurements suggest that there are many areas where the country would need to make substantial improvements before becoming a more attractive destination for FDI. The needed reforms are quite broad and the time frame for achieving visible results may take many years. This is partly true, but in fairness, many of other factors presented before (and not measured in these studies as the proximity to large markets, and the reputation gained as a world-class manufacturer in some areas) also play an important role. The need for improving the investment climate remains a critical issue and requires concerted actions involving further business deregulation, financial sector reforms, tax reforms, legal reforms and better governance. These issues are captured in the 7th FYP. The plan also shows possible shortcuts and parallel actions to accelerate FDI as these longer-term measurements gain momentum:

- *Focus on Export Manufacturing and Global Value Chains:* there are better chances to attract productive FDI focusing the attention in vertical and horizontal integration processes related with the RMG industry and in other niche markets.
- *Expansion of the Export Processing Zones (EPZs):* These zones offer an artificial environment that create special conditions to facilitate export-based manufacturing; the facilities offered (plots/factory buildings) are in a custom bonded area, infrastructural and administrative facilities work well and fiscal and non-fiscal incentives are offered. Eight EPZs were piloted with success and brought in FDI,⁵⁰ which not only boosted exports but also had spillover effects on the local economy in the application of improved management and technolog.
- *Development of Special Economic Zones (SEZs).* In a similar way, SEZs will be used to serve as “demonstration areas” for policy reforms and encourage foreign investment. The SEZs will aim to create more spillover effects for the economy than EPZs and will not just focus on the manufacturing of export-oriented products. The SEZs normally have the following attributes: (a) geographically delimited area; (b) single management; (c) eligibility of benefits based upon physical location within the zone; and (d) separate customs areas and streamlined procedures. Following international success stories, the government is planning to develop five SEZs with a special focus on attracting investors from China, India and Japan and accelerate as much investment as possible from those countries.
- *Focus on the Shipbuilding Industry.* The government identified a strategic opportunity for Bangladesh in this sector and is planning to concentrate FDI promotion to consolidate it. Promotion in this area will incorporate the lessons learned from the two decades that the country took to play a dominant role in export earnings in the RMG industry to do the same in the shipbuilding industry but in less time (10 years). For this sector, proper facilities and policies for ensuring compliance with international standards in terms of ship quality, worker safety and environmental pollution; attracting FDI; and provision of a strong network of backward linkages industries will be provided towards its development. More importantly, one of the biggest constraints, that of costly intermediate financing, will also be addressed for this particular case.

258. Whereas none of these are long-term solutions, they could provide a more targeted approach to boost FDI in the short term as more structural, long-term solutions are implemented. The list of these solutions should include at least the following key detected problems:

⁵⁰ The cumulative investment of EPZs stands at \$3.4 billion up to December 2014, and accounted for \$3.8 billion and \$4.4 billion of exports respectively in FY2013 and FY2014 (7th FYP).

259. *(i) Leadership and Capacity of the Board of Investment (BoI).* The BoI has been signalled by many sources as facing capacity constraints and the most important focus for short-term attention. Important capacity and leadership limitations are not allowing the BoI to perform its key roles for accelerating internal reforms to improve FDI, providing one stop-shop services for prospective investors and reach the foreign markets with professional and effective promotion campaigns.⁵¹
260. *(ii) Review the Corporate Tax Regime:* With corporate income tax rates that range from 25 up to 45 percent, Bangladesh has among the highest corporate taxes in the region. It has also been argued that the present tax regime is more focused on import protection than on export promotion.
261. *(iii) Ensure Overall Policy Consistency and Find a Balance for Tax Exemptions and Concessions.* Some of the government interventions are contradictory and sometimes create negative impacts on different areas. Tax exemptions to attract FDI should also be used with a more strategic approach and modelling their potential impact, especially in terms of domestic resource mobilisation. Otherwise, they may perpetuate and end up in a “race-to-the-bottom” that will deprive the government of the urgently needed revenues.
262. *(iv) Lack of a Strategic Approach to Address the Long-Term Key Issues.* Problems that exist across ministries such as infrastructure, energy, access to finance, development of PPPs and labour market regulation that are hindering the long-term development of FDI must be addressed in a coherent and strategic way. The 7th FYP does not address how these reforms are going to take shape in the short term.
263. *It has to be acknowledged that attracting quality, productive FDI is not an easy task for any country.* Most of the region’s FDI is heavily concentrated in a few key economies: China, including Hong Kong, and Singapore accounted for almost two-thirds of all regional FDI in 2012.⁵² There are also many limitations of FDI that governments have to deal with: (i) FDI hardly reaches least developed countries unless they are major exporters of natural resources; (ii) It has proved very difficult to target FDI towards medium- and small-size enterprise development; and (iii) It is often linked with significant illegal outflows of resources.⁵³ Therefore, the Government of Bangladesh should see the positive side of current results, and move on with the government reforms with the present focus that in the long term the critical issue is the quality and development contribution of FDI, as well as the quantity.

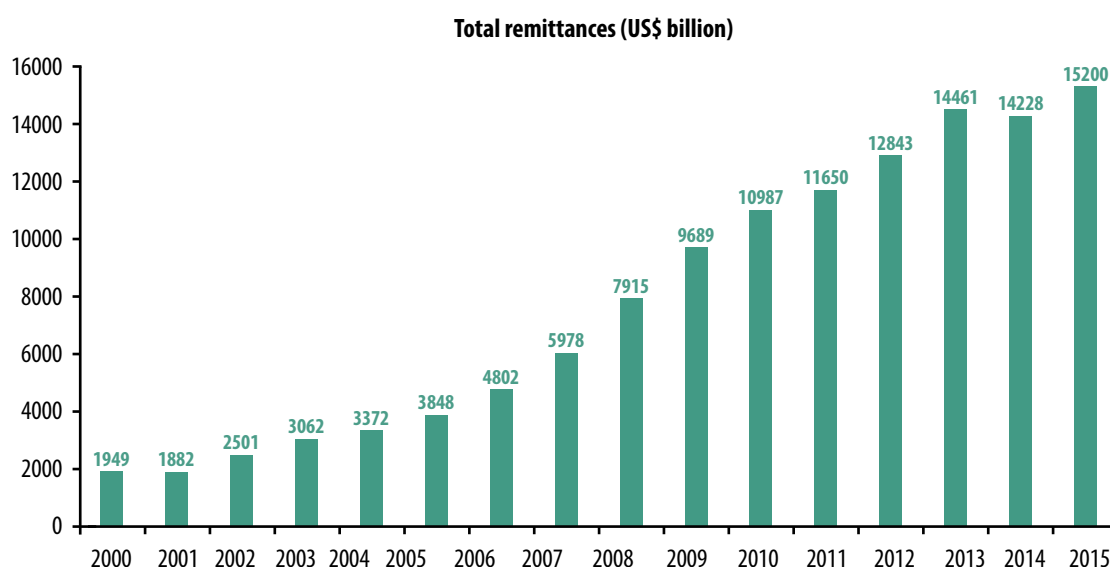
4.9 Remittances

264. Migration and global diaspora resources are an integral component of the development process in Bangladesh and it has been a key driver of social development by bringing in remittances for millions of individuals from low or marginal economic backgrounds.

51 FCCI Roundtable on FDI, Dhaka 14 October 2015

52 UNDP, *Asia-Pacific Effective Development Co-Operation Report*, 2014

53 Stratta, N., “*Strengthening Coherence between the Effective Development Cooperation and Financing for Development Agendas in Asia-Pacific*” UNDP, March 2015

Figure 4.10: Total Remittances 2000–2015

Source: Government of Bangladesh

265. Growth on remittance flows has averaged about 20 percent growth per annum since the mid-1970s with their expansion gaining momentum between 2000 and 2005, and continued to grow at a steady pace since then, swelling from \$11 billion in FY2010 to \$15.2 billion in FY2015.⁵⁴ Bangladesh is the eighth highest remittance receiving country in the world.

266. The number of overseas jobs reached by Bangladeshi migrants peaked in 2008 with over 800,000 and stabilised in a number close to 500,000 workers. The share of skilled and semi-skilled migrant workers has increased since 2010. The steady increase in the volume of remittances (around one billion dollars per year) has not been directly related to a similar increase in the number of workers. This is partly due to the fact that the composition of the migrant workforce has been also changing, and the proportion of skilled and semi-skilled workers increased in this period. The share of skilled workers of the total migrant workforce increased from 23.2 percent in 2010 to 34.5 percent in 2014 and a similar pattern is visible for semi-skilled workers, from 5.12 percent to 16.5 percent in the same period.

Table 4.5: Overseas Employment and Remittances

Year	Number of overseas workers	Total Remittances (Million \$)
2005	252702	4249.8
2006	381516	5484.1
2007	832609	6562.7
2008	875055	8979
2009	475278	10717.7

⁵⁴ Source 7th FYP, pp 11

Year	Number of overseas workers	Total Remittances (Million \$)
2010	390702	11004.7
2011	568062	12168.1
2012	607798	14163.9
2013	409253	13832.1
2014	425684	14942.6

Source: Bangladesh Bank

267. Another important trend is the growth of the female migrant worker population, which mainly happened since 2000. The total number of female migrants has been growing at a steady pace, from 454 in 2000 to 76,000 in 2014; they represent 17.8 percent of the total migrant population. Migrant workers are inherently young: from the total 9.5 million people who have gone abroad or migrated from Bangladesh, the average age was about 32 years. About 25 percent of those entering Bangladesh's labour market each year travel overseas as migrant workers.⁵⁵
268. The flow of remittance earnings is emerging as a crucial source of resources to improve rural and lagging economies in Bangladesh. It has been estimated that 60 percent of remittances accrue to the rural economy. The growth of income from non-farm sources and the rapid inflow of foreign remittances in rural areas have supported the increase in demand for a range of activities in construction, housing, trade, transport, schooling, health and other services.⁵⁶ A traditional problem was that the flow of remittances was much lower in the economically lagging districts, which was causing further economic disparities. This trend is also reverting and the share of migrant workers from lagging economic regions has also increased from 13.4 percent in 2010 to 20.5 percent in 2014.⁵⁷
269. The economic performance of international remittances is indicative of the success achieved by a number of government policies and support services implemented during this period: (i) the creation of a dedicated Ministry (Ministry of Expatriates' Welfare and Overseas Employment) that promotes the interest of the migrant workers; (ii) new banking institutions; (iii) effective diplomatic dialogue with host countries to open new markets and protect the rights and interests of the migrant workers; (iv) tax exemptions and information sharing; and (v) the promotion of new microfinance institutions and mobile banking services. The main focus of government policy has been to expand the market for migrant workers facilitating their working opportunities and providing adequate financial support.
270. The state-run Probashi Kallyan Bank (PKB) was established in 2010 with a paid up capital of Tk 1 billion⁵⁸ and provides collateral loans to workers going abroad for employment, loans to returnees, facilitates sending remittances and encourages the wage-earners to invest in the country. Currently, PKB has 49 branches across the country and three booths at three international airports. Up to December 2014, PKB has sanctioned loans worth of Tk 550 million with a recovery rate about 73

55 Rahman, M., "Advancing the Interests of Bangladesh's Migrant Workers – Issues of Financial Inclusion and Social Protection", Presentation of the Centre for Policy Dialogue (CPD) Dhaka, October 2015.

56 Planning Commission, "Seventh Five Year Plan: Accelerating Growth, Empowering Citizens", Bangladesh, October 2015.

57 Ibid.

58 Tk 950 received from Wage Earner's Welfare Fund and Tk 50 million from the government.

percent and granted migrant loans to 7,112 workers. The loan is approved after the prospective migrant secures an employment contract, visa and passport and the processing time for it is less than three days. The average migrant loan is for 24 months, with an interest rate of 9 percent and two months of grace and the amounts are fixed in Tk 84,000 for Middle East and Tk 1,40,000 for Europe. The PKB also offers migrants savings accounts for up to 10 years at 6 to 6.5 percent interest rates, but so far these services are not being widely used.

271. The Bangladesh Bank monitors the main flows of remittances and is also an active player in this market. It has taken the initiative of collecting the information of non-resident Bangladeshis and maintains an open database that is accessible for all through the Bangladesh Bank website. This database acts as an open communication channel between the Bank and migrants, and also allows them to communicate between themselves. They can use this database to search for other migrants by country of residence, profession etc. For the Bangladesh Bank this channel is used to create awareness on proper remittance tools and methods, to communicate important financial or economic measures of the government for them and to receive complaints, queries or any other feedback that is useful for the government.
272. Several other policies are being implemented by different government agencies and usually led by the Ministry of Expatriates' Welfare and Overseas Employment. The Ministry is responsible for formulating policies, plans, enacting laws, rules and regulations, developing projects, programmes and monitoring relating to the management of overseas employment as well as overall welfare of expatriate workers. It also coordinates the activities of the Bureau of Manpower, Employment and Training (BMET), PKB Bangladesh Overseas Employment and Services Limited (BOESL), and the Wage Earners' Welfare Board (WEWB).

Table 4.6: Budget Allocations for the MoEWOE (in crore Taka)

Sector	Non development expenditure			Development expenditure			Total		
	FY2014	FY2015	FY2016	FY2014	FY2015	FY2016	FY2014	FY2015	FY2016
MoEWOE	125	158	185	231	337	252	699	911	1005
Total	156383	155310	185191	67327	81807	98588	544211	489635	432913
Share as % of total	0.09	0.10	0.10	0.34	0.41	0.26	0.13	0.19	0.23

Source: Rahman, M., 2015⁵⁹

273. Attempts to ensure policy and institutional coordination are reflected in a range of policies and official documents approved by the Government: (i) the 7th FYP; (ii) the National Social Security Strategy, (iii) the National Sustainable Development Strategy 2010–2021, (iv) the Bangladesh Overseas Employment and Migrants Act (2013); and (v) the Overseas Employment Policy (in process of finalisation). Despite of the wide range of successful policies and measures, there is a growing recognition that much remains to be done to achieve the objectives and targets set in these abovementioned documents and plans which aspire to harness the full potentials of both remittances and migrant workers. The following priority areas still need further attention:

59 "Advancing the Interests of Bangladesh's Migrant Workers, Issues of Financial Inclusion and Social Protection" Centre for Policy Dialogue (CPD), 2015.

274. (i) *There is a need to strengthen the technical, organizational and financial capacity of the Ministry of the Expatriates' Welfare and Overseas Employment (MoEWOE) and its subordinate bodies to:* (i) ensure further coherence and improve coordination of the different ministries and agencies (policy research, diplomacy, finance, welfare and social services); (ii) the proposed addition of two new departments in MoEWOE (Department of Expatriates' Welfare; Department for Skill Development Training) deserves serious consideration; (iii) strengthen the focus on improving welfare services of expatriates, especially from lagging and rural regions, (iv) increase the number of Technical Training Centres and Institutes of Marine Technology and the effective monitoring on quality and certification recognition; (v) develop and implement strategies for skill development training and programs; (vi) expand the measures of the District Employment and Manpower Office at the grass-root level in collaboration with local bodies; and (vii) the need to substantially increase funding to the MoEWOE, which today represents a very small fraction of the national budget (see Table 4.6 above).
275. (iii) *Focus on reducing the cost of remittances could be linked to the progressive bankarisation of remittance recipients, especially those from poorest backgrounds and rural settings.* Providing access to formal banking services is a key step forward to reduce the cost of remittances and could also facilitate savings, future access to microcredit for productive activities and to extend access and improve monitoring of a variety of social protection services. By these means the use of remittances could be used to boost greater financial inclusion. This can go hand in hand with other poverty reduction national objectives. Remittances could also be used to leverage government spending to promote the development of savings for low-income families or their capacity to purchase health insurances or other key services. For this purpose, government must develop specialised capacities to design accurate interventions in a complex and interrelated market. Current weaknesses of the banking system must be addressed to strengthen depth, coverage and utility of the services for the recipient family. Micro finance institutions (MFIs) could be a very effective player to increase this remittance flow path and commercial banks may tap the vast networks of MFIs to gear up remittance distribution. Financial education of recipient families focusing on their formalised inclusion should be also strengthened. The 7th FYP does not explicitly address this with the same level of priority and does not provide many explicit operational linkages between these national priorities.
276. (iv) *There seems to be ample room for improving the impact of remittances on savings and productive activities.* So far the main focus of the government priorities has been on increasing the number of migrants, open new markets, improve their qualifications and provide social protection. However, remittances are mostly directed to support consumption and are not fully used to develop productive activities. This issue is clearly reflected in the unfinished business of the existing policies and strategies. The government could develop alternative sources of growth by attempting to use remittances as collateral financing for more productive sectors of the economy. For these purposes, government policy could attempt to link remittances with government-subsidised microfinance mechanisms and attempt to leverage lending of small sums of money to low-income households for small productive or commercial ventures. Available evidence suggests that this could be a promising additional line of work: (i) about 57 percent of the households saved part of their received amount and one-fourth of the remittance earning households used a part for investment, mainly in purchasing land; (ii) about 26.6 percent of remittance recipient households are engaged in some type of investment which are mainly directed to dwelling household construction, investment in owned/partnership farms/business, agricultural machinery purchase or in other types of investment.⁶⁰

60 Rahman, M., *ibid.*

277. (v) *Further strengthening of the diplomatic negotiation capacity is needed to ensure rights of migrants abroad.* Diplomacy still needs to be strengthened to develop or review of bilateral and multilateral employment agreements to ensure social security of migrant workers and generate greater oversight of working conditions and breaches of contract to ensure protection of expatriate workers. Special emphasis should be given to female migrant workers, eliminate fraudulent recruitment activities and ensure standard and ethical practices from employers.
278. (vi) *Comprehensive digitization of the migration process is also required.* Data is scattered and not always compatible and is not easy to monitor key aspects of the diaspora economy. This is important for measuring results and strengthening management of labour migration as well as for the social protection of the workers.

5. Conclusions and Recommendations

5.1 Reviewing the Financial Requirements of the 7th Five Year Plan

279. The Medium-Term Macroeconomic Framework of the 7th FYP presents the main overall financial estimates to set the strategic discussion on the mobilisation of financial resources to achieve the objectives of the plan. These are summarised in Table 5.1 below. The plan makes it very clear that two important things must happen: (i) a large expansion of public investment, especially from domestic sources; and (ii) a similarly ambitious expansion of private investment, to reach almost 78 percent of the total finance needs of the plan.

Table 5.1: Financing of the Seventh Five Year Plan Investment (FY2016 prices)

Item: BDT in Billions	Total	Share (%)	Public	Share (%)	Private	(Share %)
Total Investment	31,902.8	100.0	7,252.3	100.0	24,650.5	100.0
Domestic Resources	28,851.0	90.4	6,384.6	88.0	22,466.4	91.1
External Resources	3,051.8	9.6	867.6	12.0	2,184.1	8.9

Source: Government of Bangladesh Planning Commission – GED 7th Five Year Plan, 2015

280. As discussed before, these projections are based on several important assumptions of key achievements that must be made in the next five years:

- An increase of the overall growth rate of 7.4 percent of GDP from the average level of 6.3 percent recorded under the 6th FYP. By 2020 the forecast is to reach 8 percent GDP growth;
- Total government revenue to be raised from 10.7 percent of GDP to 16.1 percent (from Tk1.690 to Tk 4.728 trillion in 2020);
- A marked expansion of tax revenue from 9.3 percent to 14.1 percent of GDP, almost tripling current revenues from Tk 1.406 to Tk 4.052 trillion;
- A substantial growth of FDI from 0.9 percent to three percent of GDP which will demand an almost six-fold expansion of the present volume (from \$1.7b to \$9.6b);
- An overall expansion of the manufacturing sector to 21 percent of GDP by FY2020;
- A steady share of remittances as 8 percent of GDP, which will require these flows to grow from \$15 billion in 2015 to \$25 billion in 2020; and
- A substantial increase of private sector infrastructure investment driven by PPPs, which in the infrastructure sector alone should grow from 0.2 percent to 1 percent of GDP.

281. In line with the recommendations of the 7th FYP, the DFA has found that there are three key preconditions to enable the Government of Bangladesh to make significant development progress over the next five years as well as to meet the development targets of the 7th FYP. These preconditions could become the three strategic priority objectives of an Integrated Financial Strategy that would

be implemented in parallel to the plan to ensure that the necessary quantity and quality of financing is available to achieve the 7th FYP goals. These three strategic priority objectives are necessary but not sufficient condition for the final achievement of the objectives of the plan. The DFA also identified that there a range of financial flows including ODA, FDI, PPPs, SSC, climate change finance and remittances could be instrumental to achieve these three strategic objectives. Finally, there are specific conclusions on how the Economic Relations Division can work to strengthen the alignment of ODA, SSC and climate change finance with these three strategic priorities.

5.2 The Convenience of an Integrated Financial Strategy Approach

282. One of the important conclusions of the DFA is that the mobilisation of the wider variety of resources that would be needed to achieve the goals of the 7th FYP will demand the development and leverage of a wider array of finance flows behind national priorities. This will require significant institutional reforms and should bring together coherent policies to ensure that key finance flows are fully developed and aligned with national priorities.
283. In many cases, these reforms are complex and exceed the mandate of a single ministry or government agency. For example: one of the most ambitious goals of the 7th FYP is the achievement of a radical increase of FDI inflows from 0.9 percent to three percent of GDP, which in nominal terms will mean an almost six-fold expansion of the present volume. As analysed in Section 4.8 of this report, FDI promotion is not performing to meet these requirements. Apart from a more aggressive and efficient promotion of FDI, it will be necessary to address the most important issues that are perceived from abroad as the main reasons for not investing in Bangladesh. This list includes a range of problems such as: the poor supply of infrastructure; corruption; inefficient government bureaucracy; poor access to financing inadequately educated workforce, crime and theft and irregular tax regulation amongst many others. Addressing these problems will require important and coordinated long-term reforms in different areas (public administration, education, law enforcement, banking and the tax system to name a few). Many of these reforms as noted are long-term and may also transcend the scope of a single government and will demand strong, medium-term leadership and direction.
284. The overall picture that emerges from the DFA analysis is even more complex, as the development and alignment of the main priority flows that would be required to achieve the goals of the 7th FYP, will demand addressing the issues of several financial flows at the same time. The government should be able to make sure that the pace and quality of these reforms is adequate to serve the purposes established in the 7th FYP. It will not suffice to just scratch the surface and these reforms must produce visible results. To make available the necessary financing to fully implement these reforms, it might be also necessary to re-prioritise the allocation of some scarce financing resources (as for example ODA grants) across sectors. Moreover, many of these reforms transcend the responsibility of a single ministry and it will be also necessary to re-define sector or sub-sector priorities to make sure that the different components of these key reforms are coherently designed, developed, and implemented. And finally, there are far too many things in the to-do list, and therefore, a coherently prioritised list of reforms must be designed.

285. These needs suggest the convenience for the government of adopting a strategic approach to ensure that these reforms are correctly prioritised and implemented in a timely fashion. The government will need to find a way to work with new systems that are capable of providing decision makers with a more comprehensive, panoramic view of all the options available and knowledge to use them wisely. The emerging “dashboard” of development finance possibilities implies more complex and comprehensive fiscal management systems and decision-making processes. This strategic approach should encompass a more systemic and holistic vision of the development finance landscape and widen the boundaries of traditional fiscal finance planning and management systems that transcend public sector budgeting. This strategic approach should also aim to provide overall monitoring and coherence for systemic reforms that involve a wide range of areas, from public administration to good governance and the strengthening of the management capacity of the central government and line ministries and sub-regional governments.
286. The need for adopting these new strategies was also highlighted in The Third International Conference on Financing for Development held in Addis Ababa in July 2015. As it is understood that the SDGs will demand the mobilization of unprecedented amounts of financial resources. The Addis Agenda recommended that countries use their own National Development Frameworks to respond to the SDGs and build comprehensive Integrated National Financing Strategies to finance them. These financial development strategies should be capable of providing decision makers with the same holistic vision of fiscal planning and management systems mentioned above.
287. Bangladesh has already developed a comprehensive plan that is sustained with similarly comprehensive costing estimates that include specific targets for private and public financing sources. The formulation of an Integrated National Financing Strategy would add value by providing the following additional definitions: (i) a prioritised list of the institutional reforms that are needed to fully develop the main finance flows to meet the needs of the plan; (ii) a calendar for the execution of these reforms and the responsibilities of key institutions in its implementation; (iii) an overall monitoring and evaluation framework to support the government macro-management of the reform and to ensure pace and quality; and (iv) the definition of a broader government mechanism to provide the strategic management that this approach will demand.
288. The decision to develop and implement an Integrated National Financing Strategy will require high-level political and institutional discussions to find an institutional solution that can work in Bangladesh. It seems to be clear that strong and coordinated leadership will be needed from the Ministry of Finance (especially from the Finance Division and ERD) and from the Planning Commission (the Programming Division and GED) to ensure some of the key coordinated approaches needed in this new scenario. However, this will not be enough.
289. Given its broad international experience and leadership in the financing for development field, ERD may have a key catalytic role to provoke this internal discussion and to support the identification of an approach that may work. There are other consequences that will demand an active and strengthened role from ERD. This emerging scenario will demand a more strategic and innovative management of ODA, SSC and climate finance. This situation invites to re-think the strategic allocation of the available external cooperation resources for development (ODA, SSC and climate finance) and how these should be mobilized and managed in Bangladesh. Data on development cooperation with southern partners needs to be improved. Domestic and external climate finance needs to be tracked across ministries, using existing data systems. Used smartly, development

assistance can be used to help the country catalyse the development of other public and private sources of development finance. This will require ERD to measure to what extent ODA has such leveraging effect.

290. This strategy should aim to achieve the three priority objectives listed below. For each objective, the DFA has also identified some of the determinant results that should be achieved with highest priority. It is important to highlight that in this case, measureable results and not just the inputs that are needed to achieve the desired objectives.
291. This strategy should aim to achieve the three priority objectives of: (i) strengthening the quality of the budget, including the efficiency and effectiveness of public expenditures and their alignment with national priorities; (ii) deepening domestic resource mobilization with attention to its economic, social and environmental impacts; and (iii) scaling up private sector investment behind national priorities. For each objective, the DFA has also identified some of the determinant results that should be achieved with highest priority. It is important to highlight that in this case, measureable results and not just inputs are needed to achieve the desired objectives.
292. *The First Objective* relates to strengthening the quality of the budget, including the efficiency and effectiveness of public expenditures and their alignment with national priorities. According to the DFA analysis a number of issues can be tackled under the 7th FYP. Firstly strategic resource allocation and results orientation of the budget can be strengthened. Secondly the current level of subsidization and refinancing of SOEs are major drains on public resources. Thirdly, the balance between recurrent and development budgets could be more in line with development needs. While 75 percent of Bangladesh's budget goes for recurrent expenditures, in other high growth countries such as china the investment budget is around 55 percent. Fourthly, there could be greater allocative efficiency within sectors, between sectors and in terms of the actual budgetary linkages with the 7th FYP. For example, although the Government of Bangladesh is highly committed to social security and a well thought out social protection strategy has been designed for supporting poverty reduction, the total allocation to this sector is roughly 2.0 percent of GDP, which is not large enough to cover for the needs of the population. Finally, although reforms to the MTBF are ongoing ensuring more coherence between the recurrent and the ADP budget is key going forward.
293. *The Second Objective* is to deepen domestic resource mobilization with attention to its economic, social and environmental impacts. Looking back at the 6th FYP the Government of Bangladesh has recognized that the planned expansion in public expenditure as a percentage of GDP on health, education, rural development and social protection was limited by the weak expansion of tax resources. Revenue mobilization has had effects on inter-annual budget cuts as well as leading to increased levels of short term borrowing, to narrow the financing gap left by lower than forecasted levels of revenue collections. The Government of Bangladesh agrees that there needs to be stronger implementation of the Tax Modernization Project with a special focus on strengthening income tax collections. Under the on-going reform of public finances there is also a desire to increase the equity of tax collection. There are also reform initiatives underway to link taxes and incentives to climate compatible development. According to the DFA analysis the Government of Bangladesh is further constrained by the large size of the informal sector which falls out of the tax net, capacity gaps in the NBR, computerization of the tax system which needs to accelerate urgently as well as other issues pertaining to tax incentives, tax evasion and the net loss from the outflow of illicit flows which are also not captured by NBR. Close collaboration with the Bangladesh Bank on this front is recommended.

294. *The Third Objective* that emerged is the need to scale up private sector investment behind national priorities. As we know, 78 percent of investment for the 7th FYP should come from the private sector. However private sector resources do not always align with development priorities. The enabling environment and regulatory frameworks need to be put in place to ensure social and environmentally responsible private sector investment. Alongside this qualitative concern, on the quantitative side, there is still a closed capital account limiting foreign external borrowing and there is limited financial deepening in evidence of the domestic private sector. There can be better coherence between the different branches of the private sector strategy under the 7th FYP and a strengthened role of the Board of Investment is essential, especially for attracting and aligning FDI and national investment to the priority areas of the plan. At the same time, there is a clear need to improve the business sector climate and to reduce the informality of the private sector. For this, a key element is to achieve the improvement of the national infrastructure (transportation and energy) for the main areas that were prioritised in the 7th FYP and to extend the access and quality of domestic finance to increase participation of national companies in PPPs and other modalities. Increased access and quality is also necessary to ensure inclusive finance and the further development of MSMEs.

5.3 Potential Contributions of the Financial Flows Analysed

295. Some of the financial flows studied with special attention in this DFA can also be instrumental for the achievement of these three objectives. Not all of these flows are under direct government control, and for some of them, government can only aspire at influencing their development to align them with national priorities. It is also important to highlight the inter-linkages between these flows and the potential synergies that can be achieved by promoting and influencing them with an integrated strategic approach.

296. The study included a particular focus on alongside ODA, climate change finance and South-South cooperation, specific recommendations in relation to: (i) *Achieving success in FDI Promotion*; (ii) *Success in the PPP strategy is a precondition to achieve long-term success for the country and for FDI promotion*; (iii) *CSR may offer good opportunities for improving the quantity and quality of private investment*; and (iv) *Remittances are potentially important for extending inclusive finance and promoting expansion of MSMEs*.

297. To get the best contributions that these flows could bring to the development of the financing base required by the 7th FYP, the following strategic orientations might be important to take into account:

A. A more strategic and innovative management of ODA, SSC and CCF is a top priority. ODA, SSC and CCF are key resources from which to begin to build an integrated financing strategy. They are all linked with international public flows of finance and are as such they all have some relationship with national budgets, albeit to varying extents and in different ways. In the Bangladesh context all three fall under the purview of ERD in the Ministry of Finance so they also have the potential for a common institutional and policy frame. The contribution of the resources, and the modalities for their delivery, can also be considered in relation to progressing the three top strategic priorities articulated above – strengthening the quality of the budget, deepening domestic resource mobilisation and leveraging private sector contributions for the 7th FYP.

- B.** This assessment does not make any prescription on the balance that needs to be made between the more traditional role of ODA in supporting social sector or poverty reduction objectives. Rather it proposes that the existing portfolio and future portfolio of ODA, SSC and CCF be considered in relation these additional catalytic objectives of furthering an Integrated Financing Strategy for achieving national development priorities. Indeed, it is considered to be essential that the effectiveness of these financial flows be measured not just in terms of their catalytic impacts on other financial flows but also on the impact these flows have on development priorities.
- C.** Some specific potential areas for further building up this strategic use of ODA, SSC and CCF are:
- *ODA, SSC and CCF should include a focus on strategic capacity development.* ODA can be used to develop national capacity in key areas that would have multiplier effects on the impact of all the development resources available. Indeed development partners have a role to play in promoting evidence and dialogue on Bangladesh's overall financing strategy for achieving its national development priorities bringing together experiences and expertise from different contexts. In particular, this should include: strengthening the quality of the budget process; improving domestic tax mobilisation (and strengthening the capacity of the NBR); finding ways of extending public spending efficiency; developing effective PFM systems; improving FDI and PPPs; reducing illicit flows; and increasing internal accountability for performance and results-based management.
 - *Attempts should be made to build up evidence of the role of ODA, SSC and CCF for deepening Domestic Resource Mobilisation with attention to social, environmental and economic impacts.* Only a small proportion of total ODA currently goes towards domestic resource mobilisation and this is an area that has not been sufficiently explored. There are opportunities to use ODA to improve the fairness, transparency, efficiency and effectiveness of the tax system, by broadening the tax base and continuing efforts to integrate the informal sector into the formal economy and to develop modernised, progressive tax systems that encourage private sector development. There are also opportunities to use ODA to develop better protection systems (national and regional) to reduce the volume of illicit flows leaving the country. Bangladesh has already begun and should continue to pursue fiscal reforms that promote more climate compatible development.
 - **There is a potential to make 'smarter' use of these sources of finance to facilitate additional investments from multiple sources, including private finance.** This would mean that instead of applying these flows to finance specific sector demands, it could be applied to develop the sources that are needed for it. For example, instead of using ODA to finance infrastructure development in education, it may be more strategic to apply the available ODA to finance the full development of PPPs that would bring together the needed financing for education infrastructure. This is related with the focus on capacity development mentioned below. ODA can also be used to leverage other flows, as Bangladesh successfully demonstrated to the world that can be done in inclusive finance. Opportunities for using ODA, SSC and CC finance to help leverage FDI should also be pursued. For example, in Viet Nam some ODA providers have used development cooperation to strengthen policy and an enabling environment in particular sectors as well as promoted FDI from their own private companies in those sectors (e.g. Sweden and renewable energy).⁶¹ Climate change finance

61 See Vietnam Development Finance Assessment, MPI, EU and United Nations, 2015

already has a strong focus on leveraging change in the private sector. Finally in the area of SSC, while data is limited, it is widely understood that development cooperation and private sector partnerships are considered together in investment decisions.

- *It may be time to start thinking in terms of TOSSD⁶² while still including a focus on ODA.* This new approach will aim to cover the totality of international public finance extended to developing countries and multilateral institutions in support of sustainable development, regardless of the type of instrument used and the associated terms. It will also potentially cover private resources mobilised through public schemes, as well as the activities of diverse financial intermediaries, including collective investment vehicles and venture capital funds. The framework would include flows that support one or more of the three dimensions of sustainable development – economic, social and environmental and contribute to the monitoring of resources for the implementation of the SDGs. A key objective for this new measure would be to enhance international accountability by increasing transparency and rigour in reporting on development finance beyond ODA. It would not replace ODA, which will remain the yardstick of provider effort and will continue to be used for monitoring their performance against the United Nations’ ODA/GNI target of 0.7 percent. The TOSSD would complement ODA, measuring broader international financing for sustainable development. A TOSSD measure would also facilitate sharing of information about development finance with providers of development co-operation beyond the OECD DAC.
- *It is necessary to further exploit the synergies between ODA and climate change finance and advocate for availability and additionality of resources.* The synergies between ODA and climate finance can be further enhanced and reinforced. A coherent framework is needed to ensure that climate finance is new and additional to existing ODA commitments. Climate finance funds may bring interesting opportunities to raise additional finance for Bangladesh as for example, carbon-related markets emerging from climate finance. The introduction of the GCF will boost opportunities for Bangladesh and other vulnerable countries to substantially increase access to finance. However, recent experiences showed that the proliferation of vertical funds created distortions in Bangladesh and stronger planning and budgeting systems are needed. A whole-of-government approach involving both the public and private sectors is also needed and a significant engagement of the Planning Commission and the Ministry of Finance, together with other line ministries, to fully integrate climate funding within the overall national development strategy.
- *Accelerating development effectiveness should remain a top priority.* Contrary to what was expected after the Paris Declaration of 2005, traditional aid has become increasingly fragmented and earmarked, increasing its complexity, volatility, and the administrative burden for aid recipients and potentially decreasing its effectiveness.⁶³ Earmarked multilateral and bilateral ODA is on the rise and estimated to account for over 40 percent of total ODA. This means an additional complication for the government as earmarked aid is less predictable than performance-driven aid, may reduce reform incentives, skew resources towards specific items and away from other, more critical priorities, and undermine country

⁶² Total official support for Sustainable Development (TOSSD) is a new measure that the OECD DAC has been working on to complement the traditional concept of ODA/ This broader measure would cover the totality of official resources extended to developing countries and multilateral institutions in support of sustainable development, regardless of the types of instruments used and associated terms.

⁶³ Kharas, H. *The New Reality of Aid*. Washington, DC: The Brookings Institution, 2007.

ownership by altering the priorities that countries place on specific programmes.⁶⁴ Reducing aid fragmentation and transaction costs, strengthening country systems for activities managed by the public sector, improving mutual accountability and transparency, and untying aid to the maximum extent are objectives far from being met in Bangladesh.

- *Improvement of national data, information and knowledge⁶⁵ availability is also needed.* While the availability of data has improved, there is still scope to build and improve the quality of existing statistical and Management Information Systems. For example, it has been shown that lack of systematic analysis and data collection for SSC undermine the government's capacity to manage these funds properly. Domestic and external climate finance needs to be tracked across ministries, using existing data systems. There are several other areas studied (i.e. PPPs, FDI and INGOs) where key data is not systematically collected; valuable information is stored by some agencies and not adequately shared or used to produce relevant knowledge that the government could benefit from. There are important areas of information production that could be developed fairly quickly and almost at no cost. It is not possible, for example, for the government to estimate ex-ante if there are duplications of budget expenditure allocations with current or forecasted INGO expenditures in key sectors or regions. There are important opportunities for developing more comprehensive and integrated information systems linking AIMS, Foreign Aid Management System and IBAS, procurement and accounting systems. Overall, the production of knowledge is in great need of improvement. It is the main output that could add value to the management of financial flows. The present the production of knowledge with the data and information that is available is suboptimal. For example, the government could know a lot more about the specific reasons that are blocking access to finance to small and micro enterprises to act upon them or to further understand the specific mismatch between existing labour force skills and the ones demanded by the sectors that the government is trying to attract to diversify the private sector export base. Many of the studies available are mainly produced by academic or development partners and in many cases, do not seem to permeate the decision-making process.
- D.** Alongside ODA, climate change finance and SSC the report also makes specific recommendations in relation to: (i) *Achieving success in FDI Promotion*; (ii) *Success in the PPP strategy is a precondition to achieve long-term success for the country and for FDI promotion*; (iii) *CSR may offer good opportunities for improving the quantity and quality of private investment*; and (iv) *Remittances are potentially important for extending inclusive finance and promoting expansion of MSMEs.*
- E. Achieving success in FDI Promotion is also a top priority.** To achieve the wide expansion of the private sector projected in the plan, a stronger injection of FDI would be necessary. To accelerate progress, the following use of other flows may be a priority:
- *Success in the PPP strategy is a precondition to achieve long-term success in FDI promotion.* The PPPs are needed to substantially improve national infrastructure limitations (transport and energy) that are hindering FDI.

⁶⁴ GPEDC, *Making Development Co-Operation More Effective*, 18 April 2014.

⁶⁵ The following definitions apply for this paragraph: (i) *Data*: Raw unorganized facts, numbers, and pictures; (ii) *Information*: is data that has been organized in a way that is useful to a person (in our case those who manage finance flows); (iii) *Knowledge*: is when a person combines experience and judgment with information. Applying knowledge is how managers create and add value to their organizations.

- *Strategic allocation of development cooperation resources will be required to achieve the main results that are needed.* Development cooperation might be critical to strengthen the capacity of the Bol as mentioned above, as well as to develop and implement a new corporate tax regime to give incentive to exports.

F. CSR may offer good opportunities for improving the quantity and quality of private investment. Many accomplishments were achieved in this area in recent years, all of them through a multi-stakeholder approach and integrating the views of business, government, NGOs and a multiplicity of development partners. A better integration of CSR initiatives with a government-wide strategic approach is convenient and could be focused to achieve the following benefits:

- *There are potential important contributions of CSR to develop and implement an agenda to improve the business climate (needed for attracting FDI and promoting domestic business expansion).* The discussion in section 4.8 and earlier in this section explained that a wide number of important and coordinated long-term reforms are needed in different areas (public administration, education, law enforcement, banking and tax system to name some) to improve the business climate to attract FDI. Many of these reforms may also transcend the scope of a single government and will demand strong, medium-term leadership and direction to implement them and a prioritised approach. A business perspective will help the government in these prioritisation efforts. A number of CSR initiatives have already advocated for the development of government reforms in this direction, however, with scattered interactions with different government agencies that could strongly benefit from a more strategic approach. Joint efforts with private sector partners would also help to provide the necessary continuity, quality and pace of the reforms needed.
- *CSR can also be very helpful to align FDI current and future private sector development with social, economic and environmental objectives of the 7th FYP.* It is well known that FDI can be part of the solution to many problems or part of the problem itself. Private investment is not automatically aligned with sustainable development objectives, and often bypasses countries most in need, and has little or no accountability. Regional and national experience shows that governments find it difficult to deal with the negative practices from international corporations. The 2013 Savar building collapse has led to widespread discussions about the application of the United Nations Guiding Principles on Business and Human Rights and other recognised standards that could help in preventing disasters of this kind. As explained in section 3.9, the CSR corporations in Bangladesh are already aligned with the Guiding Principles and the SDGs and are focused on mitigating the negative impact of private investment and expanding the positive impact with a win-win perspective. As noted above, the CSR corporate partners developed several scattered initiatives with the government in this direction to promote clean production or to strengthen labour and child protection practices of all employers. Promising results were achieved despite the difficulties of working without a strategic approach from the government's side. A faster impact to attract the right kind of FDI could be achieved by working together with this very active corporate group.

G. Remittances are potentially important for extending inclusive finance and promoting expansion of MSMEs. Formal and informal MSMEs are the very fabric of the private economy of Bangladesh; to achieve the wide expansion of the private sector projected in the plan, and

key objectives related with poverty reduction, a greater consolidation and formalisation of this sector is needed. If the proposed focus of the DFA for improving the impact of remittances on savings and productive activities is accepted, then this flow may also become a key input to achieve this goal.

- *There is great potential to promote remittance-related investment* directed to dwelling household construction, investment in owned/partnership farms/business, agricultural machinery purchase or in other types of MSME investment.
- *There are also good opportunities for bankarisation of remittance recipients*, and by these means reduce cost of remittances, promote savings for low-income families, stimulate discrete micro investments and improve access and extend the quality and reach of a variety of social protection services.

H. INGO investment can help accelerating the social impact of remittances and achieve key poverty reduction objectives. Bangladesh has a long tradition of partnership with NGOs and the outreach of NGOs has supported the government in the delivery of a wide range of services including education, health, training, women's empowerment, microcredit, agriculture, climate change and social protection. Key initiatives can be accelerated with a strengthened use of this financial flow:

- *Promote the use of remittances to develop productive activities.* INGO interventions could provide additional, subsidised microfinance mechanisms and attempt to leverage lending of small sums of money to low-income households for small productive or commercial ventures. There are already several initiatives in these areas that could benefit from a stronger partnership with the government.
- *Improve provision of skills and qualifications training for prospective migrants, especially youth from lagging economic regions.* INGO based services can help provide better training for migrants at affordable costs and financial education for recipient families. Many INGOS are providers of quality technical and vocational education and training programmes and they sometimes have a much better reach for conducting small-scale, community based initiatives than the government.

5.4 The Way Forward: Key Challenges and Main Recommendations

298. While the agenda of promoting an integrated financing strategy for implementing the 7th FYP is a long-term and ambitious agenda, there are two immediate next steps that the DFA envisages, while focusing on ODA, climate change finance and SSC. First, it is proposed that the upcoming National Policy on Development Cooperation, as well as the proposed Joint Cooperation Strategy, integrate the three strategic objectives of: strengthening the quality of the budget; expanding domestic resource mobilisation; and leveraging private resources. Second, as part of implementing these policies, ERD should work with its development partners, as well as key government ministries and departments, to build evidence from which to strengthen the contribution of ODA, climate change finance and SSC to these strategic priorities. This process will necessarily involve further data collection, case study development, analysis and dialogue. The ambition is for government and its partners to develop a common narrative of their contribution to the three strategic objectives.

299. In the medium term, an important observation is that the implementation of the recommendations of the DFA may require high-level political and institutional discussions to find a solution that can work in Bangladesh. Significant institutional reforms are proposed that will need to bring together coherent policies for the different development finance flows and alignment with national priorities and results frameworks. However, most of the reforms are outside of the mandate of a single ministry or government agency. It seems to be clear that during implementation, strong and coordinated leadership will be needed from the Ministry of Finance, the ERD, and the Planning Commission. In addition, the agenda proposed here demands systemic reforms and involves a wide range of areas, from public administration reforms to good governance and the strengthening of the management capacity of the central government and line ministries and sub-regional governments. A realistic test of the political will to implement them is mandatory and a realistic discussion of the best possible solution is necessary.
300. Over the longer term, alignment and development of non-public flows will present strong challenges to the government, owing to the following factors: (i) It has proven to be very difficult to access and collate reliable data and evidence for many of these flows; (ii) The task of aligning private sector interests with country priorities is not always easy as some of these flows also undermine the SDGs; and (iii) The government must be able to manage the social and environmental risks and opportunities that come with private sector development.
301. As a foundation for short-, medium- and long-term actions, the government will need to develop better data and analysis. Managing resources with this new perspective will also require more holistic tools and analysis. The DFA revealed that there are still several gaps that will require additional work to resolve: (i) Key data is usually confined in different government areas and hard to find or not collected at all; (ii) There is silo production of knowledge and analysis that obstructs its effective use and integration at more general levels; and (iii) A complex integration is needed to effectively use knowledge achieved with more traditional PFM analysis and tools (PER, MTEF, PEFA).
302. In addition to the recommendations above focused on a more integrated financing framework for the achievement of national development priorities, the analysis presented in Annex F provides us with a summary of the key challenges by financial flow/area as well as the expected impact of the flow on performance. The recommendations are summarized in Table 5.2 below.
303. A next step for the Government of Bangladesh might be to consider how to develop a road map towards a more integrated finance strategy for the achievement of its national development priorities. A starting point has been proposed above in relation to ODA, SSC and CCF. Please see Annex G for recommendations that may provide useful inputs.

Table 5.2: Key Recommendations for Bangladesh 2015–2020

Area/Flow	Recommendations	
1. Public Expenditure and National Priorities	1.1	Strengthen strategic resource allocation of the MTBF to better finance policy priorities.
	1.2	Strengthen links between planning and budgeting processes to ensure full coherence between the 7th FYP and financed priorities.
	1.3	Change the balance between recurrent and development budgets.
	1.4	Gradually eliminate use of unnecessary subsidies and design a strategy to reduce/eliminate losses of SOEs.
	1.5	Extend systems to strengthen operational efficiency of the budget and improve absorptive capacity and budget execution standards.
2. Revenue According to the 7th FYP Total revenue to be raised from 10.7 percent of GDP to 16.1 percent by FY2020.	2.1	Capacity development of the NBR through training and outreach initiatives.
	2.2	Development and approval of direct tax law.
	2.3	Restructure tariff regime in order to gradually reduce effective protection levels and consequent anti-export bias.
	2.4	Fast track full computerization of the NBR system.
	2.5	Development of an action plan to fast track the registration of private sector informal workers.
3. Private Sector Development Private sector is supposed to account for 78 percent of Tk 31.9 trillion under the 7th FYP	3.1	Develop an action plan in the Bangladesh Bank to promote new entrepreneurs through active monetary and regulatory policy support to private sector initiatives.
	3.2	Arrange training for job seekers to develop their skills suitably for self-employment and/or appropriate jobs in the SME and MNEs sector.
	3.3	Develop an action plan to reduce key barriers to private sector development including access to finance, regulatory inefficiencies, clearer entitlements on access to land.
	3.4	Assess realist targets for private sector investment given current weak performance and challenge in the global environment.
4. ODA	4.1	Improved alignment of commitments, allocation and disbursement of ODA through better management by ERD and line ministries.
	4.2	Manage the reduction in the time it takes to approve and implement ODA projects through ERD and line ministries.
	4.3	Achieving LMIC status may result in less concessional terms for borrowing from ODA donors in particular from international development banks. A strategic plan taking into consideration related debt management issues can be considered.
	4.4	Fast track implementation of the PFM reforms. A reduction of perceived fiduciary risk associated with ODA will accelerate commitments and disbursement. In particular requires improvement of the procurement system.
	4.5	Under the new draft Development Cooperation Policy to promote more catalytic aid as well as the use of complementary aid modalities including budget support, concessional lending and vertical funds in support of infrastructure, social, economic and climate related funding. Budget support in particular is fully aligned to national priorities and is given once in the budget cycle which will help with expenditure smoothing.

Area/Flow	Recommendations	
5. Climate Change Finance	5.1	Accord high priority for implementing the Climate Fiscal Framework with approved results framework.
	5.2	Establish an integrated coordination mechanism and merge BCCRF, BCCTF and other sources of climate finance into this single entity.
	5.3	Enhance institutional capacities at local, sub-national and national levels to mobilize and manage climate finance and track it across government.
	5.4	Vigorously represent Bangladesh's susceptibility to the effect of climate change at international forums and negotiate for greater financial support. Mobilize finance from and prioritize bilateral donors who provide large finance for climate change adaptation.
6. South-South and Triangular Cooperation (SSTC)	6.1	Harmonize government efforts by delegating responsibility to one cell/wing for SSTC.
	6.2	Follow demand driven approach by assessing existing capacities & resources gaps, identify SSTC partners for providing assistance in identified gap, and develop partnerships with them.
	6.3	Compliment SSC with ODA for holistic development by creating a stronger demand driven balance between hard development (infrastructure, manufacturing) related to SSC and soft development issues (education, skill development, health, gender development) traditionally financed by ODA.
	6.4	Improve value-for-money and data availability of SSC.
7. FDI FDI inflows should grow from 0.9 percent to 3 percent of GDP, which in nominal terms will mean an increase from approximately \$1.7 to \$9.6 billion/year in 2020.	7.1	Focus short-term attention in providing aggressive and professional promotion to the selected strategic areas (EPZs, SEZs, shipbuilding, pharmaceuticals)
	7.2	Start a comprehensive restructure of the Board of Investment with the objective of getting in full operational mode in less than five years
	7.3	Participate in the strategic prioritization of the PPP promotion projects to ensure coherence with national FDI priorities.
	7.4	Strategic prioritisation of a list of key changes to improve the business and investment climate and development of a coordinated agenda to address them.
	7.5	Review the corporate tax regime, tariff and duty incentive to ensure coherence with the objective of attracting export promotion industries.
8. PPP PPP should grow from 0.2 percent of GDP in FY2015 to somewhere between 1 and 2 percent of GDP which in nominal terms will mean an increase from to \$1 billion/year in 2020	8.1	Strengthen the quality of current infrastructure planning and consolidate a national infrastructure development plan for PPPs.
	8.2	Start a capacity development programme for selected LMs and government agencies and develop teams capable of accelerating PPP development.
	8.3	Analyse the feasibility of re-capitalizing one of the existing institutions and strengthen it to achieve sovereign status.
	8.4	Strengthen capacity of national banks to provide equity and debt financing for PPPs, committed (indicative) financing and to be involved at an earlier stage in the PPP process.
	8.5	Develop a risk assessment strategy to find a right balance to provide incentives to stimulate private PPPs when social rates of return are high and private returns are low.
	8.6	Consider joint promotion activities for PPPs with the Bol and develop separate – targeted international promotion interventions.

Area/Flow	Recommendations	
9. Remittances Sustain present rate of Remittances/GDP at 8 percent, which in nominal terms will mean an increase from approximately \$15.5 to \$25.4 billion/year in 2020.	9.1	Strengthen the technical and organizational capacity of the MoEWOE and its subordinate bodies to be able to lead and coordinate all policies affecting international migrant economy.
	9.2	Develop new measures to promote the progressive bankarisation of remittance recipients, especially those from poorest backgrounds and rural settings.
	9.3	Identify opportunities for implementing coordinated interventions to link remittances with government-subsidised microfinance mechanisms and attempt to leverage lending of small sums of money to low-income households for small productive or commercial ventures.
	9.4	Develop new Labour Wings to strengthen welfare services of expatriates, especially from lagging and rural regions
10. Open Data	10.1	Improving national data, information and knowledge availability and integration of data systems across government.

Source: 7th FYP and DFA team recommendations

Annex A: Glossary

Source	Definitions
CLIMATE FINANCE	<p>The lack of an internationally-acknowledged definition of what qualifies as climate finance, or even more narrowly what qualifies as a climate project, presents a major challenge to understanding the scale of financial flows; there is no established basis for a methodology or measurement system for tracking climate finance flows. Discussions with many experts in the area have indicated that the meaning of climate finance is continually evolving, and captures the following aspects:</p> <ul style="list-style-type: none"> • Financial support for mitigation and adaptation activities, including capacity building and research and development, as well as broader efforts to enable the transition towards low-carbon, climate-resilient development • Public, private, and public-private flows <p>Source: CPI (2012) The Landscape of Climate Finance</p>
CONCESSIONALITY LEVEL	<p>A measure of the “softness” of a credit reflecting the benefit to the borrower compared to a loan at market rate. (cf. Grant Element). Technically, it is calculated as the difference between the nominal value of a tied aid credit and the present value of the debt service as of the date of disbursement, calculated at a discount rate applicable to the currency of the transaction and expressed as a percentage of the nominal value.</p>
CORPORATE SOCIAL RESPONSIBILITY (CSR)	<p>Is a form of corporate self-regulation integrated into a business model. The CSR policy functions as a self-regulatory mechanism whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards and national or international norms. With some models, a firm’s implementation of CSR goes beyond compliance and engages in “actions that appear to further some social good, beyond the interests of the firm and that which is required by law. The rationale is to increase long-term profits through positive public relations, high ethical standards to reduce business and legal risk, and shareholder trust by taking responsibility for corporate actions. The CSR strategies encourage the company to make a positive impact on the environment and stakeholders including consumers, employees, investors, communities and others.</p>
COUNTRY PROGRAMMABLE AID (CPA)	<p>CPA is the portion of aid that each donor (bilateral or multilateral) can programme for each recipient country. CPA is a subset of ODA outflows. It takes as a starting point data on gross ODA disbursements by recipient but excludes spending which is: (1) inherently unpredictable (such as humanitarian aid and debt relief); (2) entails no flows to the recipient country (administration, student costs, development awareness and research and refugee spending in donor countries); (3) aid that is not usually discussed between the main donor agency and recipient governments (e.g. food aid, aid from local governments, core funding to INGOs, aid through secondary agencies, ODA equity investments and aid that is not allocable by country); and (4) CPA does not net out loan repayments, as these are not usually factored into aid allocation decisions (Source: Benn et al., 2010, <i>Getting closer to the core -measuring country programmable aid</i>).</p>

Source	Definitions
DEVELOPMENT EFFECTIVENESS	<p>Aid is only part of the solution to development. It is now time to broaden our focus and attention from aid effectiveness to the challenges of <i>effective development</i>. This calls for a framework within which:</p> <ul style="list-style-type: none"> a) Development is driven by strong, sustainable and inclusive growth. b) Governments' own revenues play a greater role in financing their development needs. In turn, governments are more accountable to their citizens for the development results they achieve. c) Effective state and non-state institutions design and implement their own reforms and hold each other to account. d) Developing countries increasingly integrate, both regionally and globally, creating economies of scale that will help them better compete in the global economy. <p>Source: Busan Partnership for Effective Development Co-Operation, Outcome Document p. 9.</p> <p>Development effectiveness is the achievement of sustainable development results related to MDGs that have country-level impacts that have discernible effects on the lives of the poor and the capability of States and other development actors to transform societies in order to achieve positive and sustainable development outcomes for its citizens. (Source: The Paris Declaration, Aid Effectiveness and Development Effectiveness – Evaluation of the Paris Declaration).</p>
DEVELOPMENT FINANCE INSTITUTIONS	<p>Development finance institutions (DFIs) are investment funds (some of which are state-owned) that invest financial resources in a variety of sectors in developing countries – from the financial sector to agri-businesses. The DFIs can also provide project-specific technical assistance and promote standards in the funds or companies in which they invest. The DFIs have a number of targets to guide portfolio distribution over countries, sectors and instruments. They use different investment instruments, such as equity, loans and guarantees.</p>
FOREIGN DIRECT INVESTMENT	<p>Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. As well as the equity that gives rise to control or influence, direct investment also includes investment associated with that relationship, including investment in indirectly influenced or controlled enterprises, investment in fellow enterprises, debt.</p> <p>(a) <i>Immediate direct investment</i> relationships arise when a direct investor directly owns equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise. Control is determined to exist if the direct investor owns more than 50 percent of the voting power in the direct investment enterprise.</p> <p>A significant degree of influence is determined to exist if the direct investor owns from 10 to 50 percent of the voting power in the direct investment enterprise.</p> <p>(b) <i>Indirect direct investment</i> relationships arise through the ownership of voting power in one direct investment enterprise that owns voting power in another enterprise or enterprises, that is, an entity is able to exercise indirect control or influence through a chain of direct investment relationships. For example, an enterprise may have an immediate direct investment relationship with a second enterprise that has an immediate direct investment relationship with a third enterprise.</p>
INCLUSIVE BUSINESS FINANCE	<p>Refers to capital that supports the creation, growth and sustainability of entrepreneurs, small holders, and small- and micro-enterprises that were previously excluded from the financial markets. The instruments used in inclusive business finance include (but are not necessarily limited to) debt, equity, quasi-equity, grants, insurance, guarantees, development finance and various shared risk instruments and mechanisms. The definition of inclusive business finance also goes beyond exclusively referring to the funding activities of regulated and non-regulated, formal and informal, financial services providers. It also includes the provision of a variety of financial resources (guarantees, loans, equity, leasing) by corporations to small holders and MSMEs as distributors and suppliers within their value chains.</p>

Source	Definitions
INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS	An international non-governmental organization (INGO) has the same mission as a non-governmental organization (NGO), but it is international in scope and has outposts around the world to deal with specific issues in many countries. Both terms, NGO and INGO, should be differentiated from intergovernmental organizations (IGOs), which describes groups such as the United Nations or the International Labour Organization. An INGO may be founded by private philanthropy, such as the Carnegie, Rockefeller, Bill and Melinda Gates and Ford Foundations, or as an adjunct to existing entities, such as the Catholic or Lutheran churches. INGOs can further be defined by their primary purpose. Some INGOs are operational, meaning that their primary purpose is to foster the community-based organizations within each country via different projects and operations. Some INGOs are advocacy-based, meaning that their primary purpose is to influence the policy-making of different countries' governments regarding certain issues or promote the awareness of a certain issue. Many of the large INGOs have components of both operational projects and advocacy initiatives working together within individual countries.
ODA LOANS (ALSO CREDITS)	Transfers for which repayment is required. Only loans with maturities of over one year are included in OECD Development Assistance Committee (DAC) statistics. Data on net loans include deductions for repayments of principal (but not payment of interest) on earlier loans. This means that when a loan has been fully repaid, its effect on total net ODA over the life of the loan is zero.
OTHER OFFICIAL FLOWS	Transactions by the official sector with countries on the DAC List of ODA Recipients which do not meet the conditions for eligibility as ODA, either because they are not primarily aimed at development, or because they have a grant element of less than 25 percent.
PUBLIC/PRIVATE BORROWING FROM CAPITAL MARKETS	<p>Governments in developing countries face significant constraints on raising revenue as the set of policy instruments available is limited given the structure of the economy and low level of income. Facing such constraints, governments have strong incentives to finance government expenditure through domestic and international borrowing. The access to international credit market may, however, be limited for most of the developing countries. The governments in many developing countries in recent years thus find themselves borrowing more from the domestic sources.</p> <p>Fiscal deficit results when tax revenue of a government does not fully cover its expenditures and public debt is an accumulation of yearly deficits. There are various sources of budget deficit financing and domestic and foreign borrowings are the major sources. The borrowings from any sources may have their own positive and negative macroeconomic implications in an economy.</p> <p>A significant increase in government's domestic borrowing in developing countries may have undesired effects on private credit and thus on private investment. A significant change in the government borrowing may crowd out private borrowing and investment that must be also researched.</p>
PUBLIC-PRIVATE PARTNERSHIPS (PPPs)	<p>The PPPs are a collaborative arrangement between a government authority or public corporation and a private entity regarding the provision of public infrastructure or services. These partnerships are defined and mediated by legally-binding contracts, which clearly establish and allocate responsibilities, risks and rewards between the different parties. The PPPs are increasingly seen as a new development finance model, and several countries have used them to scale up investments in economic infrastructure.</p> <p>The PPPs frontload finance enabling large-scale public projects to take place. However, PPPs are complex and require appropriate legislation, regulatory frameworks and technical skills. Finally, a key concern is that fiscal accounting rules tend to keep most PPPs off-budget. Since PPPs usually involve a future obligation by the government (contingent debt) this should be appropriately captured.</p>
RESOURCE-RELATED TAX REVENUES	The resource income includes revenues from upstream exploration-to-processing activities in oil, gas and mining, i.e. principally royalties and corporate income taxes on resource extraction activities.
SOUTH-SOUTH AND TRIANGULAR COOPERATION	South-South cooperation (SSC) is a broad framework for collaboration among countries of the South in the political, economic, social, cultural, environmental and technical domains. Involving two or more developing countries, it can take place on a bilateral, regional, subregional or interregional basis. Developing countries share knowledge, skills, expertise and resources to meet their development goals through concerted efforts. Recent developments in SSC have taken the form of increased volume of South-South trade, South-South flows of FDI, movements towards regional integration, technology transfers, sharing of solutions and experts, and other forms of exchanges. Collaboration in which traditional donor countries and multilateral organizations facilitate South-South initiatives through the provision of funding, training, and management and technological systems as well as other forms of support is referred to as triangular cooperation.

Source	Definitions
SOVEREIGN WEALTH FUNDS (SWFS)	Sovereign Wealth Funds (SWFs) are state-owned investment funds that allow domestic and international investments in a wide range of financial products. SWFs are usually funded by the proceeds from the sale of natural resources (i.e. foreign exchange) with the purpose of saving financial resources for future generations. They can therefore enable a more efficient allocation of resources across countries (from resource-rich to resource-poor) and enhance market liquidity.
WORKERS' REMITTANCES	Remittances represent household income from foreign economies arising mainly from the temporary or permanent movement of people to those economies. Remittances include cash and noncash items that flow through formal channels, such as via electronic wire, or through informal channels, such as money or goods carried across borders. They largely consist of funds and noncash items sent or given by individuals who have migrated to a new economy and become residents there, and the net compensation of border, seasonal, or other short-term workers who are employed in an economy in which they are not resident.

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Annex C: Middle-Income Countries (MIC) versus Least Developed Countries (LDC)

The World Bank categorises countries in four groups: low income, lower-middle income, upper-middle income and high income countries. According to the World Bank, a lower-middle income country will have a per capita income between \$1,045 and \$4,125 and an upper-middle income economy needs to have a per capita income between \$4,126 and \$12,745. This is calculated using the Atlas method of the World Bank and updated every year.

In practice, attaining middle income status for a country implies two major changes: (i) Transition from grant aid and concessional financing as an International Development Association (IDA) (the World Bank's funding base for the poorest countries in the world) country to graduating to International Bank for Reconstruction and Development (IBRD) status whereby a country can access a combination of financial resources on less concessional terms, guarantees for borrowing, knowledge and technical services from the World Bank and its partners; (ii) a MIC country will have much greater access to international debt and equity markets as MICs are considered as better able to leverage equity and other assets to access both public and private international borrowing. The outcome of this shift for most observed countries to date has thus been a drying up of traditional donor aid and a shift to reliance on non-concessional borrowing from both international financial institutions as well as other sources and markets. For Bangladesh, achieving MIC status will thus imply higher costs of borrowing from the international financial institutions, the build-up of more debt, an increased financial cost of managing their debt burden, and an increasing reliance on non-traditional partners for development finance.

Bangladesh achieved LMIC status with the World Bank in 2015 but, it will remain as a least developed country (LDC) according to the United Nations. Bangladesh was not selected for graduation review in 2015 but it is likely that Bangladesh can graduate in 2018.⁶⁶ As an LDC, Bangladesh can for the next three years continue to access funds committed under international agreements such as the Istanbul Declaration and Programme of Action (2011) as well as accessing benefits such as from the duty free-quota free market and extensions for compliance with the TRIPS agreements (World Trade Organization Agreement on Trade-Related Aspects of Intellectual Property Rights, 1994).

⁶⁶ The Committee for Development Policy of the United Nations Economic and Social Council (ECOSOC) establishes the development status of countries like Bangladesh. They meet every three years to discuss amongst other issues countries which qualify to move out of LDC status. Unlike the World Bank, LDC status is broader than just national income per capita it also includes measures of the Human Asset Index (HAI) which includes information on nutrition, literacy, health and education and also an measure of economic vulnerability known as the (EVI) which is based on exogenous and endogenous shocks, population and physical exposure.

In either case it needs to be recognized that at present Bangladesh has quite strong controls on their capital account, although the authorities have been moving forward towards gradual liberalization of exchange regulations on current and capital account transactions based on a roadmap approved in September 2013.⁶⁷ While the benefits versus the challenges of opening up country's capital account have been discussed in development literature for decades, the reality is that unless Bangladesh opens its capital account, external private sector borrowing will remain low and the main source of borrowing for Bangladesh's private sector will be from the already overextended domestic banking sector. Bangladesh demonstrates a very low level of financial deepening to date.

⁶⁷ Among other measures, the authorities have eased some of the regulatory restrictions on the carrying of currency for foreign travel, advance payments on imports, money transfers abroad, and external and domestic borrowing.

Annex D: Bangladesh Achievements against MDG Targets

Target	Indicators	Target by 2015	Benchmark (1991–1992)	Achievement (Year, Source)	Status
Goal 1: Eradicate Extreme Poverty and Hunger					
Target 1.A: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.	1.1: Proportion of population below \$1 (PPP) per day, (%)	35.1	70.2 (1992)	43.3 (WB, 2010)	Needs attention
	1.1a: Proportion of population below national upper poverty line (2,122 kcal), (%)	29.0	56.7 (1992)	24.8 (GED estimates for 2015)	Target met
Target 1.B: Achieve full and productive employment and decent work for all, including women and young people.	1.4: Growth rate of GDP per person employed, (%)	-	0.90 (1991)	3.55 (WB 2012)	-
	1.5: Employment to population ratio (15+) %	For all	48.5	57.1 (Labour Force Survey, LFS 2013)	Needs attention
Target 1.C: Halve between 1990 and 2015, the proportion of people who suffer from hunger.	1.8: Prevalence of underweight children under-five years of age (six-59 months), (%)	33.0	66.0	32.6 (BDHS 2014)	Target met
Goal 2: Achieve Universal Primary Education					
Target 2.A: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.	2.1 Net enrolment in primary education, %	100.0	60.5	97.7 (2014, Annual Census, Department of Primary Education, APSC, DPE)	On track
Goal 3: Promote Gender Equality and Empower Women					
Target 3.A: Eliminate gender disparity in primary and secondary education preferably by 2005, and in all levels of education no later than 2015.	3.1a Ratio of girls to boys in primary education (Gender Parity Index=girls/boys)	1.0	0.83	1.03 (APSC, 2014, DPE)	Target met
	3.2 Share of women in wage employment in the non-agricultural sector, %	50.0	19.1	31.6 (LFS 2013)	Target met
Goal 4: Reduce Child Mortality					
Target 4.A: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.	4.1 Under-five mortality rate (per 1,000 live births)	48	146	46 (Bangladesh Demographic and Health Survey (BDHS), 2014)	Target met
	4.2 Infant mortality rate (per 1,000 live births)	31	92	32 (SVRS 2013)	On track
Goal 5: Improve Maternal Health					
Target 5.A: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.	5.1 Maternal mortality ratio, per 100,000 live births	143	574	170 (MMEIG 2013) Maternal Mortality Estimation Inter-agency Group	Need attention

Target	Indicators	Target by 2015	Benchmark (1991–1992)	Achievement (Year, Source)	Status
Target 5.B: Achieve, by 2015, universal access to reproductive health.	5.3 Contraceptive prevalence rate, %	72	39	62.4 (BDHS 2014)	Needs attention
	5.5b: Antenatal care coverage (at least four visits) %	50	5.5	31.2 (BDHS 2014)	Needs attention
Goal 6: Combat HIV/AIDS, malaria and other diseases					
Target 6.A: Have halted by 2015 and begun to reverse the spread of HIV/AIDS.	6.1 HIV prevalence among population (per 100,000 population)	Halting	0.005	<0.1 (UNAIDS 2013)	On track
Target 6.C: Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases.	6.6a : Prevalence of malaria per 100,000 population	310	441.5 (2005)	433.91 (MIS NMCP 2014)	Needs attention
	6.9a : Prevalence of TB per 100,000 population	250	504	402 (GTBR World Health Organization 2014)	Needs attention
Goal 7: Ensure Environmental Sustainability					
Target 7.B: Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss.	7.1 Proportion of land area covered by forest (%) (tree coverage)	20 (Tree density >70%)	9	13.40 (DoF2014) (Tree density>30%)	Needs attention
Target 7.C: Halve by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation.	7.8 Proportion of population using an improved drinking water sources, %	100	68.0	97.9 (MICS 2012–2013)	On track
	7.9: Proportion of population using an improved sanitation facility	100	34	55.9 (MICS 2012–2013)	Needs attention
Goal 8: Develop a Global Partnership for Development					
Target 8.B : Address the special needs of the least developed countries.					
Target 8.D: Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term.	8.1a: Net ODA received by Bangladesh (in millions of United States dollars\$)	4,175	1732	3,084 (ERD 2014)	Needs attention
Target 8.D: Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term.	8.12 : Debt service as a percentage of exports of goods and services, %	6.0	20.9	6.4 (ERD 2014)	On track

Annex E: DFA Advisory Committee for Bangladesh

Chair: Mr. Monowar Ahmed, Additional Secretary, ERD, Sher-E-Bangla Nagar, Dhaka

Members of the DFA Advisory Committee

1. Mr. Mohammad Asif-uz-Zaman, Additional Secretary, ERD, Sher-E-Bangla Nagar, Dhaka
2. Mr. Abul Mansur Md. Faizullah, Additional Secretary, ERD, Sher-E-Bangla Nagar, Dhaka
3. Mr. Md. Obaidul Azam, Joint Secretary, Ministry of Commerce, Bangladesh Secretariat, Dhaka
4. Mr. Nur Mohammad Mozumder, Joint Secretary, Ministry of Expatriate Welfare and Overseas Employment, Eskaton, Dhaka
5. Mr. Md. Habibur Rahman, Joint Secretary (Budget-1 Wing), Finance Division, Bangladesh Secretariat, Dhaka
6. Mr. Mohammad Rafiqul Islam, Joint Chief, GED, Planning Commission, Dhaka
7. Mr. Md. Abdul Awwal Sarker, General Manager (Research), Bangladesh Bank, Motijheel, Dhaka
8. Ms. Shamsunnahar Begum, Director, Board of Investment, Dilkusha, Dhaka
9. Mr. Md. Nazmul Karim, First Secretary, National Board of Revenue (NBR), Dhaka

Annex F: Key Challenges and Impacts of Key Flows and Areas for the DFA

Area	Key Challenges for Development of the Flow/Area	Impact
Public Expenditure and National Priorities	<ul style="list-style-type: none"> • Strategic resource allocation can be strengthened. • Subsidies and SOE liabilities are a large drain on the budget. • Balance between recurrent and investment budget can be improved. Need higher investment. • Locative efficiency between sectors and between plan and sectors within the FYP can be strengthened. • Reliance on deficit financing for development budget. • Coherence between recurrent and development budget under the MTBF needs to be better aligned. 	<ul style="list-style-type: none"> • Shortfalls in investment budget lead to budget cuts in year and reliance on short term borrowing. • Subsidies (e.g. in electricity) absorb \$770 million per annum.
Revenue Mobilization	<ul style="list-style-type: none"> • Government revenue to GDP is low and has been nearly stagnant over the last decade. • There are capacity weaknesses in NBR to administer tax reforms. • The country has a high level of informality that is not easy to tax. • Tax flight, tax holidays and tax exemptions are deterrents to revenue collections. 	<ul style="list-style-type: none"> • Dependence on deficit financing of the primary deficit for the ADP. • Limited scope to increase total public expenditures. • Disincentives to development partners to provide budget support if own revenues are not seen growing.
Private sector Development	<ul style="list-style-type: none"> • Expectation that private sector investment will contribute to 78 percent of planned investment under the 7th FYP. However, private sector performance stalled during the last three years of the previous plan. • Expectation that private sector will contribute to upgrade infrastructure and invest in human capital however, significant binding constraints to private sector exist. Bangladesh scores 178 out of 186 countries on the current WB 'doing business indicators'. • Key areas such as PPPs have not really taken off to date. FDI is low at 1 percent of GDP versus target of three percent. • Limited registration of private sector informal workers and firms thus remaining out of the tax net. 	<ul style="list-style-type: none"> • Shortfalls in private investment led to limited infrastructure development and fell short of investment needs in key areas of health and education. • Private sector growth continued to be constrained by weak incentives, challenges in the business environment and lack of access to public and international finance • Informal sector workers were left out of the tax net and their contribution to economic growth were limited.

Area	Key Challenges for Development of the Flow/Area	Impact
Official Development Assistance	<ul style="list-style-type: none"> • Low level of disbursement as a share of commitments which fell below 80 percent in 2003 and now hovers between 40 and 60 percent. • Value and effectiveness of foreign assistance is being undermined by the high degree of aid fragmentation on the donor side • Scope under the plan for accelerating the pace of donor funded project implementation and to reduce the large aid pipeline which currently stands at more than \$19 billion (about six years of aid utilization). • Achieving LMIC status may imply a change in the composition of ODA including reduction of grant aid and less concessional terms for international loans. 	<ul style="list-style-type: none"> • Relationships between traditional and non-traditional donors remains weak. • Time lag between project approval and project implementation has often been delayed contributing to declining rates of aid effectiveness and service delivery for public sector investments. • Fragmented viewpoint between the Government of Bangladesh and DPs on scaling up SDG financing given large aid pipeline.
South-South Cooperation	<ul style="list-style-type: none"> • Current South-South cooperation modality is mostly supply driven, suited to the priorities of non-traditional donors. • Not yet a dedicated unit for South-South Cooperation, different wings under ERD are pursuing region/country wise resources mobilisation. 	<ul style="list-style-type: none"> • Softer and important development issues, such as education, skill development, health and others are likely to be ignored. • High investment on low priority development with less focus on national development goals. • Not able to derive benefits from multi-lateral institutions on South-South Cooperation, not synchronised effort.
Climate Change Funds	<ul style="list-style-type: none"> • Donors are losing interest in multi-donor trust funds. • Not been able to mobilize large funds from multilateral institutions like AF, GCF, CIF and GEF. • Climate Change adaptation remains a very high priority but with no big commitments from international donors. • Challenges in accounting for different agencies (private foundations, CSR, different ministries) finances on climate change adaptation. 	<ul style="list-style-type: none"> • Lesser fund mobilization from international sources. • Though domestic resources are available, these are not properly taken into account, and there are duplicity of efforts. • Weak access to international climate change funds.
Foreign Direct Investment	<ul style="list-style-type: none"> • Too many factors negatively affect the business climate in Bangladesh, making it a not very interesting investment destination. • Excessive dependency on RMGs and difficulties to diversify the industrial production base to other areas. • Dependency on the success of PPPs but need to remove main infrastructural obstacles (transport, energy, etc.). • Capacity of the Bol is not adequate to fulfil its required role. 	<ul style="list-style-type: none"> • The country may become dependent on artificial measures (i.e. EPZs, ESZs) that won't produce the best spillover effects to the economy. • To compensate structural problems the country may end up entering in a race to the bottom of tax promotions that will deprive revenues. • Not attracting investors.
Public-Private Partnerships	<ul style="list-style-type: none"> • The same limitations of the business climate that are hindering FDI also apply for PPPs with the addition that Bangladesh is not known as a market for potential PPP investors. • Lack of institutional history of LMs on infrastructure financing with the private sector. • The size and quality of the financing required for projected PPP investments may exceed the capacity of the domestic institutions. • A quality and strategic national infrastructure development plan is needed to provide an integrated long-term vision. 	<ul style="list-style-type: none"> • It is much harder to attract potential investors as FDI is a market for mature investors. • Every single initiative will demand the continuous push of the PPP Authority to remove obstacles. • If insufficient national finance is available Bangladeshi firms are not going to benefit from PPPs. • An active international campaign will be required. A quality infrastructure plan is a main marketing tool to approach foreign markets. • Project-based promotion campaigns have much more a limited international impact.

Annex G: Key Recommendations for Bangladesh 2015–2020

Area/Flow	Recommendations	
1. Public Expenditure and National Priorities	1.1	Strengthen strategic resource allocation of MTBF to better finance policy priorities.
	1.2	Strengthen links between planning and budgeting processes to ensure full coherence between the 7th FYP and financed priorities.
	1.3	Change the balance between recurrent and development budgets.
	1.4	Gradually eliminate use of unnecessary subsidies and design a strategy to reduce/eliminate losses of SOEs.
	1.5	Extend systems to strengthen operational efficiency of the budget and improve absorptive capacity and budget execution standards.
2. Revenue According to the 7th FYP, total revenue to be raised from 10.7 percent of GDP to 16.1 percent by FY2020.	2.1	Capacity development of NBR through training and outreach initiatives.
	2.2	Development and approval of direct tax law.
	2.3	Restructure tariff regime in order to gradually reduce effective protection levels and consequent anti-export bias.
	2.4	Fast track full computerization of NBR system.
	2.5	Development of an action plan to fast track the registration of private sector informal workers.
3. Private Sector Development The private sector is supposed to account for 78 percent of 31.9 trillion taka under the 7th FYP.	3.1	Develop an action plan in the Bangladesh Bank to promote new entrepreneurs through active monetary and regulatory policy support to private sector initiatives.
	3.2	Arrange training for job seekers to develop their skills suitably for self-employment and/or appropriate jobs in the SME and MNEs sector.
	3.3	Develop an action plan to reduce key barriers to private sector development, including access to finance, regulatory inefficiencies, and clearer entitlements on access to land.
	3.4	Assess realist targets for private sector investment given current weak performance and challenge in the global environment.
4. ODA	4.1	Improved alignment of commitments, allocation and disbursement of ODA through better management by ERD and line ministries.
	4.2	Manage the reduction in the time it takes to approve and implement ODA projects through ERD and line ministries.
	4.3	Achieving LMIC status may result in less concessional terms for borrowing from ODA donors in particular from international development banks. A strategic plan taking into consideration related debt management issues can be considered.
	4.4	Fast track implementation of the PFM reforms. A reduction of perceived fiduciary risk associated with ODA will accelerate commitments and disbursement. In particular, this requires improvement of the procurement system.
	4.5	Under the new draft Development Cooperation Policy to promote the use of complementary aid modalities including budget support, concessional lending and vertical funds in support of infrastructure, social, economic and climate-related funding. Budget support in particular is fully aligned to national priorities and is given once in the budget cycle, which will help with expenditure smoothing.

Area/Flow	Recommendations	
5. Climate Change Finance	5.1	Accord high priority for implementing the Climate Fiscal Framework with approved results framework.
	5.2	Establish an integrated coordination mechanism and merge BCCRF, BCCTF and other sources of climate finance into this single entity.
	5.3	Enhance institutional capacities at local, sub-national and national levels to mobilize and manage climate finance.
	5.4	Vigorously represent Bangladesh's susceptibility to the effect of climate change at international forums and negotiate for greater financial support. Prioritize bilateral donors who provide large finance for climate change adaptation, and mobilize finance from them.
6. South- South and Triangular Cooperation	6.1	Harmonize government efforts by delegating responsibility to one cell/wing for SSC/TC.
	6.2	Follow a demand-driven approach by assessing existing capacities and resources gaps, and develop partnerships with them.
	6.3	Complement SSC with ODA for holistic development by creating a stronger demand driven balance between hard development (infrastructure, manufacturing) related to SSC and soft development issues (education, skill development, health, and gender development) traditionally financed by ODA.
	6.4	Improve value-for-money and data availability of SSC.
7. Foreign direct investment FDI inflows should grow from 0.9 percent to three percent of GDP, which in nominal terms will mean an increase from approximately \$1.7 billion to \$9.6 billion/year in 2020.	7.1	Focus short-term attention in providing aggressive and professional promotion to the selected strategic areas (i.e. EPZs, SEZs, shipbuilding, and pharmaceuticals).
	7.2	Start a comprehensive restructure of the Board of Investment with the objective of getting in full operational mode in less than five years.
	7.3	Participate in the strategic prioritization of the PPP promotion projects to ensure coherence with national FDI priorities.
	7.4	Strategic prioritisation of a list of key changes to improve the business and investment climate and development of a coordinated agenda to address them.
	7.5	Review the corporate tax regime, tariff and duty incentive to ensure coherence with the objective of attracting export promotion industries.
8. Public-private partnerships (PPP) PPP should grow from 0.2 percent of GDP in FY2015 to somewhere between one and two percent of GDP, which in nominal terms will mean an increase to \$1 billion/year in 2020.	8.1	Strengthen the quality of current infrastructure planning and consolidate a national infrastructure development plan for PPPs.
	8.2	Start a capacity development programme for selected LMs and government agencies and develop teams capable of accelerating PPP development.
	8.3	Analyse the feasibility of re-capitalizing one of the existing institutions and strengthen it to achieve sovereign status.
	8.4	Strengthen capacity of national banks to provide equity and debt financing for PPPs, committed (indicative) financing and to be involved at an earlier stage in the PPP process.
	8.5	Develop a risk assessment strategy to find a right balance to provide incentives to stimulate private PPPs when social rates of return are high and private returns are low.
	8.6	Consider joint promotion activities for PPPs with the Board of Investment (BoI) and develop separate – targeted international promotion interventions.

Area/Flow	Recommendations	
9. Remittances Sustain present rate of remittances/GDP at eight percent, which in nominal terms will mean an increase from approximately \$15.5 to \$25.4 billion/year in 2020.	9.1	Strengthen the technical and organizational capacity of the MoEWOE and its subordinate bodies to be able to lead and coordinate all policies affecting international migrant economy.
	9.2	Develop new measures to promote the progressive bankarisation of remittance recipients, especially those from poorest backgrounds and rural settings.
	9.3	Identify opportunities for implementing coordinated interventions to link remittances with government-subsidised microfinance mechanisms and attempt to leverage lending of small sums of money to low-income households for small productive or commercial ventures.
	9.4	Develop new Labour Wings to strengthen welfare services of expatriates, especially from rural regions

Source: 7th FYP and DFA team recommendations

