October 2019

Bangladesh Development Update

Tertiary Education and Job Skills

THE WORLD BANK
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BANGLADESH DEVELOPMENT UPDATE

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Preface

This report provides an assessment of the state of the economy in Bangladesh, discussing the outlook, risks, and key reform challenges. Coverage includes the real sector, focusing on growth and its components; inflation; monetary and financial sector developments; external sector developments, focusing on the balance of payments, foreign exchange reserves and the exchange rate; and fiscal developments focusing on revenue mobilization, public expenditures, and deficit financing. The special focus in this update is on the role of tertiary educational institutions in skills development.

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Abbreviations

ADP	Annual Development Program
ADR	Advance-Deposit Ratio
AQR	Asset Quality Review
BAB	Bangladesh Association of Bankers
BAC	Bangladesh Accreditation Council
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladeshi Taka
BEZA	Bangladesh Economic Zones Authority
BOP	Balance of Payments
BPDB	Bangladesh Power Development Board
CETP	Central Effluent Treatment Plant
CPI	Consumer Price Inflation
CRAR	Capital to Risk Weighted Asset Ratio
DSEX	Dhaka Stock Exchange
EMDE	Emerging Market and Developing Economies
EPZ	Export Processing Zone
FCB	Foreign Commercial Banks
FDI	Foreign Direct Investment
FY	Fiscal Year
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GNI	Gross National Income
ICT	Information and Communications Technology
IMF	International Monetary Fund
LC	Letter of Credit
LNG	Liquefied Natural Gas
M2	Broad Money
MLT	Medium and Long Term
MOE	Ministry of Education
MPS	Monetary Policy Statement
NBR	National Board of Revenue
NDA	Net Domestic Assets
NFA	Net Foreign Assets
NPL	Non-Performing Loan
NSC	National Savings Certificate
NSDA	National Skills Development Authority
NTRCA	Nongovernment Teachers' Registration and Certification Authority
NTSC	Nongovernment Teachers Selection Commission
OECD	Organization for Economic Co-operation and Development
PBF	Performance-Based Funding
PCB	Private Commercial Banks
RMG	Ready-made garments
SOB	State-Owned Bank
STEM	Science, Technology, Engineering and Mathematics
TEI	Tertiary Educational Institutions
TVET	Technical and Vocational Education and Training

Executive Summary

Strong growth continued in FY19, supported by rising exports and record remittances. Inflation remained within the 5.5 percent target, supported by bumper rice harvests. Broad money growth increased marginally. Private sector credit growth was weak and bank liquidity remains constrained. Non-performing loans continued to rise in the banking sector. The current account deficit declined with higher export and lower import growth. Bangladesh Bank interventions moderated the depreciation of the taka against the US dollar, but the real effective exchange rate appreciated. The fiscal deficit has reached 4.6 percent of GDP as expenditure increased and revenue collection remained below target. Recent tax policy adjustments are likely to constrain revenue growth in the near term, while additional subsidies will increase recurrent expenditure. Sustaining growth will require momentum on the reform agenda to address challenges in the business climate, public investment management, revenue mobilization, and the resolution of fragile banks. Economic transformation will require development of new skills in the workforce. Tertiary educational institutions can support this agenda if quality, relevance, and access challenges are addressed.

Recent Economic Developments

Bangladesh's economic expansion continued. Exports, private investment and private consumption boosted by strong remittances supported demand growth. Large and medium-scale manufacturing activities responded the fastest on the supply side, accompanied by broad-based growth in services, led by wholesale and retail trade. Total factor productivity growth and capital accumulation contributed to sustaining the 7 percent potential output growth rate of recent years, as employment transitioned from agriculture to manufacturing and services.

Inflation remained within the 5.5 percent target. Food inflation dropped to 5.5 percent in FY19 from 7.1 percent the previous year, as bumper rice yields led to falling prices. Non-food inflation increased from 3.7 percent to 5.4 percent, led by increasing clothing and footwear prices. Non-food inflation may have been driven by demand pull from the growing output gap (estimated at 1.4 percent of potential output in FY19) and cost push from an 8.5 percent nominal wage increase in industrial production sectors.

Broad money growth increased slightly while bank credit growth to the private sector decelerated. Broad money growth rose as public sector bank borrowing increased sharply. Private credit growth has been constrained by declining deposit growth, US dollar sales by Bangladesh Bank (BB), rising non-performing loans (NPLs), and pressure to comply with the 9 percent ceiling on the lending rate. State-owned banks (SOBs) face high NPLs and low capital adequacy. The capital markets offer no alternative, remaining volatile with a downward trend since early 2019.

The balance of payments was slightly positive in FY19. The current account deficit narrowed to 1.7 percent of GDP as the trade and services accounts deficits fell and remittances rose. The

financial account surplus fell to USD 5.6 billion in FY19 from USD 9.0 billion a year ago as rising FDI was offset by a sharp increase in net trade credit outflows. BB intervention in the foreign exchange market moderated the depreciation of the BDT/USD rate as the US dollar gained strength in global markets. However, the real effective exchange rate appreciated by about 5.6 percent, eroding Bangladesh's price competitiveness. To offset this competitive disadvantage, the RMG sector has been provided with cash subsidies. In non-RMG sectors, which do not benefit from subsidies, export growth and investment have lagged. In addition to the negative effects on competitiveness, foreign exchange interventions have contributed to the taka liquidity shortage in the money markets. Reserve coverage at the end of FY19 was adequate at 5.8 months of imports.

A revenue shortfall outweighed underperformance on capital spending. In FY19, nominal revenues and expenditures both fell short of original budget targets. Tax revenue growth was limited by slowing imports and the introduction of tax concessions in the run-up to the elections earlier in the fiscal year. Recurrent spending was the fastest growing type of expenditure, driven by increased subsidies, transfers, pay and allowances, and interest payments.

The fiscal deficit is estimated at 4.6 percent of GDP in FY19, within the budget target of 5.0 percent. The deficit was similar to the previous year, but the composition of deficit financing shifted towards bank borrowing. However, sales of high yielding National Savings Certificates exceeded the budget target. The stock of debt rose marginally to 32.8 percent of GDP as both external and domestic debt levels rose modestly. The recently completed joint debt sustainability analysis by the World Bank and IMF reconfirmed Bangladesh's low risk of debt distress while highlighting the criticality of stronger revenue mobilization, improving external competitiveness and judicious choice of financing options.

Outlook and Risks

GDP growth is forecast to continue above 7 percent in the medium-term as the demand-driven expansion continues. Macroeconomic stability and growth will be supported by several factors. The implementation of public investments in infrastructure megaprojects will continue. Private investment will be supported by business climate reforms and the operationalization of new special economic zones. Domestic consumption will be supported by growing remittances, and exports are expected to continue growing as production shifts out of China. Inflation is projected to rise moderately with increased natural gas prices, possible crop production losses due to the recent floods, and the growing output gap.

A modest increase in the current account deficit is likely with investment-driven import growth outweighing export and remittance growth. FDI is expected to rise, supported by regulatory reforms, infrastructure development and stable political conditions. Rising

investments are likely to increase import growth. Bangladesh Bank could consider allowing greater exchange rate flexibility to better manage taka liquidity, preserve foreign exchange reserves and enhance the economy's capacity to cope with external shocks.

The fiscal deficit is expected to persist. Revenue underperformance together with increased spending on subsidies, pensions and megaprojects is likely to increase the fiscal deficit in FY20. Contingent liabilities from rising NPLs in SOBs could result in fiscal pressures and higher public debt. Tax policy changes introduced in the 2019 Finance Act, particularly changes to VAT legislation, represent a missed opportunity to raise additional revenues.

Downside risks are primarily domestic. High NPLs and stock market volatility pose financial stability and credit intermediation risks. Loss of competitiveness from the real exchange rate appreciation could hinder Bangladesh's ability to capture some of the trade diversion from tariff escalation by the US against China. Beyond the RMG sector, the positive impact of trade diversion from China may be relatively small given Bangladesh's limited integration in global supply chains. Furthermore, recession in European and US markets would adversely impact export demand and remittances. Higher inflation remains a risk in the context of growing domestic demand and higher public expenditure.

Managing risks will require prudent macroeconomic management. The monetary policy announced in July 2019 seeks to contain inflation while achieving growth objectives. BB maintained the repo and reverse repo rates at 6.0 and 4.75 percent respectively. Broad money growth is targeted at 12.5 percent, with domestic credit growth of 15.9 percent. The medium-term fiscal stance is sustainable if taxation, expenditure and deficit financing policies are prudent. The FY20 budget maintains an overall deficit target of 5 percent of GDP. Domestic financing is projected to reach 2.7 percent of GDP with the balance from foreign sources. Given a low public debt-to-GDP ratio and access to concessional external finance, this does not increase the risk of debt distress.

Fiscal policy will require balancing rising recurrent expenditures with limited revenues. A rising public wage bill and the introduction of additional subsidies for remittances and exports may exacerbate budget deficits. Revenue mobilization is likely to remain limited unless tax policy is adjusted. Tax administration reforms must also move forward to increase the tax base and close the compliance gap.

With limited fiscal space, the efficiency of public investment expenditures is critical. Given the limited funding available, focus on improving expenditure outcomes in the Annual Development Program (ADP) should be renewed. The allocation of development expenditures by sectors is generally consistent with the country's development priorities. The ADP continues to be overloaded with too many projects while time and cost overruns remain ubiquitous.

Accountability of the implementing agencies for delivering completed projects needs strengthening.

Increased government borrowing from banks may crowd out the private sector. The FY20 Budget aims to reduce dependence on NSCs and increase reliance on bank borrowing. This can potentially crowd out bank credit to the private sector, with adverse effects on private investment. This risk can be reduced through an increased use of external concessional financing and resolution of NPLs in the banking system.

In the financial sector, the resolution of fragile banks and the implementation of regulatory reforms are near-term priorities. A comprehensive asset quality review (AQR) needs to be undertaken to understand the true extent of NPLs and the capital shortfall of the SOBs. NPL resolution may require mandatory write-offs and other resolution tools as well as consolidation and reform of the SOBs. Reform will require an emphasis on focused mandates and improvements in corporate governance, internal controls, risk management and underwriting standards; and an upgrade of supervision, regulation and compliance. The advance-deposit ratio (ADR) limits on commercial banks should be strictly enforced.

To support growth over the longer-term, the pace and credibility of structural reforms needs to increase. Boosting investment in the private sector and employment generation for unemployed youth are two key priorities. Addressing these priorities requires improvements in the business and investment climate. A faster pace of reform would enhance reform credibility by demonstrating momentum, while rigorous assessment of successful reforms in sectors such as banking, telecommunication and energy will strengthen conviction. Economic governance must be improved to sustain Bangladesh's recent socio-economic achievements.

Inclusive growth and job creation will also require investments in human capital. Employers in Bangladesh rank higher-order cognitive and soft skills as most relevant in the current work environment. However, a shortage of domestic skills has increased reliance on imported labor in apparels, real estate, textiles, telecommunication, information and technology sectors. The focus section of this report provides an analysis of the mismatch between the demand and domestic supply of skills with a special emphasis on the role of tertiary educational institutions.

Higher labor productivity is required to diversify the economy beyond garment exports and remittances. While employer demand for high-level skills is growing, the supply of relevant skills is constrained and recent tertiary graduates struggle to find jobs. For example, one to two years after graduation, only 19 percent of college graduates are found to be employed full-time or part-time, while nearly half are unemployed. Key challenges include inadequate resources for training, access barriers for low income groups and females, an absence of public incentives to produce market-relevant skills, and an ineffective regulatory and accountability framework.

Policymakers should focus on enhancing the quality and relevance of education by modernizing curriculum and facilities, investing in qualified teachers, developing relevant international partnerships, and improving equitable access to tertiary education. This will require a review of the financing strategy and strengthened management of educational institutions.

Recent Economic Developments

Real Sector

Real GDP growth remained above the potential growth rate in FY19. On the demand side, output expansion was primarily driven by higher net exports and private consumption, the latter boosted by strong remittances. On the supply side, the main contributors to growth were large and medium-scale manufacturing and broad-based growth in services, led by wholesale and retail trade. A bumper boro harvest supported low food prices and inflation remained within the Bangladesh Bank's target.

Table 1: Contributions to Growth

	FY13	FY14	FY15	FY16	FY17	FY18	FY19e
GDP Growth	6.0	6.1	6.6	7.1	7.3	7.9	8.1
	Contribution of Production Sectors (%)						
Industry	2.6	2.3	2.7	3.2	3.1	3.8	4.2
o/w Manufacturing	1.8	1.6	1.9	2.3	2.2	2.8	3.2
Services	2.9	2.9	3.0	3.2	3.4	3.2	3.3
Agriculture	0.4	0.7	0.5	0.4	0.4	0.6	0.5
Import duty	0.1	0.2	0.3	0.2	0.3	0.3	0.2
	Contribution of Expenditure Components (%)						
Consumption	3.8	3.1	4.3	2.4	5.1	7.8	4.0
Private consumption	3.5	2.7	3.8	2.0	4.7	7.0	3.5
Government consumption	0.3	0.4	0.4	0.4	0.4	0.8	0.5
Investment	1.6	3.0	2.2	2.8	3.3	3.5	2.8
Private Investment	0.4	2.2	1.5	2.5	2.0	2.2	1.9
Government Investment	1.2	0.8	0.8	0.3	1.3	1.3	0.9
Trade Balance	0.2	0.4	-1.3	1.9	-0.9	-3.6	1.3
Exports, goods & services	0.5	0.6	-0.5	0.4	-0.4	1.2	2.3
Imports, goods & services	0.3	0.3	0.7	-1.5	0.5	4.8	1.0
Statistical discrepancy	0.4	-0.4	1.3	0.0	-0.1	0.2	0.1

Source: BBS, Growth in constant terms, National Accounts 2005-06 base

Global growth slowed as trade tensions re-escalated in the first half of 2019.[1] Trade and manufacturing activity fell, business confidence declined, and investment growth decelerated. Financing conditions eased as central banks in developed economies adjusted policy to support continued growth. Weakening external demand from developed countries weighed on export growth in emerging markets and developing economies (EMDEs). A subset of EMDEs faced idiosyncratic challenges or ongoing financial stress (Argentina, Brazil, Mexico, Turkey). However, GDP growth in emerging Asian economies (Cambodia, China, India, and the Philippines) remained strong, buoyed by public investment and moderate inflation. Bangladesh's average 7 percent growth in last five years (per official estimates) was higher than all other countries in South Asia, except India.

[1] Based on World Bank, Global Economic Prospects, June 2019

GDP growth in Bangladesh is officially estimated at 8.1 percent in FY19, compared with 7.9 percent in FY18. Private consumption, representing 69.7 percent of GDP, remained the primary driver of growth on the demand side. It grew by 5.4 percent during the year, supported by higher remittance inflows and rising wages among government employees as well as the private sector.[2] Government real consumption growth slowed compared with the previous year, but still grew by almost 8 percent as recurrent expenditures rose.

Growth in gross fixed capital formation declined from 10.5 percent in FY18 to 8.2 percent in FY19. The decline came from slower growth in private investment which fell from 8.8 percent in FY18 to 7.5 percent in FY19. This resulted in part from slower growth in bank credit and from reduced investment demand from the RMG sector, as a series of production facility upgrades came to completion.[3] Public sector investment growth rose by 10.4 percent with progress in the implementation of mega infrastructure projects such as bridges, roads, rail lines, power plants, and special economic zones.

A turnaround in net exports boosted domestic demand growth. The contribution of net exports to GDP growth reached 1.3 percentage points. The diversion of export orders from China appears to have boosted exports, which rose by 10.5 percent in FY19 compared with 5.3 percent in FY18. RMG exports, which accounted for 84 percent of the total, grew by 11.5 percent in FY19. Non-RMG exports also recovered from a decline in the previous year. The latter were led by agricultural products, pharmaceuticals and other manufacturing products. However, leather and leather products, the second largest source of export earnings after RMG, declined by 6 percent (see Box 1). Import growth decelerated significantly, driven by a decline in food and capital machinery imports.[4]

Box 1: Market Disruption in Leather Production

Although Bangladesh has produced leather goods since the 1970s, the sector has struggled to reach its output potential. Leather, leather products and leather footwear accounted for only 2.5 percent of total merchandise exports in FY19. Developing the leather industry is a high priority in Bangladesh's 2018-21 Export Policy. Bangladesh has potential to develop the sector along the entire supply chain as it produces and processes raw leather and manufactures leather goods and leather footwear.

Small seasonal traders traditionally purchase rawhides from the population during the Eid-ul-Adha period, when millions of cattle are slaughtered. Hides are sold to wholesalers who treat the hides and in turn sell them to tanneries for onward processing.

Tanneries were historically based in Hazaribagh, a densely populated neighborhood in Dhaka without modern effluent treatment facilities, resulting in the discharge of large volumes of toxic waste in the

[2] The index of nominal wages prepared by BBS increased 6.6 percent in FY19, outpacing inflation by 1 percentage points.
[3] Following the Rana Plaza building collapse in 2013, the RMG sector made significant investments in capital improvements to meet new safety standards and to upgrade facilities.
[4] Food imports declined because of bumper rice production. A decline in capital machinery imports reflected (in part) a decline in over invoicing which may have spiked prior to the national elections and a slow down in investment demand related to recently completed restructuring in garments.

Buriganga River. To address this environmental challenge, the tanneries were required to shift operations to Savar, a new location on the outskirts of Dhaka.

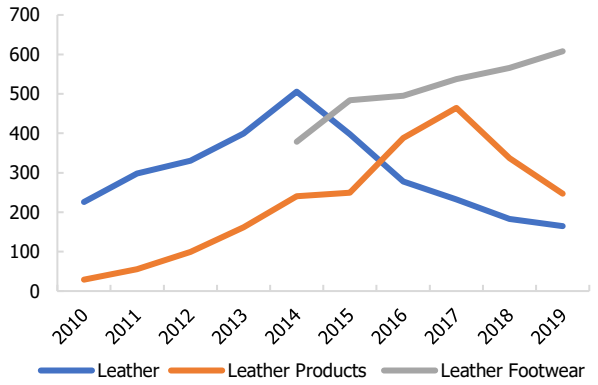
The long-planned move to Savar has faced significant implementation challenges. The Government is financing the construction of a Central Effluent Treatment Plant (CETP) which has been partially constructed but is not yet operational. A power plant required to burn CETP sludge has also not yet been adequately designed. Many tannery operations that relocated to Savar continue to produce untreated effluent, while only one producer has developed its own treatment facility.

Many large foreign buyers do not purchase leather products produced in Bangladesh because of non-compliance with international environmental standards. This has resulted in lower prices from buyers in China, a notable exception in purchasing Bangladeshi leather as an input into leather goods such as footwear.

Financial vulnerability has grown in the sector as tanneries required significant capital expenditure to relocate production to Savar, following a court order to halt production in Hazaribagh. Unable to finance the move, many smaller tanneries ceased operations. Wholesalers were also exposed to credit risk from these firms, as many tanneries do not make payment to wholesalers until their product is sold.

Trade tensions between the United States and China resulted in some disruption in the leather industry in Bangladesh in mid-2019. Reduced demand for leather in China led to a fall in export orders and prices (Figure 1). Combined with financial constraints faced by storage owners, this led to a collapse of demand for raw hides during the 2019 Eid period. Raw hide prices plummeted. Widespread anger with the price disruptions resulted in the destruction of large quantities of rawhides, as small sellers refused to accept exceptionally low prices. The government granted special permission to export wet blue rawhides to address the price disruption, but the measure came in too late to make an impact.

Figure 1: Leather Exports (USD millions)



Source: Export Promotion Bureau

Given the supply disruptions and non-compliance with environmental standards, manufacturers of leather products and footwear had to import higher-cost leather inputs from other countries. Although the industry has received tax incentives such as access to bonded warehouses and export subsidies, production and exports are declining.

Despite these recent challenges, the potential of the leather industry remains promising. Expansion of leather production will require operationalizing the CETP as soon as possible and encouraging producers to follow the path of the RMG industry in adopting international sustainability standards.

On the supply side, growth was driven by the expansion of the industrial sector. Industry is estimated to have grown by 13 percent in FY19, contributing 4.2 percentage points to growth. Industrial growth, led by manufacturing, has been in double digits for the last eight years. As export-oriented production of RMG, pharmaceuticals, and processed food expanded, manufacturing grew by a record 14.7 percent in FY19 and contributed 3.2 percentage points to

overall growth. Industries serving the domestic market, such as steel and cement, also expanded, benefiting from demand for construction materials from the mega projects. Construction grew by 9.6 percent, supported by public infrastructure spending as well as private investment in housing. The 31.3 percent share of industry in the total GDP of Bangladesh exceeds that of all countries in the South Asian region except Bhutan.

The service sector grew by 6.5 percent in FY19, contributing 3.25 percentage points to GDP growth. Service sector growth was supported by strong remittance inflows, increased export shipments and growing domestic consumption. These contributed to broad-based growth in services, led by an expansion in wholesale and retail trade, complemented by strong growth in transportation and financial intermediation services. Services accounted for 55.4 percent of GDP.

Agricultural growth fell to 3.5 percent in FY19. Slower agricultural growth was primarily attributable to the base effect of a bumper harvest in the previous year. A bumper rice harvest made a limited contribution to agricultural growth as it was the second consecutive year of high output. The growth in crops and horticulture, which accounts for 54 percent of total agricultural production, declined from 3.1 percent in FY18 to 1.75 percent in FY19. The share of agriculture in total GDP has declined over the years and stood at only 13.3 percent in FY19. However, agriculture continues to employ approximately 41 percent of the labor force and plays an important role in poverty alleviation.

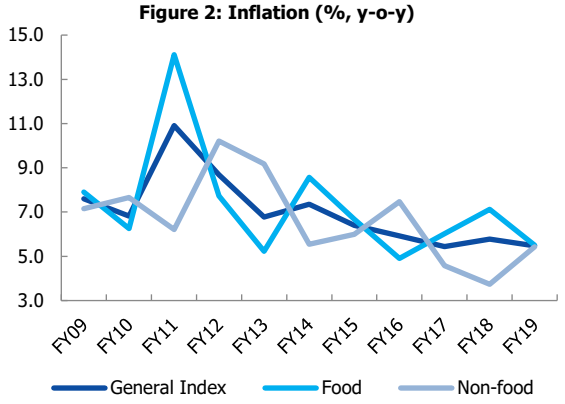
Growth in potential output has been driven by capital accumulation and total factor productivity (TFP) growth. Growth in capital accumulation has been slightly above 8 percent since FY15. This was maintained in FY19 with the capital stock growing by 8.7 percent. The estimated TFP growth has been around 3 percent, driven by reallocation of labor from lower-productivity agriculture to relatively higher-productivity manufacturing and services. The working age population has maintained a steady 1.8 percent growth in the past decade.

In FY19, headline inflation remained within the 5.5 percent target set by BB. Consumer Price Index (CPI)-based inflation declined slightly in FY19 to 5.5 percent from 5.8 percent a year ago (Figure 2).[5] The decline was primarily driven by food prices, which dropped to 5.5 percent in FY19 from 7.1 percent the previous year. Food inflation declined by 90 basis points in the first 7 months of FY19 as bumper boro harvests (the main rice crop) led to a sharp fall in rice prices in the second quarter of 2019. However, later in the year, monsoon floods reversed a part of the decrease in rice prices. Non-food inflation increased, reflecting a spike in the price of clothing,

[5] Among the large countries in South Asia, only Pakistan's 8.9 percent inflation exceeded Bangladesh's inflation in FY19. Inflation in Nepal was 4.6 percent, India 3.4 percent and Sri Lanka 2 percent.

footwear, transport and communication, and household equipment. Lower energy prices in the international markets in the recent past could not pass through to CPI, as domestic prices remained unchanged. Demand pull factors from the growing output gap (estimated at 1.4 percent of GDP in FY19) and cost push from the over 8.5 percent nominal wage increase in the industrial production sectors are likely to have driven the rise in non-food inflation.

Figure 2: Inflation (%, y-o-y)



Source: Bangladesh Bureau of Statistics

Monetary and Financial Sector

Broad money growth increased slightly. The growth in bank credit remained weak as private commercial banks breached the prudential cap on the advance-deposit ratio, limiting their lending capacity. State-owned banks face high non-performing loans and low capital adequacy, calling into question their ability to expand prudently. In addition, a weak supervisory enforcement compounds financial sector risk. Underdeveloped capital markets offer no alternative to the banking sector, remaining volatile and facing a persistent downward trend since early 2019.

Table 2: Monetary Program Performance
Y-o-Y Growth in Percentage

	FY17		FY18		FY19		FY20
	Target	Actual	Target	Actual	Target	Actual	Target
Net Foreign Assets	10.1	14.4	0.1	-0.8	-3.4	3.0	0.3
Net Domestic Assets	17.3	9.7	17.9	12.8	16.8	12.0	16.0
Domestic credit	16.4	11.2	15.8	14.7	15.9	12.2	15.9
Public Sector credit	16.1	-12.0	8.3	-0.5	10.9	19.1	24.3
Private Sector credit	16.5	15.7	16.8	16.9	16.5	11.3	14.8
Broad Money	15.5	10.9	13.3	9.2	12.0	9.9	12.5
Reserve Money	14.0	16.3	12.0	4.0	7.0	5.3	12.0
Inflation (end of period avg)	5.3-5.6	5.4	5.5	5.8	5.6	5.5	5.5
GDP	7.2	7.3	7.4	7.9	7.8	8.1	8.2

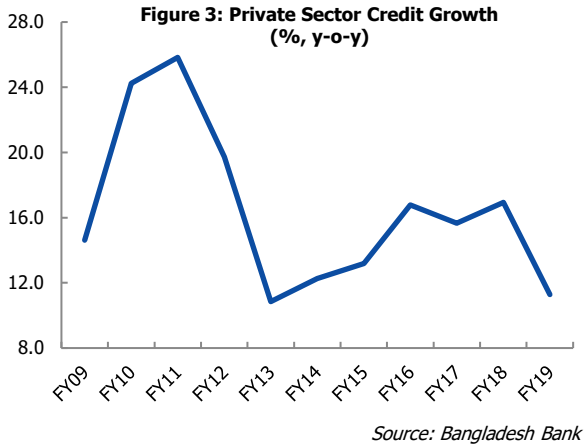
Source: Bangladesh Bank and Bangladesh Bureau of Statistics

Monetary outcomes remained below target. Reserve money growth increased marginally from 4 percent in FY18 to 5.3 percent in FY19.[6] The transmission of reserve money growth to broad money was dampened by a 10 percent increase in currency held outside banks. Broad money grew by 9.9 percent in FY19 but remained below BB's target of 12 percent. The increase was driven primarily by rising public sector borrowing from the banking system. Net foreign assets (NFA)

[6] Reserve money growth remained below the 10-year average of 16.5 percent and the BB Monetary Policy Statement (MPS) target of 7 percent as foreign exchange operations absorbed bank deposits.

also grew moderately in taka terms, largely reflecting valuation adjustments as the nominal BDT/USD exchange rate depreciated by 2.3 percent.

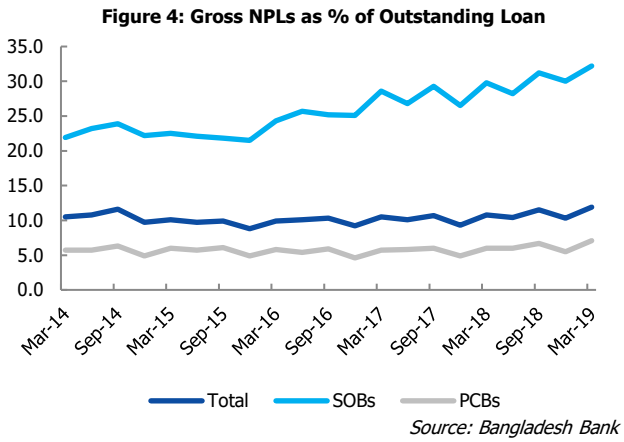
Private sector credit growth declined, constrained by banking sector liquidity. Private sector credit growth fell from 16.9 percent in FY18 to 11.3 percent in FY19 (Figure 3). The supply of loanable funds was constrained by declining deposit growth, US dollar sales by BB to moderate the exchange rate, pressure on banks to limit lending rates to 9 percent, and rising non-performing loans (NPLs). Bank deposit growth was weakened by a government directive to cap deposit rates at 6 percent, while NSCs interest rates remain in double digits. Deposit growth was 9.9 percent in June 2019, down from 10.3 percent a year ago. Depositor confidence may have been affected by the failure of some private banks to honor checks and by wide publicity on rising NPLs. As a result of BB dollar sales, reserves held with BB by the scheduled banks shifted from a BDT 164.6 billion surplus in June 2018 to an 81.3 billion shortfall by the end of June 2019. This further constrained liquidity in the banking system for expansion of credit.

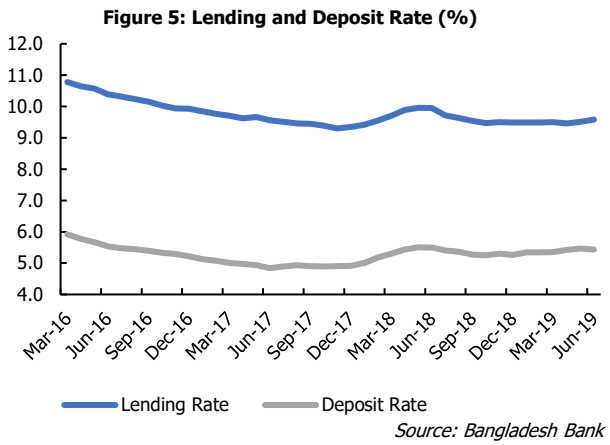


Efforts to comply with ADR requirements have limited the lending capacity of the commercial banks. To address banking sector risks, BB reduced the ADR requirement from 85.0 percent to 83.5 percent in 2018. However, the deadline for the implementation of the tighter criteria was repeatedly extended, as some banks struggled to attract deposits and reduce advances and the measure was reversed in September 2019. The ADR varied widely among key banking groups; it stood at 86.7 percent for the dominant PCBs. At SOBs, the ARD stood at just 60 percent, pointing to lower intermediation.

The increase in NPLs has persisted (Figure 4). The gross NPL ratio for the banking sector stood at 11.7 percent of outstanding loans in June 2019, up from 10.4 percent at the end of FY18.[7] NPLs are not evenly distributed – SOBs account for almost half of the total. The gross NPL ratio for SOBs is 32.2 percent (as of March 2019), a result of directed lending, poor risk management, and weak corporate governance and prudential oversight.

[7] There are concerns that the reported NPLs are underestimated considering significant under-provisioning, regulatory forbearance and legal loopholes.





Lending rates remained above 9 percent in FY19. In June 2018, the Bangladesh Association of Bankers (BAB), a forum of the owners of private commercial banks, directed member banks to fix the lending and deposit rates at 9 percent and 6 percent respectively. BB reiterated that this lending rate ceiling was to be adhered to, but banks have struggled to lower lending rates (Figure 5). Deposit growth has been constrained by the large interest differential between bank deposits (6 to 7 percent) and NSCs (11-12 percent). This differential disincentivizes the use of bank savings instruments and inhibits the development of capital markets.

Banks remain vulnerable. For the banking sector, the overall and tier 1 capital to risk-weighted assets ratio (CRAR) marginally exceeds internationally accepted minimum requirements. The latest stress test by BB (December 2018) indicates that credit concentration risk is a threat to capital adequacy. For example, the default of the top three large borrowers results in 22 out of 48 complying banks falling below the minimum regulatory CRAR.

BB has made several concessions in the loan classification rules and write-off policies. In February 2019, BB allowed banks to (i) write off loans that remain classified as bad debt for three years instead of the previous five years, subject to full provisioning; (ii) write off bad loans up to BDT 200,000 without filing any lawsuit instead of the previous threshold of BDT 50,000; and (iii) write off loans without keeping 100 percent provisions. In July 2019, additional measures were announced to ease standards of loan classification, rescheduling and restructuring. An application period for additional relief was opened, and the implementation date of the new measures has not yet been announced. The new classification rules and rescheduling terms include:

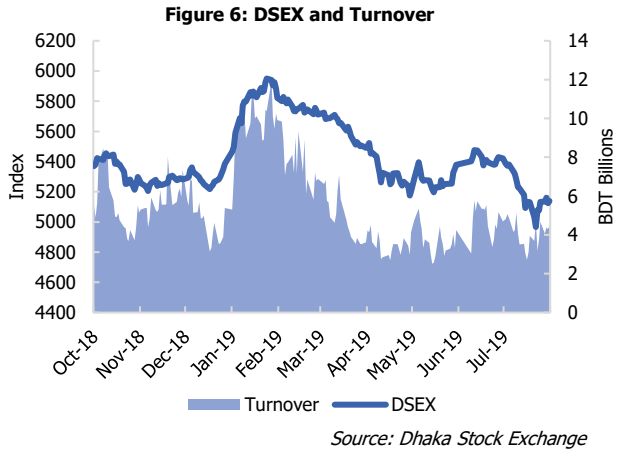
- **Classification:** Term loans will be considered sub-standard if no installments have been made for nine consecutive months, up from three months. Loans will fall under "doubtful" and "bad" categories if there is no payment of instalments for 12 months and 18 months respectively, up from six and nine months.

- **Rescheduling:** Defaulters will be allowed to reschedule loans by paying a 2 percent down payment, down from 10-50 percent.
- **Repayment Term:** Reduced to 10 years with a one-year grace period once rescheduled.
- **Interest Rate:** Capped at 9 percent compared with the current lending rate of 12 to 16 percent. Banks can also waive the interest accrued on defaulted loans after the defaulter fully repays the principal.
- **Rebates:** A 10 percent rebate for 'good borrowers' against the total amount of interest (or profit, in the case of Shariah-based Islamic banks). A borrower with no classified loan for four consecutive quarters and repaying all installments before September each year will be eligible for a rebate to be granted based on bank-client relationship.

BB urged banks to create a special monitoring cell to investigate large-scale loan defaulters. The cell will surveil defaulters with loans above BDT 1 billion and report to the central bank every quarter on the recovery progress of these loans. The management of the banks were asked to formulate a time-bound plan for realizing overdue loans.

Letters of Credit (LCs) issued by domestic banks are increasingly considered insufficient for trade transactions. Recent changes in prudential regulation of domestic banks are a departure from the global norms enacted in 2012 following the Basel III guidelines. This has affected the confidence of foreign suppliers on the ability of domestic banks to honor LC payment obligations. As a result, LCs issued by domestic banks commonly require confirmation by a correspondent bank to be acceptable by overseas suppliers, which has increased the financing cost of import transactions.

The domestic capital market remained volatile, with a recent downward trend (Figure 6). Post-election gains in the benchmark DSEX index were not sustained. The index rose ahead of the national budget in June. However, with no major policy incentives for retail or institutional investors, the decline continued in July, marking an overall decline of 17 percent from the January 2019 peak. Trading volume also declined from BDT 350 million in January to BDT 46.6 million in April. The number of new equity issues in 2019 has remained low, and the credibility of financial information of one of the three initial public offerings has been questioned by market participants.



Changes in the Finance Act 2019 are expected to have mixed results on corporate finance. To encourage distribution of cash dividends by listed companies, the Act introduced an additional 10 percent tax on retained earnings above 70 percent of net profit after tax. Stock dividends that exceed cash dividends will also be subject to a 10 percent tax. These measures are expected to benefit shareholders seeking a moderate, stable income from investments in adequately-capitalized companies. However, the measures may have negative consequences for firms seeking to expand their capital base, including growth-oriented firms. Financial institutions struggling to raise capital and improve liquidity may also be negatively affected by the changes.

External Sector

The balance of payments was slightly positive in FY19. The current account deficit narrowed to 1.7 percent of GDP as the trade and services account deficits fell and remittances rose. The financial account surplus fell to USD 5.6 billion in FY19 from USD 9.0 billion a year ago as rising FDI was offset by a sharp increase in net trade credit outflows.

Table 3: Balance of Payments
USD million

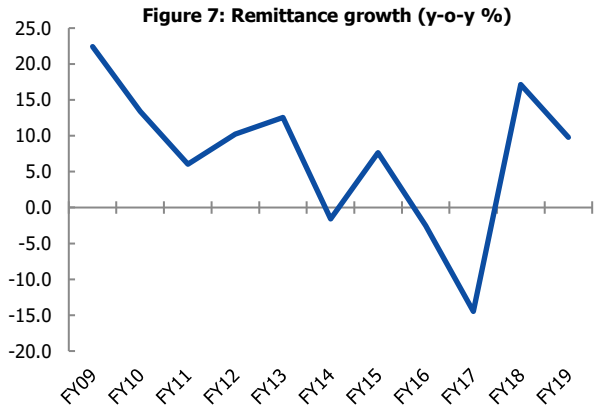
	FY15	FY16	FY17	FY18	FY19
Overall Balance	4,373	5,050	3,169	-857	12
Current account balance	2,875	4,262	-1,331	-9,567	-5,254
Trade balance	-6,965	-6,460	-9,472	-18,178	-15,494
Merchandise export f.o.b. (inc. EPZ)	30,697	33,441	34,019	36,285	39,945
Merchandise import f.o.b. (inc. EPZ)	-37,662	-39,901	-43,491	-54,463	-55,439
Services	-3,186	-2,708	-3,288	-4,201	-3,715
Income	-2,869	-1,915	-1,870	-2,641	-2,930
Current transfers	15,895	15,345	13,299	15,453	16,885
Official	75	67	59	51	23
Private	15,820	15,278	13,240	15,402	16,862
o/w Remittances	15,170	14,717	12,769	14,982	16,420
Capital account	496	478	400	331	233
Financial account	1,925	944	4,247	9,011	5,628
Foreign direct investment (net)	1,830	1,285	1,653	1,778	2,540
Portfolio investment (net)	379	139	457	349	172
MLT loans (excludes supplier credit)	2,472	3,033	3,218	5,987	5,954
MLT amortization payments	-910	-849	-895	-1,113	-1,202
Other long-term loans (net)	-35	-110	-153	141	666
Other short-term loans (net)	-105	-435	1,030	1,508	209
Trade Credit (net)	-2,508	-2,101	-1,185	-1,270	-2,903
Commercial Bank	802	-18	122	1,631	192
Errors and omissions	-923	-634	-147	-632	-595

Source: Bangladesh Bank

The current account deficit narrowed in FY19, as the trade and services deficits fell, and remittances rose. The trade deficit fell to USD 15.5 billion in FY19 from USD 18.2 billion a year ago. Merchandise import growth dropped sharply to 1.8 percent in FY19 after surging by 25.2

percent in the previous year. Merchandise export growth increased from 6.7 percent in FY18 to 10.1 percent in FY19. The dynamics in the trade balance were primarily driven by declining food imports and rising RMG, pharmaceutical and agricultural exports. The receipts from services exports increased by 49.5 percent led by transportation, travel, telecom, and business services. Payments for services increased by 20.1 percent, reducing the services account deficit from USD 4.2 billion in FY18 to USD 3.7 billion in FY19. The rise in official interest payments was more than offset by the USD 1.4 billion increase in remittances in FY19 relative to the previous year.

Remittance inflows grew by 9.8 percent (Figure 7), reaching a record USD 16.4 billion. Over 77 percent of the total remittance increase in FY19 came from the Gulf Cooperation Council (GCC) countries. Inflows from Saudi Arabia, the largest source of remittances for Bangladesh (18.9 percent of the total), grew by 20 percent in FY19 while inflows from the United States declined. The 5.6 percent increase in the total number of Bangladeshis working abroad, a modest 2.3 percent nominal currency depreciation and increasing use of formal channels for transfers has supported the growth in remittances.

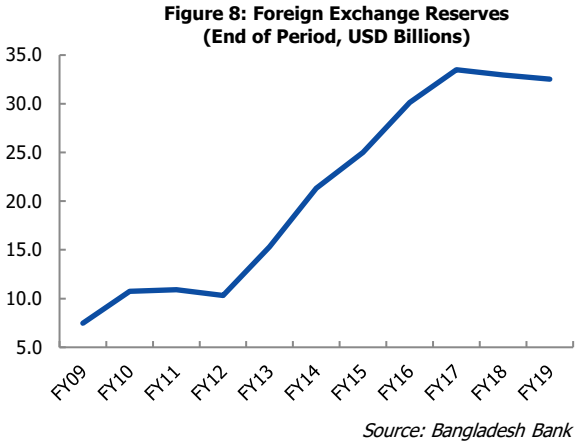


Source: Bangladesh Bank

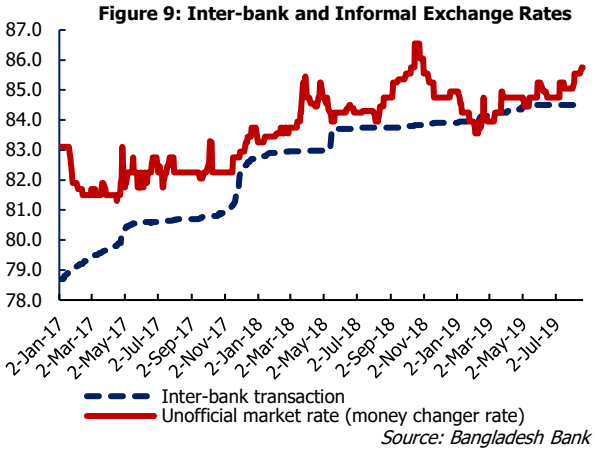
Net foreign direct investment (FDI) increased by 42.9 percent in FY19 from a low base. The major recipient sectors included power, food and textiles and the main investors were from China, UK, the Netherlands and South Korea. FDI has been supported by the establishment of economic zones,[8] and stable political conditions. However, Bangladesh remains behind competitors such as Vietnam, where FDI averaged 6.0 percent of GDP in the last five years compared to 0.7 percent in Bangladesh. Slow progress in infrastructure development, limited access to credit, high interest rates, and a complex regulatory regime remain the key challenges. Foreign portfolio investment remained at very low levels.

[8] 88 economic zones have been approved in the government, non-government and G2G systems in different parts of the country to date. USD 15.8 million of investment proposals have been received in the economic zone areas, USD 12.5 billion of which has been approved by BEZA.

Gross reserves declined modestly. Foreign exchange reserves declined modestly to USD 32.5 billion at the end of FY19 (5.8 months of import cover)[9] as rising exports and strong remittances offset foreign exchange interventions. With a strengthening US dollar, BB sold USD 2.3 billion in the foreign exchange market in FY19 to stabilize the BDT/USD exchange rate. Total US dollar sales in the last two years amounted to USD 4.65 billion, almost double the amount sold in the preceding 7 years combined.



The BDT/USD rate depreciated moderately while the real effective exchange rate (REER) appreciated by 5.6 percent. The average nominal interbank BDT/USD exchange rate rose from 82.13 in FY18 to 84.03 in FY19. However, the taka appreciated against the euro (from 97.78 to 94.77) and the pound sterling (110.36 to 107.51) over the same period. The average nominal effective exchange rate appreciated slightly to 97.6 in FY19. Exchange rate interventions have supported convergence of the interbank and informal rates. Interventions have kept the inter-bank exchange rate within a narrow BDT 83-85 per USD range over the past two years, significantly weakening the incentive to remit money through informal channels (Figure 9). However, the use of a crawling peg to the US dollar led to appreciation of taka against the currencies of other important trading partner currencies. Consequently, the REER appreciated, leading to a loss of price competitiveness internationally, particularly when combined with relatively low productivity and high inflation. The RMG sector has been provided with cash subsidies which have offset this competitive disadvantage. However, in non-RMG sectors, which do not have such easy access to the export incentive regime as RMG, export growth and investment have lagged. In addition to the negative effects on competitiveness, foreign exchange interventions have contributed to the taka liquidity shortage in the money markets.



[9] Reserve coverage of a minimum 3 months of imports is considered adequate under IMF methodology in the case of Bangladesh.

Fiscal Sector

Domestic revenues rose modestly to 10.3 percent of GDP while expenditures increased to 14.8 percent of GDP, led by continued execution of a large program of infrastructure investments. The FY19 fiscal deficit at 4.6 percent of GDP remained almost at last year's level and within the budget target of 5 percent. The stock of public debt remains low at 32.8 percent of GDP and Bangladesh continues to be at low risk of debt distress.

Table 4: Fiscal Outcomes

	FY15	FY16	FY17	FY18	FY19e
	(Taka in Billion)				
Total Revenue	1,459.7	1,729.5	2,012.1	2,165.6	2,605.1
o/w Tax Revenue	1,288.0	1,518.9	1,780.8	1,943.3	2,334.9
Total Expenditure	2,043.8	2,384.3	2,695.0	3,218.6	3,763.5
o/w Current Expenditure	1,189.9	1,444.3	1,644.9	1,788.8	1,901.79
o/w ADP	603.8	793.5	840.9	1,195.4	1,583.7
Deficit	-584.2	-654.8	-682.9	-1,053.1	-1,158.4
Net External Financing	72.3	147.4	123.0	264.9	458.7
Net Domestic Financing	511.7	507.3	559.9	788.2	699.7
o/w Non-Bank Borrowing (Net)	506.6	401.2	643.6	670.8	499.4
General Government Debt Stock	4,819.3	5,455.2	6,083.2	7,185.8	8,318.7
External	1,856.4	2,058.9	2,346.7	2,751.3	3,170.2
Domestic	2,962.9	3,396.3	3,736.5	4,434.5	5,148.4
	% of GDP				
Total Revenue	9.6	10.0	10.2	9.6	10.3
o/w Tax Revenue	8.5	8.8	9.0	8.6	9.2
Total Expenditure	13.5	13.8	13.6	14.3	14.8
o/w Current Expenditure	7.9	8.3	8.3	7.9	7.5
o/w ADP	4.0	4.6	4.3	5.3	6.2
Deficit	-3.9	-3.8	-3.5	-4.7	-4.6
Net External Financing	0.5	0.9	0.6	1.2	1.8
Net Domestic Financing	3.4	2.9	2.8	3.5	2.8
o/w Non-Bank Borrowing (Net)	3.3	2.3	3.3	3.0	2.0
General Government Debt Stock	31.8	31.5	30.8	31.9	32.8
External	12.2	11.9	11.9	12.2	12.5
Domestic	19.5	19.6	18.9	19.7	20.3

Source: Ministry of Finance
Note: e -World Bank staff estimation

As in previous years, revenues fell short of budget targets. Total revenues at the end of FY19 are estimated at BDT 2,605.1 billion, about 76 percent of the original budget target. Overall revenues reached 10.3 percent of GDP while tax revenues reached 9.2 percent of GDP in FY19. Slowing imports together with various tax concessions limited tax revenue growth. Exemptions provided in FY19 included a tax holiday for asset managers, various ad hoc waivers of taxes on imports, expanded tax incentives for the RMG sector and high-tech firms, and exemptions for natural gas imports from VAT. Current data on the cost of tax expenditures is not available. As the economy transitions from agriculture to industry and services, the accessible tax base should

be rising. However, revenues remain among the lowest in the world, constraining financing available for public investment in infrastructure and human development.

Total government expenditure increased to 14.8 percent of GDP in FY19, 0.5 percentage points higher than the previous year. Current expenditures rose by 38.5 percent due to increased payments on subsidies, staff pay and allowances, employment related social transfers and higher interest payments on NSCs. In the revised FY19 budget, BDT 212 billion in cash loans and subsidies were planned, almost 250 percent higher than FY18. The Bangladesh Power Development Board (BDBP) is expected to be the largest recipient of the cash loans at BDT 92 billion, as the government continues to provide high-cost electricity at subsidized rates. Higher imports of LNG also resulted in a subsidy of BDT 45 billion in FY19.

Capital expenditures continued to rise, driven by spending on the government's large infrastructure projects. Annual Development Program (ADP) expenditure rose from 4.3 percent of GDP in FY17 to 6.2 percent in FY19. The execution of the ADP budget reached 91.5 percent of the original allocation in FY19**.** The higher ADP spending was primarily facilitated by simplifying the fund release process. Project directors have been authorized to release project funds for all four quarters without additional approvals from Finance Division or the line ministries. Together with the introduction of the ibas++ digital platform in all ministries, these were expected to smoothen the fund release process and enable more transparent management. However, as in previous years, spending accelerated at the end of the fiscal year with 27.1 percent of the ADP allocation spent in the final month.

Public investment management (PIM) remains a challenge. The ADP continues to be overloaded with too many projects while time and cost overruns remain ubiquitous. Among the ten fast track mega projects, only the floating LNG Terminal has been completed. Although the pace of implementation has picked up, the deadline for the completion of Padma Bridge, the largest among all the projects, may be extended again. The eagerly awaited Dhaka metro rail project is behind schedule. The Sonadia Deep Sea Port has been put on hold and the main work of the Cox's Bazar-Ramu-Dohazari trail track project has not started. The remaining six projects[10] are at different stages of implementation (with 15 to 60 percent completed). These projects reflect recurrent PIM challenges, including procurement delays, startup delays after the tendering process and inadequate project management.

The fiscal deficit was 4.6 percent of GDP in FY19.[11] NSCs[12] were the primary source of domestic financing of the deficit, the sale of which exceeded the FY19 budget target by 11 percent. In

[10] These include: Dhaka Mass Rapid Transit Development Project known as Metro
Rail project, Ruppur Nuclear Power Plant, Matarbari Coal-Fired Power Project, Moitri Super Thermal Power Project, Deep Seaport at Paira, Patuakhali and Padma Bridge Rail Link project.
[11] This is a highly provisional estimate as a consistent set of revenue, expenditures and deficit financing data is not yet available.
[12] NSCs are a domestic instrument providing above-market yields to targeted groups

addition, the government also borrowed significantly from banks. The use of concessional external loans also increased in FY19, raising net external financing to 1.8 percent of GDP, up from 1.2 percent in the previous year.

Overall public debt is estimated at 32.8 percent of GDP in FY19. The overall level of public debt in Bangladesh remains modest by international standards. External public debt has historically been driven by favorable growth and current account dynamics. The share of external financing has risen with an increase in externally-financed infrastructure projects in recent years. However, 56 percent of public debt is domestic, of which over 50 percent consists of NSCs.

State-owned enterprises (SOEs) constitute the most significant source of contingent liabilities. SOEs made a loss in FY19, breaking the profit-making trend of the previous five years. The Bangladesh Petroleum Corporation made a profit attributable to a growing differential between lower oil prices and fixed domestic prices. However, the BPDB, Bangladesh Sugar and Food Industries Corporation, Bangladesh Chemical Industries Corporation, Bangladesh Jute Mills Corporation and others contributed to a net loss of BDT 43.24 billion, as estimated in April 2019 by the Ministry of Finance. Outstanding government guarantees to the SOEs amounted to USD 6.3 billion, constituting about 7 percent of the outstanding domestic and external public debt.

Total public debt, including the explicit guarantees, remains sustainable. The just published joint World Bank-IMF Debt Sustainability Analysis suggest a low overall risk of debt distress.[13] Revenue-based indicators show a slightly increasing trend while external debt indicators remain below the baseline and stress test scenarios. There is however no reason for complacency. Favorable debt dynamics in these scenarios depend crucially on the sustainability of the assumed 7 plus percent GDP growth underpinning the projected path of primary fiscal deficit and the external current account deficit. Sustainable financing for infrastructure and human development investments will require stronger revenue mobilization, improved external competitiveness and judicious selection of external and domestic financing instruments.

[13] See IMF, Bangladesh: Staff Report for the 2109 Article IV Consultation, September 2019.

Outlook and Risks

Growth is likely to continue at more than 7 percent, driven by manufacturing. Macroeconomic stability is expected to be sustained with less than 6 percent inflation and modest increases in the twin deficits. Increasing potential output through structural reforms will be critical for achieving Bangladesh's development aspirations in the medium and long-term. Downside risks include financial sector vulnerability, reform reversals, fiscal pressures and loss of external competitiveness.

Outlook

Slower growth is forecast in Bangladesh's major export markets.[14] The global growth forecast for 2019 was revised downward by 0.3 percent to 2.6 percent and is forecast to remain tepid at 2.7 percent in 2020 and 2.8 percent in 2021. Euro area growth is projected to fall from 1.8 percent in 2018 to 1.4 percent in 2020 while growth in the United States, growth is forecast to decline from 2.9 percent in 2018 to 1.7 percent in 2020. With a weaker growth outlook, major central banks shifted from tightening to easing, resulting in more accommodative financial conditions. Weakening demand in developed economies has dampened trade and investment growth.

Emerging market and developing economies (EMDEs) will benefit from softer financing conditions. While EMDE growth was revised downwards to 4.0 percent in 2019 (a reduction of 0.3 percent), it is expected to recover to 4.6 percent in 2020 and 2021 barring an expansion of trade restrictions. Pressure eased in countries with external financing needs, as US and European monetary policy has been more accommodative than previously forecast. Investment growth remains weak in EMDE countries affected by recent global pressures such as sanctions, financial stress, or cuts in oil production. In South Asia, regional growth is projected to remain around 7 percent, with strong growth in private consumption and a gradual pick-up in investment.

Inflation and commodity prices are likely to remain stable. Industrial commodity prices recovered in the first half of 2019 while agricultural prices were little changed. Crude oil averaged USD 64 per barrel during this period, rising from 2018 lows as major producers reduced output. Oil prices are forecast to rise modestly given the recent geopolitical tensions and production disruptions in Saudi Arabia. High agricultural yields were sustained in the first half of 2019, particularly wheat output. Agricultural prices are forecast to fall in 2019 before stabilizing in 2020. Stable commodity prices supported moderate inflation in South Asia in 2019, with the exception of Pakistan.

Bangladesh is likely to maintain GDP growth above 7 percent over the medium term, although risks are rising. Output growth will be supported by strong macroeconomic fundamentals, faster implementation of public investments in megaprojects, continued movement of labor away from

[14] Based on World Bank, Global Economic Prospects, June 2019

low productivity sectors in agriculture, higher domestic demand aided by remittances, and continued export growth as production shifts from China. Private investment may rise if the ongoing business climate reforms begin to produce improvements in services to investors and the expected operationalization of new economic zones materialize. At the same time, a challenging global outlook may reduce aggregate demand in Bangladesh's main export markets, putting export growth under pressure. Similarly, the growth of remittance inflows may be negatively impacted if economic conditions deteriorate in Saudi Arabia, the UAE, and the United States.

Table 5: Selected Macroeconomic Indicators
(annual percentage change, unless indicated otherwise)

	FY16	FY17	FY18	FY19e	FY20f	FY21f
Real GDP growth, constant market prices	7.1	7.3	7.9	8.1	7.2	7.3
Private Consumption	3.0	7.4	11.0	5.4	6.2	6.4
Government Consumption	8.4	7.8	15.4	8.0	8.1	10.6
Gross Fixed Capital Investment	8.9	10.1	10.5	8.2	9.1	8.7
Exports, Goods and Services	2.2	-2.3	8.1	14.9	8.0	8.3
Imports, Goods and Services	-7.1	2.9	27.0	4.8	8.1	8.5
Real GDP growth, constant factor prices	7.2	7.2	7.9	8.3	7.2	7.3
Agriculture	2.8	3.0	4.2	3.5	3.0	3.1
Industry	11.1	10.2	12.1	13.0	9.0	10.0
Services	6.2	6.7	6.4	6.5	7.0	6.5
Inflation (Consumer Price Index)	5.9	5.4	5.8	5.5	5.9	5.7
Current Account Balance (% of GDP)	1.9	-0.5	-3.5	-1.7	-2.0	-2.2
Net FDI (% of GDP)	0.6	0.7	0.6	0.8	0.8	0.8
Fiscal Balance (% of GDP) 1/	-3.7	-3.4	-4.7	-4.4	-4.8	-4.7
Debt (% of GDP)	31.5	30.8	31.9	32.8	33.8	34.8
Primary Balance (% of GDP) 1/	-1.8	-1.6	-2.8	-2.5	-2.6	-2.4

Source: World Bank staff estimation; Bangladesh Bureau of Statistics; Bangladesh Bank, Ministry of Finance
1/Including grants
f=forecast; e=estimated

Inflation is projected to rise modestly in Bangladesh with increased natural gas prices, possible crop production losses due to the recent floods and the growing output gap. BB Monetary Policy for FY20 seeks to contain CPI inflation at 5.5 percent. The repo and reverse repo rates have been maintained at 6.0 and 4.75 percent respectively. The broad money (M2) growth target has been raised slightly to 12.5 percent while the domestic credit growth target remains unchanged at 15.9 percent. The private sector credit growth target has been revised down by 1.7 percentage point to 14.8 percent.

A modest increase in the current account deficit is likely as investment-related import growth is likely to outweigh export and remittance growth. FDI is expected to be sustained, supported by regulatory reforms, infrastructure developments and stable political conditions. Reserve coverage is likely to remain adequate. Given the high share of concessional borrowing, the risk of external debt distress continues to be low. The authorities should continue to rely on

concessional financing to the extent possible for externally-financed infrastructure spending. In addition, a gradual increase in exchange rate flexibility (by limiting interventions in the foreign exchange market) will help sustain the foreign exchange reserves, buffer the economy against external shocks and increase monetary policy autonomy.

The fiscal deficit is expected to persist in Bangladesh. Revenue underperformance together with increased spending on subsidies (on exports, remittances and LNG) and megaprojects is likely to increase the fiscal deficit in FY20. Subsidies were recently expanded, including a 2 percent subsidy on remittances and an additional 1 percent cash subsidy on RMG exports (in addition to a 2-4 percent subsidy for various categories of garment exports). Public debt was 32.8 percent of GDP at the end of FY2019, with a low risk of debt distress. Tax policy reform remains incomplete, including reviewing tax expenditures, broadening the tax base, reducing trade protection, and implementing a modern VAT. A lack of progress in modernizing tax administration may result in revenue shortfalls while higher spending and donor fatigue for the Rohingya response could add to fiscal pressures. Contingent liabilities from high NPLs in State-owned banks (SOBs) as well as losses from SOEs could result in higher debt.

Tax policy changes introduced in the 2019 Finance Act may not support medium-term revenue objectives. Recent changes to VAT legislation represent a missed opportunity to raise additional revenues, streamline administration, reduce compliance costs and eliminate trade barriers (see Box 2). A reduction in the corporate tax rate and structure simplification have not been addressed, while tax holidays have been extended. The Advance Income Tax on exports has remained at 0.25 percent even though it was supposed to end in FY19. Reform of the tax surcharge may not produce significant revenue yields. Increases in the taxable price base across all tobacco market segments and Supplementary Duty (SD) of 30 to 35 percent on all tobacco products are steps in the right direction.[15] An additional 5 percent SD on mobile phones will yield revenues but increase the cost of doing business. An upward adjustment of the tax-free ceiling for dividend income is supportive for the share market but represents a significant tax expenditure.

Box 2: VAT Revisions – Additional Rates, Additional Complexity

Bangladesh intended to modernize its Value-Added Tax (VAT) under the VAT Act (2012). This law targeted a 15 percent standard rate with input credit for firms along the value chain – a standard feature of VAT. The 2012 law also required the introduction of an automated VAT system at the National Board of Revenue (NBR) to match taxpayer declarations and input credit claims. To administer the VAT more effectively, NBR planned to transition from a geographic structure to a function-based organizational structure for VAT, in line with good international practice.

This type of VAT implementation would have several advantages. The administrative reforms would reduce compliance costs for taxpayers while raising VAT revenues through stronger controls. The

[15] However, NBR must ensure consistent enforcement against illicit brands because price increases in low segments will increase the pricing gap with illicit brands.

automated system would allow for the introduction of electronic fiscal devices to reduce fraud. Since a single VAT rate with deductible input credits creates no advantages for vertical integration along the value chain, Small and Medium Enterprises (SMEs) would not be disadvantaged against integrated conglomerates. The VAT would also replace supplementary duty on imported products, reducing distortions by applying the same consumption tax rate on domestic and imported goods.

However, implementation of the 2012 VAT law was repeatedly delayed under pressure from various stakeholders. Some progress has been made on the development of the automated VAT system, but implementation is incomplete. Proposed changes to the NBR organizational structure were not implemented.

In mid-2019, the government announced significant changes to the VAT Act (2012), taking effect from July 1, 2019. Revisions to the law will result in a complex and distortionary VAT implementation. The single 15 percent rate has been modified to a series of rates (5 percent, 7.5 percent, 10 percent and 15 percent) and two special rates on pharmaceuticals (2.4 percent) and petroleum products (2.0 percent). An additional 5 percent advance tax on imports and an expanded schedule of additional tax for certain protected goods was also introduced.

With these changes, the VAT will continue to incentivize integrated production. Manufacturers will have the option of applying a 10 percent rate with no input credit or a 15 percent rate with input deductions allowed. Products with the non-deductible rate would not be admissible for deduction as inputs further along the value chain. For example, an SME applying the 15 percent VAT rate purchasing goods from a manufacturer applying the 10 percent rate cannot deduct VAT on inputs and will face a cascading tax.

Limited administrative capacity is likely to be a significant challenge to the effective management of this complex new regime. Further study of the new VAT regime will be required to understand the implications of the multiple rates and optional rates. However, in the absence of a functional electronic receipting system, efficiency challenges are likely to continue or worsen.

Risks

Downside global risks remain elevated in the context of trade tensions and policy uncertainty. The challenging policy environment has resulted in higher uncertainty in global growth forecasts. The probability of growth falling at least 1 percentage point below projections in 2020 is estimated at 20 percent.[16] Escalating trade tensions in major economies may continue to weigh on confidence and investment while reducing trade flows. Policy uncertainty from a no-deal Brexit also poses risks of trade disruption and economic contraction. Global financial sector risks are tilted to the downside. Debt levels have risen, particularly lower rated corporate issuances. Rising default rates could result in a rapid deterioration of market sentiment. Capital flows could be disrupted by shifting expectations of monetary policy in EMDEs, which also face currency depreciation risks. Sovereign exposure to the financial sector has also risen, particularly in EMDEs. Geopolitical tensions escalated recently, with the attack on Saudi oil facilities.

[16] World Bank, Global Economic Prospects, June 2019, Page 32.

In Bangladesh, downside risks are primarily domestic. There could be a loss of competitiveness through exchange rate appreciation because of BB's interventions in the forex market to stabilize the BDT/USD rate. Higher inflation remains a risk in the context of growing domestic demand and higher public expenditure. In the financial sector, high NPLs and stock market volatility remain risks. Weak governance in the banking sector could impair its capacity to extend credit and support growth if the economy slows down. Liquidity pressures may be exacerbated by additional government borrowing from domestic banks. A further deterioration in the financial health of SOBs could undermine the fiscal balance. Reform reversals such as easing of loan classification standards, ceilings on lending rates, reduced autonomy of BB and the state-owned non-financial corporates, increases in untargeted subsidies and ad hoc changes in taxes and fees through nontransparent processes pose additional risks.

External risks are rising, although Bangladesh may benefit from trade diversion in the short-term. Tariff escalation by the US against China may provide a further boost to exports in the short run if Bangladesh can capture some of the trade diversion. The overall impact from global trade conflicts will depend on further developments. With the exception of the RMG sector, the positive impact of trade diversion from China could be relatively small given Bangladesh's limited integration in the global supply chain. However, recession in European and US export markets and appreciation of Bangladesh's real exchange rate would adversely impact export demand and competitiveness. Recent developments in the gulf region could impact remittance inflows to Bangladesh.

Policy Challenges

Managing risks will require prudent monetary policy. Monetary policy announced in July 2019 seeks to contain inflation while achieving growth objectives. However, monetary policy transmission through policy rates remains a challenge given the prevalence of non-market NSC instruments for government borrowing. The MPS acknowledged potential risks arising from the destruction of crops due to floods, inflation related to the cascading effects of the VAT law, inflationary expectations and international trade and geopolitical disputes. Close monitoring of inflation will be critical to maintain an appropriate stance.

The medium-term fiscal stance is prudent. The FY20 budget maintains an overall deficit target of 5 percent of GDP. Domestic sources will provide financing of 2.7 percent of GDP with the remainder financed by foreign sources. The deficit target does not create any additional risk of debt distress, given Bangladesh's low public debt-to-GDP ratio.

More revenues are required to create additional fiscal space. Revenue mobilization is likely to remain limited unless tax policy is adjusted to increase the tax base and reduce exemptions. Achieving the revenue target will depend critically on the planned expansion of the income tax

base from the current 2.1-2.2 million people. This in turn will depend on progress in tax administration reforms, particularly in automation.

Managing increased recurrent expenditures will be a fiscal policy challenge. With an increase in pay and allowances, pensions and gratuities, and grants-in-aid outpacing revenue growth in recent years, some of the proposed increases in subsidies risk reducing fiscal space because of their stickiness or irreversibility. The expansion of the subsidies on remittances and RMG exports poses challenges and further consideration should be given to this reform. Some limited exceptions may be justified on grounds of inclusion, such as agricultural subsidies targeted to small and marginal farmers.

As fiscal space is limited, the efficiency of public investment expenditures is critical. Given the limited public resource envelope, focus should be renewed on improving expenditure outcomes in the ADP. The allocation of development expenditures by sectors is generally consistent with the country's development priorities. Adequate provisions for transformative projects such as the Padma bridge and Metro Rail Transit in Dhaka are reassuring. Increased spending on the development of rural infrastructure will support progress on poverty reduction and shared prosperity. However, implementation speed and efficiency remain key challenges. The ADP continues to be overloaded with too many projects while time and cost overruns remain ubiquitous. Accountability of the implementing agencies for delivering completed projects needs strengthening.

Increased government borrowing from banks may negatively impact the private sector. The FY20 Budget aims to reduce dependence on NSCs and increase reliance on bank borrowing, a desirable shift in the composition of domestic financing. However, excess liquidity in the banking system has shrunk considerably. Increased bank borrowing by the government in such a situation will increase the risk of crowding out the private sector with adverse effects on private investments. This can be avoided by ensuring increased use of concessional external financing and, more importantly, resolving the non-performing loan problem in the banking system.

In the financial sector, the resolution of fragile banks and regulatory reform are near-term priorities. A comprehensive asset quality review (AQR) should be undertaken to understand the true extent of NPLs and the capital shortfall of the SOBs. NPL resolution may require mandatory write-offs and other resolution tools as well as consolidation and reform of the SOBs. Reform will require an emphasis on focused mandates and improvements in corporate governance, internal controls, risk management and underwriting standards; and an upgrade of supervision, regulation and compliance. The ADR limits on commercial banks should be strictly enforced.

To support growth over the longer-term, the pace of structural reforms needs to increase. Boosting investment in the private sector and employment generation for millions of unemployed

youth are two key priorities. Improvements to the business climate are required to support domestic and foreign investment, particularly the predictability of regulation. Concerns about increasing corruption and harassment in service delivery are pervasive across households and businesses alike. Improved economic governance remains a key prerequisite for building on and sustaining Bangladesh's recent socio-economic achievements. Addressing youth employment will require investment in skills development for the next generation, creating the conditions for a transformation from RMG exports to a broader export base.

Reform implementation will require managing competing interest groups. Reduced trade protection is required to shift incentives towards labor-intensive export activities and away from highly protected capital-intensive industries with high-wage organized labor. While such a shift is likely to improve job creation and income distribution, it is bound to be resisted by forces benefiting from the status quo. Dialogue is required to demonstrate the benefits and to generate necessary support, while establishing a fiscally sustainable safety net for those negatively impacted. Adequately targeting safety nets is essential in the context of limited fiscal space.

To influence investment decisions, reform implementation must be credible. Economic restructuring can succeed only if investors believe that the reforms are enduring and will not be reversed. Investors will not take long term decisions in response to new policy signals if they are not convinced that the reforms will be sustained. A faster pace of reform could add to credibility by demonstrating momentum, while rigorous assessment of successful reforms in sectors such as banking, telecommunication and energy will strengthen conviction.

Trade policy reform will be more effective if business climate and infrastructure constraints are addressed. As the Ease of Doing Business indicators show year after year, Bangladesh suffers from excessive regulation of individual sectors which are of special importance for economic performance such as telecommunications, roads, ports and power generation, transmission and distribution. It is important to implement sector specific deregulation to maximize efficiency gains and to attract private investment to ensure rapid expansion in the future.

Continued investment in human development is a foundation for economic transformation. Bangladesh has lagged the OECD, Latin America and Asia in expenditure on education, health care, and social protection. The budget for education as a share of GDP increased to 2.1 percent in FY19 while expenditure on health has consistently been below 1 percent of GDP. Social safety net expenditures, excluding pension for public sector, declined from 2.1 percent of GDP in FY11 to 1.6 percent in FY19. Increasing expenditure on education, health and social protection will also require strengthening the capacity to spend. These sectors should be prioritized over unproductive expenditures elsewhere. The special focus section of this report addresses the role of tertiary educational institutions in developing the skills that will be required as Bangladesh moves towards upper-middle income status.

Tertiary Education and Job Skills

Higher labor productivity will be essential to diversify the economy beyond garment exports and remittances. Demand for high-level skills is growing, but supply is constrained. To harness the benefits of Bangladesh's growing labor supply, investments in human capital are required. Key challenges include inadequate resources for skills training, access barriers for low income groups and females, absence of public funding mechanisms that incentivize production of market relevant skills; and lack of an effective regulatory and accountability framework.

Skills Development and Economic Growth

Sustaining economic growth in Bangladesh will require a transition to a high-productivity economy. Bangladesh reached lower middle-income country status in 2015, with one of the fastest declines in child and infant mortality rates among developing countries. It attained near universal access to primary education, achieved gender parity in access at the primary and secondary levels, and improved access to tertiary education for both males and females. However, the demographic bulge in the youth population is expected to last for another two decades, with around two million youth joining the labor force every year.[17] Sustained socio-economic growth will require transitioning from a *low-productivity and low-wage* model to a *high-productivity and high-wage* model. In addition to investment in physical capital, human capital accumulation is required to build the skills of the workforce to meet the demands of the present and future jobs. A shortage of domestic skilled labor has increased reliance on imported skilled labor in apparels, real estate, textiles, telecommunication, information and technology sectors. Outward remittances from these workers erodes inward remittances received from low skilled Bangladeshi workers abroad.[18]

Employment skill requirements have evolved with economic growth and changes in technology. Growth is expected to continue in high potential sectors including export-oriented manufacturing, light engineering, shipbuilding, agribusiness, information and communication technology (ICT), and pharmaceuticals (Nakata et.al, 2018). Expansion in these sectors will require skilled professionals in managerial, technical, and leadership positions while workers will need to adapt to changes in technology and production to remain competitive. Labor market surveys have consistently demonstrated that employers struggle to fill job vacancies for highly-skilled positions such as professionals, technicians, and managers – around 69 percent of employers reported a shortage of skilled applicants for professional positions (Figure 10).

[17] In the low variant, it will end in 2035 while in the medium and high variants it will end in 2040 (Matin, K.A, 2012).

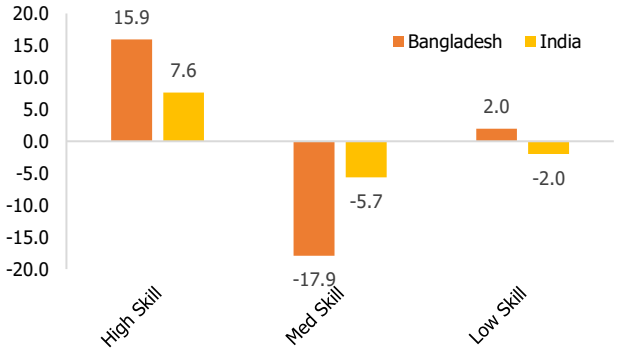
[18] There are no hard estimates, but various anecdotal evidence suggests the size of such outward remittances could be between USD 5-6 billion annually. The Centre of Excellence for Bangladesh Apparel Industry recently began a research titled 'Employment of Expatriates and its Alternatives in the RMG Sector of Bangladesh' in collaboration with the Faculty of Business Studies of Dhaka University. Some of their preliminary findings were reported in the New Age, March 10, 2018 issue.

Demand for high-level skills is growing, while demand for mid-level skills is falling. The introduction of new technologies and automation is changing the employment market, putting jobs with mid-level skills under pressure. At the same time, demand has grown for highly-skilled professionals who can understand technology and perform more complex tasks. These technology-driven changes have resulted in hollowing out of middle-skilled jobs (Figure 11).

Figure 10: Reported lack of skilled applicants across occupations, (percent of respondents)

Source: World Bank, 2016

Figure 11: Changes in Employment Share by Skill Level 2000-2017 (percentage points)



Source: World Development Report, 2019

Skills are developed at every level of education, although tertiary institutions play an important role in job-specific skill training. Basic cognitive skills such as literacy and numeracy are typically acquired in primary school, while job-specific skills are usually acquired through higher education and technical and vocational education and training (TVET) or through apprenticeships and on-the-job training. Non-cognitive or soft skills, such as social and emotional skills are often acquired by interactions with family members, peers, or colleagues. Recent studies show that non-cognitive skills, particularly social and emotional skills, are as important as cognitive skills for success in the workplace.[19] Social and emotional skills built in childhood improves capacity to develop cognitive and job-specific skills later in life.[20] Skills development across the different learning environments and schooling stages is imperative, from pre-primary to primary and secondary education and finally to tertiary education, on-the-job training and new learning investments.

Tertiary educational institutions (TEI) face pressure to train the workforce for high-skill positions. In Bangladesh, the TVET system provides diploma programs in polytechnics. In the general education system, universities and tertiary colleges provide graduate and postgraduate

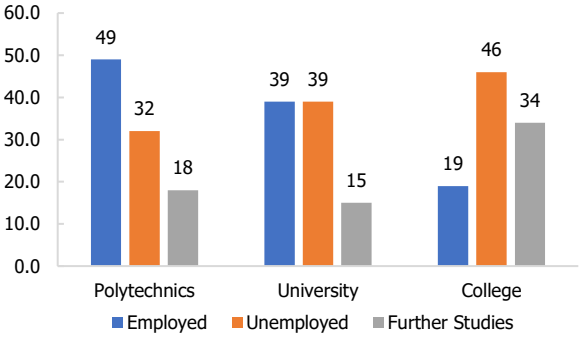
[19] Heckman, J.J, J. Stixrud and S. Urzua (2006), "The effects of cognitive and non-cognitive skills abilities on labour market outcomes and social behaviour", Journal of Labor Economics, Vol. 24, No. 3,
[20] OECD (2015), Skills for Social Progress: The Power of Social and Emotional Skills, OECD Skills Studies, OECD Publishing.

programs. These institutions face increasing access and quality pressures as economic, technological and demographic changes continue to increase demand for training.

Tertiary Graduate Skills and Employability

Tertiary graduates in Bangladesh struggle to find jobs. Recent graduate-tracking surveys confirm the challenging job market for tertiary graduates (Figure 12). Regardless of the type of institution, more than a third of graduates remain unemployed one or two years after graduation.[21] Rather than working, many graduates go on to further studies. Unemployment is most problematic for graduates of affiliated colleges, which account for more than two-thirds of tertiary enrolled students. Only 19 percent of college graduates are found to be employed full-time or part-time, while nearly half are unemployed. Employment outcomes of tertiary-level polytechnics are somewhat better, with 49 percent employed within two years of graduation. Technical knowledge and applied skills training may have helped graduates from these institutions to be more attractive to employers, especially in the industrial sector.

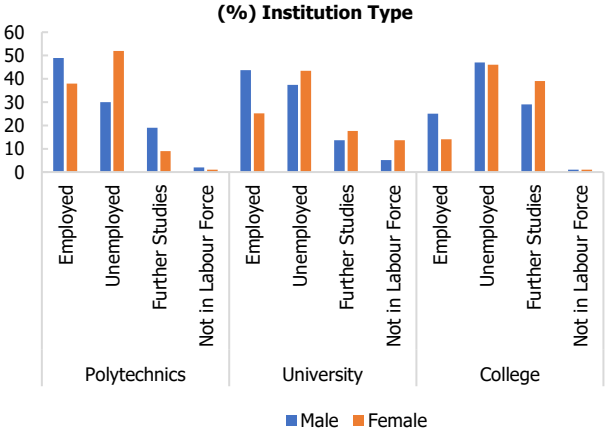
Figure 12: Employment Status of Graduates 1–2 Years after Graduation (percentage)



Source: Graduate Tracer Studies (2016, 2017, 2018)

Female graduates are far more likely to be unemployed and out of study two years after graduation. Among male graduates, 44 percent from universities; 25 percent from colleges and 49 percent from polytechnics are found to be working. For female graduates, the share of those working is much lower, 25 percent from universities; 14 percent from colleges and 38 percent from polytechnics (Figure 13). The share of unemployed female graduates is much higher – 43 percent of female university graduates as compared to 37 percent of male graduates and 52 percent of female polytechnic graduates as compared to 30 percent of male graduates. Female graduates from universities and colleges may seek further

Figure 13: Employment Status of Graduates 2 Years after Graduation by Gender (%) Institution Type



Source: Graduate Tracer Studies (2016, 2017, 2018)

[21] The latest Labour Force Survey 2016–2017 also show that the unemployment rate among those with tertiary education qualifications stood at 11.2 percent, much higher than the national average of 4.2 percent in 2017. Unemployment among female tertiary graduates (24.3 percent) is nearly three times as high as that for males (8.3 percent)

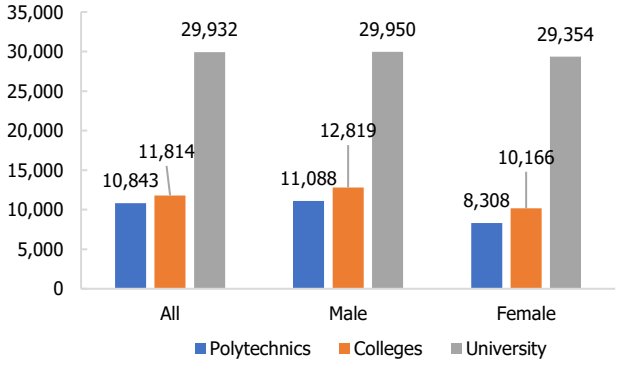
education and training, while this is less common for polytechnic graduates. About 14 percent of university female graduates remain out of the labor force entirely.

Long periods of unemployment are common for tertiary graduates. Graduate tracking surveys found that around 75 percent of polytechnic graduates, 30 percent of college graduates, and 20 percent of university graduates have experienced joblessness lasting more than a year. Many unemployed graduates opt to pursue higher levels of education, with mixed results. The high incidence of prolonged unemployment among graduates raises concerns about the job readiness and relevance of skills that TEIs in Bangladesh impart to their students.

Employed tertiary education graduates tend to work in professional jobs in the private sector and in educational institutions. More than two-thirds of employers of tertiary graduates are private enterprises. Educational institutions (primary, secondary, colleges, and training institutions) employ around 23 percent of university graduates and 43 percent of college graduates. The manufacturing sector is the next largest employer, employing around 17 percent of university and college graduates. Within the manufacturing industry, RMG, food products, agro-processing business, and pharmaceuticals are the main employers. Polytechnic graduates are employed in the manufacturing sector (29 percent) and construction sector (15 percent). Female polytechnic graduates are more concentrated in the educational sector (32 percent) where they are hired as instructors and trainers.

Employed tertiary graduates generally earn reasonable salaries, with university and male graduates faring better. Most tertiary graduates make at least BDT 11,000 per month (USD 138) within one or two years after graduation (Figure 14). This level of income is comparable to the average national monthly earnings.[22] However, the return on qualification is not uniform. University graduates earn significantly more than graduates from colleges or polytechnics, as expected. On average their earnings are three times as high as that of tertiary college or polytechnic graduates. A university graduate earns on average around BDT 29,932 per month (USD 375) with no significant gender wage gap. On the other hand, gender wage gaps are significant among employed graduates from college and polytechnics, especially among those who are not full-time permanent employees.

Figure 14: Graduates - Average Current Gross Salary (BDT)



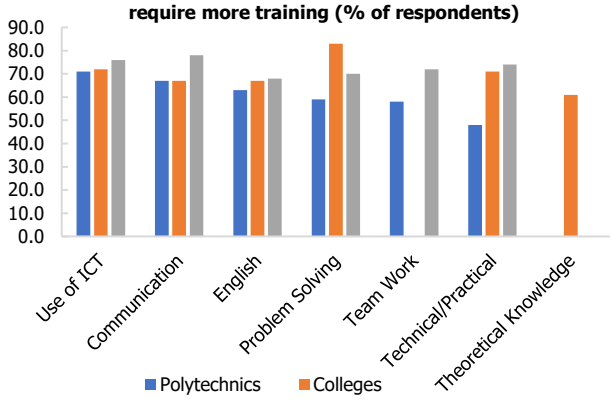
Source: Graduate Tracer Studies (2016, 2017, 2018)

[22] The national average monthly income for people of ages between 25 and 34 was around BDT 12,800 (USD 156) in 2016, according to the Labour Force Survey.

Employer Perceptions of Skill Requirements

Employers in Bangladesh are seeking higher-order cognitive skills and soft skills. Employers rank three higher-order cognitive and soft skills as most relevant for current work environment: (a) problem solving and independent thinking, (b) work attitude, and (c) positive personality.[23] However, they struggle to find graduates with these skills. Around 80 percent of employers of polytechnic graduates reported that problem-solving skills is a key area where polytechnics need to train students better (Figure 15). Similarly, employers would like universities and colleges to strengthen skills training on ICT, English, and higher-order thinking such as communication, problem-solving, and team work. Scarcity of qualified employees has resulted in higher pay for jobs requiring these skills in Bangladesh (Nomura et. al, 2017; World Bank, 2013). To address this shortage, academic programs should be improved.

Figure 15: Employer perceptions of skills that require more training (% of respondents)



Source: Graduate Tracer Studies (2016, 2017, 2018)

Challenges in Responding to the Skills Gap

Based on a recent sector review, the following key issues emerge as main challenges faced by tertiary education in meeting the skills needs of employers:[24]

i. ***Low quality and relevance of education***: With changing technologies and business environment, technical skills needed for jobs are increasingly elusive and unpredictable. To keep up-to-date on the latest changes in industries, some universities and polytechnics have already successfully launched partnerships with industry in areas such as research collaboration, skills training, teacher training, among others. However, these initiatives still occur on a small scale and there is urgent need to promote and strengthen such collaborations to better prepare students for the job market. The classroom teaching, learning and assessment system continues to follow traditional and rigid approach that impede effective learning and the development of higher-order cognitive skills and soft skills among students. Inadequate and outdated teaching, learning and ICT facilities further make the teaching learning environment challenging. There remains a shortage of qualified teachers and opportunities for their professional development through

[23] Bangladesh Institute of Development Studies. 2018. Tracer Study of University Graduates. Higher Education Quality Enhancement Project. Dhaka. Bangladesh.
[24] Rahman, Tashmina; Nakata, Shiro; Nagashima, Yoko; Rahman, Mokhlesur; Sharma, Uttam; Rahman, Muhammad Asahabur. 2019. *Bangladesh Tertiary Education Sector Review Skills and Innovation for Growth*. Washington, D.C.: World Bank Group.

structured in-service professional training, thus constraining delivery of quality instruction.

ii. ***Inequitable access to tertiary education:*** Despite progress, enrollment in tertiary education (17 percent) in Bangladesh trails behind its neighboring countries and does not match the average of lower middle-income countries (24 percent). Access to tertiary education is not equitable across gender and income groups, with females and students from poor families and rural areas at a disadvantage. The overall participation in STEM (Science, Technology, Engineering and Mathematics) disciplines is low in all the tertiary sub-sectors while the technical education sub-sector faces additional challenges of perceived low social value and inadequate awareness of technical degrees among students and families.

iii. ***Performance de-linked financing strategy:*** While Bangladesh has long been allocating relatively low public funds to the education sector in general and tertiary education in particular, the higher out-of-pocket expenses for students, especially in polytechnics, are often considered a barrier for potential students. There is a clear need for better incentive mechanism with funding for public TEIs. Public financing for public TEIs in Bangladesh pays little attention to the performance of individual institutions. Moreover, TEIs in Bangladesh have made limited progress in terms of diversification of revenue other than the grant financing from the government and fees from students. A lack of financial autonomy and clear regulatory and accountability framework constrain income-generating activities of TEIs, especially for government colleges and polytechnics.

iv. ***Underdeveloped tertiary education management at central and institution levels:*** Overall, the planning, implementation and management capacities at the ministry and institution levels remains underdeveloped. There is an urgent need to improve TEIs' capacity to better link supply and demand sides of skills towards more adaptive skills development system. The absence of regular monitoring of the labor market outcomes of recent graduates and gathering feedback from employers about skills gap of graduates makes TEIs less readily adaptive to the changes in the job market. Moreover, state controls create rigidity in TEIs' capacity to be responsive and flexible to human resource needs and academic program changes. Except for public universities, government tertiary colleges and polytechnics lack the autonomy to take lead and implement critical academic, human resource, and financial decisions[25]. The Bangladesh Accreditation Council (BAC) for

[25] For affiliated colleges, the academic curriculum is centrally set by the National University while for polytechnics it is determined by the Bangladesh Technical Education Board. Introduction of a new academic program also require permission from the central agencies. Human resource staffing in the government colleges and polytechnics is also conducted centrally through MOE via Public Service Commission, which can take up to two years in completing teacher recruitments.

higher education is still at a nascent stage and will have to initiate the accreditation process. While institutional quality assurance has been introduced in most universities, these activities need to be fully institutionalized and more deeply integrated within the mandate of the institutions. The central skills agency for accreditation and skills certification is in urgent need of substantial capacity improvement and international recognition.

Ongoing Reforms and Initiatives

The Government has taken key reforms and initiatives to address some of the challenges discussed above. These include:

- **Quality assurance at the national and institutional level**: At the national level, the BAC Act was enacted[26] and the Accreditation Council was established as an independent autonomous body responsible for overseeing the quality of higher education at the institutions against the benchmark given in the National Qualifications Framework. The Council is also tasked with accreditation of programs at the initial stage and later of institutions and will conduct external assessments of the quality of teaching and learning in the higher education institutions[27]. The Ministry of Education supported 69 public and private universities to set up internal quality assurance cells which help departments carry out self-assessments (SAs) and to develop and implement improvement plans to address quality issues. Till December 2018, around 800 SAs and improvement plans have been produced to help faculties steer reforms in curricula; plan in-service teachers' professional development trainings; improve facilities and administrative processes for students, among others.
- **Competency framework for technical education**: The National Technical and Vocational Qualifications Framework was developed and endorsed under the National Skills Policy 2011 to promote competency-based skills training and assessment. Based on the framework, competency standards are being developed and competency-based training and assessment implemented across TVET programs.
- **National Skills Development Authority and National Human Development Resource Fund**: The GoB is establishing the NSDA in efforts to improve coordination in the skills sector. This will involve multiple ministries offering varied skills training programs[28]. A National Human Resource Development Fund has been created to pool resources for accelerating skill development training, including tertiary level technical education.
- **Formation of National Teacher Selection Commission**: The MOE has taken initiatives to amend the Nongovernment Teachers' Registration and Certification Authority (NTRCA)

[26] The BAC Act became effective on March 21, 2017, with its publication in the Bangladesh Gazette.
[27] The BAC Act covers only universities and affiliated tertiary colleges, while technical education remains outside of its mandate.
[28] A skills mapping exercise conducted in 2014 documents 22 ministries which are involved in skills training.

and establish the Nongovernment Teachers Selection Commission (NTSC). This is to introduce a competitive and merit-based selection process for non-government education institutions[29] and ensure the quality of teaching in these institutions.

- **Competitive funding to promote research, innovation and industry collaboration**: Competitive innovation fund to promote research and innovation, introduced in 2009, was institutionalized by the University Grants Commission[30] to ensure a more efficient and results-based allocation of research grants to public and private universities. The activity further promotes the model of 'university-industry' collaboration in research and commercialization of research outputs in supporting innovations and generating revenues, which had been missing in Bangladesh's higher education sector. The MoE has also introduced competitive grants for research for university faculty under its revenue budget, thereby institutionalizing the mechanism.

Despite these reforms taken up by the GoB, some areas remain unaddressed:

- **Teachers and education leaders' performance management**: There is a need to review the government teacher recruitment and promotion process to ensure teachers are attracted and motivated to take up the teaching profession. A Teachers' Competency Framework by subject areas to track performance across both technical and non-technical areas requires to be developed to ensure quality of learning in all tertiary education institutions. Similarly, well-defined pathway and criteria for teachers transitioning to education leadership positions with effective professional development opportunities is missing. These efforts would have to be supported by a comprehensive and continuous teachers' professional development program at the institutional and central level.
- **Intellectual Property Right law to support academic innovations**: The current intellectual property law does not cover innovations developed from academic research. This is a hindrance to the commercialization of outputs from the increasing uptake of research among academics.
- **Student Loan System**: Among financial assistance programs, the GoB is yet to explore the possibility of introducing subsidized student loan scheme in partnership with public and private financial institutions to support meritorious low-income students, and other marginalized groups to pursue higher education. Such a scheme would need to be designed carefully with in-depth analysis of international experience and the country's social context to build an effective incentive system and efficient collection mechanism for better repayment.

[29] The NSTC will function similar to the recruitment process of government teachers by the Public Service Commission.
[30] The University Grants Commission, attached agency under the Ministry of Education, is responsible for supervising and coordinating public and private universities, maintaining the quality standard of university education, managing the allocation of government funding to universities, and advising the government on issues related to higher education.

- **Performance-based funding in tertiary education:** Performance-based allocations could be used in conjunction with the existing traditional budgeting system.[31] For example, institutions may continue to receive a major portion of their regular budget through a guaranteed allocation to ensure funding for their operations while a smaller share of their budget may be allocated against agreed-upon performance indicators and other conditions. The approach would have to be implemented with accountability measures, e.g. financial reporting and verifications; yet would be a big step toward improving quality and performance of TEIs.

Policy Recommendations

To address the skills development challenges, the government should improve tertiary education through following measures:

Area 1: Enhance the quality and relevance of education and training

Short to Mid-Term Measures

- **Implement modern practices in teaching, learning, and assessment**. Key actions include: conducting periodic curriculum review against industry needs and subsequently developing and adopting an outcome-based curriculum which incorporates higher-order cognitive skills and soft skills development; incorporating active learning practices for teachers as part of professional development training and using a learning management system for tracking student learning outcomes.
- **Increase private industry engagement in providing market-relevant education and training programs**. This can be done through private industry partnerships in curricula development, teacher training, shared facilities and student internships. To attract private investments in education and collaboration, the government may consider special incentives (for example, tax rebate, recognition) for industry.
- **Attract and retain highly qualified teachers through better performance management and professional development**. This would require a review of the current teacher recruitment and career development process, especially for government colleges and polytechnics. Other than performance-based financial incentives, good teachers can be attracted and retained through the provision of opportunities for professional growth and recognition linked with teacher professional development needs assessments and teacher competency requirements across subject areas. Teachers' professional development programs – structured pre-service and in-service professional training – also need to be upgraded.
- **Forge partnership with renowned foreign universities to bring international best practices**. This can be done through twinning or joint programs to raise the quality of

[31] The Strategic Plan for Higher Education 2018-2030 envisions to explore performance-based approach in the financing of universities. Varied models of Performance-Based Funding have been found to be successful in countries such in areas such as Europe, Australia, and North America.

teaching and learning in universities. Activities that promote knowledge transfer, exchange of experience, and capacity development could be explored.

- **Operationalize the Bangladesh Accreditation Council**. This would require ensuring the full staffing of the BAC; development of program standards and institutional standards under each area of QA aligned with international standards; development of self-assessment manuals for programs and institutions; and initiation of training for the development of professional accreditors from the academic community.
- **Create a conducive environment for academic research and commercialization of innovation**. Develop and implement a strategy for ensuring adequate and sustained financing for promoting academic research and commercialization of research innovation. Concurrently, the IP law needs to be reviewed to support academic innovation and commercialization of research outputs.

Long-term Measures

- **Ensure sustainable public and private partnership models for industry and private sector engagement**. Develop and implement a strategy for promoting private sector and industry collaboration in higher education and skills training.
- **Harmonize the national qualification frameworks** across general and technical education to support articulation between general education and TVET.
- **Strengthen management of teachers**. Ensure continuous professional development opportunities, which are monitored and tracked, implemented at institutional and central levels.
- **Establish regulatory and financing policies to facilitate innovations from TEIs.** Ensure research funds and facilities along with mechanisms for commercialization of research innovations, including upgraded Intellectual Property Right law, are in place at universities, colleges and polytechnics.

Area 2: Improve equitable access to tertiary education

Short to Mid-Term Measures

- **Increase financial assistance for socio-economically disadvantaged students**. Expand poverty-targeted scholarship and tuition support for students to encourage low-income secondary school graduates, especially females, who are proven meritorious to continue with higher education in the universities and colleges. Conduct a feasibility study and pilot on introducing subsidized student loan system in Bangladesh.
- Conduct a needs assessment, in terms of facilities and learning resources, for people with special needs in accessing tertiary education.

- **Ensure learning environment for people with special needs.** Invest in teaching and learning facilities and programs in tertiary education for people with special needs.

Long-term Measures

- **Introduce a subsidized student loan system**. This could be initiated in the university and polytechnics in partnership with public and private financial institutions to support meritorious low-income students, and other marginalized groups to pursue higher education.

Area 3: Improve financing strategy in tertiary education

Short to Mid-Term Measures

- **Introduce Performance-Based Funding (PBF)**. This would require the UGC to conduct an assessment to develop and pilot PBF in government universities.
- **Promote revenue generation for public TEIs**. A guideline for income-generating activities for TEIs would need to be developed and implemented by the MOE.

Long-term Measures

- **Institutionalize and expand PBF.** This would require MOE to develop and implement the policy, rules and regulations for PBF and gradually expand PBF to all public TEIs.

Area 4: Strengthen tertiary education management

Short to Mid-Term Measures

- **Strengthen planning, management and implementation capacities of central regulatory bodies**. Develop and implement performance results agreement with agencies and educational institutions under the Ministry of Education. Provide professional development opportunities for tertiary education managers and administrators at the ministry and institutional levels.
- **Implement institutional-level and national-level graduate tracking and feedback systems**. The establishment of career service centers at TEIs to better link between supply and demand sides of skills would enable regular labor market tracking and information flow. The centers will need to conduct graduate tracer studies and employers' feedback surveys; gather job market information; and provide career development support to students and graduates.
- **Leverage technology to support management**. Technology-based tools, including introducing institutional level management information systems and learning management systems in the universities, tertiary colleges, and polytechnics, can improve

monitoring and management of tertiary education. The MOE would need to deploy and utilize an integrated management information system to improve monitoring and reporting across the three subsectors.

Long-term Measures

- **Grant autonomy to well-performing tertiary colleges and polytechnics**. Granting some autonomy to colleges and polytechnics in specific areas, such as academic curriculum and financial management, with clear objectives and monitoring system may enhance flexibility in responding to emerging demands from local situations. This would require periodic review of performance of the institutions to determine good performance and develop an accountability and monitoring system.

Annex I - Bangladesh Macroeconomic Indicators

	FY14	FY15	FY16	FY17	FY18	FY19
GDP Growth Rates and Per Capita Income						
GDP Growth (percent, 2005-06 base year)	6.1	6.6	7.1	7.3	7.9	8.1
GDP Growth Per Capita (percent)	4.8	5.3	5.9	6.2	6.5	6.9
Per Capita GDP (current USD)	1086.8	1212.2	1358.9	1516.7	1641.9	1787.8
Per Capita GNI (current USD)	1159.2	1290.9	1437.1	1581.9	1716.7	1867.9
Per Capita GDP (USD, official estimate)	1110.0	1236.0	1385.0	1544.0	1675.0	1827.0
Per Capita GNI (USD, official estimate)	1184.0	1316.0	1465.0	1610.0	1751.0	1909.0
Per Capita GDP Atlas Method (USD)	1040.9	1151.9	1297.1	1460.3	1674.3	1861.1*
Per Capita GNI Atlas Method (USD)	1110.0	1230.0	1370.0	1520.0	1750.0	1944.5*
Inflation						
Rate of Inflation (CPI, percent) (year on year)	7.3	6.4	5.9	5.4	5.8	5.5
Inflation (GDP deflator)	5.7	5.9	6.7	6.3	5.6	4.2
Saving & Investment (percent of GDP)						
Gross Domestic Saving	22.1	22.2	25.0	25.3	22.8	23.9
Gross National Saving	29.2	29.0	30.8	29.6	27.4	28.4
Private Investment	22.0	22.1	23.0	23.1	23.3	23.4
Of which: FDI	0.8	0.9	0.6	0.7	0.6	0.8
Public Investment	6.6	6.8	6.7	7.4	8.0	8.2
Central Govt. Budget (percent of GDP)						
Total Revenue	10.4	9.6	10.0	10.2	9.6	10.3*
Total Expenditure	13.8	13.5	13.8	13.6	14.3	14.8*
Overall Budget Deficit	3.6	3.9	3.8	3.5	4.7	4.6*
Balance of Payments (percent of GDP)						
Trade (merchandize export + merchandize import)	38.4	35.0	33.1	31.0	32.9	31.6
Exports	17.2	15.7	15.1	13.6	13.2	13.2
Imports	21.2	19.3	18.0	17.4	19.7	18.4
Services & Income (net)	-3.9	-3.1	-2.1	-2.1	-2.5	-2.2
Current Transfers	8.6	8.1	6.9	5.3	5.6	5.6
Current Account Balance (including transfers)	0.8	1.5	1.9	-0.5	-3.5	-1.7
Public Debt and official reserves						
Total Debt as percent of GDP	31.7	31.8	31.5	30.8	31.9	32.8*
External Debt (USD b.)	24.4	23.9	26.3	28.3	33.5	37.7*
External Debt as percent of GDP	14.1	12.2	11.9	11.3	12.2	12.5*
Gross Reserves (USD b.) (end of period)	21.3	25.0	30.1	33.7	32.8	32.6
Gross Reserves (in months of imports)	5.8	7.0	7.9	8.0	6.3	5.8
Money and Credit						
M2 Growth (percent, year-on-year)	16.1	12.4	16.3	10.9	9.2	12.0
Net Domestic Asset Growth (percent, year-on-year)	10.3	10.7	14.2	9.8	12.8	16.8
Ratio of Private Sector Credit to GDP (percent)	37.8	37.9	38.7	39.3	40.3	39.8
Ratio of Total Deposits (Time + Demand) to GDP (percent)	46.4	46.1	45.8	44.4	43.0	42.0
Exchange Rate						
Nominal Period Average (BDT/USD)	77.7	77.7	78.3	79.1	82.1	84.0
Nominal End of Period (BDT/USD)	77.6	77.8	78.4	80.6	82.8	84.5
Real Effective Exchange Rate-REER Index, 2010=100	107.4	120.6	133.0	139.2	133.2	139.6
Memorandum Items						
GDP at Current. Prices (BDT billions)	13436.7	15158.0	17328.6	19758.2	22504.8	25361.8
GNI at Current. Prices (BDT billions)	14332.2	16142.0	18326.7	20607.2	23531.1	26497.9
GNI at Current. Prices Atlas Method (USD billions)	171.3	191.3	216.3	242.8	282.0	316.6
GDP at Current. Prices Atlas Method (USD billions)	160.6	179.6	204.5	232.8	269.7	303.0
GDP at Current. Prices (USD billions)	172.9	195.2	221.4	249.7	274.0	302.0
GNI at Current Prices (USD billions)	184.4	207.8	234.1	260.5	286.5	315.5
Population (millions)*	159.1	161.0	162.9	164.6	166.9	168.9

*Source: Bangladesh Bureau of Statistics, Bangladesh Bank, Ministry of Finance, The World Bank and IMF. Population data from Development Economics Prospects Group, World Bank. *World Bank staff calculations.*

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