

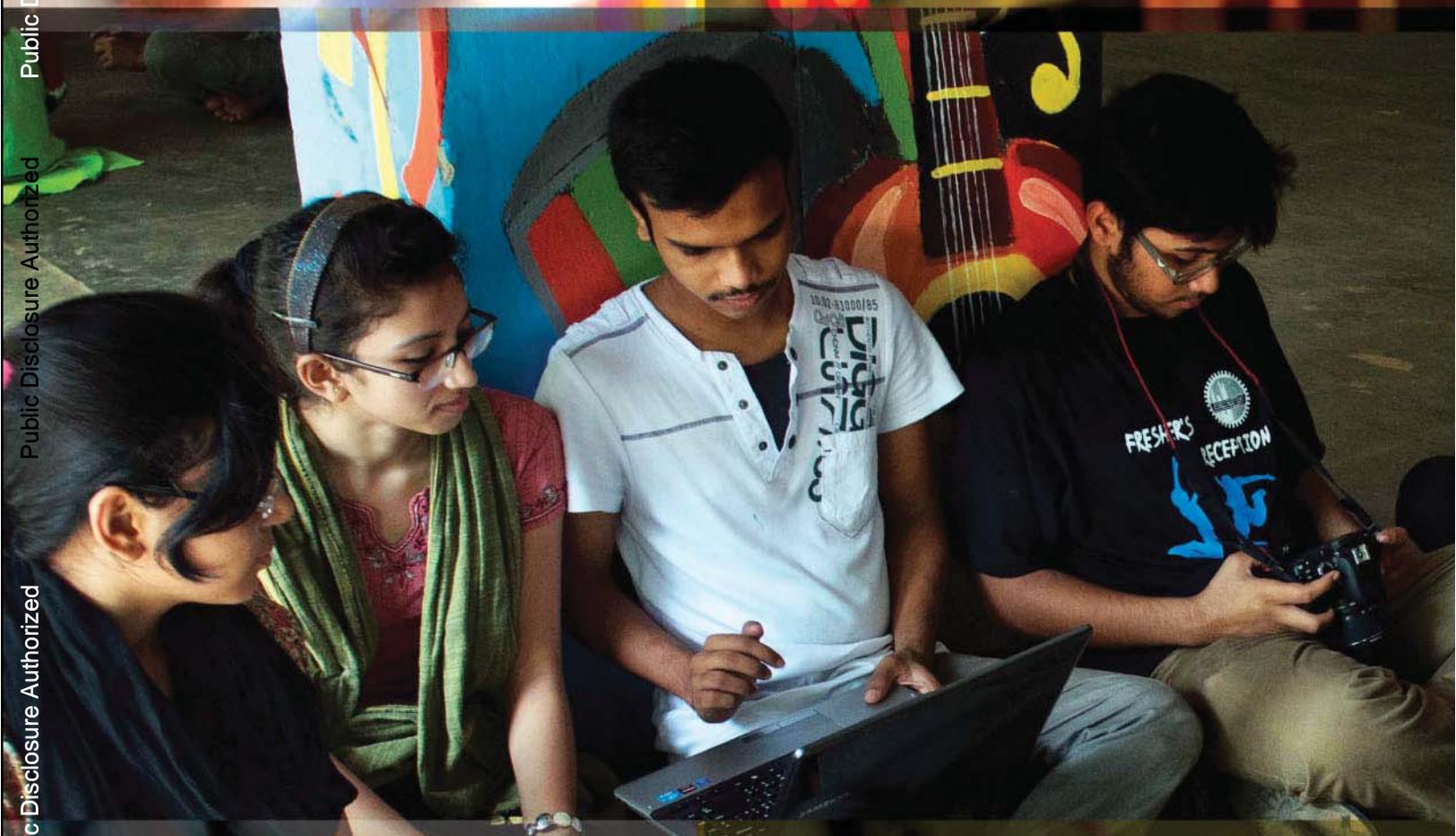
BANGLADESH DEVELOPMENT UPDATE

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BANGLADESH DEVELOPMENT UPDATE



THE WORLD BANK
IBRD • IDA

October 2014

World Bank Office Dhaka

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Cover Photo: Ismail Ferdous

Printed in Bangladesh

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Executive Summary

Progress on reducing extreme poverty and boosting shared prosperity through human development and employment generation has continued. This needs to be further consolidated in the near-term by sustaining Gross Domestic Product (GDP) and remittances growth recovery, creating jobs, containing inflation, and making progress on improving the quality of service delivery in health and education. To sustain growth in the near- and medium-term, private investments need to increase significantly. At the same time, the quality of public investment needs to be substantially enhanced to alleviate the infrastructure constraints on private investments and to expand service delivery. Moving forward in the immediate future, stronger attention is needed to (a) swiftly complete the transition in the garment industry, (b) finish the critical ongoing road development projects, (c) enact the Public Private Partnership (PPP) law, and (d) award contracts to build Special Economic Zones (SEZs).

Commendable progress on poverty reduction and shared prosperity

1. There is no survey-based evidence on what has happened to poverty since 2010. But most simulations done by the Planning Commission suggest poverty incidence is likely to have declined to less than 25 percent in FY14, compared with 31.5 percent in FY10.¹ Employment and wage growth are likely to have boosted shared prosperity—increased the income of the bottom 40 percent. According to the UN Human Development Report 2014, Bangladesh has graduated from the Low Human Development (LHD) category to the Medium Human Development (MHD) category. The challenge now is to consolidate this position by accelerating economic growth in an inclusive and sustainable manner.

2. Growth recovery has begun with the return of political stability. Economic activities in FY14 suffered a setback due to political turmoil, remittance declines and declines in the private investment rate. However, the Bangladesh Bureau of Statistics (BBS) provisionally estimated FY14 GDP growth at 6.1 percent, compared with 6 percent the previous year. While increased agriculture and service sector growth outweighed the decrease in industrial growth, overall how growth in FY14 (a very abnormal year) exceeded growth in FY13 (a relatively normal year) is not well understood.

¹ Based on a national poverty line of US\$1.13 per person per day.

Overall macroeconomic stability maintained, albeit with some erosion of competitiveness

3. Inflation is still high but stable. Overall consumer inflation increased to 7.4 percent in FY14 relative to 6.8 percent in FY13, driven by an increase in food inflation. Part of the rise was due to supply disruptions caused by the political unrest of late 2013. The gap between rural and urban food inflation narrowed. Stable international oil prices and prudent monetary management helped reduce non-food inflation from 9.2 percent in FY13 to 5.5 percent in FY14.

4. Foreign exchange reserve accumulation has continued despite remittance declines. Despite a lower trade deficit, reflecting a rise in export growth, the current account surplus narrowed last fiscal year because of a 1.6 percent decline in remittances. The overall balance of payment surplus increased from \$5.1 billion in FY13 to about \$5.5 billion in FY14, creating an upward pressure on the nominal exchange rate. The Bangladesh Bank (BB) remained active on the buying side of the foreign exchange market to prevent any significant nominal exchange rate appreciation, although the real effective exchange rate has appreciated by 8.5 percent. BB interventions perpetuated foreign exchange reserve build up, reaching over US\$21 billion by mid-September, which is equal to over six months of imports.

Macroeconomic policies remained on course, but the financial sector not out of the woods yet

5. Monetary management was challenged by fast reserve accumulation, but the Bangladesh Bank managed to keep reserve and broad money growth within target by stepping up sterilization operations. BB's net domestic assets and reserve money targets were met. Private sector credit growth remained subdued, reflecting both the impact of lingering political uncertainty and the reluctance of bankers to extend loans due to high level of non-performing loans. With comfortable banking sector liquidity, deposit and lending rates have declined. BB raised the banks' cash reserve ratio (CRR) by 50 basis points to 6.5 percent in late June 2014.

6. Credit and risk management status in the banking sector is unsatisfactory. Asset quality in the state-owned commercial banks (SCBs) deteriorated in FY14. While their aggregate stock of assets and share in the total assets of the banking system has declined, deposits continued to grow at a healthy rate, thus ensuring adequate liquidity. High liquidity levels are also reflected in below average loan-to-deposit ratios. The Bangladesh Bank has begun implementing the new provisions related to lending and banks' exposure to stock markets, which is likely to prevent excessive risk taking by banks.

7. Fiscal policy is plagued by revenue collection and development budget implementation shortfalls. The overall fiscal deficit in FY14 has been kept in check despite underperformance in tax collections due to weak imports and slow economic activity. Public debt as a share of GDP has remained on a downward path. The overall FY15 budget deficit target is less than 5 percent of GDP notwithstanding somewhat ambitious revenue targets. The fuel subsidy bill has declined, but there has been little visible improvement in the quality of Annual Development Plan (ADP) implementation. Yet, the size of ADP in FY15 is envisaged to increase by 34 percent relative to the FY14 revised ADP.

Good progress in the garment industry, but the overall pace of structural reforms is slow

8. While the fourth review of the IMF's Extended Credit Facility (ECF) arrangement has been successfully completed, the pace of structural reforms in general has remained slow. Significant progress has been made towards improving working conditions for factory workers including amendments to the labor and the Export Processing Zone (EPZ) laws, capacity building of the government in assessing factory safety and agreement on common standards to assess structural building safety. Speedier progress is needed in the implementation of the new value-added tax (VAT) law, liberalization of exchange regulations, infrastructure management, and financial supervision.

Growth and inflation outlook is favorable

9. Political stability since early January, signs of an uptick in remittance inflows from last year's near 2 percent decline, continued strength in exports if compliance reforms are speedily implemented, as well as buoyant consumption demand relative to last year, bode well for growth in FY15, which is projected at 6.2 percent. Macroeconomic stability, better governance in the banking system, development of markets for long term finance, further trade liberalization, and stronger attention to efficient implementation of infrastructure investments with necessary institutional changes relating to regulation and policy formulation remain key factors in this process.

10. Underlying inflationary pressures, as reflected in non-food inflation, are expected to maintain a downward trend on continued policy restraint. Achieving this will depend on international price trends as well as domestic supply conditions and macroeconomic policies.

Moving forward, stronger attention is needed to swiftly complete the transition in garments, finish the critical ongoing road development projects, enact the Public Private Partnership (PPP) law, and award contracts for building Special Economic Zones (SEZs).

- In garments, much more needs to be done for effective implementation of wage increases and the new labor legislations, recruiting more factory inspectors and complete building inspections followed by swift remediation measures such as relocation of closed factories. So far inspections have been completed in about 50 percent of factories, and 17 factories have been closed. The non-availability of land, gas and electricity, as well as the reluctance of workers to move to new locations have emerged as major impediments to relocation.
- There is also a need to focus on speedy completion of transformational ongoing projects in the road and energy sectors, particularly the Dhaka-Chittagong and Dhaka-Mymensingh highway; Double Tracking of Dhaka-Chittagong Railway; the Padma Bridge; the Dhaka metro rail; and the two Bibiyana gas field based large power plants. The government should prioritize the most transformative projects and provide all necessary resources for completion within a specified timeline.
- The Government should enact the PPP law and equip the PPP office with staff having knowledge and experience in developing, negotiating and supervising PPP projects. A proper legal framework providing internationally attractive guidelines and incentive policies is essential. PPP cannot be managed as a part of the day-to-day bureaucracy.
- In addition, there is an urgent need for the Government to finalize the awarding of contracts for the proposed economic zones to be developed under Bangladesh Economic Zone Authority while ensuring the related services such as power, gas, good road-connectivity, and security are available in the developed land.

I. Poverty Reduction and Shared Prosperity

Commendable progress on poverty reduction

1. There is no survey-based evidence on what has happened to poverty since 2010.² However, it is reasonable to assume that the sustained GDP growth rate in excess of 6 percent, a decent 3.3 percent agricultural growth, and remittance growth of 6.7 percent on average since 2010 contributed to maintaining the 1.74 percentage point annual decline observed during 2000-2010. There have also been corresponding improvements in several social indicators such as life expectancy and the fertility rate. The poverty incidence, based on Bangladesh's national poverty line, is projected to have declined to 24.47 percent by 2014.³ UNDP's Human Development Report 2014 finds a significant decline in Bangladesh's Multidimensional Poverty Index from 0.292 in 2007 to 0.237 in 2011.⁴ This remarkable progress in poverty reduction is attributable to a decline in population growth rate and the changing age structure, increases in labor income, internal and external migration, improved connectivity, and the government's targeted safety net program.⁵

2. The income of the bottom 40 percent is likely to have continued to increase because of increased employment and wages. Total domestic employment is estimated to have increased from 51.9 million in FY10 to 56.5 million in FY13. The shortfall in GDP growth relative to the Sixth Plan target reduced the overall domestic job creation, but manpower exports abroad more than compensated. As a result, the total number of additional labor who found employment in the domestic market or abroad exceeded the number added to the labor force. Consequently, the unemployment rate is likely to have decreased. Agricultural real wages have continued to increase.⁶

² Poverty measurement cannot properly be done without collecting household consumption data throughout a year so that seasonal effects do not distort the measurements. BBS is considering increasing the frequency of household income and expenditure surveys, but has so far not been able to ensure a sustainable source of funding for such surveys.

³ Government of Bangladesh, Mid-Term Implementation Review of the Sixth Five Year Plan (2011-2015) of Bangladesh, July 2014. Page 39.

⁴ This index is a composite of multiple deprivations at the household level in education, health and standard of living. This is additional confirmation that Bangladesh's rise on the human development dimension is no artifact of statistics.

⁵ Government of Bangladesh, Millennium Development Goals, Bangladesh Progress Report 2013, August 2014.

⁶ Government of Bangladesh, *ibid.* Page 124.

Consolidating the gains in human development and moving further up remain as big challenges which Bangladesh needs to tackle relentlessly.

3. In the Human Development Index 2013, Bangladesh's ranking improved by one step relative to 2012.⁷ Bangladesh graduated from Low Human Development (LHD) category to Medium Human Development (MHD) category. In 2012, Bangladesh was below Congo, Solomon Islands, Sao Tome and Kenya at the top of 45 LHD category countries. In 2013, Congo, Sao Tome and Bangladesh graduated to MHD, with Bangladesh ranking third from the bottom in this list. Countries like Nepal, Kenya, Pakistan, Nigeria, Zimbabwe, Tanzania and Ethiopia continued to be in the LHD category.

4. Bangladesh graduated to the MHD category despite an increase in the cutoff point for the category from 0.535 in 2013 to 0.550 in the 2014 index. It surpassed not only last year's cutoff point but also its increase this year. This testifies the robustness of the magnitude of increase in Bangladesh's HDI 2013 score relative to the Human Development Index (HDI) 2012. Bangladesh's recent progress has been impressive on both Gross National Income (GNI) per capita and life expectancy (Table 1).

Table 1: Bangladesh's Recent HDI Trends

Year	Life Expectancy at Birth	Mean Years of Schooling	GNI per Capita (2011 PPP\$)	HDI Value
2010	69.4	5.1	2337	0.539
2011	69.9	5.1	2457	0.549
2012	70.3	5.1	2592	0.554
2013	70.7	5.1	2713	0.558

Source: Human Development Report, 2014 (UNDP)

- GNI per capita has grown rapidly because of growth in GDP per capita and remittance per capita. Sustained acceleration of GDP growth, declining population growth rate, and continued growth of the stock of Bangladeshis working abroad contributed to growth in GNI and remittance per capita. Most recent research evidence reconfirm that remittances contribute significantly to poverty reduction both directly by augmenting the income of the receiving families and indirectly by contributing to local level development.⁸
- Bangladesh has made impressive gains in the health MDGs, increasing the odds of surviving through childhood and pregnancy and controlling the burden of communicable disease. The health sector (government and NGO providers) has continually incorporated proven cost-effective interventions, which have contributed to the impact of health services. The development of a highly pluralistic health system environment characterized by the participation of a multiplicity of different stakeholders and agents and by ad hoc, diffused forms of management has contributed to these outcomes by creating conditions for rapid change.⁹ With donor support, the government has focused attention on expanding access to services and strengthening governance.

⁷ The Human Development Index (HDI) is a composite measure of life expectancy, education, and income indices used to rank countries into four tiers of human development. It is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and having a decent standard of living. The HDI is the geometric mean of normalized indices for each of the three dimensions.

⁸ Professor Tasneem Siddiqui and Dr. Raisul Awal Mahmud, Key Findings, Impact of Migration on Poverty and Local Level Development, August 31, 2014.

⁹ Syed Masud Ahmed et al, Bangladesh: Innovation for Universal Health Coverage, Lancet 2013.

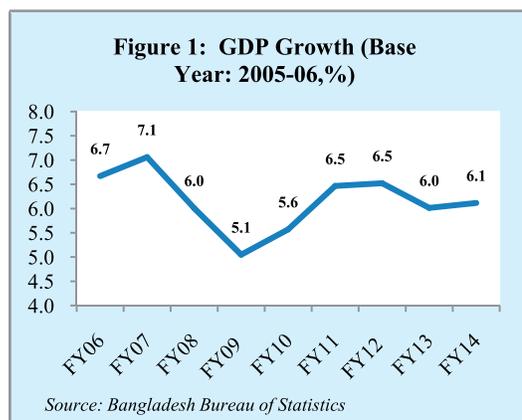
- Bangladesh has improved access and completion at all levels of education, especially at the primary level. As a result of massive expansion of supply, targeted stipends to bring the poorest and girls into schools and continued investments in education, Bangladesh achieved almost universal access in primary education. The primary net enrollment rate (NER) is most recently reported as 93 percent. Enrolment in pre-primary is low at 23 percent (2009). Primary, lower secondary and secondary education completion have systematically increased over time. Thirty-six percent of people aged 41–50 in 2010 have completed primary education; whereas that same share among people aged 15–19 is 76 percent, indicating that the share of primary school completers has more than doubled in 30 years.¹⁰
- Still, the system in health and education remains challenged on the governance front, particularly in holding civil service employees accountable for performance, and associated with the strong centralization of authorities and decision making.

5. There is no reason for complacency. Bangladesh has achieved the MHD category before (2007 for instance), but later slipped back, due to both methodological changes and a slowdown in progress on human development. A recent International Labor Organization (ILO) report finds that 53.4 percent of youth leave primary school before completion.¹¹ The combined effects of the ongoing demographic transition and the growing labor force participation of women are increasing the size and share of working population. Providing quality jobs to new entrants and increasing productivity of the employed population in agriculture and services are major challenges.

II. Recent Economic Developments

Growth recovery has begun with return of political stability

6. During the first half of FY14, the Bangladesh economy weathered severe disruptions in production, transport, and service delivery. The second half was remarkably stable, although lingering political uncertainties resulted in a deceleration in private investment growth, which constrained the transmission of the relative macroeconomic stability into higher economic growth. Bangladesh Bureau of Statistics (BBS) provisionally estimated FY14 GDP growth at 6.1 percent (Figure 1). Most analysts expected the economic growth in FY14 to be between 5.5-6.0 percent in view of political unrest in the first half of the fiscal year and the trends of associated growth correlates (Box 1).¹²



¹⁰ The World Bank, Education Sector Review, 2013.

¹¹ ILO, Labor market transitions of young women and men in Asia and Pacific, August 2014.

¹² These included the Bangladesh Bank, IMF, WB, ADB and CPD.

Box 1: The Growth Debate

The consensus forecast earlier was that GDP growth in FY14 would dip below 6 percent. These forecasts were based on a storyline that hinged on weak growth in private consumption and stagnant or even declining private investments. These two components account for nearly 93 percent of GDP.

BBS data reaffirmed the composition of growth scenario sketched on the basis of proxy indicators and anecdotal evidence. Yet the bottom-line is very different. Growth is estimated to have been higher than last year despite declining private consumption and investment rates. Part of the explanation may be an over-estimated public investment, amounting to Tk 986 billion (about US\$12 billion) in FY14.

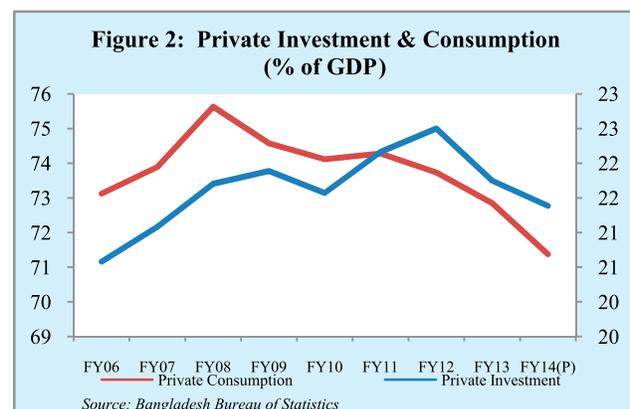
BBS estimates public investment from budget data. The public investment data reported in the national accounts show large variance from the government budget. Not all government expenditures classified as “capital” expenditures (recapitalization of state owned banks for instance) constitute creation of real wealth. Such capital expenditures are not investment expenditures from a national point of view. The items constituting investment expenditures (based on the revised FY14 budget) amount at best to Tk 510 billion. This leaves unexplained Tk 476 billion which could be attributed to investments by public enterprises and local governments from own sources. Most large public enterprises run an operational deficit. Local governments rely on central government transfers to meet their operating and investment costs. It is therefore difficult to see how the public enterprises and local governments could possibly fund such large investments, equivalent to 3.5 percent of GDP, from their own sources.

It is possible that the proxies and methods used to estimate production and expenditures work well in a normal year, but fail to capture the impact of disruptions in an abnormal year.

7. According to BBS, growth was driven by the industry sector, notwithstanding a decline in industrial growth from 9.6 percent in FY13 to 8.4 percent in FY14. Industrial growth decline reflected slower growth of manufacturing from 10.3 percent in FY13 to 8.7 percent in FY14. Construction sector registered a growth rate of 8.6 percent, the highest in the last five years despite prolonged disruption in activities in the first half due to work stoppages (hartals) and blockades. Agriculture growth is projected to have improved to 3.4 percent from 2.5 percent in the previous year. This is not implausible, given good harvests of aman rice and aus rice.

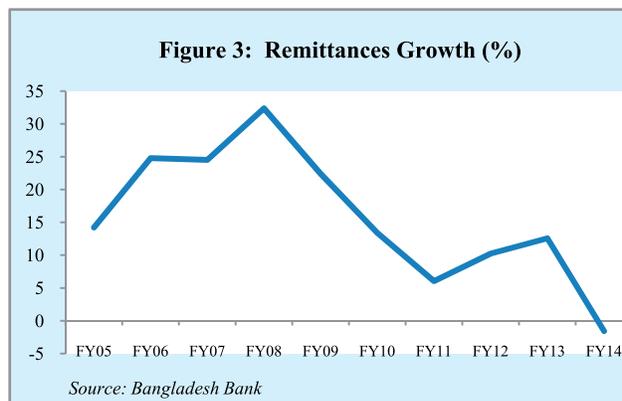
8. The biggest surprise is the estimated growth rate for the services sector, which increased to 5.8 percent in FY14 from 5.5 percent in FY13. All the nine sub-sectors are projected to have grown at a higher rate relative to FY13. Political turmoil affected the services sector most badly, yet the BBS estimates show a significant improvement in the performance of the sectors presumably more adversely affected by political unrest—land transport, wholesale and retail trade, hotels, restaurants, real estate, renting, and business activities.

9. On the expenditure side, the share of private consumption in GDP declined by about 1.5 percentage points while the share of private investment declined by 0.36 percentage points (Figure 2). Remittances declined by 1.6 percent (Figure 3). The public investment rate on the other hand increased from 6.6 percent of GDP in FY13 to 7.3 percent of GDP in FY14. The deficit in external resource balance (export minus import) in FY14 shrank significantly with increase in export-



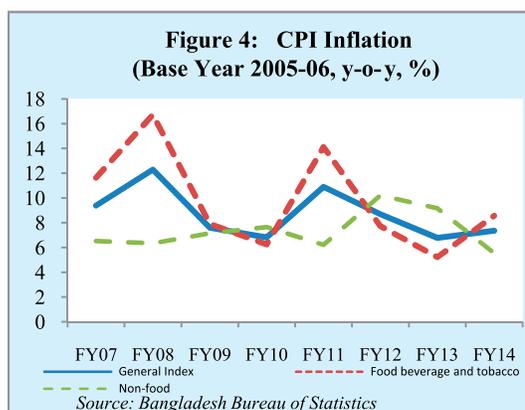
GDP ratio from 19.5 percent in FY13 to 19.8 percent in FY14 while the import-GDP ratio declined from 26.8 percent to 25.2 percent. The national savings stagnated at 30.5 percent, although still 1.85 percentage points higher than the domestic investment rate. The excess of national savings over investments reflect weaknesses in the domestic investment climate. Bangladesh is not able to redeploy its entire national savings in the domestic economy. An emerging economy like Bangladesh is expected to have deficits in its current account driven by strong imports of capital machinery and intermediate inputs. While imports appear to have recovered relative to last year, the growth rate is still in single digit, a significant part of which came from increase in food and other consumer goods imports.

10. The FY15 budget has set a very ambitious 7.3 percent growth target. Achieving this will require the total investment to GDP ratio to rise by over 5 percentage points—from 28.7 percent in FY14 to 33.8 percent (new 2005/06 base). This cannot happen without a major rise in the private investment rate. The other source of growth could be increased capacity utilization, but the potential is limited because, according to the recently released Enterprise Survey (ES) 2013 by the IFC, Bangladeshi manufacturing firms report very high levels of capacity utilization. Average capacity utilization for Bangladesh is 84 percent whereas the average for 122 countries with ES data is 73 percent.¹³ Labor productivity increases in Bangladesh historically has predominantly come from capital accumulation. Total factor productivity (TFP) growth has remained rather small. Findings of an Asian Development Bank (ADB) study also suggest that the gap between actual output and estimated potential output is small.¹⁴



Inflation is still high but stable

11. The overall inflation increased to 7.4 percent in FY14 relative to 6.8 percent in FY13, driven largely by increases in food inflation (Figure 4). For the first time in FY14, year-on-year inflation came down below 7 percent in June, but the average for the whole year has exceeded the 7 percent target. Food inflation rose in FY14 while non-food inflation declined. These were closely linked with the political turmoil experienced in the first half of FY14. The food supply chain was severely disrupted due to nation-wide and regional strikes (hartals) and blockades. At the same time non-food inflation declined in the face of lower domestic demand. In addition, the exchange rate of the taka was stable and broad money growth declined.



¹³ IFC, Country Highlights, Bangladesh 2013, Enterprise Survey.

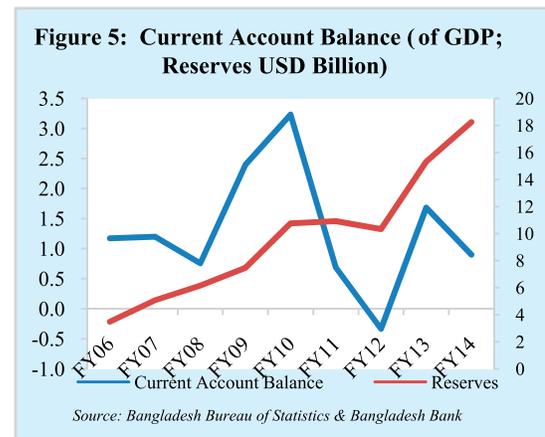
¹⁴ ADB, Bangladesh Quarterly Update, June 2014.

12. The rising trend of food inflation towards the end of FY14 is largely explained by the higher retail price of rice. Indeed, during the harvest season for boro rice, prices at the retail levels were significantly higher than the same period in the previous year. The widening gap between wholesale and retail rice and flour prices after January 2014 suggests that middlemen in the food distribution network may have raised their margins to make up for losses during the disruptions. One notable feature of recent food inflation is the narrowing gap between rural and urban food inflation. The higher rural food inflation could be due to the higher purchasing power due to rural wage growth and expanded safety net coverage.¹⁵

13. Non-food inflation declined from 9.2 percent in FY13 to 5.5 percent in FY14. The decline encompassed all sub-categories of non-food inflation—clothing, footwear, rent, lighting, household equipment, transport, communication, medical care, recreation, and entertainment. It therefore looks very much like a demand driven phenomena in which remittance decline, slow pace of economic activity due to uncertainties and structural bottlenecks, and prudent monetary management contributed. Stability in global oil prices helped contain the cost-push to non-food inflation.

Increase in the overall BOP surplus contributed to continued accumulation of foreign exchange reserves.

14. Despite a lower trade deficit, the current account surplus narrowed last fiscal year because of declines in remittances and increased deficit in the services account (Figure 5). The impact of the current account surplus on the overall balance of payments was reinforced by surplus in the financial account, despite a decline in foreign direct investment (FDI) inflows and a sharp increase in outflows on account of trade credit. The financial account surplus came largely from a reversal of errors and omissions from US\$752 million outflows in FY13 into US\$504 million inflow in FY14 and increase in net medium and long-term official loans.¹⁶



15. The overall balance of payments surplus increased from US\$5.1 billion in FY13 to about US\$5.5 billion in FY14, creating an excess supply of foreign exchange relative to demand in the foreign exchange market. This led to an upward pressure on the nominal exchange rate. Bangladesh Bank remained active on the buying side of the foreign exchange market to prevent any significant exchange rate appreciation. BB's net purchase of foreign currencies amounted to US\$2.35 billion during first half of FY14 and US\$2.80 billion in the second half. Reserve accumulation reached US\$21.6 billion at the end of June 2014, sufficient to cover nearly six months of projected goods and non-factor services imports (Figure 5).

16. The exchange rate has remained stable between Tk 77 and Tk 78 per US dollar in recent months. The difference between the unofficial market rate and the inter-bank rate has remained very small, indicating a very stable foreign exchange market. The difference between the Real Effective Exchange Rate based nominal rate and the inter-bank rate has shrunk in recent weeks, indicating that the nominal exchange rate is in line with the economic fundamentals. BB's interventions in the foreign exchange market have limited the loss of external competitiveness by stemming any significant nominal appreciation of the taka. However,

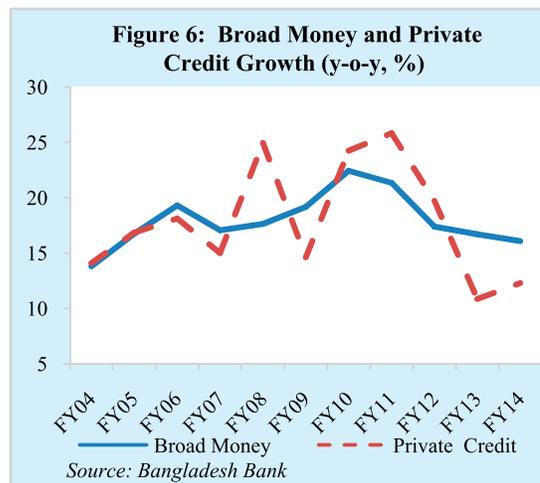
¹⁵ Bangladesh Bank, Monetary Policy Statement, July-December 2014.

¹⁶ The positive errors and omissions signifies that the mismatch between changes in foreign exchange reserve and recorded balance of payments flows was dominated this year by mismatch in recorded balance of payment inflows.

because of a small nominal appreciation and higher domestic inflation, the real effective exchange rate appreciated by 8.5 percent in FY14 relative to FY13.¹⁷

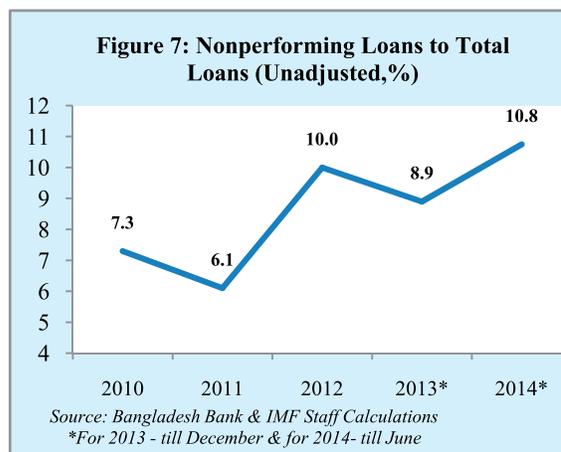
Monetary management remained on course

17. BB succeeded in keeping the FY14 broad money and reserve money growth below target rates of 17 percent and 16.2 percent, respectively. Broad money growth slowed to 16.1 percent while reserve money growth increased to 15.5 percent relative to FY13. BB had to contain growth of net domestic assets to counter the overshooting of target for net foreign asset growth. Private sector credit growth remained subdued at 12.3 percent (Figure 6). Policy rates were not changed despite pressures from stakeholders. With ample liquidity created by BB purchases of foreign exchange, sterilization operations had to be stepped up which adversely affected BB profitability. To mitigate the rise in BB’s interest costs, the Cash Reserve Requirement was increased from 6 percent to 6.5 percent in June 2014 after nearly three and a half years. BB conducted Treasury bills auctions regularly. With excess liquidity, the T-bills were in high demand which resulted in declining interest rates on instruments of all maturities. Weak private investment due to political uncertainty and deteriorating infrastructure and increased international borrowing by the corporate sector contributed to perpetuation of weak private demand for domestic credit.



Financial sector not out of the woods yet

18. Credit and risk management status is unsatisfactory in the banking sector (Box 2). There has been a steady rise in non-performing loans (NPLs) to 10.75 percent in June 2014, up from 10.5 percent in March 2014 and 6.1 percent in December 2011 (Figure 7). Defaulted loans in the banking sector increased to Tk 513.45 billion as of June 30, 2014 from Tk 405.83 billion as of December 31, 2013—an increase of over 26 percent in six months. Some of these banks also require recapitalization and cleaning up of unrecognized loan losses from ever-greening of loans, weak loan classification and provisioning requirements, especially in SCBs.



19. The banking sector faces risks due to low capital base in State-owned Commercial Banks (SCBs) which account for a quarter of the assets of the banking system. Asset quality in the SCBs deteriorated in FY14. The deterioration reflected both the impact of disruptions caused by political unrest as well as the lagged effects of poor lending decisions in the past. With over 70 percent of financial assets in the banking system, banking assets to GDP at 77 percent and deposits to GDP at 60 percent, risks in the SCBs are systemically significant.

¹⁷ IMF data.

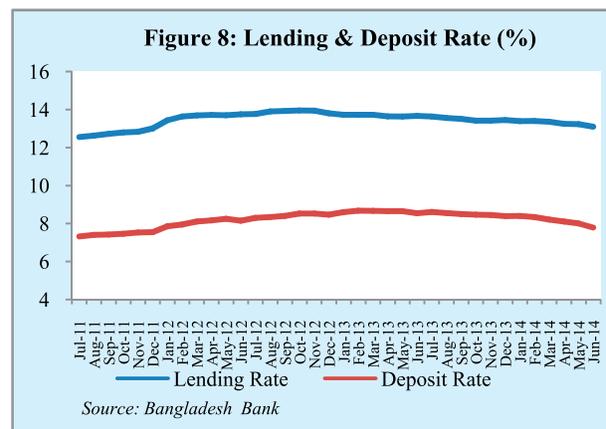
- The Capital Adequacy Ratio (CAR) of the scheduled banks stood at 10.68 percent¹⁸ at the end of June, which was 11.52 percent six months ago.
- Nine banks failed to keep the minimum required capital. Their capital shortfall collectively stood at Tk 119.33 billion which pulled down the overall capital base of the banking sector.
- The banking sector faced a capital shortfall of Tk 8.48 billion in the first half of 2014 against the required capital of Tk 645.42 billion.
- Capital shortfall in the SCBs stood at Tk14.42 billion with 8.65 percent CAR as of June 30, 2014 while shortfall in the four state-owned specialized banks rose to Tk 75.24 billion in the first half of 2014 from a shortfall of Tk 63.82 billion as of December 31, 2013. Their CAR was *negative* 13.68 percent as of June, 2014.

Box 2: Financial Sector Woes

Weak corporate governance, especially in state-owned banks, has led to sub-optimal lending decisions. The government passed the Bank Company (Amendment) Bill, 2013, amending key provisions in order to improve governance and bring discipline in the banking sector. Bangladesh Bank’s supervisory and regulatory capacity is still weak -- compliance based instead of risk based -- and this needs to be strengthened to improve efficiency and stability of the banking sector. Other issues to be addressed are: high cost of finance, low level of access to finance for SMEs and agriculture. Access to affordable finance is identified as one of the top four obstacles for doing business (2013 Doing Business report). Long term finance (only 19 percent of total lending in June 2013) particularly for exporters and SMEs is limited, and the financial sector remains ineffective in its capacity to perform its term transformation functions.

20. The government on its part, injected Tk 50 billion (US\$633 million) for recapitalization of state-owned banks in FY14 and made a budgetary allocation of Tk 55 billion (US\$729 million) for FY15.

21 Excess liquidity in the banking system has increased. In the second half of FY14 call money rates declined to around 6 or 7 percent since their peaks (20 percent) in early 2012. At the retail level both deposit and lending rates fell in the second half of FY14, but interest rate spreads have on average increased—from 4.99 percent in January 2014 to 5.22 percent in May 2014. The deposit rates have fallen faster than lending rates (Figure 8). Domestic lending rates have fallen due to lower cost of funds for banks, lower demand for credit as well as increasing competition from overseas lenders whose lending rates are in single digits.

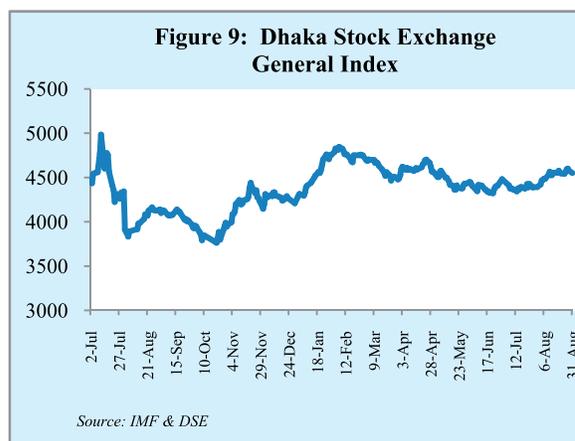


22 For the capital market, overall, 2014 has been a year of some recovery and relative stability (Figure 9). The stock index gained grounds in the second half of FY14 after remaining sluggish in the first half. The benchmark index of Dhaka Stock Exchange, DSEX, gained 5 percent between January and June. The uptrend started at the beginning of the calendar year, following national parliamentary election on January 5, 2014. DSEX reached its peak at 4,845 on February 6, 2014. However, the post-election euphoria

¹⁸ The average CAR is significantly lower in Bangladesh than other countries in SA like India (14.20%), Pakistan (15.40%) and Sri Lanka (14.50%). Banks in Bangladesh hold low level of risk weighted assets.

dissipated shortly and the benchmark index lost 5.7 percent in the following five months, reaching its lowest at 4,363 on June 23, 2014. From July onward it moved within a band of 4,400 to 4,600. Stocks with good fundamentals marked higher return compared to the overall return on the market portfolio. DS30, the blue chip index, marked a sustained 12.7 percent yield, which is more than double the return on the benchmark index (5 percent).

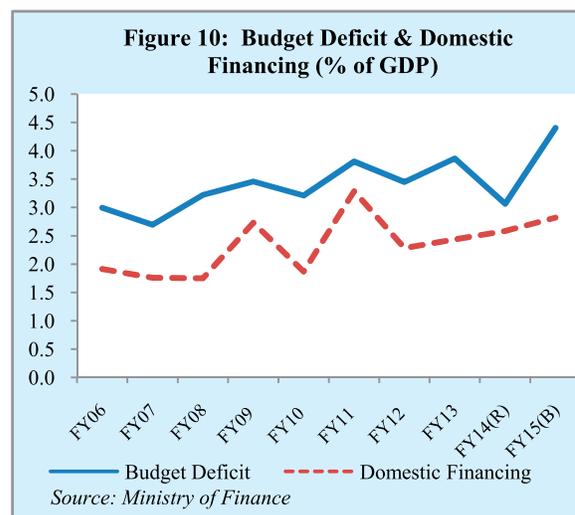
23. The trade volume improved between January and June, 2014. Average daily turnover exceeded the Tk 6 plus billion in January 2014 for the first time after 2011, when the average daily turnover was Tk 6.6 billion following the 2010 market crash. Improvement in the average daily turnover was also a result of the euphoria associated with the January 2014 national election. After declining to around Tk 3 billion in May, daily turnover started picking up again from early August and crossed Tk 6.0 billion mark on September 4, 2014. Recent episodes of volatility in emerging markets have so far had negligible impacts on Bangladesh's financial markets, with continued strong performance in stock markets helped by a return of foreign portfolio investment flows.



24. Bangladesh Bank has begun implementing the new provisions related to lending and the banks' exposure to stock markets under the amended Banking Companies Act. It has also taken steps to implement the plans to strengthen the bank resolution and lender of last resort frameworks. The financial policy for FY14 sought to strengthen credit and debt markets by taking steps to improve corporate governance, supervisory capacity, stimulate higher demand for government securities and broaden financing options. The enhanced authority given to BB over the appointment and dismissal of senior management in SCBs in the 2013 revisions to the Bank Companies Act has been exercised providing a clear signal to the industry. The temporary relaxation of loan classification and provisioning policy introduced during the December 2013 turmoil expired in June 2014. However, some of the rescheduled loans, particularly of SCBs, have become non-performing again. BB has set financial improvement plans with the four SCBs and Basic Bank which include differential ceilings on loan growth. Debt markets are becoming active with several recent auctions over-subscribed and a sharp fall in devolvement from 26.6 percent in the first half of FY14 to 5.3 percent in the second half.

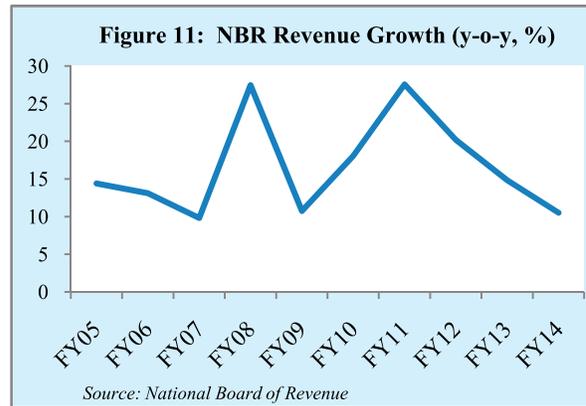
Fiscal policy plagued by revenue and development budget implementation shortfall

25. The overall budget deficit narrowed to 3.1 percent of GDP in FY14, from 3.9 percent in FY13, while the share of non-bank financing of the deficit increased (Figure 10). Net external financing declined from 1.5 percent of GDP in FY13 to 1.1 percent in FY14. The shortfall in foreign finances (in terms of both foreign grants and net foreign borrowing) was offset by a boom in sales of national savings bonds. Net



sale of National Savings Directorate (NSD) certificates surpassed the budget target by a significant margin. Consequently, government borrowing from banking sources remained below budget target and the government managed to repay its debt to the Bangladesh Bank and other short term loans under ‘other non-bank sources’.¹⁹ Public debt to GDP ratio remained on a downward path with external debt at about one half of total public debt.

26. Having surpassed budgetary targets for three years in a row prior to FY13, the National Board of Revenue (NBR) faced a revenue shortfall in FY14, when compared to the budget target, for the second year in a row (Figure 11). Although tax revenue collection gained some momentum in the second half, it failed to recover fully from the slowdown experienced in the first half of FY14 resulting in weaker revenue growth relative to FY13 across most revenue categories. As a result, in FY14, NBR targets were revised downward for the first time since FY09. Although efforts from non-NBR and non-tax sources have also lagged behind the target growth in FY14, they maintained performance at 0.3 and 1.8 percent of GDP as in FY13.

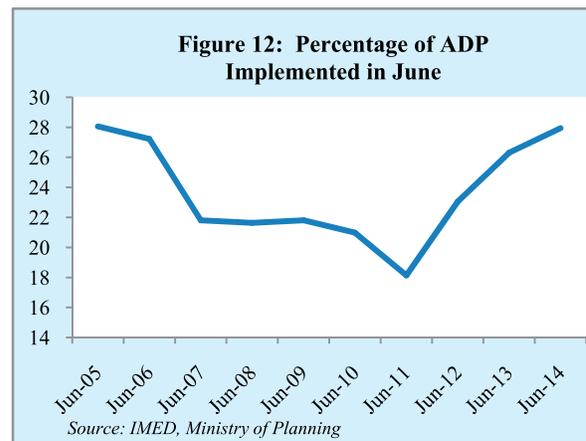


NBR attempted to boost tax collection by launching a drive focused on collection of unpaid taxes by tax dodgers and through resolution of pending tax related disputes in a speedy manner with limited results.

27. Sluggish expenditure growth compensated for the shortfall in revenue mobilization in containing the budget deficit (Box 3). The sluggish growth is attributable mainly to low implementation of the Annual Development Program (ADP) and restraints on subsidies, transfers and net lending. Progress on the implementation of ADP was slow in the first eleven months followed by about 20 percentage point increase in the implementation rate in June alone. No major breakthrough could be achieved in addressing the year-end bunching problem in ADP implementation (Figure 12).²⁰ There has been inadequate visible improvement in the management of ADP implementation in a way as to improve the quality of public investments.

Implementation the main challenge in the FY15 budget

28. The overall FY15 budget deficit target is prudent (less than 5 percent of GDP), notwithstanding somewhat ambitious revenue targets. The Revenue-to-GDP ratio is projected to increase by over 1 percentage point. This is not beyond the realm of possibility since such an increase was achieved in FY11, but it has been rather rare. The Expenditure-to-GDP ratio is projected to increase by about 0.7 percentage points—slightly less than the 0.8 percentage point annual increase achieved on average in last five years.



¹⁹ This shift in the composition of domestic debt towards costlier non-bank domestic sources is a concern in view of interest payments emerging as one of the major sources of non-development expenditures.

²⁰ ADP expenditures increased from Tk 399.8 billion by the end of May to Tk 567.5 billion in June—an increase of almost 42 percent in just one month.

29. Improving the quality of ADP implementation is difficult when the number of projects keep increasing. The size of the ADP in FY15 is envisaged to increase by 34 percent from the FY14 revised ADP. Usual problems of too many projects with too little allocation have not been addressed. The FY15 ADP includes 959 new projects in addition to the 1034 ongoing ones. Of the new projects, there are 683 unapproved projects that are proposed to be financed from domestic sources and 276 unapproved ones expected to be funded from external sources. Most of the unapproved projects are for constructing rural roads, bridges and culverts, and expanding power distribution lines which are generally undertaken by some ministries and agencies under pressure. The highest number of such projects is related to those of the Roads and Highways Department (RHD), the Railway Ministry, Local Government Division (LGD), and Bangladesh Water Development Board (BWDB).

Box 3: Fiscal performance deficit in Bangladesh

Despite recent gains, tax collection in Bangladesh remains below that in other Asian countries: Vietnam (24 percent), China (18 percent), India (15 percent), Nepal (13 percent), and Sri Lanka (13 percent). The collection of both direct and indirect taxes relative to GDP in Bangladesh is significantly lower than in the Asian comparators, while the collection of international trade taxes relative to GDP exceeds that of most comparators. With comparatively high nominal tax rates but low revenue yields, Bangladesh's revenue productivity for personal income tax and the VAT is very low compared with its regional comparators because of excessive use of a variety of *tax incentives*; structural flaws in the main taxes; and weak tax administration.

A similar pattern exists on the expenditure side. In FY13, total public expenditure to GDP ratio in Bangladesh was 16.9 percent, compared with 26.2 percent in Vietnam, 28 percent in India, 17.2 percent in Nepal, and 19.3 percent in Sri Lanka. Opportunities, policies, and finance are not the binding constraints on expenditure effectiveness in Bangladesh. The binding constraint is implementation. According to a recent ADB portfolio review, no less than half the project time elapses by the time 20 percent fund is released primarily because of poor project readiness. Apart from procedural constraints, there is a capacity problem in the planning cell of executive agencies and line ministries. Delays in procurement and recruitment of consultants remain endemic in infrastructure projects. Low level of delegation of power in the government approval system also contributes to delays. Resettlement and land acquisition delay project implementation by 2 to 2.5 years.

30. Expenditures on subsidies in FY15 are projected to decline to Tk 260.5 billion, compared with Tk 323.8 billion in FY14 conditional on upward adjustments in fuel and electricity prices. The government has committed to provide budgetary transfers of subsidy cost to the state-owned enterprises (SOEs) on a regular basis and improve financial reporting by SOEs. The government released the full FY14 budget allocation of Tk 134.5 billion to settle part of the past liabilities of Bangladesh Petroleum Corporation (BPC) and Bangladesh Power Development Board (BPDB) to banks and other creditors.

31. Steady implementation of the new VAT law and stronger revenue administration will be needed to go beyond the cyclical recovery in revenue in FY15. Bangladesh will enter FY15 on the heels of a disappointing revenue performance in FY14. In the FY14 budget, the government had set an ambitious NBR revenue target of Tk. 1,360 billion which was 25.2 percent higher than the FY13 actual. Achieving this would have been very challenging even under normal circumstances. Economic slowdown exacerbated by shutdowns and strikes made its achievement even more difficult, resulting in only 10.5 percent NBR revenue growth in FY14. The revenue growth slowed across the board, although the deceleration was dominated by trade based taxes which grew by only 3.2 percent. Both VAT (domestic) and income tax revenue growth have been well below the rates of growth required to achieve their respective budget targets. The government has already reduced the Advance Income Tax on exports which will remain effective throughout FY15. In this context of a weakened tax effort, achieving the one percentage point increase in the tax-to-GDP ratio will

be a huge challenge. Delay in the implementation of the new VAT law will make it even tougher.

32. The composition of deficit financing can be improved by ensuring that the net foreign financing target is met. Foreign financing is a lot cheaper with an effective interest rate of less than one percent. The effective interest rate on domestic debt is around 11.4 percent. Increasing foreign financing will require a significant increase in the disbursement rate from the outstanding aid commitment, which is over US\$19 billion. Meeting the target will require a 22 percent disbursement rate in FY15. The only way this can be achieved is through prioritized attention to large and high impact aided projects.

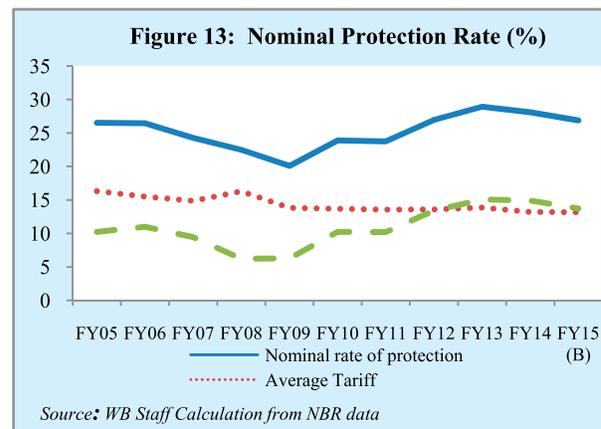
33. Inability to meet the net foreign financing target will not necessarily mean greater than targeted reliance on domestic financing because foreign financing shortfalls usually arise from the inability to spend on the aided projects. However, the relationship is not one-to-one and domestic bank financing target of about Tk 350 billion is rather large and may constrain private credit growth if private investment demand picks up. It may also challenge achieving the inflation target. The government will need to tread carefully on this front.

III. Structural Reforms

Structural reforms progressed, but the pace is slow. The fourth review of the IMF's ECF arrangement has been successfully completed as all performance criteria at the test date for the fourth review were met and the structural benchmarks have been completed.

34. Trade tax rationalization: The nominal protection rate declined further. The average nominal protection declined further to 26.7 percent in FY15 from 28.1 percent in FY14. This was due mainly to the rationalization of the supplementary duty (SD) structure (Figure 13). In FY15, the SD regime has been changed from 10 slab structures to 12 slab structures with SD on 770 items moving mainly to the next nearest lower slab. As a result, average effective supplementary duty at import stage declined from 11.9 percent in FY14 to 10.7 percent in FY15. The rationalization of supplementary duty primarily impacted final consumer goods as average nominal protection declined from 50.7 percent in FY14 to 47.8 percent in FY15. However, there was an increase in average nominal protection on raw materials and capital goods by 0.2 percentage points and 0.1 percentage points respectively. Average rate of para tariff as well as share of para tariffs in nominal protection decreased, respectively from 14.9 percent in FY14 to 13.5 percent in FY15 and from 53 percent in FY14 to 50.7 percent in FY15.

35. The Bangladeshi Cabinet approved the draft “Bangladesh Export Processing Zone (EPZ) Labor Act, 2014” allowing EPZ workers the right to form trade unions. Protecting the freedom of association and collective bargaining rights of the EPZ workers was a critical action highlighted both in the Sustainability Compact of the EU and the action plan provided by the United States (US) in order to improve labor conditions and reinstate Generalized System of Preferences (GSP) privilege in the



US. The law is consistent with the amendments made in the Bangladesh Labor Act 2013 and maintains all the existing amenities of the EPZ workers. According to this proposed law, to form a union in a factory, at least 30 percent of the workers have to submit application for registering an association with the Bangladesh Export Processing Zone Authority (BEPZA). After registration, union's executive committee will be elected for one year. Effective and swift implementation of this law will be crucial. However, the implementation progress on the amended Bangladesh Labor Act 2013 has been rather slow due to weak monitoring and follow up.

36. There have been several other policy reforms with respect to the ready-made garment (RMG) sector. Annex A provides an update on garment sector reforms since the Rana Plaza tragedy, when a building collapsed in Dhaka, killing more than 1,100 RMG workers. The government has increased cash incentives for RMG exporters by 0.25 percent. In addition, RMG exporters exporting new products or exporting to markets other than the European Union, the United States, and Canada will receive cash incentives of 3 percent, up from the existing 2 percent. These will be effective for the products exported from January 1, 2014 until June 30, 2015. Tax at source on cash incentives has also been reduced from 5 percent to 3 percent. A special tax rate of 10 percent that the RMG exporters enjoyed on their export earnings since FY06 has been withdrawn. The exporters will now be taxed at the normal tax bracket which is 35 percent for private limited companies and up to 30 percent for individual taxpayers.²¹ Earlier, the government had reduced the Advance Income Tax at source from 0.8 percent to 0.3 percent.

37. The Government has decided in principle to collect tolls in phases from all vehicles using highways. Tolls will be collected from the 21,481 km highways of which 3,544 km national, 4,278 km regional and 13,659 km inter-district and bridges over 200 meters under the RHD. The Local Government Engineering Department (LGED), which is responsible for the road networks up to the villages, remains out of the purview of the policy. There will be a Tk 300 "base toll" for national highways, Tk 200 for regional highways, and Tk 100 for inter-district highways. Some highways will be designated as "important" and their base toll will be Tk 400. Vehicles have been divided into 13 categories for the toll collection. The toll collected will go to the Road Fund and will be spent on development and maintenance of the road infrastructures across the country. The toll will be collected by appointing contractors through bidding or open auction and by the RHD itself if there is no taker.²² Preventing political rent-seeking in the name of tolls and ensuring transparency in usage of collected funds will be a challenge during implementation of this policy.

38. The FY15 budget introduced some revenue reforms. These include a new income tax slab of 30 percent for incomes above Tk 44.2 lakh. A surcharge of 20 percent will be imposed on individuals with wealth between Tk. 200 million (US\$2.5 million) to Tk 300 million (US\$3.8 million) and 30 percent on assets above Tk 300 million. The tax exemption limit for women and senior citizens has increased by Tk 25,000 and for physically challenged people by Tk 50,000. The corporate tax on non-publicly traded companies has been reduced to 35 percent from 37.5 percent. Turnover tax has been reduced to 0.3 percent from 0.5 percent. New revenue generation measures include increase of tax rate at the source on the deed value of land from 3 percent to 4 percent in areas other than the important commercial and posh areas within the jurisdiction of the Dhaka city development authority, RAJUK, and the Chittagong Development Authority. Besides, tax at source has been imposed at 3 percent, 2 percent and 1 percent on the registration value in other city corporations and municipalities at district headquarters, other municipalities, and other areas outside municipalities respectively. One percent surcharge on mobile phone usage has been introduced. In addition,

²¹ The Financial Express, August 26, 2014.

²² No Free Road, The Daily Star, March 25, 2014.

a green tax of 1 percent has been imposed on an *ad valorem* basis on all kinds of products manufactured by polluting industries. The tariff value of crude petroleum has been increased from US\$32 per barrel to US\$40 per barrel while the tariff value of other refined petroleum products has increased by 9 cents per liter. These are expected to increase indirect tax revenues.

39. BB has relaxed foreign exchange regulations on repatriation of sale proceeds of non-resident equity investment in unlisted companies and private limited companies. Under the new regulation, BB will now accept fair value of the shares as on the date of sale, based on the appropriate combination of three valuation approaches (net asset value approach, market-value approach, and discounted cash flow approach) rather than using only the net asset value approach. The net asset value approach is considered a conservative valuation as it does not take into account the intangible assets of a company leading to investors not getting the fair value of shares when repatriating their investments. BB expects this liberalization to contribute to a rise in foreign investment through the private equity channel.

40. The Speedy Supply of Power and Energy (Special Provision) Amendment Act 2014 has been passed. This legislation increases the effectiveness of the controversial provision of indemnity to the authority from the court of law for implementing any power or energy projects till October 11, 2018. Any power or energy projects can be implemented without going through the existing lengthy procurement process in order to expedite implementation. This law was first enacted in 2010 for two years and then extended for another two years in 2012.²³

41. Cabinet approved the National Broadcasting Policy, 2014, the first of its kind in Bangladesh. The policy will be gradually implemented by a yet-to-be-constituted independent “National Broadcast Commission.” The Chairman and members of the commission will be selected through a search committee. Although the policy has been formed allegedly to ensure freedom of speech, transparency and accountability of the media, stakeholders are terming it a draconian policy that will enable the government to take control of the media.

42. A constitutional amendment bill to restore the national parliament’s authority to impeach Supreme Court (SC) judge has been approved by the parliament. The existing provision in the constitution requires the Supreme Judicial Council (SJC) comprising of the chief justice and two senior judges of the Appellate Division to investigate allegation of misconduct and incapacity against any SC judge and make necessary recommendations. According to the amendment, the parliament will regulate the impeachment procedure and investigation against a SC judge by enacting a law.

²³ Indemnity extended for 4 more years, New Age, August 26, 2014

IV. Outlook and Risks

Immediate global outlook is fragile

43. A less optimistic outlook for several emerging markets combined with a weak first quarter in 2014 in the United States led the IMF to mark down global growth projection for 2014 by 0.4 percent to 3.3 percent.²⁴ However, the global growth projection for 2015 lowered from 4 percent to 3.8 percent with somewhat stronger growth expected in some advanced economies next year. Downside risks remain a concern. Financial market risks include higher-than-expected U.S. long-term rates and a reversal of recent risk spread and volatility compression. Global growth could be weaker for longer, given the lack of robust momentum in advanced economies despite very low interest rates and the easing of other brakes to the recovery. In some major emerging market economies, the negative growth effects of supply-side constraints and the tightening of financial conditions over the past year could be more protracted.

44. Bangladesh's ability to diversify export markets will depend on the strength of growth in emerging economies. Growth in **emerging markets and developing economies** is projected to fall to 4.4 percent in 2014 and then strengthen to 5 percent in 2015. Growth in 2014 in **China** is projected to be 7.4 percent due to limited and targeted policy measures to support activity in the second half of the year, including tax relief for small and medium enterprises, accelerated fiscal and infrastructure spending, and targeted cuts in required reserve ratios. Growth in **India** appears to have bottomed out, and activity is projected to pick up gradually after the post-election recovery in business sentiment, offsetting the effect of an unfavorable monsoon on agricultural growth. In a number of major emerging market economies, growth projections for 2014–15 have been marked down. Tighter financial conditions in Brazil and continued weakness in business and consumer confidence are holding back investment and dampening consumption growth. Weaker construction and a slower U.S. recovery are projected to result in slower growth in 2014 relative to the previous forecast. In **Russia**, investment is expected to remain weaker for longer, given geopolitical tensions. Growth in **South Africa** is expected to stay sluggish as a result of electricity constraints and labor conflicts.

45. Regional inflation and international commodity prices are key risks to Bangladesh. Crude oil prices have been remarkably stable in the first half of 2014 although they reached a six-month high in June due to re-escalated turbulence in Iraq. Increased geopolitical risks could lead to sharply higher oil prices. Global food prices have increased between January and April 2014 from their low levels last year. Supply concerns emerged for various food commodities due to adverse weather and disease. However, international food prices declined to a four year low between July and August. Global food prices are expected to remain stable in the near term.

Sustaining growth recovery is the key challenge

46. GDP growth in Bangladesh is most likely to recover in FY15. It is projected to rise to 6.2 percent, driven by stronger domestic demand resulting from increased public investment in infrastructure, some revival in private investment activities, and domestic consumption growth getting a boost from remittance recovery and implementation of wage increases in the garment industry. Export growth in the first two months of FY15 dipped to 2.1 percent with garment export growth dipping to 1.7 percent. Non-RMG exports growth was also weak. Remittances have rebounded significantly with 21.9 percent growth in the first three months relative to the same period the previous year. Although flooding this year has lasted longer than last year, the crop production outlook is still very positive. As usual, ADP implementation in July-August has been tiny—only 4.8 percent of the total FY15 ADP.

²⁴ IMF, World Economic Outlook Update, July 24, 2014.

47. Growth recovery cannot be sustained without mitigating the infrastructure deficit. Infrastructure investment increased from less than 1 percent of GDP in FY09 to about 2 percent in FY13,²⁹ still considerably lower than the 7-10 percent needed annually for next ten years.³⁰ Key infrastructure pillars are energy and transport (Box 4). Bangladesh has made some progress in improving its competitiveness ratings, most visibly in electricity supply. But comparison of infrastructure indicators among different Asian countries show Bangladesh is still deficient on the quality of infrastructure compared with different Asian countries except Myanmar (Table 2). Even Pakistan, which ranks lower than Bangladesh in country competitiveness, is ahead on the quality of its roads and port infrastructure. The infrastructure gap is especially large with competitors like Sri Lanka, India and Cambodia. Bangladesh needs to pay stronger attention to efficient implementation of infrastructure investments along with necessary institutional changes relating to policy making and regulation.

Box 4: Dilapidated highways and regional roads

Slow progress in completing major roads construction and rehabilitation has hindered achieving the desired inter-modal transport mix of the government's transport strategy. The Roads and Highways Department (RHD) for instance targeted constructing 4,672 kms of new roads and widening and strengthening 8,433 existing roads by FY15. Of these targets, RHD achieved only 15 percent and 22 percent respectively between FY11 and FY13.

The road situation gets worse during the monsoon season and Eid festival as the number of people travelling home multiplies. Under the RHD, there are 21,481 kms of national highways, regional highways and zilla roads in total, of which national highways constitute 3,544 kms.²⁵ According to the officials of the Ministry of Communications, the RHD has been provided Tk 14 billion from the FY15 revenue budget for repair, maintenance and rehabilitation work of the roads and highways, compared to Tk 13.38 billion in FY14.²⁶ Despite large government allocations every year, the quality of construction of roads and highways and their maintenance remain neglected.

The main reasons for the messy condition of the roads are sub-standard work of the contractors, incessant rainfall during monsoon season, and slow pace of work on the four-lane project of Dhaka-Chittagong and Dhaka-Mymensingh highways. According to a survey conducted by the Highways Development and Maintenance (HDM) department of RHD in December 2013, 41 percent of the roads and highways are in a bad shape, 12 percent of these are in a deplorable state, full of potholes and ruts. Of the remaining 59 percent, 20 percent are in a poor state and 39 percent are in decent shape.²⁷ Since, the repair and maintenance are being done on a temporary basis mainly with bricks, brickbats and sand, numerous potholes and cracks develop on the roads because of the downpour, which increases the chances of accident as well. A recent study entitled "Road Safety in Bangladesh: Realities and Challenges" stated that 95 percent of accidents take place within a total of 57 kms of nine national highways, making them the most accident-prone. There are 208 black spots across the country listed by the RHD where road accidents frequently occur. The report also pointed out that faulty road designs are among the few primary causes, responsible for those accidents.²⁸

Therefore, any unsustainable short-term solution for road safety is not only a death-trap for the commuters but also an exercise in wasteful spending. A year-long action plan for maintenance and repair works for the roads and highways across the country and regular updating of the list of accident black spots and action plans for improvement deserve priority attention from the policymakers.

²⁵ Roads and Highways Department, Ministry of Communication.

²⁶ The Financial Express, 27 July, 2014- Higher spending has little impact on road condition.

²⁷ Prothom Alo, 8 July, 2014.

²⁸ The study was conducted by the Power and Participation Research Centre (PPRC) and BRAC.

²⁹ Sadiq Ahmed, The Infrastructure Challenge in Bangladesh: Progress and Issues, paper presented at the Bangladesh Economic Forum, July 2014.

³⁰ The World Bank, Reducing Poverty by Closing South Asia's Infrastructure Gap, December 2013.

Table 2: Comparison of Infrastructure Quality 2014-2015

Country/Region	Country Ranking*	Overall Infrastructure Score	Electricity	Roads	Railroads	Port
Bangladesh	109	2.8	2.5	2.9	2.4	3.7
India	71	3.7	3.4	3.8	4.2	4.0
China	28	4.4	5.2	4.6	4.8	4.6
Cambodia	95	3.4	3.0	3.4	1.6	3.6
Myanmar	134	2.3	2.8	2.4	1.8	2.6
Pakistan	129	3.3	2.1	3.8	2.5	4.4
Sri Lanka	73	5.0	4.8	5.1	3.7	4.2
Thailand	31	4.1	5.1	4.5	2.4	4.5

Source: *The Global competitiveness Report 2014-2015 (2014 World Economic Forum)*; *Ranking among 144 countries. The rankings are in descending order with "1" as the best performer.

48. The availability of serviced land is the other binding constraint for sustained growth enhancement. The land market is dysfunctional. Bangladesh has achieved limited success in establishing Export Processing Zones (EPZs) and none whatsoever yet in establishing Special Economic Zones (SEZs). The establishment of SEZs is hindered by a number of bottlenecks including infrastructure support for connecting with ports and airports with world class roads and rail links along with efficient services. Deficiencies in the availability and quality of power and gas are an equally important constraint as are water and drainage connections, effluent treatment, and other basic facilities.

Macroeconomic stability is expected to be maintained

49. Underlying inflationary pressures, as reflected in non-food inflation, are expected to maintain a downward trend on continued policy restraint. However, higher wages and administered price adjustments pose upside risks to inflation. Bangladesh Bank has set a 6.5 percent inflation target for FY15. Year-on-year inflation increased in July reflecting increase in non-food inflation while food inflation softened. Recent recovery in economic activity aided by stability, revival of income growth in services and a significant moderation of remittance decline is likely to have contributed to temporary increase in non-food inflation in July. The overall year-on-year inflation declined from 7.04 percent in July to 6.91 percent in August, thanks to a fall in food prices in the international markets and stable situation in domestic market. Food inflation dropped to 7.67 percent in August from 7.94 percent in the previous month. Non-food inflation, however, increased marginally in August to 5.76 percent from 5.71 percent in July because of rise in house rent, cost of transportation, education and medical expenses and other non-food items.

50. Achieving the FY15 inflation target will depend on international price trends as well as domestic demand and supply conditions. Internationally, despite favorable prospects for cereal supplies, several uncertainties hanging over the near future, exerting upward pressures on prices, such as weather in the United States and possible escalation of geopolitical tensions in the Arab world or Ukraine. However, what will matter most for Bangladesh are domestic supply-demand conditions and macroeconomic management.

Inflation may be adversely affected if current floods are prolonged³¹ and domestic demand is boosted by the monetary effects of a surge in remittances.³² The 5 percent budget deficit target, if achieved, is unlikely to be inflationary if it is not monetized. The monetary policy statement for FY15 maintains a cautionary stance to ensure price and exchange rate stability as it did in the year just past (Box 5).

Box 5: Challenges in Monetary Management

The monetary stance for FY15 targets a monetary growth path which aims to reduce average inflation to 6.5 percent by end FY15 while remaining supportive to growth. Specifically BB will aim to contain reserve money growth to 15.5 percent and broad money growth to 16.0 percent. The space for private sector credit growth of 16.5 percent (including foreign borrowing by local corporates) is in line with output growth targets and is sufficient to accommodate any substantial rise in investment. The projected pick-up in economic activity in FY15 should absorb some of the current excess liquidity.

The challenge in implementing the monetary policy is to strike a proper balance between accommodation and stabilization. BB has met this challenge reasonably well in recent years. Although the June increase in the cash reserve ratio (CRR) is likely to have been driven by BB's rising interest costs associated with reverse-repo operations, it still signals a tightening of monetary policy. Tightening may have been motivated by inflation being still higher than the target. In the current state of the economy, continuity of the stance pursued in the previous MPS is a step in the right direction.

The balance between stabilization and accommodation this year need not differ from that of last year. BB is expected to refrain from loosening monetary policy to cover the shortage in fiscal policy or to compensate for policy failings in the stock market or public banks. Focus on the stability of the inflation and exchange rates will continue. Under low excess capacity and structural constraints on capacity expansion, monetary accommodation is likely to fuel inflation with little, if any, favorable impact on growth. BB should therefore err on the side of stable inflation and exchange rate. Should upside risks to inflation materialize, BB would need to tighten reserve money growth and consider exchange rate to appreciate within limits without hurting external competitiveness.

Slippage in structural reforms and political stability are major concerns

51. Domestic factors dominate risks to near-term outlook. A resurgence of political unrest, even if it is not as ferocious and as long as experienced in the last half of 2013, is the principal risk for the near term. This will depress private investment, push up inflation and potentially put reserves under pressure. Lack of visible progress in upgrading labor and safety standards in garment factories could trigger loss of preferential access to EU markets. The inability to reopen job opportunities in the Middle-East clouds the sustainability of remittance growth prospects. These are high impact risks, particularly when combined with the possibility of a protracted slowdown in advanced economies.³³ The deterioration in the state banks' financial solvency could challenge fiscal sustainability and constrain the availability of resources for public investment. An oil price shock from heightened geopolitical tensions in the Middle East, or

³¹ Starting from the 10th of August, 2014 the northern part of Bangladesh and upstream Indian States of Assam, Meghalaya, West Bengal and Sikkim have been experiencing heavy rainfall for several days. This has caused a rising trend of the major river system and, consequently, some low-lying areas have been inundated.

³² Some recent macro-econometric analysis shows that remittance inflows cause inflationary pressures in Bangladesh. The responsiveness of food inflation is almost two-and-a-half times higher than general inflation. A 1 percent increase in remittances causes 0.72 percent increase in overall inflation. Ripon Roy and Md. Mokhlesur Rahman, An Empirical Analysis of Remittance – Inflation Relationship in Bangladesh: Post-Floating Exchange Rate Scenario, WP 1403, Bangladesh Bank, April 27, 2014.

³³ Owners of more than 400 readymade garment (RMG) factories have been compelled to shut their operations following the Rana Plaza tragedy, mostly due to loss of orders from foreign buyers and for non-compliance with international standards. According to the Bangladesh Garment Manufacturers and Exporters Association (BGMEA), about 450 small and medium RMG units, including 218 BGMEA members, faced closure in the past one year, rendering around 1.5 lakh workers jobless.

protracted slow growth in trading partner economies, would adversely affect inflation and the balance of payments. Bangladesh's closed capital account limits its vulnerability to global financial volatility, but a large depreciation of the Indian rupee could strain deepening and diversification of Bangladesh's exports, particularly in garments, footwear, and light manufacturing.

52. Even if all the conditions are growth friendly, growth may still elude Bangladesh unless there is confidence about political stability and policy continuity. Bangladesh is well known as a case of growth governance conundrum. The governance environment may have been barely adequate thus far to cope with an economy breaking out of extreme poverty and low growth. Bangladesh needs to create a system of governance that can successfully manage the interactions between the state and a well-functioning globally integrated economy. Managing such an economy requires inputs that markets do not easily provide: infrastructure, security, rules, standards, certifications, training, and so on. These can be provided only by professionally competent and well-funded government agencies operating in a system that decentralizes power to identify problems, work out solutions and monitor performance. The non-elected state institutions—higher judiciary or the higher echelons of civil bureaucracy or the Election Commission or the Anti-Corruption Commission (ACC) and other watch dog bodies—need total confidence of the public. Without restoring the credibility of these institutions, governance will not grow out of patronage politics.

V. Bank Support and Activities

53. At the end of FY14, The World Bank Group's Bangladesh portfolio had 63 projects, including 32 International Development Agency (IDA) credits, 16 Trust Fund (TF) projects, and 15 co-financing Trust Funds, with a net commitment of US\$7.2 billion. In addition, there are two regional projects, an IDA credit for the Regional Strengthening Cooperation for Wildlife Protection Project, the national portion of which is a commitment of US\$36 million; and a TF for Engaging the Poor in South Asia Project (CARTA), the national portion of which is US\$640,000. Disbursements in FY14 reached US\$944 million, with the disbursement ratio of 23.1 percent for IDA/TF projects. FY14 disbursement was around 23.4 percent higher than FY13 disbursements.

54. New commitments in FY14 increased as well. Eight new IDA projects (US\$1.89 billion, of which US\$1.6 billion in new IDA commitments and over US\$200 million in re-programmed commitments) and 10 new TFs (US\$131.75 million) were approved in FY14. The approved operations are a combination of successful follow-on and new projects as well as smaller yet innovative pilot operations. Some significant approvals among these have been:

- *The US\$600 million Rural Electricity Transmission and Distribution Project* aims to reduce system losses and enhance capacity in the rural distribution network of primarily the eastern part of Bangladesh. The development objective is to improve the reliability and quality of supply of electricity to rural consumers in Bangladesh through improvements in technical efficiency of the rural distribution system. The project is also expected to support transmission enhancements by the Power Grid Company of Bangladesh (PGCB).
- *The US\$410 million Municipal Governance and Services Project* aims to improve municipal governance and basic urban services in participating Urban Local Bodies (ULBs), and to improve the recipients' capacity to respond promptly and effectively to an eligible crisis or emergency. The project development objective (PDO) will be achieved through an integrated approach including improving planning, resource management, accountability and social inclusiveness.

- *The US\$265 million Secondary Education Quality and Access Enhancement Project* aim to improve the quality of secondary education, systematically monitor learning outcomes, and to increase access and equity in project subdistricts (*upazilas*). The original project implementation targets have already been achieved, and 100 percent of the original credit has been disbursed.

55. In terms of Analytic and Advisory Activities (AAA) and Technical Assistance (TA), to ensure and extend the development work in Bangladesh, the World Bank has completed a number of important analytical activities, including a policy note for the new government, poverty mapping, a diagnostic trade integration study, and various studies related to climate change, and to public financial management. The Bank remains a committed partner with Bangladesh and will continue to work significantly to reduce poverty and bring prosperity to all Bangladeshis, focusing on the poor mostly.

Annex A: Update on Bangladesh Ready-Made Garment (RMG) Industry

RMG exports from Bangladesh has so far been resilient amid wide apprehension of growth getting stalled after the Rana Plaza collapse exposing the state of poor physical and social compliance in the industry. The actions taken by the government, buyers and manufactures for the betterment of worker safety and welfare are promising. However, a lot more needs to be done to reach international standards of compliance.

56. More than a year has passed since the Rana Plaza multipurpose building collapsed in Dhaka, killing more than 1,100 RMG workers. Since then, compliance in the Bangladeshi garment industry has been under serious scrutiny of both the local and international community. Detailed action plans were laid out by the European Union and the US administration, the global brands and the government of Bangladesh to improve compliance (particularly worker safety and rights) and avoid such industrial accidents in the future. After reviewing the garment export performance in the aftermath of the tragedy, this update provides an analysis of the current status of competitiveness of the RMG industry, the actions taken by the stakeholders to improve compliance and what more needs to be done to take labor safety and rights situation to an acceptable standard.

57. RMG is the most important manufacturing sector in Bangladesh. In FY14, garment exports accounted for 81.2 percent of Bangladesh's total export, increasing from 79.6 percent in FY13. RMG export was 14.1 percent of its GDP in FY14 and is the largest employer in Bangladesh outside agriculture with around 4 million workers, 80 percent of whom are women. The garment industry has the potential to create huge additional employment as the production focus on low value garments is slowly shifting from China. The industry also had significant impact on improving social indicators involving gender (see Box 6), apart from its significant contribution in value addition through production and employment creation.

Box 6: Welfare effects of the Garment Sector in Bangladesh

Rachel Heath and A. Mushfiq Mobarak have recently studied the effects of new employment opportunities in the ready-made garment industry on women's schooling, work, marriage and fertility decisions in Bangladesh based on a survey of 1395 households in 60 villages. They find that access to factory jobs has statistically significant effects on declining fertility and early marriage in Bangladesh. They estimate that exposure to the garment sector reduces the hazard of early marriage and childbirth by 28 percent and 29 percent respectively. The results can be explained by parents' propensity to keep younger girls in school to have a better shot at high paid garment sector work later and older girls' propensity to engage in work in factories.

The study estimates the gender gap in educational attainment closes by 1.5 years due to the presence of garment factories in proximity of villages. They also find that in villages within commuting distance to garment factories, exposure to these jobs led to a 38.6 percentage point increase in school enrollment rates and that roughly 14.8 percentage points of the national gain in female enrollment could be attributed to the growth in this export industry. The study explains that the increase in girls' educational attainment may stem from garment factories enhancing the perceived and actual market returns to skill, thereby creating greater demand for schooling. Benchmarking the magnitude of the effects of the garment industry against the effects of the Female Stipend Program (FSP), the authors conclude that the rapid expansion of the garment sector is a more likely cause of attaining gender parity in education and decline in early marriage and fertility than the FSP.

Source: Heath, R. and A.M. Mobarak. 2014. "Manufacturing Growth and the Lives of Bangladeshi Women", NBER Working Paper 20383.

Ready Made Garment (RMG) export from Bangladesh post Rana Plaza demonstrated strong growth

58. RMG exports displayed impressive growth in FY14 in the backdrop of increased global attention to safety compliance and prolonged political turbulence. Despite suffering from a severe image crisis after the Rana Plaza incident and nationwide general strikes in the first half of FY14 that disrupted the supply chain severely, RMG exports stood at an all-time high of US\$24.5 billion in FY14, with a growth rate of 13.8 percent compared to the previous year. Exports of both knitwear and woven garments had robust growth of 15 percent and 12.7 percent respectively compared to FY13. The European Union and the United States remain the primary destinations for Bangladeshi garments as they accounted for 60.2 percent and 21 percent share of the total garment export from Bangladesh respectively. The share of garment exports from Bangladesh to non-traditional markets (other than the European Union, the United States, and Canada) grew from 13.8 percent in FY13 to 14.7 percent in FY14.

Table A1: Bangladesh RMG Export Performance in EU and US									
Value (Million US\$)									
	FY13			FY14			Growth (Percent)		
	Knitwear	Woven	Total	Knitwear	Woven	Total	Knitwear	Woven	Total
EU	7391.0	5173.9	12564.8	8672.5	6072.9	14745.4	17.3	17.4	17.4
US	1130.9	3865.7	4996.6	1197.9	3943.5	5141.4	5.9	2.0	2.9
Volume (1000 Kg in EU and 1000 dozens in US)									
EU	486166	295148	781313	578966	317478	896445	19.1	7.6	14.7
US	49780	58802	108582	50867	60774	111641	2.2	3.4	2.8

Source: Compiled from EPB, Eurostat and USITC Trade data

59. Growth in garment exports in FY14 was volume driven. Exports grew by 17.4 percent in the European Union in FY14 compared to FY13. This was mainly due to the 19.1 percent increase in volume of knitwear products. Overall export volume growth in EU was 14.7 percent in FY14. However, export performance to the United States was sluggish. Export volumes and value increased by 2.8 percent and 2.9 percent respectively in the US market. Export volumes of both knitwear and wovens grew slowly by 2.2 percent and 3.4 percent respectively (Table A1).

60. RMG export performance in the United States is a concern. While garment exports to the United States grew at 13.2 percent in the first half of FY14 compared to the same period of FY13, it started to lose steam in the second half with a 5.8 percent decline. Bangladesh's market share remained virtually stagnant at 5.8 percent in FY14 compared to 5.7 percent in FY13 while market share of competitors like Vietnam has grown to 10.6 percent in FY14 compared to 9.5 percent in FY13. Adverse publicity due to the Rana Plaza disaster and subsequent cancellation of the Generalized System of Preferences (GSP) on the grounds of labor safety might have led US buyers to rethink their sourcing strategy from Bangladesh. Early signs for the new fiscal year are not encouraging as garment export in the US declined by 8.8 percent in the first two months of FY15 compared to same period of FY14.

Although Bangladesh still has an edge as apparel exporter over other competitors, its competitiveness may erode in the long run if working conditions do not improve.

Country	Minimum Wage (US\$ per Month)
Myanmar	50.6-60.6
Bangladesh	68
Cambodia	100
Pakistan	101
India	65-142.6
Vietnam	88.7-126
Indonesia	103.1-209.7
China	134.5-293.1

* As of July 2014.

Source: Compiled from National Wages and Productivity Commission, Department of Labor and Employment, Government of Philippines and www.wageindicator.org

61. Bangladesh is still considered the leading apparel sourcing destination alternative to China. Despite the ongoing debate on worker safety issues, buyers plan to increase their sourcing share from Bangladesh through 2020. The advantage of low wage and abundance of labor is still the most important factor in sourcing from Bangladesh.³⁴ Although the government raised the minimum wage by 77 percent in the aftermath of the Rana Plaza tragedy, Bangladesh still has the lowest wage rate among its competitors, except for Myanmar (Table A2). Though some buyers are considering Myanmar as an option for sourcing apparel in the future, it is at an early stage of development requiring a lot of investment. Several other industries are also interested in locating there which might lead to Myanmar focusing on industries other than apparel.³⁵ Vietnam's wage is set to increase even more (by US\$14-18 per month in 2015)³⁶ while labor unrest is ongoing in Cambodia to increase minimum wage to US\$160 per month,³⁷ reinforcing Bangladesh's cost advantage even more. Apart from costs, Bangladesh still holds the advantage of capacity and ability to handle large volumes of orders in a timely manner. With India not being favored by the western retailers as a replacement of Bangladesh even after the Rana Plaza tragedy because of cumbersome regulations³⁸ and the uncertain political situations in Pakistan, Bangladesh remains the best possible option for the buyers' alternative to China.

62. Bangladesh's advantage cannot be taken for granted. Bangladesh's popularity as a top destination for apparel sourcing in the next five years dropped³⁹ after Rana Plaza incident. This led to order cancellation of US\$110 million from 37 factories.⁴⁰ Increased attention to compliance has led buyers to reconsider their

³⁴ The global sourcing map-balancing cost, compliance and capacity, Mckinsey and Company, October, 2013

³⁵ Berg, A and Hedrich, S.(2014) "What's next in apparel sourcing?" Mckinsey and Company.

³⁶ Vietnam's minimum wage to increase \$14-18 per month in 2015, Thanh Nien News, August 6, 2014

³⁷ Trade unions approve minimum wage, draft law proposals, The Cambodia Daily, August 25, 2014.

³⁸ Bangladesh overtakes India in RMG exports, The Daily Star Online, January 19, 2014

³⁹ The global sourcing map-balancing cost, compliance and capacity, Mckinsey and Company, October, 2013

⁴⁰ Safety compliance a make-or-break from many garment factories, The Dhaka Tribune, April 30, 2014.

supplier base in Bangladesh and search for new alternatives. These might result in fewer orders placed in Bangladesh in the future. Top brands have already stopped placing orders in factories with shared buildings, which constitute 30 percent of total factories⁴¹ while some have slashed previously placed orders.⁴² Around 450 factories had to shut down their operations mainly due to lack of export orders and compliance.⁴³ With increasing apparel sourcing cost due to compliance issues and consumers unlikely to be willing to pay higher prices, companies are looking to reduce costs by sourcing from untapped low cost markets like Southeast Asia and Sub-Saharan Africa. H&M from Europe have placed a small order in Ethiopia to check their capacity.⁴⁴ PVH Corp of the United States, which was already sourcing from Lesotho and Kenya, is making a 20 year commitment to the Africa region with a long term plan of developing vertical operations and socially responsible factories.⁴⁵ If India's attempt to get into a free trade agreement with the European Union materializes, they may emerge as a serious competitor in that market.

There has been considerable progress in improving labor safety and working conditions through the joint efforts by the government, buyers and factory owners.

63. The government has made progress in improving worker rights and safety. In accordance with the EU Sustainability Compact and US Action Plan, the government fulfilled many of the commitments made.

- Minimum wage for the garment workers working in the lowest grade (Grade 7) has been raised to Tk 5300 (US\$68) from Tk. 3000 (US\$38).
- Amendments to the Labor Law have been made and draft “Bangladesh Export Processing Zone (EPZ) Labor Act, 2014” has been approved to protect both non-EPZ and EPZ workers fundamental rights to freedom of association and collective bargaining. Number of registered trade union increased from 131 in 2012 to 334 in 2014. The amendments in the Labor Law facilitated Bangladesh's inclusion in the “Better Work” program.⁴⁶
- To strengthen the labor inspection system, Office of the Chief Inspector of Factories and Establishments has been upgraded to a Department of Inspection of Factories and Establishment (DIFE). It has an authorized total of 575 inspectors: 392 new positions, 107 upgraded and 76 existing positions.⁴⁷
- Duty free import of fire safety equipment was allowed in the FY15 budget.

64. The government also adopted the National Occupational Safety and Health (OSH) Policy. Under the National Tripartite Plan of Action on Fire Safety and Structural Integrity (NTPA), signed by the National Tripartite Committee (NTC) comprising the government and representatives of employers and workers, Bangladesh University of Engineering and Technology (BUET) examined buildings of 282 factories based on the common standards agreed with the Accord and the Alliance. Two factories out of these 282 were shut down.

⁴¹ Big buyers stop sourcing from RMG factories in shared buildings, The Financial Express, February 11, 2014.

⁴² Drop in RMG profits, The Bangladesh Chronicle, April 14, 2014.

⁴³ About 400 factories shut from loss of orders, compliance issues, The Independent, September 10, 2014.

⁴⁴ Berg, A and Hedrich, S.(2014) “What's next in apparel sourcing?” Mckinsey and Company.

⁴⁵ Garment exports to US may lose out to Africa, The Daily Star, August 29, 2014

⁴⁶ “Better Work” is a partnership program of the International Finance Corporation (IFC) of the World Bank Group and International Labor Organization (ILO) with an aim to improve both compliance with labor standards and competitiveness in global supply chains. “Better Work Bangladesh” was launched in October, 2013 with a view to provide factory-level services, including assessments of compliance with national labor laws and international standards, and advisory and training services to improve working conditions in the RMG sector.

⁴⁷ Technical Progress Report on Sustainability Contact – July 8, 2014

65. Buyers are paying more attention to ensure safety compliance and improve supply chain transparency. The Accord, consisting over 180 global brands (mostly European), and the Alliance, an initiative of 27 North American retailers, have inspected a total of 1,438 factories out of which 15 have been shut down and 5 were partially closed. Fifteen factories were allowed to continue operation after taking remedial actions (Table A3). The Accord brands and factory owners have agreed to more than 250 corrective action plans.⁴⁸ Factories that are participating fully in inspection and remediation are rewarded with long-term sourcing commitments from these brands.⁴⁹ On the other hand, 50 percent of the factories inspected by the Alliance are in remediation process. The Alliance trained 1.1 million workers on basic fire safety and compensated 1000 displaced workers due to factory closures with 50 percent of four months' salary with rest 50 percent being the liability of the factory owners.⁵⁰ The inspection reports are being published gradually in the respective authority's websites to ensure transparency. Furthermore, retailers like Target Australia, Kmart, and Woolworths have disclosed the identity of the suppliers in Bangladesh in an effort to maintain transparency in apparel sourcing⁵¹ with larger corporations like VF Corporation also planning to follow suit.⁵²

Table A 3: Summary of Building Safety Assessment-Structural Integrity				
	NTPA	Accord	Alliance	Total
Total Factories	1500	1400	608	3508
Inspection Completed for Factories	282	834	604	1720
Referred to Review Panel	1	23	14	38
Partially Closed	0	3	2	5
Closed	2	12	3	17
Decision Pending	0	1	0	1
Allowed Operations	0	6	9	15

Source: Technical Progress Report on the Sustainability Compact- July 8, 2014, EU

66. Factory owners have taken some steps. Owners have become more cautious in awarding sub-contracting to smaller non-compliant firms. They are either avoiding sub-contractors or opting only for the compliant ones. Some manufacturers are trying to relocate their manufacturing units to more compliant buildings to avoid work place safety issues.⁵³ Many exporters have started to invest in making their buildings more compliant by installing necessary fire safety equipment like sprinkler systems, fire resistant doors, emergency lights etc.⁵⁴ The Bangladesh Garment Manufacturers and Exporters Association (BGMEA) has started training mid-level managers on work place safety and compliance with a target of 14,000 mid-level managers.⁵⁵

⁴⁸ Accord: Reap progress made towards safe RMG goal, Dhaka Tribune, September 7, 2014

⁴⁹ Annual Report 2013, Accord on fire and building safety in Bangladesh

⁵⁰ Protecting the Lives and Livelihoods of Bangladesh's Garment Workers, Annual Report of the Alliance for Bangladesh Worker Safety, July 2014.

⁵¹ Target Australia Discloses Bangladesh Factories, August 13, 2014. www.sourcingjournalonline.com

⁵² VF to Reveal Names of its Bangladesh Factories, June 2, 2014. www.sourcingjournalonline.com

⁵³ 50 non-compliant RMG units being relocated for safety. The Financial Express, August 26, 2014

⁵⁴ Tk 80 billion new investment in RMG sector to meet compliance needs, The Financial Express, March 30, 2014.

⁵⁵ BGMEA starts training factory managers, The Daily Star, April 20, 2014.

Progress in improving workplace compliance is on track but more needs to be done in order to fulfill the commitment of raising it to international standard.

67. Safety compliance is improving. Only 2.2 percent of total buildings assessed thus far have been referred to a government review panel for structural issues and only 1.3 percent was partially or fully closed. The US Trade Representative (USTR) expressed satisfaction over the improvement in worker safety situation and the execution of its action plan.⁵⁶ However, there is no place for complacency. Sustainable compliant industry warrants constant monitoring and continued action by the stakeholders.

68. The government needs to expedite enforcement of labor rights. Implementation progress of the amendments made in the Labor Law is extremely slow with a weak monitoring mechanism. The new EPZ law also needs to be properly enforced. For swift implementation of the new legislations, effective measures, for instance, preparation of necessary rules and regulations should be completed immediately and appropriate monitoring mechanism should be put in place to ensure proper enforcement. Government red tape has stalled the recruitment of factory inspectors in DIFE. Only 88 inspectors have been recruited as of August 2014, against the target of recruiting 200 inspectors by December, 2013. Currently there are only 135 inspectors against 575 positions,⁵⁷ which are inadequate. This capacity needs to be increased as per commitments made in the EU Sustainability Compact and US Action Plan. The publicly accessible database of garment manufacturers launched by DIFE should be more transparent by including more detailed information on the factories, results of inspection conducted and follow-up measures taken. These reform initiatives will not translate into tangible and sustainable improvement unless implementation is expedited. Safety inspections of the factory buildings outside the purview of the buyers must be completed and reports should be made publicly available. Although these inspections stopped in January 2014, the government is expected to resume this process in mid-September.⁵⁸

69. Lack of infrastructure will reduce compliance if not addressed urgently. According to the Global Competitiveness Report 2014-2015, the inadequate supply of infrastructure ranks the highest among the problematic factors for doing business in Bangladesh. Unavailability of suitable land is hampering the relocation of the firms that are willing to do so. In addition, energy shortages (power and gas) are not allowing authorities to install new connections to larger sites where factories can relocate. For example, there is a shortage of gas supply in the industrial areas in Dhaka and its adjoining areas.⁵⁹ According to Doing Business 2014, Bangladesh requires 404 days to get an electricity connection, which places it last in the rankings of 189 countries. Relocation of factories is also becoming difficult due to the scarcity of workers. Workers are reluctant to move to new locations because of the lack of basic needs including proper accommodation, education and health facilities. Although the government plans to develop a garment industrial park to address these impediments, there has not been any visible progress in this regard.

70. Buyers should improve coordination on factory inspection and shift gear towards assisting the implementation of remediation measures. Lack of coordination among the global brands is leading to inspection fatigue for some manufacturers and creating confusion. For example, among the 250 factories that Wal-Mart blacklisted for issues of safety compliance, some are producing for other reputable North American and European brands who term them as compliant.⁶⁰ There are about 300 factories common to

⁵⁶ USTR team satisfied over action plan execution, The Daily Star, August 7, 2014.

⁵⁷ Bureaucracy delays recruitment of factory inspectors, The Daily Star, August 24, 2012.

⁵⁸ 2nd phase of govt-led inspection likely to begin mid-September, New Age, August 28, 2014.

⁵⁹ Gas crunch turns severe, hits the industries, The Financial Express, August 28, 2014.

⁶⁰ Standards Clash in Bangladesh Reforms, May 16, 2013, The Wall Street journal

both the Accord and the Alliance. Recently, the Accord declined to accept the inspection of these common factories done by the auditors hired by the Alliance brands and give qualified consideration to inspection reports by firms working for the Alliance staff.⁶¹ This will result in duplication of efforts creating additional burden for factory owners and questioning the integrity of the overall inspection process. Furthermore, there is a growing concern on the financing of the remedial works. In some cases buyers are allegedly not getting involved as promised.⁶²

71. Cooperation among garment manufacturers needs to improve. The implementation of new minimum wage scale was slower than expected as 40 percent factories could not implement the new rate at the agreed time of December 2013, according to a BGMEA survey.⁶³ There have been sporadic incidences of labor unrest for unpaid wages due to factory closures though most of the issues have been resolved eventually. There are reports of increased denial of trade union registration and anti-trade union discrimination.⁶⁴ The BGMEA is yet to develop a worker database as per their commitment.⁶⁵ The association and its respective members should be more proactive in maintaining the credibility of the commitments made to transform garment manufacturing into a socially compliant industry.

⁶¹ According to the “Accord Policy on Initial Inspections at Joint Accord-Alliance Factories”, the Alliance inspections can be divided into two categories: inspections done by firms hired directly by the Alliance and inspections done by firms hired by Alliance brands.

⁶² Reuters Insight Inspection intensifies Bangladesh garment industry’s woes, The Bangladesh Chronicle, June 27, 2014.

⁶³ 40pc garment units fail to pay new wage, The Daily Star, January 24, 2014.

⁶⁴ Technical Progress Report on Sustainability Contact – July 8, 2014

⁶⁵ Worker database seems far off, The Daily Star, August 18, 2014

Annex B: Data Sheet

Table B 1: Bangladesh Macroeconomic Indicators									
Description	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14(P)
Growth Rates (%)									
GDP Growth	6.7	7.1	6.0	5.1	5.6	6.5	6.5	6.0	6.1
GDP Growth Per Capita	5.5	6.0	5.0	4.0	5.6	5.4	5.3	4.8	4.9
Per Capita GDP (current US\$)	486.0	533.3	608.8	674.0	762.6	841.3	862.3	957.4	1096.2
Per Capita GNI (current US\$)	514.0	568.2	656.5	728.4	824.9	908.8	935.3	1034.4	1169.2
Inflation (%)									
Rate of Inflation (CPI, %) (year on year)**	-	9.4	12.3	7.6	6.8	10.9	8.7	6.8	7.3
Inflation (GDP deflator)	-	6.7	8.1	7.1	6.4	7.1	7.7	7.7	6.2
Saving & Investment (% of GDP)									
Gross Domestic Saving	21.4	20.7	19.2	20.3	20.8	20.6	21.2	22.0	23.4
Gross National Saving	27.8	27.9	27.8	28.6	29.4	28.9	29.9	30.5	30.5
Private Investment	20.6	21.1	21.7	21.9	21.6	22.2	22.5	21.7	21.4
Public Investment	5.6	5.1	4.5	4.3	4.7	5.3	5.8	6.6	7.3
Central Govt. Budget (% of GDP)									
Total Revenue	9.4	9.1	10.0	9.2	9.5	10.1	10.8	10.7	10.4
Total Expenditure	12.4	11.8	13.3	12.7	12.7	13.9	14.2	14.6	13.5
Overall Budget Deficit	3.0	2.7	3.2	3.5	3.2	3.8	3.4	3.9	3.1
Total Public Debt	41.2	41.0	41.4	40.3	37.3	38.3	37.4	35.5	34.4
Balance of Payments (% of GDP)									
Trade	33.8	35.5	37.3	35.6	32.6	41.4	43.2	40.4	38.4
Exports	15.0	15.6	15.7	15.4	14.1	17.8	18.2	18.0	17.4
Imports	18.9	19.9	21.6	20.1	18.6	23.6	25.0	22.4	21.0
Services & Income (net)	-2.5	-2.8	-2.8	-3.1	-2.4	-3.0	-3.4	-3.7	-3.8
Current Transfers	7.7	8.4	9.5	10.1	10.1	9.7	10.1	9.9	8.6
Current Account Balance (including transfers)	1.2	1.2	0.8	2.4	3.2	0.7	-0.3	1.6	0.9
External Indicators									
External Debt (US\$ b.)	17.9	19.6	21.0	23.0	22.4	25.4	25.5	25.4	27.5
Ext. Debt as % of GDP	25.4	25.1	23.3	22.8	19.4	19.7	19.1	16.9	15.8
BB Gross Reserves (US\$ b.) (end of period)	3.5	5.1	6.2	7.5	10.8	10.9	10.3	15.3	18.2
BB Gross Reserves (in months of imports)	2.8	3.4	3.4	3.7	5.4	3.9	3.3	4.6	5.4
Money and Credit									
M2 Growth (% , year-on-year)	19.5	17.1	17.6	19.2	22.4	21.3	17.4	16.7	16.1
Net Domestic Asset Growth (% , year-on-year)	19.7	12.6	18.1	17.8	19.1	25.0	18.5	11.8	10.3
Ratio of Private Sector Credit to GDP (%)	28.0	28.2	30.8	31.4	33.9	37.2	38.7	37.7	37.6
Exchange Rate									
Nominal Period Average (TK/US\$)	67.2	69.1	68.6	68.8	69.2	71.2	79.1	79.9	77.7
Nominal End of Period (TK/US\$)	69.7	68.8	68.5	69.0	69.5	74.2	81.8	77.8	77.6
Real Effective Exchange Rate Index (IMF)	98.6	96.5	95.8	105.5	108.3	108.9	105.2	111.6	106.7
Memorandum Items									
GDP at Current. Prices (taka bill.)	4730.0	5394.0	6180.0	6933.0	7975.4	9158.3	10552.0	11989.2	13509.2
GNI at Current. Prices (taka bill.)	5002.1	5746.8	6663.9	7492.0	8626.9	9892.4	11445.1	12953.5	14409.4
GDP at Current. Prices (US\$ bill.)	70.4	78.1	90.1	100.8	115.3	128.6	133.4	150.1	173.9
GNI at Current Prices (US\$ bill.)	74.5	83.2	97.1	108.9	124.7	138.9	144.7	162.1	185.4
Population (mill.)*	144.9	146.5	148.0	149.5	151.1	152.9	154.7	156.7	158.6
Population growth Rate	1.2	1.1	1.0	1.0	0.0	1.1	1.2	1.2	1.2

* Population data is from DECPG.

Source: Bangladesh Bureau of Statistics, Bangladesh Bank, Ministry of Finance, The World Bank and IMF
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Table B 2: Bangladesh Current Macroeconomic Indicators

	FY12	FY13	FY14	FY15 ¹	FY15	FY14
			(Projection)	(July-August)	(July- August)	
GDP Growth (%)	6.5	6.0	6.1	6.2	..	..
Inflation ²	8.7	6.8	7.3	7.0	6.9	7.4
Export Growth (%)	5.9	11.2	11.7	6.0	2.1	14.7
Import Growth (%)	9.9	0.8	8.9	13.2		
Remittance Growth (%)	10.2	12.6	-1.6	6.0	21.9*	-8.1*
Reserves (Months of Import)	3.3	4.6	5.4	5.2	6.1	4.9
Exchange Rate (taka per dollar)	78.9	79.9	77.7	..	77.5	77.8
Total Revenue (% of GDP)	10.8	10.7	10.4	11.0	..	..
o/w Tax (% of GDP)	9.02	8.96	8.6	9.2	..	..
Total Expenditure (% of GDP)	14.2	14.6	13.5	14.6	..	..
o/w Current Exp. (% of GDP)	8.4	8.3	7.7	8.2	..	..
o/w Subsidies						
(% of GDP)	2.5	2.7	1.5	1.8	..	..
ADP (% of GDP)	3.4	4.2	4.2	4.7	0.3	0.3
Fiscal Deficit (% of GDP)	3.4	3.9	3.1	3.6	..	..
NBR Revenue Growth (%)	19.6	14.8	10.5	13.2	15.0	16.4
ADP Spending Growth (%)	15.3	31.6	13.4	27.0	-6.5	-10.1
M2 Growth (%)	17.4	16.7	16.1	16.4		
Growth of Credit to Public Sector (%)	19.1	8.3	8.9	24.8		
Growth of Credit to Private Sector (%)	19.7	10.8	12.3	17.0		

¹Projections are based on IMF, World Bank and government estimates

² Base Year 2005/06

* Till July-September of relevant fiscal year

All growth rates are year-on-year

Source: Bangladesh Bank, Bangladesh Bureau of Statistics, Export Promotion Bureau, IMF and WB staff estimate



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