Bangladesh

Economic Growth Assessment

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Acronyms

ADB	Asian Development Bank
ADP	Annual Development Plan
ASEAN	Association of Southeast Asian Nations
BEI	Bangladesh Enterprise Institute
BFTI	Bangladesh Foreign Trade Institute
BQSP	Bangladesh Quality Support Program
BTC	Bangladesh Tariff Commission
CAS	Country Analytic Support project
CEO	chief executive officer
CIDA	Canadian International Development Agency
CPD	Center for Policy Dialogue
DCA	Development Credit Authority
DFID	U.K. Department for International Development
EG	Economic growth
EPZ	Export processing zones
ERG	Economic Research Group
FDI	Foreign direct investment
FSRP	Financial Sector Reform Project
FY	fiscal year
GDP	gross domestic product
IBFB	International Business Forum of Bangladesh
MIDAS	Micro Industries Development Assistance and Services
MSMEs	micro, small, and medium-sized enterprises
NGO	nongovernmental organization
PRI	Policy Research Institute
PRICE	Poverty Reduction by Increasing the Competitiveness of Enterprises
PROGATI	Promoting Governance, Accountability, Transparency and Integrity
PSD	private sector development
REER	real effective exchange rate
RMG	readymade garment
SAARC	South Asian Association for Regional Cooperation
SEC	Securities and Exchange Commission
SMEs	small and medium-sized enterprises
SPEMP	Strengthening Public Expenditure Management Program
TACTS	Tax Administration Compliance and Taxpayer Service
TIFA	Trade and Investment Framework Agreement
USAID DG	USAID Democracy and Governance Office

USAID EG	U. S. Agency for International Development Economic Growth
VAT	value-added tax
WEF	World Economic Forum

The exchange rate used in this paper is US$1 = Tk 69.20.

Executive Summary

A five-member team (consisting of a senior economist, macroeconomist, private sector adviser, financial sector adviser, and project coordinator) organized by Nathan Associates identified constraints and opportunities for USAID/Bangladesh programming during a three-week field study in the following areas: macroeconomics and trade, financial sector, private sector, and economic governance. The field assessment followed a desk study provided to the mission through the Country Analytic Support (CAS) project implemented by Nathan Associates. The impetus for this work was to provide USAID/Bangladesh's Economic Growth office guidance on programmatic areas to consider during development of its five-year strategy for 2011–2015.

Interviews were conducted with senior government officials, other donors, leading private sector companies and associations, financial institutions, economic policy research institutes, and academics. The recommendations contained in this report are based on areas that the team perceived would likely have a positive payoff for USAID given host counterpart interest and capability. In addition, these recommendations reflect interviewees' identification of opportunities and constraints in each of the report's four subsectors.

Bangladesh, with a gross domestic product (GDP) per capita of US$497[1] in 2008, clearly faces the same formidable development challenges that confront all other low-income countries. In addition, its geographical location—most of the country's land mass is less than 10 meters above sea level—makes it particularly vulnerable to climate changes. The global recession continues to have an impact on the country, with exports, investment, and remittances, the key factors spurring growth, all showing a slow-down.

On a positive note, the Ministry of Finance's management of the economy has helped to maintain overall stability relative to other countries facing significant rises in inflation and balance-of-payments crises. The global financial crisis has also had only a modest negative impact on Bangladesh because of its modest integration into the global financial system and its position as a producer of low-cost exports.

As the global economy recovers, investment and remittances should also rebound, allowing Bangladesh to focus on a long-term high-growth agenda. In looking broadly at different facets of

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[1] World Bank, World Development Indicators, updated May 7, 2010: http://data.worldbank.org/data-catalog/world-development-indicators?cid=GPD_WDI

the economy, the assessment team found that while there is still a great deal to be done at the macro level—revenue collection is one of the lowest in the world—and there are severe infrastructural and power constraints that need to be addressed, USAID/Bangladesh's comparative advantage vis-à-vis other donors is to work with the private sector to support a competitive, private sector–led economic growth strategy that leads to significant increases in the country's exports and jobs.

The private investors that the assessment team met with, both foreign and local, were clearly determined to start and/or expand their businesses in the country but also pointed to a number of regulatory constraints hindering their endeavors. The anecdotal evidence of the difficulties they encountered is validated by the country's overall investment data. Investment in the country has been virtually stagnant in recent years, with gross fixed investment as a percent of GDP remaining virtually unchanged at 24 percent per annum during the 2004–2008 period. Private sector investment has increased slightly but is far behind neighboring India and other Southeast Asian countries. Foreign direct investment in particular lags behind, as FDI into Bangladesh in 2009 was just below US$1 billion, while India attracted up to US$40 billion in the same period.

This is certainly a wide gap, and due to the global recession and Bangladesh's less favorable investment climate, it could widen—according to the Central Bank, foreign direct investment halved, to $297 million, in the first half of fiscal 2010 compared to the same period last year, although a $300 million investment by Bharti Airtel in January should boost the overall 2010 FDI figures.[2] Many observers point to the current opportunities for Bangladesh as China begins to lose its competitive advantage in cheap labor. In an article in China International Business, the author documents how Bangladesh businesses are beginning to benefit from China's losing competitiveness:

> One of the country's leading garment processors, Apex, got a 25 percent boost in business in 2008 from buyers shifting orders from China to the company, explains Mohammed Zahid Hossain Mia, manager of marketing at the company's spinning and knitting division. ”They're coming for the cheap and plentiful workforce,” he says. In one case an order for 100 million items from Swedish cheap chic chain H&M ballooned into 125 million pieces after a factory in China ran short of workers.[3]

Bangladesh's competitiveness for investment is determined by its low-cost labor, one of the cheapest in the region. Bangladesh beats everyone in the cost of labor: workers get an average US$ 0.22 an hour compared to counterparts in China (US$ 0.86) and India (US$ 0.51) according to the Jassin-O'Rourke Group, a U.S. consultancy. “We are being told by buyers that factories are closing in China because of rising costs.”[4]

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[2] Quadir, Serajul Islam, FDI In Bangladesh drops by half-cenbank, *REUTERS India*, March 16, 2010.

[3] Mark Godfrey, “Dressed for Success” *China International Business* (April, 12, 2010), p.1.

[4] Ibid., p. 2.

As pointed out by Professor Papanek in his recent visit to the country, this provides Bangladesh with an opportunity to accelerate growth rates from its current 5–6 percent to 8–10 percent, the kind of growth needed to achieve middle-income country status.[5] Papanek points to an ineffectual government bureaucracy and excessive government regulation as some of the main obstacles hindering investors, particularly foreign investors. It was also evident to the assessment team that government agencies could play a much stronger supporting role for the private sector than seems to be the case. The economic cost of the ping-pong effect caused by switches in leadership between the two main political parties, coupled with weak technical expertise within government agencies, has been a major handicap to the private sector. The Public-Private Partnership Initiative to provide large investments in the infrastructure and power sector has been considerably delayed because of delays in establishing guidelines and because investor enthusiasm for this initiative is eroding.[6]

While donors can press for an improved investment climate, ultimately it has to be the private sector that advocates for these changes. It is only when there are effective business associations that have a clear sense of the needs of the overall industry and can act cohesively, that wide-sweeping changes will come. USAID's Economic Growth program has done some pioneering work in building up the agribusiness association, but continued work needs to be done to support dynamic leadership within this organization and other associations so that members can see the benefits of belonging to such an organization. This is a long-term goal, but working in coordination with other donors, the necessary progress can be made on this front. A recent report of the UK Department for International Development (DFID) program in Bangladesh submitted to the British House of Commons led to the following observation:

> Creating effective producer associations is an important way of linking smaller producers and creating a larger constituency to lobby for help with marketing or general improvements in the investment climate… However we have seen little evidence to suggest that donors have a coordinated plan for strengthening such commercial associations. We accept that demand for change must come from Bangladeshi society but consider that donors can and should work to encourage the creation of more producer and professional associations in a more strategic and coordinated manner.[7]

Efforts to improve the business-enabling environment have to include greater accountability and transparency, aspects that, according to Transparency International's rankings of Bangladesh, have improved somewhat recently, but corruption in the country still seems to permeate many aspects of business activity. One advantage USAID/Bangladesh has vis-à-vis other donors in working on greater accountability and greater advocacy of an economic agenda is the progress that the USAID Democracy and Governance (DG) office has made in its programs in this area.

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[5] A Z M Anas, "Once-in- a- Lifetime Opportunity to Grow at 10pc Awaits Bangladesh," *Financial Express*, May 17, 2010.

[6] Asset & Investment Management Services of Bangladesh Ltd, *Weekly Market Review*, May 2, 2010.

[7] House of Commons International Development Committee, *DFID's Programme in Bangladesh*, March 4, 2010

Greater coordination with the USAID/Bangladesh DG office will allow transmitting specific concerns of the private sector into the political arena through the existing Promoting Governance, Accountability, Transparency and Integrity (PROGATI) project as well as new programs the DG office will implement in the near future. As chair of the Political Governance Consultative Group, USAID has the responsibility to see that the overall donor effort will allow economic policy reforms to gain a stronger foothold within the political establishment. Working with the DG office, as well as donors such as DFID that are also working heavily on the private sector enabling environment, the USAID Economic Growth office could make significant headway in reducing several obstacles faced by the private sector within the next five-year strategy period.

But as important as the work on the business-enabling environment is, it cannot jump-start investment on its own. Interestingly, local investors who comprised the majority of our interviews with private sector representatives had fewer complaints about the excessive regulations and bureaucratic obstacles than their foreign counterparts. This could be due to the fact that we met with the top captains of industry who had effective channels of communication with the government and knew how to maneuver around the bureaucracy. Their biggest constraint was lack of skilled labor to add value and meet quality and safety standards in export markets as well as marketing information to penetrate these markets. With over 50 percent of the population lacking basic literacy, much needs to be done to train workers to produce products that can meet international standards.

USAID/Bangladesh could provide support to training institutes to assist in providing the necessary skills and certifications that will allow Bangladesh to compete in the global market. This training is not necessarily to produce a large number of engineers and doctors that are not appropriate for Bangladesh's level of development, but rather to produce workers that can operate simple computerized equipment and handle packaging specifications so that products can meet international standards. It can also be to train people with basic financial skills such as bookkeepers and accountants that add transparency and accountability across the business community. If USAID's EG office was to support a training institution that produced 100 graduates with some certification every year, it could have a much wider impact than training that is provided to individual clients through contractors or by exposing groups of companies to better practices by organizing trade fairs abroad.

Another major factor that will improve Bangladesh's overall growth prospects is diversification away from garment exports, which comprise 75 percent of total exports. Bangladesh's overall trade performance (measured by total imports and exports as a percent of GDP) continues to lag well behind both regional competitors such as India and Vietnam and the average for low-income countries overall. This is largely due to a relatively protectionist trade policy environment coupled with infrastructure and logistics bottlenecks that hinder trade and increase import and export costs. Additionally, Bangladesh trade with South and Southeast Asia remains relatively low—despite the potential for significant increases—because of the constraints described above and broader political concerns. Exporters have developed good relationships with buyers in the United States and United Kingdom and are expanding to markets in Japan but need information about consumer tastes and demands to further penetrate these markets.

USAID/Bangladesh has a comparative advantage vis-à-vis other donors in providing information that will improve trade relations between Bangladesh and the United States, one of its major trading partners, and could capitalize on this by making trade activities a key component of their EG strategy. Another aspect of trade deals with trade negotiations regionally and within the World Trade Organization (WTO) context. As neighboring countries increasingly embark upon regional trade agreements—the China-ASEAN Free Trade Area and an agreement between India and the Association of Southeast Asian Nations (ASEAN) went into effect in January 2010—it is clear that Bangladesh needs to increase its trade expertise and USAID/Bangladesh could support these efforts.

While Bangladesh faces a huge development agenda, there is reason for optimism concerning Bangladesh's growth prospects. It is worth considering that it has been only in the last 10 years or so that India began its steep upward climb in attracting new FDI; thus much can be done in a relatively short time with a successful strategy. USAID's Economic Growth program in Bangladesh, in strong coordination with other donors and its own Democracy and Governance office, can launch a program to help Bangladeshi private sector and leadership orient themselves toward a mindset of achieving the changes in Bangladesh that will enable it to compete regionally and globally for markets and investment.

1. Introduction

This assessment was undertaken at the request of USAID/Bangladesh's Economic Growth Office. It is intended to serve as an input for the development of a new mission strategy. The fieldwork follows a desk study prepared by Nathan Associates under the CAS project managed by USAID/Washington's Economic Growth Office in the EGAT Bureau. The desk study provided a broad overview of the current economic situation in Bangladesh, with performance benchmarking relative to regional and international standards.

The assessment team was led by the principal author of the desk study, Rita Aggarwal, senior economist with Nathan Associates, and included Tom Timberg, a senior financial expert with Nathan Associates; Mark Gellerson, division team leader for Economic Policy and Governance in EGAT/EG; Orzu Matyakubova, a private sector competitiveness expert from J.E. Austin Associates; and Molly James, project manager for the CAS project at Nathan Associates.

This assessment is one of several undertaken by USAID/Bangladesh that will provide an input into the design of new economic growth activities to be implemented under the new strategy. The mission has also contracted assessments covering such themes as gender, the Global Development Alliance, energy, agricultural productivity, nutrition, and food security. The scope of work for this assessment directed the team to survey the current state of Bangladesh's economy, identify constraints to its further broad-based economic growth, and then suggest possible USAID interventions to help address these constraints. Specific areas of focus included macroeconomic policy and international trade, finance, private sector development, and economic governance.

DONOR INVOLVEMENT

USAID had a strong track record of strengthening economic growth in Bangladesh from the 1980s to the early 2000s. The USAID Financial Sector Reform Project (1991–1995) continues to receive accolades for the creation of a national credit information bureau and for implementing enhanced supervision and regulatory systems in Bangladesh Bank, including a new policy analysis unit and a vastly improved bank examination unit. USAID was instrumental in establishing and funding the Rural Electrification Board and in establishing the Bangladesh Energy Regulatory Commission and building its capacity. The Bangladesh Agricultural University, the agricultural research and extension system, and many other critical institutions also received USAID assistance. Many firms dealing in agribusiness trace their present development to USAID assistance—most recently under the Job Opportunities and Business Support (JOBS) project that ended in 2005, and before that, the Agro based Industries and Technology Development Project (ATDPI, 1996–2000 and ATDPII, 2001–2005).

Additionally, USAID support for training midlevel civil servants at U.S. universities has meant that there is a strong cadre of U.S.-trained Ph.D.s, especially in economics, now in senior levels of government. The current finance secretary and the private sector adviser of the World Bank Dhaka office, for example, received funding from USAID to obtain doctoral degrees from Boston University. The former secretary of Power, Energy, and Mineral Resources under the caretaker government is also a USAID-sponsored Boston University alumnus.

In recent years, limited funding has meant that USAID's project portfolio has been scaled back, while other donors have maintained or expanded their programs. The main project being implemented—Poverty Reduction by Increasing the Competitiveness of Enterprises (PRICE)— is focused on alleviating constraints hindering the competitiveness of the aquaculture, horticulture, and leather products sectors. PRICE works throughout the value chain in these three target sectors to improve competitiveness and enhance the global competitiveness of Bangladesh's small and medium enterprises.[8]

USAID is also continuing its work in the energy sector to provide technical support to the Rural Electrification Board and to the Bangladesh Energy Regulatory Commission to make it fully functional, as well as to assist regional cooperation and renewable energy efforts.

Table 1-1 presents donor funding for 2007/2008 in Bangladesh. While funding levels are not disaggregated by sector, it is evident that bilateral donors such as DFID and Japan, and multilateral donors such as ADB, are major players.

Table 1-1
Donor Funding Levels, 2007/2008 ($US million)

Donor	
BILATERAL	
Australia	6.5
Canada	41.7
Denmark	32.8
Germany	29.8
Japan	88.7
Netherlands	5.4
Sweden	42.4
Switzerland	2.1
United Kingdom	127.6
United States	14.6

[8] For further details, see www.price-bd.com

Table 1-1 continued

Donor	Disbursement
MULTILATERAL	
Asian Development Bank	448.3
European Commission	70.2
IDA	795.6
IFAD	28.6
NDF	2.9
UNICEF	52.0
UN System	177.9

Note for United States: USAID/Bangladesh programs roughly $100 million per year. The ERD figure grossly under-reports U.S. funding estimates because much of the assistance goes to nongovernmental organizations (NGO)s and the private sector directly instead of through a bilateral mechanism.

SOURCE: Economic Research Division, Ministry of Finance, Bangladesh.

POLITICAL ENVIRONMENT

Donors are well aware of the risks that political change can create for their programs, and the government that took power in January 2009 is certainly a critical factor in determining what areas of reform are possible. The government aspirations of achieving 8 percent growth by 2013 (as envisaged in the National Strategy for Accelerated Poverty Reduction II, Revised FY 2009-2011) and reaching middle-income status by that time are ambitious. An analysis of the political and economic environments indicates that with the new government in power for just over a year, the jury is still out on the extent to which the government is committed to pursuing an economic reform agenda. Though some program elements are moving forward, some remain stalled, and others may be regressing. There are signs that work on the Anti-Corruption Commission and the passage of the Right to Information Act are making progress, as is the process of civil service reform. However, there are indications that other reform activities/initiatives, while not having been completely terminated, are no longer making progress. These include high-level public-private dialogue initiatives such as the Better Business Forum and the Regulatory Reform Commission.

Public policy or economic reform can seldom be designed in a narrow economic context, but instead must take into account the broader political and institutional environment. Not only are the policy reform initiatives under the new government mixed, but there have been also been mixed signals from certain government policy pronouncements. Pronouncements on the Government's reform agenda in the Ministry of Finance's Economic Survey (released in March 2009), the Annual Report of the Bangladesh Bank (released in January 2009), and pronouncements by a number of other senior officials such as the Finance Minister (Dr. AMA Muhith), the Economic Adviser to the Prime Minister (Dr.Mashiur Rahman), the Energy Adviser to the Prime Minister (Dr. Taufiq-e-Elahi Chowdhury), and the new Bangladesh Bank Governor (Dr. Atiur Rahman) have generally been welcomed by donors. Nonetheless, there is such a greater emphasis on state-owned enterprises, albeit in the context of improving their efficiency and other "populist" measures, that USAID/Bangladesh will have to monitor these changes closely, as an important variable in its programmatic success will be the ability to ally with champions of reform in government ministries or agencies that are competent and capable of delivering results. When this is not possible, support might be provided to private sector actors who have sprung up to fulfill the gap between public sector needs and private sector aspirations.

The opportunity provided to the mission by the Feed the Future and the Global Climate Change Initiatives to scale up its programs will allow it to explore options for larger catalytic activities in a wider range of sectors than was recently possible. Such new activities should be developed in close coordination with other donors, who may already be active in these sectors. In meeting with various stakeholders, the team attempted to identify potential USAID/Bangladesh involvement according to three principles: (1) areas where gaps exist that USAID can fill, (2) areas where USAID expertise is particularly useful even if other donors are also involved, and (3) areas where complementarities with existing USAID programs in Bangladesh will leverage greater impact.

In the following sections we examine recent developments, identify key constraints, review current donor involvement, and provide recommendations in five areas: macroeconomic policy, international trade, finance, private sector development, and economic governance. We conclude with a discussion of key programmatic issues.

2. Macroeconomic Policy

RECENT DEVELOPMENTS

Bangladesh experienced solid average annual growth of 6.3 percent between 2004 and 2008. In fiscal 2009, despite the global financial crisis, Bangladesh recorded 5.9 percent real GDP growth, only a 0.3 percentage point decline from 6.2 percent growth in fiscal 2008.[9,10] This was due in large part to the generally sound macroeconomic policies implemented by the government over the period. As a result, per capita GDP has risen by one-third from US$392 in 2004 to an estimated US$497 in 2008. In constant prices, average incomes rose by 19 percent over this time frame.[11]

As discussed in the CAS Economic Performance Assessment, Bangladesh's strong growth and gains in poverty reduction have also caught the international community's attention. Goldman Sachs coined the term "Next 11" for Bangladesh and 10 other countries with growing consumer markets and significant industrial potential.[12] However, to deliver 8 percent growth by 2013 as targeted in the government's "Vision 2021," the Finance Division in the Ministry of Finance projects that private sector investment must be increased to 30–32 percent of GDP.[13] Currently, private investment averages only 19 percent of GDP. Over the past five years, gross fixed investment has remained virtually stagnant at 24 percent of GDP.

There has been some improvement in increasing investment efficiency as evidenced by the change in the incremental capital-output ratio—the amount of investment needed per unit of extra output. This declined from 4.5 in 2004 to 4.0 in 2008, indicating less capital investment has been needed to produce the same amount of output. This improvement may partially be explained by productivity gains in the garment industry. However, future growth in this and other sectors will

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[9] Preliminary fiscal 2009 estimates from the Bangladesh Bureau of Statistics.

[10] Growth for FY 2010 is expected to slow further to a still respectable 5.5 percent. ADB, Quarterly Economic Update, March 2010.

[11] GDP per capita from World Development Indicators, The World Bank, http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?cid=GPD_57 Data for 2008 published as of June 1, 2010.

[12] Media, E. The Next 11 Emerging Economies, *Euromonitor,* 4 Feb 2008. http://www.euromonitor.com/The_Next_11_emerging_economies

[13] Macreconomic Scenario: July-September 2009, Finance Division, Ministry of Finance.

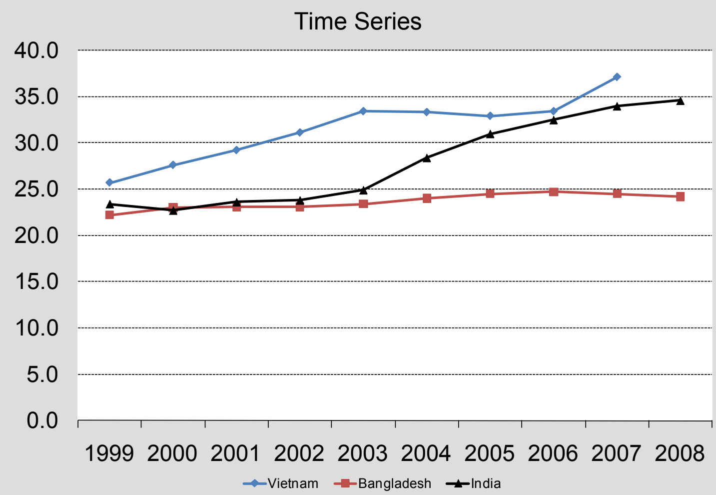
require adequate provision of power and energy, increasing port efficiency, and removal of transportation bottlenecks.

Figure 2-1

Gross Fixed Investment, Percent of GDP

Investment rates have been stagnant in Bangladesh; much higher levels are needed to accelerate growth.

Year	Bangladesh	India	Vietnam
1999	22.2	23.4	25.7
2000	23.0	22.7	27.6
2001	23.1	23.6	29.2
2002	23.1	23.8	31.1
2003	23.4	24.9	33.4
2004	24.0	28.4	33.3
2005	24.5	31.0	32.9
2006	24.7	32.5	33.4
2007	24.5	34.0	37.1
2008	24.2	34.6	-



Source: World Development Indicators, 2009 CAS code: 11S3

Bangladesh's low government budget deficit, 3.6 percent of GDP in 2009, is another indication of Bangladesh's resilient macroeconomic environment. However, one reason for Bangladesh's low deficit is weak budget implementation capacity. The Bangladeshi government has consistently fallen short of its Annual Development Program expenditure targets (see Constraints, p. 7, for more details). In 2009, government spending was just 14.9 percent of GDP, compared to 29.8 percent in India and 22.8 percent in Vietnam. Clearly, development expenditures by the government need to increase.

On the revenue side, extremely low levels of revenue collection are a persistent concern. Averaging just 11 percent of GDP in recent years, Bangladesh's tax effort is one of the lowest in the world. The government has committed to raising revenue by expanding tax coverage, rationalizing and simplifying the tax system, decentralizing tax operations, and making institutional reforms separating tax policy from tax administration. In fact, during the first half of FY 2010 tax collections increased by roughly 16 percent compared with the first half of FY 2009.[14]

In FY 2009, Bangladesh's balance of payments situation remained sound, with a current account surplus of $2.5 billion or 2.8 percent of GDP and foreign exchange reserves totaling $7.5 billion.

[14] Source: ADB Quarterly Economic Update, March 2010.

Both the current account and foreign exchange reserves benefited from the continued increase in remittances. In the five years to 2009, remittance receipts as a percentage of exports of goods and services grew by an annual rate of 8.8 percent. In 2008–2009 remittances were $9.7 billion and are projected to reach $11 billion next year. Indeed, for the first half of FY 2010 remittance receipts increased by roughly 17 percent over the same period in FY 2009.[15]

Additionally, the nominal exchange rate has remained stable—although the real effective exchange rate (REER) appreciated an estimated 6 percent in FY 2009[16] because of the declining inflation rate in the United States and other trading partners relative to inflation in Bangladesh, putting additional pressure on exports.

The inflation rate averaged a moderate 7.5 percent from 2005 to2009—excluding 2008 when it rose to nearly 10 percent because of high international prices for food and energy. However, there is growing concern that prices have started to rise again. Consumer price inflation was 6.7 percent in the year ending October 2009, arising primarily from exogenous factors due to rising prices of primary commodities in international markets. The inflation uptick has been broad based in both rural and urban areas, and it has been driven by a rise in food prices (which account for over two-fifths of the consumer price index). A recent Daily Star Nielsen opinion poll found that two-fifths of those surveyed believe that prices, agriculture, and food security should be the single most important focus for the government.[17]

KEY CONSTRAINTS

Despite the generally good recent performance of the government of Bangladesh in managing the macroeconomy, a number of interrelated challenges remain. Key macroeconomic constraints include low investment, weak public expenditure management, and low resource mobilization. These constraints need to be addressed if Bangladesh's development and poverty reduction goals are to be met in the near to medium term.

Investment. To achieve sustained rapid growth Bangladesh must achieve higher levels of investment. Removing impediments to investment will require a multifaceted approach of business environment and administrative reforms coupled with workforce development and major improvements in infrastructure.

Public Expenditure Management. For the government to meet its growth and poverty reduction objectives, the efficiency of public spending must also be improved so that planned development spending by the government is actually realized. There is a need to strengthen the capacity of line ministries to manage resource allocation. In Bangladesh, most public resources to promote development and poverty reduction are allocated through the Annual Development Plan (ADP).

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[15] Source: Bangladesh Bank, Major Economic Indicators, April 2010.

[16] Bangladesh Bank Annual Report 2008-2009, p. 192. REER rose from 86.02 (FY 2008) to 91.50 (provisional FY 2009 figure).

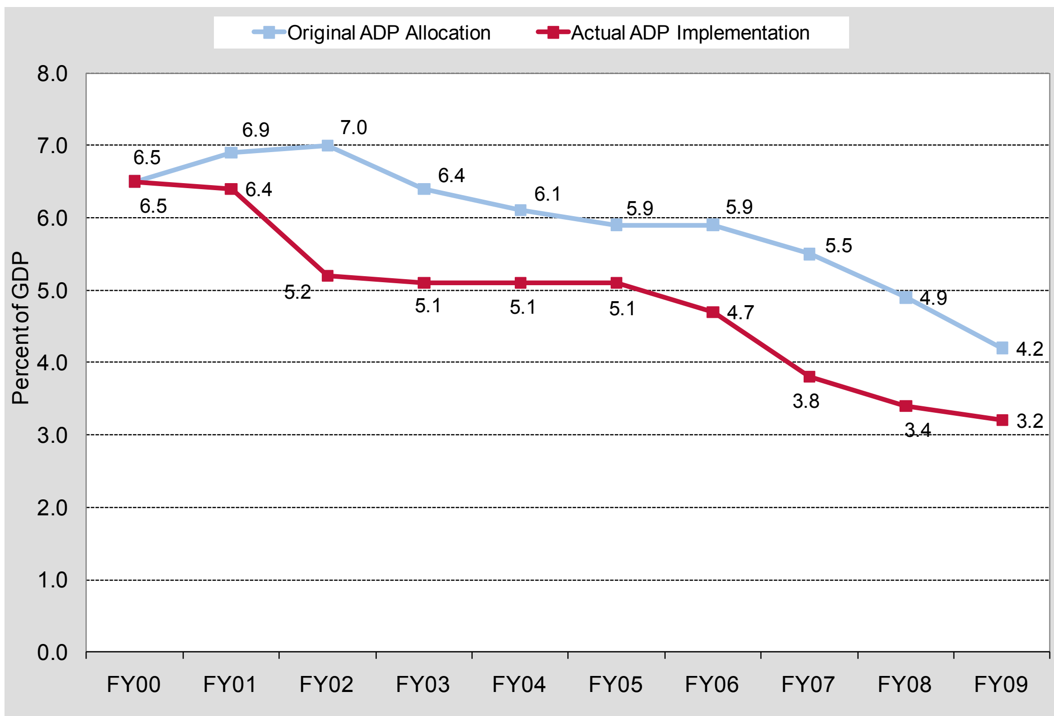
[17] "A fist full of Takas," *Forum,* a monthly publication of the Daily Star, Vo.3, 2, February 2010.

In recent years, ADP spending has been significantly lower than targeted (on the order of 15 percent), and this spending (as a percent of GDP) has declined by nearly half—from 6.4 percent in FY 2001 to 3.2 percent in FY 2009 (Figure 2-2).[18]

This is the result of inadequate capacity of implementing agencies to execute expenditures along with lack of proper monitoring of these agencies. The proposed ADP for FY 2010 is 32 percent larger than the target ADP for FY 2009 and a whopping 56 percent larger than actual FY 2009 ADP spending. Successful implementation of the FY 2010 ADP will be a major challenge for the government and will require improvements in both public expenditure management and execution.

Figure 2-2

ADP Original Allocation and Actual Implementation Rates, as Percentage of GDP (FY00-FY09)



SOURCE: *Ministry of Finance.*

Resource Mobilization. The government's fiscal stance as reflected in the FY 2010 budget is expansionary and includes, in light of the global financial crisis, a $494 million (Tk 3,420 crore)[19] stimulus package.[20] To be successful in this regard while maintaining reasonable price stability, the government will need to strengthen resource mobilization.

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18 Bangladesh Economic Review 2009 and Center for Policy Dialogue, Delivering on Budget FY2009-10: A Set of Implementation Issues, p.21.

19 A crore is Tk 10 million. The exchange rate used in this paper is Tk 69.2 to US$1.

Improved resource mobilization will require reforms in tax policy and strengthened tax administration. An effort should also be made to increase the share of direct (income) taxes in total tax revenue. Though both indirect and direct tax revenue has grown in recent years, direct tax revenue consistently lags behind indirect tax revenue (Table 2-1). This effort is increasingly important now in the context of the global economic crisis, which will likely limit the growth of revenues from import duties in the near future. Increasing direct tax revenues means bringing more people into the tax net since there are only about half a million individual income taxpayers in Bangladesh.[21] Other areas of reform might include strengthening the effectiveness of the large taxpayer unit and improving the efficiency of the value-added and corporate income tax collections—both of which are very inefficient by international norms.

Table 2-1
Tax Revenue, crore Tk

	FY06-07		FY06-07		FY07-08		FY08-09	
	Budget	**Actual**	**Budget**	**Actual**	**Budget**	**Actual**	**Budget**	**Actual**
Indirect	27,190	26,580	28,242	28,169	34,496	35,247	39,044	38,253
Direct	7,266	7,423	9,237	9,050	11,474	12,188	13,956	14,273
Total	34,456	34,002	37,479	37,219	45,970	47,436	53,000	52,526

SOURCE: *National Board of Revenue.*

USAID/BANGLADESH'S CURRENT INVOLVEMENT

The mission is not working with the government to address the macroeconomic challenges described above in any formal project activity.

OTHER DONOR INVOLVEMENT

The World Bank and DFID are implementing activities related to macroeconomic policy. The largest is the $95 million Strengthening Public Expenditure Management Program (SPEMP). This 5-year comprehensive program—the largest program on public financial management in the world—is being administered by the World Bank with joint funding and contributions from DFID, EU, DANIDA (Danish), and the Canadian International Development Agency (CIDA). The program includes both public financial management capacity building and upgrading systems and skills development in both central and line agencies, including the Ministry of Finance, the Comptroller and Auditor General, and the Parliament (Figure 2-3).

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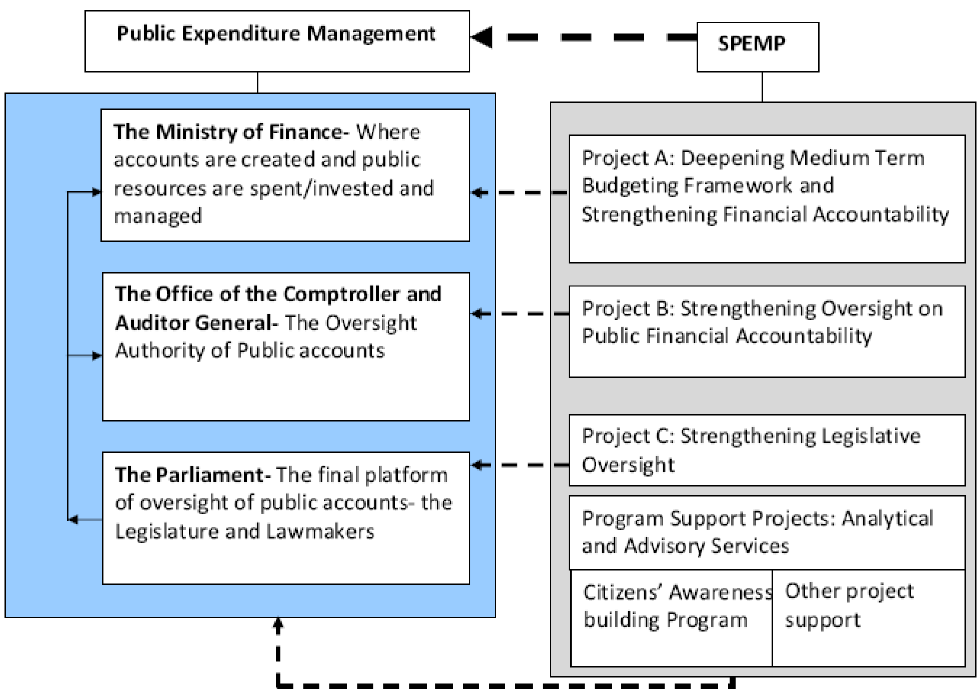
[20] The stimulus package allocated Tk 450 crore in cash subsidies for the export industries most affected by the crisis. From the rest of the allocations, Tk. 1,500 crore was provided for agriculture, Tk 600 crore for the power sector, Tk 500 crore for recapitalization of agriculture loans, and Tk 374 crore for social safety net programs. In Delivering on Budget FY09-10: A set of Implementation Issues, p. 17.

[21] The tax-free threshold is Tk 165,000—approximately five times the average per capita GDP. Thus most Bangladeshis are exempt from payment.

Second, DFID very recently (January 2010) launched a $14.5 million (approximately Tk 100 crore) Tax Administration- Compliance and Taxpayer Service (TACTS) Program (2010–2015). This program will support efforts by the National Board of Revenue to increase the number of taxpayers, promote transparency and public trust in the revenue administration system, and increase public revenue.[22] TACTS will also assist the Board of Revenue in implementing a comprehensive program on taxpayer services aimed at improving outreach to the public. This will include improving the availability of information by setting up one-stop service centers and web-based systems. In addition, the functioning of the Large Taxpayer Units and the Central Intelligence Cell of the Board of Revenue will be strengthened. TACTS builds on DFID's Reforms in Revenue Administration project (2002–2008), which supported the establishment of two pilot Large Taxpayers Units for income tax and VAT in Dhaka, as well as a Central Intelligence Cell to investigate and prosecute tax evasion.

Figure 2-3

SPEMP Program Structure



SOURCE: Presentation by Junghun Cho, 10 November 2009. Regional Seminar on Financial Oversights and Role of Public Accounts Committee.

RECOMMENDATIONS

Given the large multidonor effort managed by the World Bank and DFID to assist the Ministry of Finance with public expenditures and tax collection, and that the ministry is not seeking

[22] http://www.dfid.gov.uk/Media-Room/Press-releases/2008/UK-provides-7-million-for-tax-reform-in-Bangladesh/

additional donor support at this time, the team does not recommend that the Mission attempt an assistance program in the macroeconomic area at this time. However, a low-key effort to cultivate a relationship with the Ministry of Finance would be useful given the importance of this ministry in formulating and implementing tax and expenditure programs.

3. Trade Policy

RECENT DEVELOPMENTS

Bangladesh's trade performance in recent years has been something of a paradox. On the one hand, export earnings from readymade garments (RMGs) have boomed—increasing from US$4.9 billion in FY 2003 to US$10.7 billion in FY 2008 and generating major inflows of foreign investment and export earnings.[23,24] On the other hand, Bangladesh's export base remains very concentrated, with RMGs accounting for roughly 75 percent of total exports.

Moreover, the importance of trade (exports plus imports of goods and services) for the Bangladesh economy has risen slowly from 36.3 percent of GDP in 2004 to just 47.0 percent in 2008, and remains lower than regional comparators such as India's 53.4 percent, Sri Lanka's 63.2 percent, and Vietnam's 167.0 percent (Figure 3-1). Bangladesh suffers from a chronically weak foreign trade account because of its dependence on imports of most essential goods, particularly petroleum. But during the last five years, exports of goods and services have grown by an annual average rate of 15.1 percent. Export growth, though, slowed considerably in the second half of FY 2009, as total exports (year-on-year) grew by only 2.6 percent, down from 20 percent in the first half of the year.[25] In addition to the merchandise trade deficit, Bangladesh also runs a large deficit on its services account, "primarily arising out of the costs of freight and insurance on imports and expenses relating to technical and financial service for development projects."[26] These structural deficits are balanced by current account transfers such as high remittance rates (See Macroeconomic Policy section.) In FY 2009, Bangladesh in fact achieved an impressive current account surplus of $2.5 billion, or 2.8 percent of GDP.[27]

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[23] Source Export Promotion Bureau, in *Bangladesh Economic Review 2008*, p. 70.

[24] Total export earnings grew from $14.1 billion in FY 2008 to $15. 6 billion in FY 2009. However, export earning actually declined by 6.2 percent during the first half of FY 2010 when compared with the same period in FY 2009. Imports declined by 5.9 percent during the first half of FY 2010.

[25] Bangladesh Economic Update: September 2009, World Bank, p. 1.

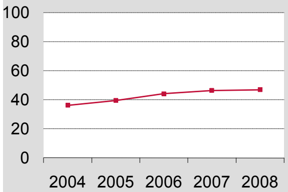
[26] Economist Intelligence Unit Country Profile, Bangladesh, July 2008, p. 18.

[27] Asian Development Outlook, September 2009, p.121.

Figure 3-1
Trade as Percent of GDP

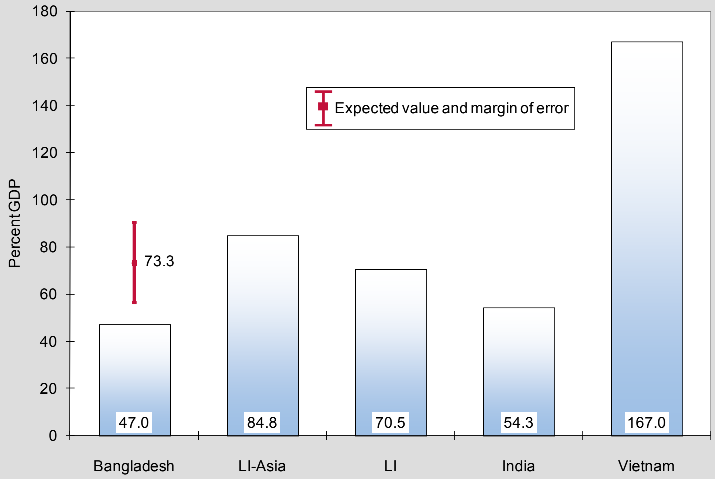
Bangladesh's integration into the global trading system lags behind all benchmarks.

Time Series



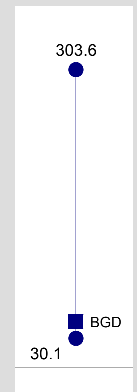
Year	Value
2004	36.3
2005	39.6
2006	44.2
2007	46.5
2008	47.0
Summary for 2004–2008	
Five-year average	42.7
Trend growth rate	6.8

Comparison to Other Countries, Most Recent Year



Global Standing

Highest-five average



Lowest-five average

Source: World Development Indicators 2009

In recent years Bangladesh has enacted fiscal and trade facilitation reform to reduce the cost of trade. For example, the introduction of a customs clearance automation system at Chittagong port has shortened the average time to clear goods.[28] Yet additional reforms are required because of persistent infrastructure bottlenecks relating to power, roads, ports, and burdensome customs procedures. The World Bank's composite ease of trading across border index ranked Bangladesh an unsatisfactory 107 out of 183 in its 2010 edition (reflecting conditions in early 2009). Doing Business estimates that the logistics time and costs for Bangladesh to import and export are higher than regional comparators (Table 3-1). According to USAID's TCBoost Trade Facilitation calculator, a 5-day reduction in export processing time could increase Bangladesh's GDP anywhere from $2.4 billion to $3.8 billion annually.[29]

According to the World Bank's 2010 Logistic Performance Index, an international benchmarking tool designed to identify the challenges and opportunities on trade logistics performance, Bangladesh ranks 79 out of 155 countries. This is an improvement from its overall rank of 87 on the 2007 index but remains high compared to India's 47 and Vietnam's 53. The index provides a qualitative evaluation within the areas of customs, infrastructure, international shipments, logistics quality and competence, tracking and tracing, and timeliness. Under the area of tracking

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[28] Doing Business 2010 Bangladesh, World Bank, p.52.

[29]Trade Facilitation Impact (TFI) Calculator developed under the USAID's TCBoost project is an easy to use tool for estimating the impacts of reducing import and export times on a country's economy. For the purpose of this example, we have used the 2009 GDP estimate and an estimated unskilled labor force of 50 million.http://www.tcboostproject.com/resources/tools/impactcalculator.php

and tracing, defined as the ability to track and trace consignments, Bangladesh received a ranking of 92; India and Vietnam ranked 52 and 55 respectively in this area.

Table 3-1
Time and Cost of Importing and Exporting

Country	Exports			Imports		
	No. of Docs	Avg. Days	Avg. Cost	No. of Doc	Avg. Days	Avg. Cost
Bangladesh	6	25	970	8	29	1,375
India	8	17	945	9	20	960
Pakistan	9	22	611	8	18	680
Vietnam	6	22	756	8	21	940
Thailand	4	14	625	3	13	795

SOURCE: World Bank Doing Business, 2010

The Dhaka-Chittagong Corridor is the most important transportation corridor, accounting for 16 percent of the area of the country, 50 percent of the population, 57 percent of the nation's economic activity, and two-thirds of the country's exports and imports. A 2007 study on the efficiency of transport logistics in the corridor resulted in recommendations to the logistics system; multimodal transport network; Chittagong Port Development; the road, rail, and inland waterway system; and institutional, legal, and policy issues. Some of these recommendations are being pursued under ADB programs, such as the Chittagong Port Project.[30] However, this and other studies indicate that additional reforms are required to reduce trade costs and increase trade efficiency within Bangladesh.

Trade Liberalization

In addition to fundamental changes in international commerce and finance, including reduced transportation costs and advances in telecommunications technology, lower policy barriers have fueled a rapid increase in global integration over the past 25 years. Yet, Bangladesh's economy is still heavily protected, which limits its ability to take full advantage of the opportunities available to it in the global economy. In the early 1990s, the government began to move away from the highly protectionist, inward looking import substitution policies that had largely been in place since independence. Tariffs were significantly reduced and rationalized, with average unweighted customs duties falling from 100 percent in FY 1985 to roughly 13 percent in FY 2008. Similarly, maximum tariff rates declined from 350 percent in FY 1990 to 25 percent at present (Table 3-2).[31]

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[30] This report, Improving the Efficiency of Transport Logistics in the Dhaka-Chittagong Corridor, was completed for the ABD by Nathan Associates in 2007. The analysis uses FastPath to indentify bottlenecks in the transport freight corridor.

[31] RMGs typically benefit from a more liberal trade regime because of their access to duty-free imported raw materials.

Trade-related quantitative restrictions, which covered 21 percent of HS 4-digit tariff categories in FY 1990, have been virtually eliminated, and import licenses are no longer needed. Additionally, foreign exchange regime liberalization has resulted in a unified exchange rate and the removal of most foreign exchange restrictions.

Table 3-2
Bangladesh Tariff Structure

FY	Maximum Tariff	Unweighted Average Tariff Rates (%)	Weighted Average Tariff Rates (%)	Operative Tariff Bands
2002	37.5	17.3	9.7	5 (0, 5, 15, 25, 37.5)
2003	32.5	16.5	12.4	5 (0, 7.5, 15, 22.5, 32.5)
2004	30	15.7	9.8	5 (0, 7.5, 15, 22.5, 30)
2005	25	13.5	9.6	4 (0, 7.5, 15, 25)
2006	25	13.4	8.4	4 (0, 6, 13, 25)
2007	25	12.2	7.0	4 (0, 5, 12, 25)
2008	25	13.4	7.6	4 (0, 10, 15, 25)

SOURCE: *National Board of Revenue up to November 2007, in Bangladesh Economic Review, 2008.*

Nevertheless, Bangladesh's trade regime remains one of the least liberal in Asia. The average nominal protection rate of 23 percent is relatively high in the context of South Asia even if it is similar to low-income countries overall. Moreover, this rate of nominal protection actually increased in FY 2010 because of the wider imposition of protective levies (paratariffs)[32] and the introduction of a 5 percent regulatory duty.

Finally, the level of effective protection enjoyed by Bangladesh's domestic industry has actually increased in 2010—since on average, duties on raw materials and intermediate goods have been reduced relative to duties on finished goods. Many trade bodies have applauded such protectionism on the grounds that it increases domestic demand for domestically produced goods at a time when external demand for Bangladeshi products is weak because of the financial crisis. However, this short-run view ignores the negative impacts of such protectionism on consumers, exporters, and the long-term competitiveness of Bangladeshi firms.

In FY 2009 the government also increased subsidies and cash incentives for exports of jute goods (from 7.5 percent to 10 percent), leather products (from 15 percent to 17.5 percent), and frozen

[32] Paratariffs are imposed primarily to generate additional revenue. However, they are also seen as a measure providing extra protection to local industries.

foods and fish (from 10 percent to 12.5 percent), which created significant distortions in the market for Bangladeshi goods.[33]

Exhibit 3-1
Regional Trade Agreements

The **ASIA PACIFIC TRADE AGREEMENT**, also known as the Bangkok Agreement, was signed in 1975. It is a preferential tariff arrangement to promote intraregional trade through exchange of mutually agreed concession by member countries. Members include Bangladesh, India, Sri Lanka, Philippines, Korea, Laos, and Thailand. China joined in 2001.

The **SOUTH ASIA ASSOCIATION FOR REGIONAL COOPERATION** was established in 1985 to promote the welfare of the people in South Asia through regional cooperation. It originally included Bangladesh, Bhutan, Maldives, Nepal, Pakistan, India, and Sri Lanka. Afghanistan joined in 2007.

The **BAY OF BENGAL INITIATIVE FOR MULTISECTORAL TECHNICAL AND ECONOMIC COOPERATION** was established in June 1997 to promote an enabling environment for rapid economic development. It includes Bangladesh, India, Sri Lanka, Thailand, Myanmar, Nepal, and Bhutan.

The **SOUTH ASIA FREE TRADE AREA** agreement was signed in January 2004 by members of the South Asia Association for Regional Cooperation to enhance trade and economic cooperation. Under this agreement, customs duties on nearly all regionally traded products are to be reduced to zero by 2016, with India and Pakistan lowering duties to zero by the end of 2012, Sri Lanka by 2013, and LDC members (Nepal, Bhutan, Bangladesh, and Maldives) by 2016.

Trade Agreements

The establishment of preferential trade access afforded to developing countries and multilateral agreements eliminating quotas and reducing tariffs have helped open markets and expand trade opportunities for Bangladesh. However, and as described in greater detail below, many of these opportunities for increased regional trade have not been realized.

Regional

Despite a variety of initiatives to promote increased regional trade (see sidebar), intraregional trade for South Asia remains very low by international standards. Exports to the ASEAN+3 (China, Japan and South Korea) accounted for only 1.4 percent of Bangladesh's total exports (excluding those from export processing zones [EPZs]).

Research suggests there is potential for considerably greater regional trade and that such increased regional trade would produce significant economic benefits for South Asia as a whole

[33] "Tk 3,424 cr stimulus plan rolled out," *Daily Star,* 20 April 2009.

and for Bangladesh in particular. Nevertheless, and as noted above, regional trade within South Asia is low relative to most other regions in the world, and Bangladesh's trade within the region is low relative to the trade of most other countries in the region. This is largely the result of the tariff and nontariff barriers to trade, infrastructure bottlenecks, and political attitudes in the region.

WTO

Bangladesh has been a WTO member since 1995. A formal WTO Cell within the Ministry of Commerce handles all WTO and other multilateral trade issues. The WTO cell includes a committee to deal with functions and activities related to WTO issues and seven working groups to deal with specific WTO issues.[34]

1. Nonagricultural market access and WTO rules
2. Agriculture and sanitary and phytosanitary measures
3. Services
4. Trade facilitation and customs valuation
5. Trade and environment
6. Trade-related technical assistance
7. TRIPS and technical barriers to trade

TIFA

Discussions of a trade and investment framework agreement (TIFA) with the United States have been ongoing for more than seven years. The current government has expressed its interest in moving toward signing an agreement and the U.S. ambassador has indicated that he is hopeful that it will be in the near future. A TIFA is simply an agreement to formalize discussions of mutual concern. Nevertheless, a major campaign has been launched against such an agreement by Bangladesh political parties that oppose the current Government. Establishment of a U.S.-Bangladesh Economic and Trade Cooperation Forum as an alternate to TIFA is under discussion between the two governments.

Trade with India

Prime Ministers Sheikh Hasina's recent visit to India has once again reignited calls for increased regional trade with India. India has agreed to remove 47 products from its Bangladeshi export blacklist in exchange for increased access to the Mongla and Chittagong seaports.[35] Bangladesh presently has a huge trade deficit with India due to low exports. Many within Bangladesh are skeptical that these recent talks will lead to a major shift or increase in intraregional trade. Nevertheless, it seems likely that the government will actively pursue increased trade with India. To date, the Chittagong Chamber of Commerce and Industry (Bangladesh) has signed a

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[34] Bangladesh Review, 2008. p. 72.

[35] Mushfique Wadud, "One Way Traffic," NewAgextra, www.negagebd.com 5 Feb 2010.

memorandum of understanding with the trade bodies of the North-Eastern Indian states to explore the potential for increased bilateral trade between the two countries.

KEY CONSTRAINTS

Trade Facilitation. As discussed above, trade facilitation reforms, particularly in the areas of customs and transportation, remains a key constraint. Cumbersome customs procedures, infrastructure bottlenecks—including gas and energy constraints and high transport costs—are an ever-present burden for the private sector.

Trade Policy Environment. Despite considerable liberalization over the last two decades, Bangladesh continues to have one of the most protectionist trade regimes in the world. The RMG sector is relatively insulated from the adverse effects of this regime because of special provisions being available to them such as duty-free access to raw materials and machinery and their location in EPZs. However, other exporters—especially those exporting less than 100 percent of output—are more adversely impacted by trade policies that increase production costs, reduce efficiency incentives, and divert resources into production for the domestic market. Other policy-related impediments relate to weaknesses in the application of, and testing for, sanitary and phytosanitary standards, which have hindered the continued growth of the shrimp export industry.

Weak Trade Policy Development Capacity. The principal responsibility for making trade policy in Bangladesh appears to be shared between the Ministry of Finance and the Ministry of Commerce Ministry of Commerce. Commerce has the lead in shaping the government's multilateral (WTO) and bilateral or regional trade policy (SAFTA, BIMSTEK, etc.) and in dealing with such issues as dumping, safeguards, and countervailing duties. However, it is the Minister of Finance who makes final decisions regarding trade tariffs.

Trade policy analysis in the government is carried out by the Bangladesh Tariff Commission (BTC)[36] or the Bangladesh Foreign Trade Institute (BFTI) ,[37] both of which are under or relate to the Ministry of Commerce. It appears that the capacity of both the BTC and BFTI to carry out the necessary trade-related analysis is limited. While the size of the BTC greatly exceeds that of the BFTI (122 vs. 15), both entities have a shortage of properly trained analysts and generally lack access to the analytic tools and know-how needed for sophisticated trade analysis. Moreover, the BFTI appears to be overly-reliant on donor funding.

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[36] The BTC was established in 1992 under the Bangladesh Tariff Commission Act. It is a statutory autonomous organization that provides analysis and recommendations regarding trade policy (especially tariff structure and coverage), trade remedies (investigations and recommendations regarding antidumping, countervailing, and safeguard measures), and international cooperation (bilateral, regional, and multilateral trade issues). The commission advises the government in charting course to safeguard the interests of the national economy. http://www.bdtariffcom.org/

[37] The BFTI was established in 2004 via a public-private partnership to provide the government of Bangladesh with independent trade-related analysis as well as trade-related training and policy advocacy. The BFTI is registered as a private company. The heads of all major business chambers serve on the BFTI board, as do selected GOB representatives. Individuals must pay to attend BFTI training events.

USAID/BANGLADESH'S CURRENT INVOLVEMENT

The mission's recent involvement in the trade sector is limited and comes about mainly through the PRICE project. Specifically, PRICE is providing assistance and capacity training to trade associations within its three priority sectors: aquaculture, horticulture, and leather products.

In recent years USAID's EGAT Bureau through the Trade Capacity Building Project, FasTrade and others have sponsored several studies to examine Bangladesh export potential and regional trade opportunities. These include South Asian Free Trade Area: Opportunities and Challenges (Nathan Associates 2005),[38] Bangladesh Export Trade Practices and Their Effect on the Competitiveness of the Garment Industry (Louis Berger 2006).[39]

OTHER DONOR INVOLVEMENT

Two donors that are actively engaged with the Bangladesh trade sector are the European Commission (EC) and the Asian Development Bank (ADB). The EC's involvement is primarily with BFTI. It appears that BFTI has been heavily dependent on EC funding. It received an initial grant in April 2008 and is expecting to receive a second grant of one million euros in early 2010. This funding is used to pay for a core staff of approximately 15 and to cover the costs of bringing in on a short-term basis various international experts to conduct training over the next four years. Under the Bangladesh Trade Support Programme (BTSP) (2005–2008), the EC provided assistance to the BTC to strengthen its human resources and institutional capacity in order to promote trade reform. However, the BTC is no longer receiving direct donor assistance. The European Commission's jointly funded Bangladesh Quality Support Program (BQSP) (2006–2009) also worked to increase quality, standards, and conformity within the multiple sectors in Bangladesh to meet the accepted quality standards set by South Asian Association for Regional Cooperation (SAARC) and the WTO.

The ADB is also assisting in trade policy reform through national and regional projects in trade facilitation. Through these projects the ADB has sponsored various studies, including the Dhaka Chittagong Transport Corridor analysis (2007), the study Intraregional Trade and Investment in South Asia (2009), and the Quantification of Benefits from Economic Cooperation in South Asia 2008.

RECOMMENDATIONS

Bangladesh's trade policy environment has improved significantly over the last two decades. However, there is still a vast need for further improvements to bring Bangladesh more in line with international norms. USAID could provide assistance to support the following reforms and capacity building:

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[38] South Asian Free Trade Area: Opportunities and Challenges (Nathan Associates 2005). See full report at *pdf.usaid.gov/pdf_docs/PNADE563.pdf*

[39] http://www.louisberger.com/berger/macro-iqc/papers/betp.pdf.

Support for Trade Facilitation. Trade facilitation assistance typically falls into two categories: (1) assistance to improve the operations and institutions overseeing border management, and (2) assistance to improve trade infrastructure. USAID/Bangladesh should seek to identify high-return interventions that address "behind the border" trade constraints, especially in the Dhaka–Chittagong corridor, which accounts for roughly two-thirds of the country's imports and exports. Such interventions might help address constraints relating to inadequate infrastructure (ports, roads, railways, and inland waterway systems); slow and inefficient customs procedures; and policy impediments that result in excessive paperwork for importers and exporters, hinder freight forwarding, and create opportunities for corruption. The corridor analysis mentioned above contained a wide range of recommendations, and an updated assessment of the implementation status of these would be useful.

Support for improved trade analysis. As noted above, the government's capacity to undertake the high-quality and timely trade analysis that is needed to properly inform the government's trade policy decision making is very limited. USAID/Bangladesh should explore working with existing institutes such as the BFTI and the Bangladesh Tariff Commission to strengthen their human resources and analytic capacity so as to improve the quality of the trade policy analysis that underlies trade policymaking. Strengthening the BFTI would also increase the private sector's understanding and awareness of international trade issues.

Support for enhanced regional/bilateral trade. As noted above, there are significant opportunities and gains to be had from increased regional or bilateral trade in South Asia. Bangladesh, with its deep pool of low-cost labor, its ports in Chittagong and Mongla, and its location vis-à-vis the east Indian states, is well positioned to benefit from increased openness to trade. The recent visit of the Bangladesh Prime Minister to India and the accords signed there perhaps suggests that the time may be ripe for the government to more actively pursue increased intraregional trade. Nevertheless, the slow progress made against this objective over the past 20 or so years suggests that progress will not be quick or easy. The government is establishing 18 interministry working groups to address the multitude of issues relating to increased Bangladesh–India trade. In this context, USAID/Bangladesh could contribute in several ways. First, it could fund a small secretariat consisting of local and foreign experts as needed to help with the coordination, planning, and analysis needed to move the overall process forward. Second, USAID/Bangladesh could help strengthen the government's capacity for trade analysis. Finally, USAID/Bangladesh could work with civil society, think tanks, and the media to build public understanding of, and ideally support for, increased regional economic cooperation. An activity by USAID/Bangladesh that addressed all three of these approaches would likely be most effective.

4. Financial Sector Development

RECENT DEVELOPMENTS

In the 40 years since independence, Bangladesh has endeavored to improve and develop a financial system that supports real sector economic development and provides more systematic access to the formal financial sector. The successes of these efforts have been mixed; the following section reviews the key results of these efforts in microfinance, small and medium enterprise (SME) finance, agriculture credit, the nonbank financial sector, and capital markets. The discussion also provides a review of recent developments concerning interest rates.

The Bangladesh financial system provides savings, payment, remittance, and limited credit. The formal financial system is dominated by commercial banks—30 percent of deposits and 50 percent of branches are concentrated in the four publicly owned commercial banks.[40] There are also five publicly owned development banks, though these institutions do not serve a large portion of the population. The development banks manage extensive subsidized credit programs characterized by a high level of nonperforming loans and low levels of efficiency. Additionally, a dynamic group of 39 privately owned commercial banks (9 foreign) has expanded activities. These banks generally have a lower level of nonperforming loans and higher efficiency. Two examples are the BRAC Bank and Premier Bank. BRAC Bank, which is promoted by the large BRAC NGO, has undertaken extensive and innovative programs to increase access to finance, particularly for SMEs, and Premier Bank has a development credit authority (DCA) with USAID.

Table 4-1

Bangladesh Lending (Tk billion)

Type of Institution	No. of Borrowers	Amount of Outstanding Credit	Date of Report
NGO microfinance institutions	18,415,878	79	June 2006
Grameen Bank	6,908,704	32	June 2006
Government programs	1,997,240	8	December 2005
Nationalized banks	2,311,150	33	December 2005
Private banks	164,113	1	December 2005
Total microcredit	30,836,096	154	

SOURCE: Bangladesh Bank, NGO-MFIs in Bangladesh.

[40] As of June 30, 2009. Bangladesh Bank.

Microfinance

Within the financial system, numerous microfinance institutions serve a large number of poor and some middle-level clients with basic financial services. In 2003, it was estimated that microfinance accounts for close to 10 percent of all bank lending (latest year for which comprehensive figures are available). As of June 30, 2006, 82 percent of microfinance borrowers in Bangladesh were women.[41] The bulk of NGO microfinance activity is accounted for by a small number of large NGOs such as BRAC, Proshika and ASA. Another major player is of course the Grameen Bank. Approximately 25 percent of microfinance is funded by member savings.[42] To date, 298 microfinance institutions have been licensed by the Bangladesh Bank. An additional 4,000 applied but did not meet the Bangladesh Bank's minimum capital requirements.

It is estimated that there are actually about 18 million microfinance borrowers, of whom perhaps 11 million are absolutely poor according to government standards.[43] Efforts to extend microfinance to the "ultrapoor" are still in the early experimental stage. The assessment team is unfamiliar with any systematic study of the various programs for graduates of the programs, but as small enterprises these presumably fall under that general rubric rather than microfinance.

The Bangladeshi microfinance sector is highly innovative by international standards, though less so than regional comparators India and Pakistan. The use of electronic communications and provision of remittance and other financial services is only now beginning. There has also been some development of microinsurance mechanisms. For example, BRAC members are offered the right to buy $77 of life insurance. Additionally Shore Bank is exploring opportunities to open operations in partnership with BRAC Bank and start microsavings programs that would encourage and teach people the value of savings.

The interaction between the different microfinance programs, moneylenders, and borrower incomes is of particular concern because borrowing from multiple sources is likely to lead to overindebtedness, and borrowing from one lender to pay another can lead to an endless cycle of debt.[44] Furthermore, there is renewed controversy about the overall positive effects of microfinance in Bangladesh—fed by some recent work by several microfinance research centers around the world. Nevertheless, the general consensus still maintains that the microfinance programs have had significant effects on their typical clientele, the enterprising poor.

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[41] Credit and Development Forum. Bangladesh Microfinance Country Profile, June 2006, p. 8.

[42] "NGO-MFIs in Bangladesh," Microcredit Regulatory Authority, Vol. 3, June 2006 and Bangladesh Bank Website.

[43] This figure takes into consideration borrower overlap—the extent to which individuals may simultaneously borrow from several microenterprise lenders.

[44] A draft paper on this topic, "Dynamics and Determinants of Overlapping Borrowing from Microfinance Institutions, by Atoni Rohbani, was presented at Economic Research Group seminar, January 23, 2010.

SMEs

In addition to microenterprises there are also SMEs. The full legal definition of micro, small, and medium enterprise for Bangladesh Bank's purposes along with statistics related to the size of the sector are provided in Appendix B. SME loans account for roughly 18 percent of total credit in Bangladesh. In September 2009, approximately Tk 425 billion in SME loans was outstanding. The bulk of SME loans are from the public sector banks' often undermandated and subsidized credit programs, as is the case for agriculture. The Bangladesh Bank refinances a considerable proportion of this SME lending.[45] Privately owned banks also account for about quarter of these loans, while nonbank financial institutions account for 14 percent.

An assessment of SME loan volume and demand is difficult. The World Bank's Enterprise Survey, a worldwide exercise parallel to the World Bank's Doing Business Study, reports that 50 percent of enterprises of all sizes receive bank loans, compared to 32 percent for the region as a whole, but only 24 percent receive credit for investment, compared to 27 percent for the region as a whole. Presumably the others receive credit for working capital.[46] Other studies estimate that there is demand for roughly Tk 200 billion in additional SME credit and that SMEs in specific industries have less than 10 percent of the funds employed coming from credit, while the rest comes from their own and family funds.[47]

A recent World Bank study states that only 7 percent of the one million potentially eligible small businesses have access to bank credit. Moreover, accessing the bank credit requires 29 administrative steps, 9 meetings with the bank, 50 forms, and 20 hours.[48] It is also reported in the same study that Dhaka and Chittagong banks are responsible for 78 percent of bank lending in the whole country, compared to only 11 percent in rural areas.

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[45] Nazima Nazneen Rikta. Institutional Lending and Financing Policies for SMEs in Bangladesh, Policy Note 804, December 2007, and Bangladesh Bank Monthly Economic Indicators, December 2009. The Bangladesh Bank reports Tk 5.3 billion of loans it refinanced to over 6,000 borrowers. There are at least two major funds involved—the entrepreneur growth fund for SMEs, which has received $20 million from the World Bank and Tk 30 million from the ADB; and the Bangladesh Bank's own fund, which has Tk 100 million. There are also government programs run by the Bangladesh Small and Cottage Industries Corporation in cooperation with the Bangladesh Shilpa Bank as well as other organizations. The USAID Micro Industries Development Assistance and Services (MIDAS) is given special mention in a Bangladesh Bank Study.

[46] World Bank, Enterprise Surveys, Bangladesh.

[47] Dr. Momtaz Uddin Ahmed, "Role of Institutional Financing in the Development of Small and Medium Enterprise (SMEs) in Bangladesh," p. 27-30 in the brochure *SME Financing Fair 2009,* Dhaka, December 8-9, 2009.

[48] Aurora Ferrari, Increasing Access to Rural Finance in Bangladesh: The Missing Middle, World Bank, 2008. This study published by the World Bank contains a number of key if highly controversial recommendations, particularly the refunding and revival of the two enormous and largely dormant agricultural development banks. The study benefits from extensive empirical work, which itself would require lengthy analysis. Whether other concerned parties will agree with this book and approve of its methodologies is not clear.

Agricultural Credit

An important segment of lending in Bangladesh is agricultural credit. As reported in the Economic Performance Assessment, Bangladesh's economy is still heavily dependent on the agricultural sector. The agriculture sector generates roughly 20.1 percent of GDP, but also—more importantly—provides employment to almost half the labor force (48.0 percent).[49] State-owned banks provide considerable agricultural credit, but as discussed above, they are highly constrained by their own financial weakness, especially their high level of nonperforming loans. In FY 2009, state-owned banks disbursed Tk 70 billion of agricultural refinance to the banks and recovered Tk 66 billion.[50] However, state-owned banks are also carrying Tk 60 billion of overdue agricultural loans on their books.[51] Indeed, over one-third of the agricultural loans by state-owned institutions are nonperforming, compared to less than 2 percent for private institutions.[52] Privately owned domestic banks, which typically lack rural branches, distributed just Tk 18 billion, and foreign banks Tk 5 billion in FY 2009. Private sector banks, in fact, constitute a declining share of the market. Most microcredit is too small in maximum loan amount to support significant crop agriculture—though many of the loans go for animal husbandry, fisheries, horticulture, and small-scale agricultural processing and trading. Some private sector commercial banks have reached agriculturists through second-tier lending or by supporting contract farming. Recently Citibank, for example, announced a loan to BURO, a large NGO, for agricultural purposes.

Nonbank Financial Sector

The formal nonbank financial sector in Bangladesh is small and varied—including leasing companies, other forms of commercial and consumer finance firms, firms connected with the capital market, and insurance companies.[53] The first nonbank financial company in Bangladesh dates backs to only 1984. Although leasing was initially the company's main operation, it has fallen from 67 percent of its portfolio in 2002 to just 40 percent to 2008.[54] This decline in leasing has resulted in a corresponding increase in term lending, including housing finance, which has risen from 15 percent of the portfolio (2002) to 40 percent in 2008. Finance companies are frequently active participants in the burgeoning capital market. On the source-of-funds side,

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[49] Although data for output shares are available for 2009, for consistency we have used 2005 data for employment and output shares in this comparison.

[50] For reference, the state-owned commercial and development banks account for roughly 30 percent of credit overall. The total amount of agricultural credit disbursed is reported as Tk 137 billion—a large discrepancy. Roughly two-thirds of the Bangladesh Bank financing went for longer-term credit. The Bangladesh Bank has targeted Tk 110 billion of agricultural refinance for fiscal 2010. It has also just transferred Tk 5 billion to BRAC for credit to sharecroppers without land title.

[51] Bangladesh Bank, Annual Report, p. 71.

[52] Annual Report, p. 73.

[53] "Non bank Financial Institutions in Bangladesh: An Analytical Review," by Mohd. Nehal Ahmad and Mainul Islam Choudhry, Bangladesh Bank Working Paper 0709, March 2007, on Bangladesh Bank website.

[54] Mafizuddin Sarker, "An Overview of the Financial Sector," p. 86, Bangladesh Leasing and Financial Companies Association, Yearbook 2008.

though, equity and long-term deposits are frequently important sources of funds, as are longer-term bank loans in many cases. The outstanding portfolios of nonbank financial companies total Tk 128 billion, while their new disbursements in 2008 were Tk 47 billion.

There are 29 registered nonbank financial institutions (exclusive of the capital market and insurance companies) with Tk 99 million of outstanding loans. Although there are 62 insurance companies, the industry is dominated by the parastatal Sadharan Bima Corporation and Jiban Bima Corporation. Our interviews indicate that the nonbank financial institutions are growing steadily and are mostly engaged in leasing (autos, equipment) and housing finance, though factoring and term loans are also available. The companies can take term deposits, bank loans, and other sources of finance, which are also important. It is useful to note that some firms in the past have had difficulties and problematic relationships with donors, which means that relationships with the sector need to take its history into consideration.

Table 4-2

Premium Income from General and Life Insurance, Tk billion

Item	2001	2007
Total premium general insurance	4.19	1,404
Public company	0.76	456
Private company	3.43	949
Total premium life insurance	8.18	3,163
Public company	1.50	245
Private company	6.68	2,918
TOTAL	10.87	4,567

SOURCE: Ministry of Commerce, Insurance Directorate.

Capital Markets

The capital market is active, and the growing market capitalization was Tk 1,837 billion (roughly $27 billion) in November 2009. The capital market is still focused on shares and government paper, but some private debt issues have occurred. Banglalink, the second-largest mobile phone operator in Bangladesh, is raising Tk 7.07 billion in 13.5 percent 5-year bonds with a guarantee by its main shareholder, Orascom Telecom Holdings, a Middle Eastern telecommunications group.[55] Banglalink revised the figure up from Tk 4.25 billion, inspired by oversubscription of its bond offer by private placement.

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55 "Banglalink to Raise Tk 425 Cr in Bonds," Sohel Parvez, *Star Business*, 27 Jan 2010, p. 1., http://www.thedailystar.net/story.php?nid=123633 and Banglalink issues more bonds on high demand, Sohel Parvez and Md Hasan, *Star Business*, 11 Mar 2010, p. 1. , http://www.thedailystar.net/story.php?nid=129539

Table 4-3
Formal Financial Institutions as of October 2008

Institution	Number
Commercial Banks *Credit* Tk 25,231 billion *Deposits* Tk 22,866 billion	48
Public	4
Development	5
Private	39
Microfinance *Deposits Tk* 154 billion	NA
Nonbank *Deposits* Tk 99 million	91
Insurance	62
Other	29
Stock Market	1
Total	**217**

SOURCE: Bangladesh Bank, Sadharan Bima Corporation.

The financial system also provides working finance for both existing firms and start-up capital for a very limited proportion of new start-ups. Except for an unusual, but not unique, penetration of microfinance services, the situation is not atypical for developing countries. Beyond the formal sector there is an extensive informal system that has a complex interconnection with the formal system, especially for micro, small, and medium-sized enterprises (MSMEs).

Interest Rates

The level of current interest rates in Bangladesh is a matter of considerable controversy. In July 2009, the Bangladesh Bank imposed a cap of 13 percent for corporate lending to try to drive down rates—the move was seen by some as a setback to financial sector development. However, the cap applies only to larger corporate lending rather than SME loans. In September 2009, Bangladesh had a "lending rate" of 11.59 percent, down from 11.87 percent in July, and the borrowing rate was 6.57 percent. The rates banks quoted for normal small and medium credits were in the 14–17 percent range. Small and medium lending is typically connected with fees, and in many cases with illegal "commissions" to loan officers. The rates to microborrowers vary certainly up to 18–24 percent, though the Palli Karma-Sahayak Foundation, which is a major source of funds, imposes a 12.5 percent flat cap.[56]

From one point of view, the question is whether interest rates are so high as to limit lending. Many bankers argue that this is not the case given that margins in Bangladeshi business are so

[56] Bangladesh Policy Note 804, and ADB publication, "Bangladesh Financial Sector: An Agenda for Further Reforms," 2008.

high. Others feel they are justified in terms of the risks and costs of banking in Bangladesh. The factors to consider are the actual lending costs influenced by the level of non-repayment and the comparative situation in other countries. In 2008, the gross ratio of nonperforming loans to total loans was 13.2 percent for the banking system, but 30 percent for state-owned commercial banks, 27.9 percent for development banks, 5.4 percent for private commercial banks, and 1.5 percent for foreign-owned banks. Recovery in microfinance institutions is higher—certainly over 90 percent. The director of BRAC Bank, which has a large small and retail loan portfolio, was reluctant to give figures, but he indicated that nonperforming loans were under 5 percent. These microfinance interest rates are low in international comparison, but the Bangladesh microfinance scene is dominated by not-for-profit social institutions using considerable donated funds. The commercial bank operating margins are certainly high compared to those in neighboring India, even accounting for a relatively high level of nonrepayment, but lower than other regional comparators. The interest rate margin in Bangladesh is 5.17 percent, compared to 3.5-4 percent in India, 7.49 percent in Pakistan, and 7.57 percent in Sri Lanka.[57] Lending rates in India are supposed to follow a prime rate of 11–12 percent, though banks' cited rates are often 15–16 percent and deposit rates for term deposits are often 7–8 percent. In Indonesia, the central bank reports lending rates of 12–15 percent.

One possibility is that lending rates reflect neither higher costs nor even inefficiency, but rather monopoly power. To the extent this is the case it would be reflected in higher rates of return on banking activity for which the rates of return on assets (loans) and equity are the normal measures. Of course, higher rates of return are also justified by higher risks in banking operations and returns available to bankers in alternative markets. Rates of return on assets and therefore equity in Bangladesh are relatively high by international standards. In 2006, they were 0.75 percent for return on assets and 14.13 percent for return on equity. Return on assets was 1.19 percent, compared to 1.0 percent in India overall, but with variable returns by category of banks. Domestic private banks had a return on equity of 16.37 percent in December 2008 and for public commercial banks the return on assets was 22.52 percent.[58] In any case, the banks are quite liquid, which means they might be expected to be ready to lend at market rates, but small businessmen typically report that the most serious problems are with availability of credit, not high interest rates.

The bankers argue that margins in most economic activities for which they lend are high enough so that borrowing is not price sensitive. Nonetheless, the banking and government authorities feel that the rates are excessive and are trying to reduce them. In fact, they have been fairly successful in slowly forcing down rates without apparently impairing bank viability or the volume of lending. Nonetheless, to the extent the authorities continue their focus on margins they may come

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[57] The Bangladesh Bank has been particularly concerned by these margins and put on considerable pressure. They are actually reported as low by the public sector banks, and much higher in private sector and foreign banks. The latter two argue that the margins are justified by their higher level of services, and in the case of BRAC (the highest margin Bangladeshi bank) by its concentration on the SME market.

[58] "Bangladesh Financial Sector: An Agenda for Further Reforms," Asian Development Bank 2008

up against what appears to be the higher margins of the private banks serving SMEs such as BRAC Bank and also the foreign banks.[59]

KEY CONSTRAINTS

The financial sector in Bangladesh faces the following constraints:

- Financial services for domestically owned SMEs are limited, even if they have significant foreign or diaspora involvement. For statistics on SMEs, see Appendix B.
- There is still limited development in some nonbank areas such as insurance.
- The development of the capital market has been rapid. Some observers feel it is overheating, while others think that the development is on solid ground. In any case, this report is not focused on the capital market except for its potential involvement in the corporate bond market.
- There are gaps in the supporting environment for the financial sector such as corporate governance and accounting services. Bangladesh has lagged in the development of some standard pieces of donor-supported innovation—credit bureaus, secured lending, revision of lending laws—yet has moved ahead with others, particularly in connection with the stock market. The Bangladesh Bank and the financial sector as a whole are conservative—partially because of its relatively highly regulated nature.
- There are problems with the efficiency of the core banking system itself related with the conservatism noted above. Operational costs are high and nonrepayment a serious difficulty.

USAID/BANGLADESH'S CURRENT INVOLVEMENT

During the 1980s and early 1990s, USAID played a major role in Bangladesh's financial sector reform. In a series of projects culminating in the Financial Sector Reform Project (FSRP) of 1990–1995, the Mission supported assistance to the Bangladesh Bank in both its macroeconomic regulatory and banking supervision functions, to the commercial banks, and other supporting institutions, as well as in other projects to development finance institutions. A description of this project is provided in Appendix C. After its completion, FSRP was evaluated by the World Bank as one of the most successful in the world. However, the mission and USAID in general decided that the involvement was not appropriate for their overall program direction, and the project and similar activities ended. Since that time the World Bank and the ADB, with some assistance from DFID, have been the main donors engaged in financial sector development (see description below).

[59] "Bank Spread Comes Down: 19 Banks still beyond the limit," Rejaul Karim Byron, Star Business p. 1, January 16, 2010.

Although USAID has not had a financial sector reform program in Bangladesh in recent years, the mission has had more than one DCA in place. The current DCA with Prime Bank supporting its small-scale lending is now about to end.

The Dhaka mission has also had some small-scale activities involving strengthening capacity of the Bangladesh Small and Cottage Industries Corporation's Women Entrepreneurship Development Program and supported the establishment and capitalization of Micro Industries Development Assistance and Services (MIDAS), an NGO devoted to enterprise support that still continues to function.[60] Even during USAID/Bangladesh's JOBS Project (1997–2005), there were segments devoted to developing financial services for clients.[61] However, these are not present in PRICE, its successor.

Additionally other bureaus within the mission support minor, though often far-reaching, microfinance programs typically conducted by NGOs.

OTHER DONOR INVOLVEMENT

The Bangladesh government has been pursuing a financial sector reform program since 1990, and extensive donor involvement within the financial sector reform continues. The Bangladesh Government's efforts are theoretically underlain by the Financial Stability Assessment of 2004, which is now undergoing a new formulation, with a preliminary analysis to be delivered in 2010.

The World Bank's current projects include the $105 million (with another $272 million awaiting board approval) Investment Promotion and Financing Policy 2006–2011; the $37 million Bangladesh Central Bank Strengthening Project, 2003–2011; and the $250 million Enterprise Growth and Bank Modernization Program, 2004–2010.

In addition, the IFC is managing the BICF. Jointly funded by Norad, EC, and DFID, the fund is working with the Bank of Bangladesh on secured lending, the e-payment system, and developing the framework for a credit bureau. The IFC also holds a third share in BRAC Bank (along with BRAC and Shorebank).

The IFC, in partnership with DFID and Norad, also manages the South Asian Enterprise Development Facility (SEDF). The access-to-finance component is assisting four banks, mostly through technical assistance, though some guarantees and capital inputs are being provided.

DFID has a major program called the Remittance and Payments Partnership that consists primarily of a 5.5 million pound "challenge fund" under which grant agreements in support of innovative initiatives have been signed with a large number of financial institutions.[62] The

[60] A member of the assessment team worked as a consultant with the Mission in the 1980s and was associated with these efforts.

[61] http://www.jobsproject.org/index.htm

[62] For the overall project www.cardno.com.au/pdfs/projects/economic_payments.pdf,

program originally focused on reducing the cost and increasing the speed and reliability of remittances. However, further research revealed that Bangladesh remittance costs were among the world's lowest, and the proportion of remittances through informal channels was low. The program then assisted in developing a clearing house for the banking system as a whole and worked on promoting mobile banking and e-payment on both the policy and technical levels. It has started programs to promote access to bank accounts among a larger population (only 3 million accounts now exist) and to counsel migrants on dealing with agents, arranging their finances, and similar matters. The program is coming to an end September 30, 2010, and it is not clear who, if anyone, will continue this work.

The ADB launched the $1.7 million Capital Market Development Program in 2007, which aims to strengthen the SEC and upgrade accounting and auditing standards. It also had three recent technical assistance programs: helping with the secured transactions law, strengthening debt recovery mechanisms and corporate governance (2003), and strengthening market governance mechanisms in the 2003–2005 period. The ADB reported that the overwhelming majority of its financial sector projects were unsatisfactory.

However, the ADB, like DFID, is rapidly expanding its Bangladesh assistance, and the papers over the last few months have announced $2 million for microinsurance, $76 million for SME finance, and $744 million for trade finance, though the local office did not seem particularly well informed about them.

Microfinance funding frequently comes through central grants, NGO programs, and the like, and the local offices of the donor are often not very involved. All of the major microfinance NGOs have coordinating offices that supervise them on behalf of all donors in order to avoid the burdens of dealing with multiple donors such as the BRAC Donor Liaison Office, Bangladesh, and Proshika Donor Consortium.

The microfinance sector, in particular, involves heavy foreign donor involvement. All of the above listed donors have projects in this area. For example, DFID is implementing the PROSPER Project.[63]

RECOMMENDATIONS

Since it is generally agreed that an efficiently functioning financial system is a key asset in economic development, the following section provides a list of potential areas for USAID intervention.[64]

Increase Efficiency of Remittances. Emigration and the connected diaspora are valuable assets not to be wasted. Assistance in increasing the efficiency of remittance services, both internationally and internally in the country, is important. Financial arrangements that leverage

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63 www.prosperprogram.org.

64 Any intervention will need to be framed by the emerging consensus.

diaspora assets, both financial and entrepreneurial, will help in economic growth as well as assisting with insuring food security and ameliorating the results of climate change. The growing sophistication of the microfinance and small enterprise finance sectors means that a large variety of value-added services in remittance, payment, and insurance, often linked to business information and value chain development, are now being promoted. Just as with small enterprise finance, these services could increase their impact if they could extend their reach upward without neglecting their chief market at the bottom of the pyramid.

A programmatic tool to make remittances more productive is called for. DFID has a faltering project, to be completed September 30, 2010. On its last legs, it has identified some high potential prospects. DFID itself has not decided to what extent it wants to do anything on remittances in further financial sector projects. These initiatives are not really limited to a remittance focus but look at the entire process of manpower export and work with local groups to increase the yield to migrants and their communities. The element can be introduced into any area in which a USAID project is working that is a catchment area for labor export.

Access to Finance. It would be valuable to add an access-to-finance element to PRICE and future enterprise development programs. But it should not necessarily be a DCA; interventions involving training for credit market participants, consultancy to clients and partners, and arrangements with larger-scale firms in the value chain are possible. USAID does not have enough money for a significant loan fund. In any case, what is needed is to promote commercially sustainable financing arrangements that will survive long after USAID is off the scene. Furthermore, funds provided directly from USAID often have relatively tough terms to make them commercially sustainable. There is a lot of easier money available that USAID can leverage and that the clients and partners will obviously prefer.

Access-to-finance elements may already be part of local government projects. This might be a use for a DCA, to support a loan fund from which the local governments and especially their committees (usually a level lower than dealt with routinely) can borrow. USAID has some experience with this for municipalities in India. Big infrastructure finance is likely to require big money operations and therefore normally ADB, the World Bank, the Chinese, or the commercial parties involved (including those from the United States) will be the prime actors. But “little infrastructure”—small pier repairs, local roads, storage sheds at local markets—are logical complements to the activities USAID often supports. They empower local economies and government and make the whole chain work. Furthermore, though these units are not yet used to borrowing from banks and repaying them—which is the challenge a USAID initiative in this area would have to deal with —they do have considerable experience, and the LGED and some of the NGOs have experienced and relatively strong bureaucracies.

Financial sector training courses. Bangladesh has a shortage of good financial skills and professionals at the local level. There is a complex of issues to be faced connected with professional rivalries between chartered and costs and works accountants, actuaries, and financial analysts. Such training programs would form logical elements of other financial sectors and even general capacity strengthening efforts. Further, involving what are relatively strong organizations, the professional associations, would give USAID a seat at the micro policy table in many of the areas in which it operates.

PPPs to support infrastructure development. As has been indicated elsewhere, one of the key obstacles to Bangladeshi growth is the lack of appropriate infrastructure. As is clear to all observers, the provision of this infrastructure will require public-private partnerships for both the capital and the creation of the physical infrastructure. Some few public-private partnerships have already been initiated in the power generation sector, and the World Bank and ADB have made or are in the process of making several hundred millions of dollars available to complement private funds through an arrangement with the Bangladesh Bank. (See discussion of other donor projects.) The present budget relies on public-private partnership investment for critical parts of its planned infrastructure expansion. It is noted that the organizational alternatives for any such partnership arrangement, such as equity sharing or management contracts, needs careful scrutiny, since this has important implications for cost-cutting, risk sharing, quality of maintenance, supervision, and regulation.

However, there is also general agreement that this will not occur until an appropriate legal and regulatory framework is in place. The Finance Division of the Ministry of Finance was developing such a framework, but jurisdiction has been transferred to the Board of Investment, which has established a PPP cell for which it is seeking donor assistance and submitted a draft set of guidelines to the Cabinet Secretariat for approval.

A Development Credit Guarantee is a USAID device involving up to 50 percent guarantee of lending by private sector financial institutions. They have been used for a variety of purposes, including to support municipal borrowing in decentralization programs, to assist clinics in borrowing, to assist postdisaster loans, and more generally to promote SME or agricultural lending. Since the program was established in 1999 it has made $1.8 billion of loans, at a cost to USAID of $61 million; claims against the guarantees have been under 1 percent.

5. Private Sector Growth and Competitiveness

If you want one year of prosperity, grow rice. If you want ten years of prosperity, grow trees. If you want a hundred years of prosperity, grow people – train and educate them. – Chinese proverb

RECENT DEVELOPMENTS

The private sector in Bangladesh that the assessment team met with is optimistic about growth. They are making investments in new products and markets locally in Bangladesh, in the Middle East, and globally, by exploring opportunities for more value-added goods in their existing export products—garments, plastics, processed food, and seafood. In addition, new high-value tourism products are developing, business schools are encouraging students to start enterprises and not just be job seekers, and food-exporting companies are exploring value-added product opportunities to penetrate Middle East, UK, and U.S. markets. In April 2010, Standard and Poor's Ratings Services assigned its "BB-"long-term and "B" short-term foreign and local currency sovereign credit ratings to Bangladesh. Although this rating probably will not bring an influx of highly desired foreign investors, it has been perceived as a positive start in the process of credit ratings. In fact, Bangladesh, with a GDP per capita of $497, is given the same S&P ranking as Vietnam (GDP per capita $1,051), Philippines (GDP per capita $1,847), Indonesia (GDP per capita $2,246), and Turkey (GDP per capita $9,942).[65]

Bangladesh wants to graduate to a middle-income country by 2021.[66] The private sector has been the driver of Bangladesh's economic growth, and the goal of becoming a middle-income country with gross national income of $976 and higher has to be through private sector–led growth. The objective of our field assessment was to identify the strategies businesses and government are pursuing, what enabling environment constraints limit their ability to reach those goals, and how

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[65] A.N.M. Nurul Haque "Poised for a good turn" The Daily Star. www.dailystar.net, Monday, April 19, 2010 and GDP per capita numbers from World Development Indicators, The World Bank, http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?cid=GPD_57 Data for 2008 published as of June 1, 2010.

[66] Countries are divided in World Bank and IMF documents according to GNI per capita: low income $975 or less; lower middle income $976–$3,855; upper middle income $3,856–$11,905 and high income $11,906 and more. From former executive director, Center for Policy Dialogue, Dr. Debapriya Bhattacharya's presentation on Bangladesh's Graduation from LDC Status Timeline & Policy Implications.

a donor-funded project might provide meaningful support to helping the private sector grow and become more competitive. The intent is to identify patterns and the points of interventions where USAID/Bangladesh can facilitate growth and have an impact on a broader scale.

The Doing Business Indicators Bangladesh 2010 provides a good framework for looking at the business-enabling environment constraints. Detailed discussions of the rankings are presented in the Economic Performance Assessment for Bangladesh done prior to this field work. The fact that Bangladesh needs an improved business-enabling environment is recognized by all donors operating in Bangladesh and the Government of Bangladesh itself.

Bangladesh has been working on improving Doing Business indicators for a number of years now. A multidonor advisory facility, the BICF, has been established to advise the Government of Bangladesh on creating a better business operating environment that will design and implement business-friendly policies, laws, and regulations and strengthen institutions that implement them. The Regulatory Reform Commission (RRC) has been established to oversee the regulatory reform in Bangladesh. The RRC has the mandate to recommend elimination of redundant regulations and streamline the existing regulations. Wanting to keep the private sector actively engaged in the process of reform, RRC and IFC helped to set up the Bangladesh Better Business Forum in 2007 to begin addressing ways to improve the business-enabling environment through interactions between the business community and government officials. This organization was formed during the caretaker government with the best intentions, but during our visit to Dhaka, the IFC team informed us that it is no longer functioning or meeting original expectations. It is housed under the Board of Investment.[67]

There is progress in the reforms, and the Doing Business indicators are not as negative as often portrayed, especially if they are compared to those of India, which has been enjoying the economic growth rate of 8 percent. One example is Starting a Business indicators. Bangladesh historically has a higher ranking than India, and yet India seems to have a better business climate that is reflected through higher domestic investment, FDI, and GDP growth.

Starting a Tourism Project in Bangladesh

American investor Kristen Boekhoff will soon be opening a boutique ecoresort in Kulhna, called Panigram Resorts. This is welcome news, because Bangladesh has only 5,000 tourist arrivals per year (not counting returning visitors of Bengali origin who live abroad). Yet the only reason Panigram is moving forward in Bangladesh is Ms. Boekhoff's sheer commitment and drive. Ms. Boekhoff characterized her experience of setting up a business in Bangladesh as "*The business Olympics—If you can make it here you can make it anywhere.*" All 100 percent foreign-owned companies must register with the Board Of Investment, which can take up to a year. Foreign investors lack transparent information regarding specific requirements for registering a business or applying for a license. This investor spent six months "running around" to make an application or respond to a bewildering array of requirements and was obligated to pay "all kinds of fees that nobody tells you about."

[67] For more information, please refer to www.bbbf.org.bd

Figure 5-1

Doing Business Indicators for Starting a Business, Bangladesh and India

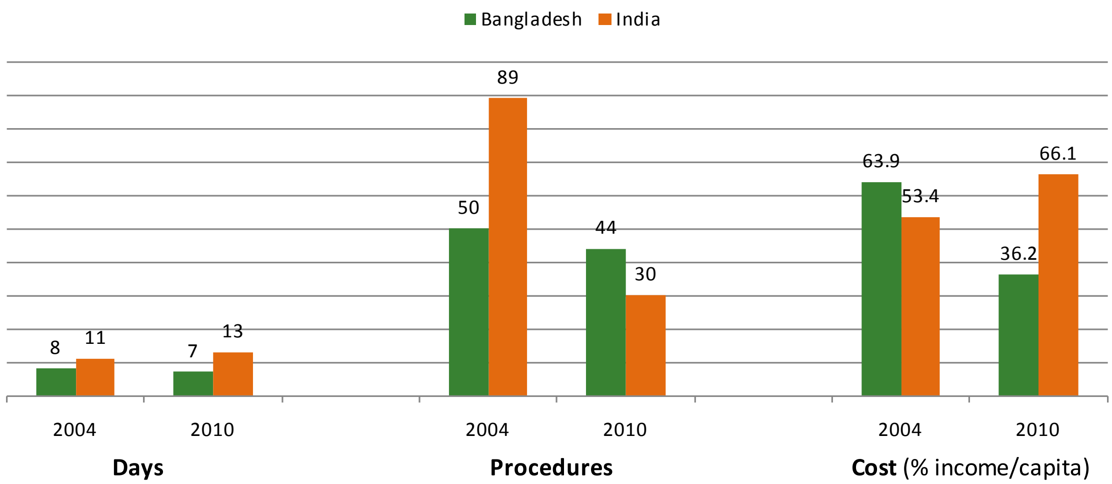

Table 5-1 is the snapshot of Doing Business Indicators for Bangladesh in 2010 and upcoming changes and major reforms recently reported by the RRC that will be reflected in future indexes.[68]

Table 5-1

Doing Business Indicators 2010 for Bangladesh

Doing Business Indicators 2010	Bangladesh (119)	India (133)	South Asia	Changes Planned for 2011
Starting a Business	98	169		
Procedures (numbers)	7	13	7.3	
Time (days)	44	30	28.1	-1
Cost (% of income per capita)	36.2	66.1	27	
Min capital (% of income per capita)	0	210.9	26.9	
Dealing with construction permit	118	175		
Procedures (number)	14	37	18.4	
Time (days)	231	195	241	-121
Cost (% of income per capita)	645.1	2,394.9	2,310.6	
Employing Workers	124	104		
Difficulty of hiring index (0-100)	44	0	27.8	
Rigidity of hours index (0-100)	0	20	10	
Difficulty of redundancy index (0-100)	40	70	41.3	

68 Financial Express, Doing Business Indicators likely to improve next year, May 12, 2010 (http://www.thefinancialexpress-bd.com/more.php?page=detail_news&news_id=68922) and notes from the meeting with the IFC BICF team in Dhaka during the January 2010 visit.

Table 5-1 continued

Doing Business Indicators 2010	Bangladesh (119)	India (133)	South Asia	Changes Planned by 2011
Rigidity of Employment index (0-100)	28	30	26.3	
Redundancy costs (weeks of salary)	104	56	75.8	
Registering Property	176	93		
Procedures (number)	8	5	6.3	
Time (days)	245	44	105.9	-45 days
Cost (% of property value)	10.2	7.4	5.6	
Getting Credit	71	30		
Strength of legal rights index (0-10)	7	8	5.3	
Depth of credit information index (0-6)	2	4	2.1	
Public registry coverage (% of adults)	0.9	0.0	0.8	
Private bureau coverage (% of adults)	0.0	10.2	3.3	
Protecting Investors	20	41		
Extent of disclosure index (0-10)	6	7	4.3	
Extent of director liability index (0-10)	7	4	4.3	
Ease of shareholders suits index (0-10)	7	7	6.4	
Strength of investor protection index (0-10)	6.7	6.0	5.0	
Paying Taxes	89	169		
Payments (number per year)	21	59	31.3	
Time (hours per year)	302	271	284.5	
Profit tax (%)	25.7	25.1	17.9	
Labor tax and contributions (%)	0.0	18.2	7.8	
Other taxes (%)	9.2	21.4	14.2	
Total tax rate (% of profit)	35.0	64.7	40.0	
Trading Across Borders	107	94		
Documents to export (number)	6	8	8.5	
Time to export (days)	25	17	32.4	
Cost to export (US$ per container)	970	945	1,364.1	
Documents to import (number)	8	9	9.0	
Time to import (days)	29	20	32.2	
Cost to import (US$ per container)	1,375	960	1,509.1	
Enforcing Contracts	180	182		
Procedures (number)	41	46	43.5	
Time (days)	1,442	1,420	1,052.9	
Cost of claim (% of claim)	63.3	39.6	27.2	
Closing a Business	108	138		
Time (years)	4	7	4.5	
Cost (% of estate)	8	9	6.5	
Recovery rate (cents on the dollar)	23.2	15.1	20.4	

It seems that the government has been doing positive reforms to encourage more growth and create the environment for high foreign direct investment, yet Bangladesh is behind. Perhaps the questions that could be asked are: What is India doing to stimulate and maintain its economic growth and why is India ranked so much better on the Global Competitiveness Index?

Bangladesh ranks 106th out of 133 countries in the Global Competitiveness Report prepared by the World Economic Forum every year. The report captures the microeconomic and macroeconomic foundations of national competitiveness. They define competitiveness as "the set of institutions, policies, and factors that determine the level of productivity of a country."[69] Table 5-2 summarizes Bangladesh's ranking in the 12 pillars of competitiveness, alongside rankings for India (which ranks 44th out of 133 countries) and lower-middle-income countries in general.

Table 5-2
Global Competitiveness Index Ranking for Bangladesh, 2010

Global Competitiveness Index 2009-2010	Bangladesh	India	Lower Middle Income (excluding India)
1st Pillar: Institutions	122	54	97
2nd Pillar: Infrastructure	126	76	80
3rd Pillar: Macroeconomic stability	84	96	78
4th Pillar: Health and Primary Education	105	101	86.5
5th Pillar: Higher education and training	129	66	94
6th Pillar: Goods market efficiency	102	48	85
7th Pillar: Labor market efficiency	112	83	97
8th Pillar: Financial market sophistication	71	16	94
9th Pillar: Technological readiness	125	83	93.5
10th Pillar: Market size	48	4	79
11th Pillar: Business sophistication	100	27	88.5
12th Pillar: Innovation	122	30	100

According to the World Economic Forum's Global Competitiveness Report 2010, Bangladesh is a factor-driven economy, reliant on endowments like cheap labor. Companies in Bangladesh compete on the basis of price, selling either raw commodities or low-value products; and their low productivity is reflected in the wages. The private sector aims to leverage its position as a low-cost producer to access new markets. These markets can serve as a platform for developing value-added products and services resulting in more efficient production processes and increasing productivity. Increased efficiency and productivity will set the stage for increased wages, long-term growth, and poverty reduction. "We are too dependent on cost," said one businessman, "to grow further, we need knowledge and technology, particularly at the intersection of agriculture and education." The private sector wants to focus on productivity growth or competitiveness.

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[69] The Global Competitiveness Report, World Economic Forum, page 4.

Productivity growth or competitiveness results from the efficient allocation of resources. Productivity growth enables wages to rise without causing inflation.

“WE ARE TOO DEPENDENT ON COST.”

Competitiveness is the key to sustainable economic growth, job creation, income generation, and consequently poverty alleviation. Bangladesh has been ranked in the Global Competitiveness Report since 2003, yet there is seems to be no dialogue on how to address improving its competitiveness. Many countries use these indicators to address and prioritize initiatives to improve the competitiveness of the country.

There are many definitions for competitiveness, but in the context of economic development the definition of Dr. Howard Rosen, former executive director of the U.S. Competitiveness Policy Council, is appropriate: “An economy’s ability to produce goods and services that meet the test of international markets while its citizens earn a standard of living that is both rising and sustainable over the long run.” For a firm, competitiveness can lead to long-term growth in profits and increased market share. For an economy, it should lead to rising and sustainable increases in the standard of living. Economywide competitiveness implies not only the competitiveness of firms but also a business and investment environment, institutions, workforce, and other factors that contribute to competitiveness.

Walking through the hotel lobbies of Dhaka, one sees that the Bangladesh economy has by and large been resilient in the face of the global financial crisis because of the continued strength of the garment industry. The Radisson and Westin hotels are extended trading floors for readymade garments. In 2009, while many developing countries were faced with lower demand for export products, Bangladesh’s exports, dominated by readymade garments, remained fairly stable. The country was able to maintain its share of the global market while other garment-exporting countries faltered because it is the cheapest source for those goods and services. Bangladesh was protected from the crisis by the same thing that makes it poor.

“It’s good to be poor sometimes,” said one prominent government official. However, the global downturn has not been without cost to the garment industry. Businesses have had to accept lower margins, and in some cases, reduce wages that were already low. We must be careful not to confuse “competitiveness” with a race to see who can stay poorest the longest on the basis of cheaper costs—a comparative advantage in wages does *not* easily translate to competitive advantage. Increased value and prosperity come from identifying and serving specialized markets, adding unique product features, adding value and services to export products or clients, and developing sophisticated products that are not easily replicable.

Competitiveness is discussed in limited circles in Bangladesh. The private sector understands that to improve long-term productivity, the public and private sectors must address the inefficient allocation of resources, but a visible national agenda on competitiveness does not exist, and businesses address competitiveness only in terms of their own firm-level profitability. The Center for Policy Dialogue (CPD) mentioned that although it is involved in the government’s policy decision-making process, there is no agenda for improving Bangladesh’s competitiveness.

PRIVATE SECTOR IS INVESTING

The private sector is actively investing and believes that one of the industries ripe for growth is agribusiness. Investors are motivated by the growth of neighboring India and the accomplishments of China. As Farooq Sobnan from the Bangladesh Enterprise Institute said, "We used to see geographic location as weakness and vulnerability, but it is a great advantage." He believes that as consumption rises in Bangladesh and in the greater subcontinent economic improvement will occur. With more disposable income and increased urbanization, consumer spending on processed food is expected to grow. The World Economic Forum (WEF) forecasts the global population will reach 9.2 billion by 2050 and demand for agricultural products will double.

The garment industry provides a sound model for the agribusiness industry's planned expansion. Growth in the garment industry was initially based on low wages. Some companies have used the access generated by these new markets to introduce new technologies and begin integrating up the value chain. The continual focus for the government and donors must be: What policy changes will create a platform for growth throughout Bangladesh? How can we leverage our comparative advantages to gain exposure to new technologies, attract know-how, and develop a more highly skilled workforce? On the basis of the insights from the garment industry, some companies are already offering value-added services that demand more skilled workers and therefore contribute to rising wages.

KEY CONSTRAINTS

This section outlines key constraints identified through discussions with the business community, chambers, think tanks, and other donors. The objective of these discussions was to identify current business strategies, constraints in the business environment, and how donor-funded projects can support private sector growth and increased competitiveness.

Skills and Knowledge. According to our analysis, the primary factor that needs to be addressed is the lack of skilled workers able to perform the tasks and develop products that businesses would like to offer. Skilled human resources enable companies to compete in new markets, develop products aligned with market demand, and deliver consistent product quality and volume. Education and training that is high quality and responsive to industry's needs are essential to enhancing value along the supply chain and moving beyond commodity production toward value-added products.

Bangladesh has 56 private universities and 26 public universities. Although some universities are skilled in many fields, there is a strong desire among academic and business leaders to introduce curricula that will promote practical knowledge so that graduates are better prepared to meet the needs of the private sector. Academia and the industry have limited interaction. Both parties have a role in this disconnect, but it is clearly reflected in the frustration of businesses that spend limited training resources teaching new employees fundamental skills.

The puzzling reality is that on one hand Bangladesh has an abundance of cheap labor and on the other hand, fast-growing companies are struggling to find qualified and skilled workers to develop products fast enough to meet the market needs. There are indications that two million people every year are ready to enter the workforce in Bangladesh. Yet the private sector is struggling to find people with the right skills and knowledge to run the businesses. And the shortage of a quality labor force limits the performance of the public sector, too. The private sector seems to fill the gap by hiring expats, while the public sector does not have that option.

It is a common pattern among business operations in Bangladesh—particularly heavily export-oriented firms—to hire expats for high-level management and technical positions. According to our interviews, as many as 200,000 professionals from Pakistan, India, and the Philippines fill senior management or technical jobs in Bangladesh. Businessman Mainuddin Monem stated that within his own businesses, the Igloo plant that makes ice cream is managed by a Sri Lankan, his Coca Cola plant is managed by an Indian, and his sugar factory by a Filipino. Moreover, the top mechanic in his construction business is also a Filipino. According to Monem, developing human resources at the management level is an essential factor to increasing the competitiveness of Bangladesh. The presence of skilled foreign professionals is an opportunity to transfer knowledge and skills to Bangladeshis. The challenge is to develop programs and techniques that ensure this happens.

Large companies that can afford to provide the training necessary for the job also face workforce challenges. According to leading private sector companies, approximately 50 percent of new employees leave once the company has invested in training them. Hiring and training are large expenses for a company of any size, but especially to SMEs, because this investment is a greater percentage of their operating costs and severely limits their ability to grow and become more competitive. One businessman said: “We need the training that meets the business needs. Please bring the best teachers from the U.S.”

The business community in Bangladesh sees neighboring India as a good role model for economic growth. Like Bangladesh, India is a factor-driven economy challenged by weak infrastructure and energy shortages. Almost 20 years ago, the Indian business community acted on the realization that an adequately skilled workforce is critical for prosperity. In the last decade, India has sustained a spectacular growth rate that many attribute to rising trends in domestic investments and cost-effective and skilled labor, as well as strategic investments in building world-class educational institutions, which provide an increasingly skilled workforce to fuel the country’s economic growth.

Table 5-3
Key for Efficiency-driven Economies

Country / Efficiency Enhancers	India	Bangladesh	Pakistan	Thailand	Turkey
Higher education and training	66	**129**	118	54	73
Goods and markets efficiency	48	**102**	83	44	56
Labor market efficiency	83	**112**	124	25	120
Financial market sophistication	83	**71**	64	49	80
Technological readiness	16	**125**	104	63	54
Market size	4	**48**	30	21	15

SOURCE: *Global Competitiveness Report 2010, Appendix F: Bangladesh Global Competitiveness Index in Detail.*

The key elements of a productivity growth strategy are workforce development, investment promotion, research and innovation, and the ability to gain access to international markets. The development of these elements is interconnected. Research and innovation are not likely to happen in a country with an inadequate educational system and are more difficult in economies lacking good market information and trade linkages. Investment is likely to be limited without skilled labor—particularly FDI.

Workforce quality is one of the key considerations for potential foreign investors. A team member interviewed one of the A. T. Kearney Global Business Policy Council (GBPC) faculty as about why Bangladesh is lagging behind in attracting FDI. Every year, GBPC conducts Foreign Direct Investment Confidence Index (FDICI) to analyze global investors' perception of the market trends. To the question of why India and Vietnam are doing so much better in attracting FDI, this person responded that every year when they ask what are the most important factors driving investment decisions, every year by far the most important factor is "market size and growth." All the countries that lead the index (China, India, United States, Germany, Brazil) either have very big and growing domestic markets or they are part of a large free-trade block. India offers access to a huge and fast-growing domestic market, while Vietnam has a big market of its own and also offers access to ASEAN.

But what is interesting about the FDICI is not the big markets, but the exceptions to the rule—the big countries that do not do so well, such as Russia, or the smaller countries that do much better than their size suggests, such as Singapore, Chile, and UAE. This reveals more about what countries can do to improve their FDI attractiveness. Countries do well compared to their peers when they focus on their business environment (Doing Business indicators) as well as competitiveness drivers such as skills and infrastructure, and their openness to trade. What are the implications of this discussion for Bangladesh? It is a big country in terms of population, but to become a big market, Bangladesh must continue to focus on economic growth and income growth so it becomes a big market of consumers, not poor people.

The Bangladeshi private sector believes that a USAID program could help develop linkages between leading American universities, bringing American university training and know-how to the country, improving academia-industry collaboration, and encouraging adoption of technology in order to help Bangladesh develop its productivity growth.

USAID/BANGLADESH'S INVOLVEMENT

In the Economic Growth Office portfolio, USAID/Bangladesh has the PRICE program. PRICE works to reduce poverty in Bangladesh by supporting the creation of sales, jobs, and investment in the aquaculture, horticulture, and leather products sectors, particularly for the benefit of women and SME suppliers. PRICE does this through three mechanisms: designing and implementing strategic technical activities to promote growth throughout the value chain, facilitating training and technical assistance, and identifying policy issues that act as constraints to sector growth and advocating for policy reform. PRICE works throughout the value chain to arrange training and technical assistance, find buyers, organize SME suppliers, and source equipment and financing to create sales, jobs, and investment. By targeting growth constraints in each sector to increase sales, jobs and investment, PRICE promotes sustainable, equitable private sector growth.

Under the agricultural arm of the Economic Growth Office, there are three ongoing projects: National Food Policy Capacity Strengthening Program , Promoting Urea Deep Placement technology to increase rice productivity, and Agriculture Biotechnology Support Project.

OTHER DONOR INVOLVEMENT

Other donors are also addressing economic growth. Here is a summary of what the other donors are doing in the areas of private sector growth, business environment constraints, and poverty alleviation.

DFID is the biggest donor engaged in private sector growth in Bangladesh. It has seven major programs:

1. Katalyst II, £11.8 million ($17.37 million)[70]
2. RISE—Regulatory and Investment Systems for Enterprise and Growth, £4 0million ($58.89 million)
3. PROSPER—Promoting Financial Services for Poverty Reduction, £40.15 million ($59.11 million)
4. RPP—Remittances and Payments Partnership, £13.4 million ($19.72 million)
5. Rural Electrification Development Programme (REDP) £40 million ($58.89 million)
6. Policy Fund project—Bangladesh Social Enterprise Project, £90K ($132.51K)
7. Policy Fund project—Diaspora Project, £82K ($120.73K)

Katalyst, a multidonor program supported by DFID, Swiss Development Cooperation, Embassy of Netherlands, and CIDA, aims to increase competitiveness of MSMEs in selected urban and rural sectors. The counterpart on the government side is the Ministry of Commerce. The program is in Phase II, which started in 2008. The program is likely to be evaluated mid-2010 and analyzed to determine what programming activities make sense for Phase III. Katalyst is implemented by Swisscontact and GTZ (German Development Cooperation). Table 5-4 summarizes sectors where the program is working and areas where USAID's and other donors' programs work together.

RISE, January 2007–June 2015. RISE is focused on improving the investment climate in Bangladesh and consists of three projects:

1. ***BICF.*** This £20 million ($29.44 million) project is being implemented by the IFC. BICF is working with the Government of Bangladesh to reduce the procedures, time, and cost to start a business in Bangladesh. In addition, it is working on automating the Dhaka customs house. Other accomplishments of the program are automation of Chittagong Customs House, which reduced steps for import and export clearance processes from 48 to 42 steps. It is estimated that this reduced the cost of doing business by 40–50 percent. Making it easier to start a business should entice more entrepreneurs into the market,

[70] British pound and U.S. dollar equivalents are based on rates listed on www.oanda.com on May 5, 2010.

many of whom may introduce innovative ideas and processes and create more competition and jobs. One of the results of the program is reducing the number of days to register a business in Bangladesh, which should go from 44 to 1.

2. ***SEDF(£5 million [$7.36 million]).*** The objective is to support a more competitive SME sector by increasing access to finance and improving services and information access to targeted subsectors. The program is implemented by IFC in partnership with DFID and Norad.

3. ***Private Sector Development Support Program (£15 million [$22.8 million]).*** This program is supporting the feasibility study in four areas for possible economic zones and considering international standards of environmental and social aspects of work.

Table 5-4

Donor Programs at the MSME Level in Various Sectors

Sector	Donor Involvement
Maize	Katalyst
Vegetables	Katalyst, PRICE/USAID
Fish	Katalyst, PRICE/USAID
Prawn	Katalyst, PRICE/USAID
Furniture	Katalyst
Media	Katalyst
ICT	Katalyst
Distribution	Katalyst
Agro Inputs	Katalyst, PRICE/USAID
Potato	Katalyst, PRICE/USAID
Jute	Katalyst
Tourism	Katalyst
Irrigation	Katalyst
Packaging	Katalyst
Leather	ITC, PRICE/USAID
Dairy	Brac & Gates Foundation
Poultry	IFC SEDF
Light Engineering	IFC SEDF
Plastics	IFC SEDF

SOURCE: USAID, DFID, IFC.

The EC is also engaged in the private sector development and its portfolio is more oriented toward trade issues. Until recently, it had a two-component program, the BQSP. Component 1 was implemented by United Nations Industrial Development Organization and component 2 was implemented by the International Trade Center. Component 1 started in January 2006 and is scheduled to end June 30, 2010. The project worked with the National Institute of Standards within the Ministry of Industry to disseminate information on the application of standards for product quality improvement and acceptance into international markets. In addition to the

Ministry of Industry, BQSP also worked with the Ministry of Commerce, Ministry of Fisheries and Livestock, and Ministry of Textiles and Jute. The program introduced a traceability system that operates throughout the shrimp/prawn value chain, from pond to exporter. The Government of Bangladesh plans to introduce it throughout the fisheries and seafood industry. Although the introduction of traceability is welcome news, traceability is not available to other food products yet. The project also introduced a registry of farmers' and middlemen's ability to keep written records and computerize databases. When the current program ends in June of 2010, a new 5-year program, Better Work and Standards, will start on July 1, 2010, to build on the legacy of BQSP. In addition to the four ministries that the earlier program worked with, this new program will work with the Ministry of Agriculture, Ministry of Labor, and Ministry of Health.

Component 2 of BQSP, implemented by the ITC, was focused on export strategy design with focus on application of quality standards, packaging, and supply chain techniques. The program worked on the following sectors between 2006 and2009: horticulture, processed foods, herbs, herbal medicine and natural ingredients, light engineering, and IT-enabling services. In August 2008, ITC in partnership with policymakers, relevant ministries, the business community, and other stakeholders, were brought together in a series of workshops. According to the Dhaka Chamber of Commerce, which was one of the key implementing partners, the strategy process took 3 years and was completed toward the end of 2008. The Sector Strategy Implementation Committee was supposed to be working on implementation actions suggested by the Strategy Paper. A sense of frustration was expressed by Dhaka Chamber that the strategy process took almost 3 years and it would have been highly desirable to have more action-driven program with concrete results.

RECOMMENDATIONS

The area that seems to represent a gap for potential donor involvement is addressing competitiveness issues on the national level. Bangladesh has not yet outlined a clear plan for moving from 6 percent growth to 8 percent growth nor sufficiently prioritized the reforms needed to ensure this growth. Donors and the government are talking about increasing growth, but there is no clear agenda. This could be an opportunity for USAID/Bangladesh to engage.

USAID/Bangladesh could consider doing a Competitiveness program. There is some awareness of competitiveness but no real depth of understanding. A competitiveness program could be done in two stages: in the initial stage, competitiveness is introduced, tools and experiences are shared, and an assessment is made as to whether follow-on implementation will be useful. The follow-on work could involve in-depth work with industry groups and clusters to improve their strategies, and with businesses and government to facilitate supportive policy and service improvements and to improve the effectiveness of the public-private dialogue.

Using these global indices could encourage economic reform and an increase in competitiveness if there is enough buy-in and interest from local government, business, and civil society leaders. Currently, as stated elsewhere in this report, positive reforms are taking place using World Bank's Doing Business indicators. Some countries were more productive using WEF's indicators to improve their competitiveness. The point is not to replace reforms in Doing Business indicators with the reforms in the global competitiveness index; both provide valuable insights into the economy's performance. The reason why there is strong success in some countries and more modest gains in others usually comes down to the ownership and opportunities. It takes time to create ownership, which is why we recommend a competitiveness assessment to gauge the interest of Bangladesh's private sector and government leadership on the topic. Ideally, this would happen before the design of a big economic growth program.

Illustrative activities under a competitiveness assessment could be:

Step 1: Set out the goals, rationale, inspiration and expectations up front and reinforce them at every stage of the process below. Setting expectations means clear guidelines:

- Discussions will focus on strategy.
- Labor, academia and civil society must have a seat at the table.
- The media will be engaged and kept informed.
- Business must work together to take ownership of some problems that do not necessarily require regulatory intervention, and government should discourage rent-seeking behavior.
- In turn, government should pledge to genuinely consider proposals that come through this process.
- A business leader should be the chairman or facilitator for any formal discussions among stakeholders.
- There must be explicit outcomes within a year of starting a formal process. At a minimum this usually includes a more detailed analysis of the issues underlying the worst-performing indicators, a set of policy recommendations and industry-only sector or topic advocacy groups. These groups can be formal or informal and advocate on policy issues to government as well as encourage collaboration within the business community.

Step 2: Stakeholder Mapping. Identify who the real opinion leaders are in government and business. Often these are powerful figures out there who have a disproportionate impact on decision making than might normally be surmised by their title or organization. For example, among the individuals the team met, it could be people like Mr. Feroz Rahim (Rahimafrooz LTD) and Dr. Arif Dowla (managing director, Advanced Chemical Industries Limited) who have very forward-looking visions for how Bangladesh is likely to grow. In person they are very modest individuals who avoid publicity, yet their vision indicates an optimistic and practical approach to how Bangladesh can grow.

One-on-ones with key business leaders and power brokers. This is to help them better understand the benefits of an engaged private sector and to get a better idea of exactly which leaders intuitively understand what is being proposed, have the ability to think longer term, are respected by their peers, and are best suited to a collaborative approach. Personalities are important, and often the most powerful businessperson is not the right person to lead this type of effort.

- ***Prepare State of Bangladesh Competitiveness Report*** and use the findings to jump-start the dialogue. For example, a report like this could do more in-depth analysis of what India and other countries in the region did to attract more FDI; what were the policy changes and business environment changes that stimulated domestic investment, the growth of which was important in attracting large volumes of FDI; what were the policy decisions they had to take to jump from 6 percent to 8 percent growth; what is the strategy to sustain that growth; what are the challenges and opportunities for Bangladesh as China is discouraging low-value-added investments.

- ***Competitiveness forum.*** A forum that brings the key stakeholders together to test their ability to cooperate, further refines the Mission's understanding of the best partners for such an activity, starts building enthusiasm and ownership, and engages the media to start building public awareness is incredibly useful. Ideally this would be held on or shortly after the WEF in Davos that usually takes place in January of each year. This timing elevates the status of the event by making the participants feel they are part of a bigger, global process and by generating more news coverage by association.
- ***A readiness assessment*** that draws on the results of the above to clearly
  - Determine whether such an approach can work in Bangladesh and under what circumstances;
  - Specify who the most likely local leaders from business, government, academia, and labor are with the best combination of personality, decision-making authority, and respect from their peers;
  - Identify the businesses, sectors, and industries most prepared and, more importantly, most *willing* to work together to promote private sector competitiveness; and
  - Outline next steps and/or a suggested project structure tailored to the Bangladesh context

Industry Focus. As mentioned earlier, there are a large number of comprehensive donor programs focused on various industries in Bangladesh. The agribusiness industry was highlighted during our field assessment, and with its backward linkages to agriculture, where the majority of the population still lives and works, it is possibly one of the important industries to grow. But several other donors have made large investments studying and analyzing the industry, helping the industry develop its strategy and outline obstacles to growth. It is highly recommended that USAID build upon agro assessments done by other donors. For example, ITC under the BQSP program helped to design a comprehensive strategy for developing the agro-processed foods sector in Bangladesh. It took the project 3 years to complete the strategy and it was done in close collaboration with the Dhaka Chamber of Commerce and Industry and key players in the private and public sectors. The ITC part of the program is complete, and the strategy is being implemented under the auspices of DCCI. The quality of the implementation is something to be investigated further. In the same year, 2008, the World Bank wrote a report on high-value agriculture in Bangladesh. However, using a competitiveness framework will allow the mission to explore whether to focus on this industry or cast a wider net to other emerging industries such as light manufacturing, pharmaceuticals, and telecommunications.

6. Economic Governance

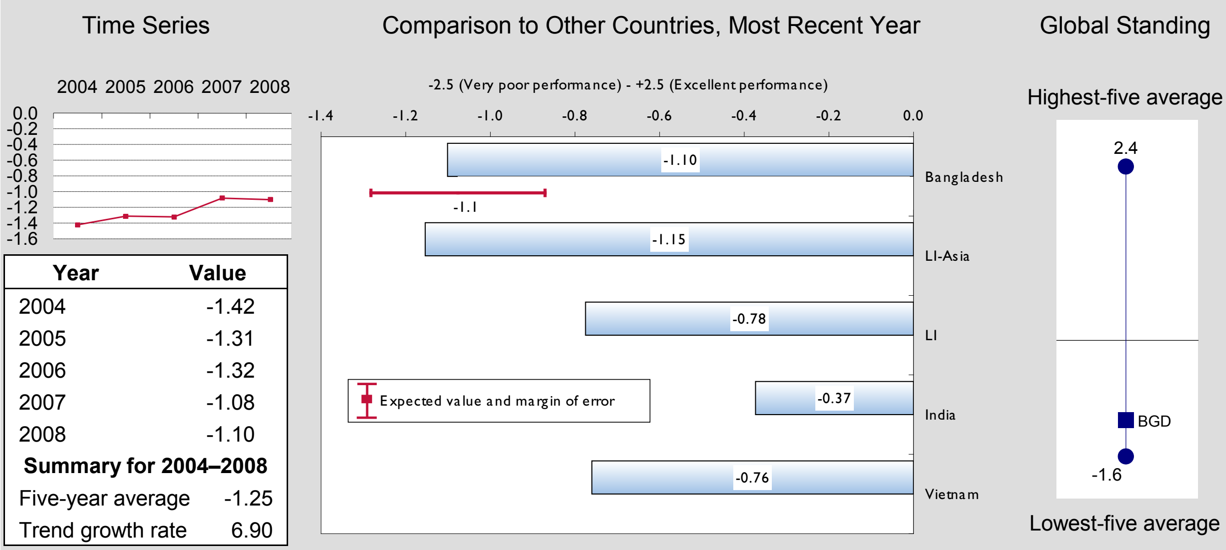
RECENT DEVELOPMENTS

Bangladesh has achieved high growth rates and is a well-functioning democracy. More than 80 percent of eligible voters participated in the 2008 parliamentary elections, and voters elected candidates from eight political parties to the Ninth Jatiyo Shangshad. However, Bangladesh suffers from its negative reputation regarding lack of transparency and accountability, performing at the bottom of indicators of good governance. Business executives surveyed by the WEF for the 2009-10 Global Competitiveness Report ranked corruption in Bangladesh as the second-most problematic factor, after inadequate supply of infrastructure, in doing business in the country.

The World Bank's Control of Corruption Index shows that the business community in Bangladesh views corruption as a much more serious impediment than do the business communities in neighboring countries such as India and Vietnam (see Figure 6-1).

Figure 6-1
Control of Corruption Index

Despite recent improvement, Bangladesh lags behind most benchmarks in controlling corruption.



Year	Value
2004	-1.42
2005	-1.31
2006	-1.32
2007	-1.08
2008	-1.10
Summary for 2004–2008	
Five-year average	-1.25
Trend growth rate	6.90

Source: World Bank Governance Indicators CAS code: 22P1

However, it also shows a slight improvement in this perception in recent years, and other indicators that track governance, such as Transparency International Corruption Perception Index, cited Bangladesh as one of nine countries that improved most in their rankings in 2009. Institutional efforts to combat corruption, such as the establishment of the Anti-Corruption Commission set up in 2004 in response to donor and civil society pressure have seen their effectiveness ebb and flow depending on the political climate. Under the new government, the commission is seen to be moving forward in carrying out its mandate. Other recent positive developments include the Right to Information Act 2009 and anti–money laundering legislation.

The issue of corruption is a large and complicated one, and many donors are addressing its various manifestations. This section highlights efforts by donors to broadly increase transparency and public-private cooperation.

USAID AND OTHER DONOR INVOLVEMENT

The USAID/Bangladesh Democracy and Governance office is implementing the PROGATI project to fight corruption and improve transparency and accountability. The project works closely with the Bangladesh Jatiyo Shangshad, its oversight committees, and the Office of the Comptroller and Auditor General. It is also supporting the creation of a budget analysis and monitoring unit within the Parliament Secretariat to provide financial analysis to Members of Parliament, assisting them with oversight of national budgets and monitoring government expenditures.

PROGATI is also partnering with the Institute of Governance Studies at BRAC University and has established an investigative journalism center, as part of the Journalism Training and Research Initiative (JATRI) to train journalists on investigative reporting.

There is a great deal of donor activity centered on economic governance. For example, the ADB is increasing the capacity of the Ministry of Finance in budgeting. The World Bank has projects designed to create more uniform public sector procurement regulations and to improve monitoring and auditing of donor-funded public sector projects. CIDA is focusing attention on the audit capacity in the office of the comptroller and auditor general.

In the area of improved governance and transparency in terms of economic development strategies, the team was requested to explore the capabilities of the numerous think tanks that operate in Bangladesh to strengthen the dialogue on economic policy reforms.

Economic Policy Research Institutes

Bangladesh has a large reserve of intellectual capacity in the areas of economic policy analysis. The country has at least half a dozen active economic policy think tanks. The team met with the CPD, the Bangladesh Enterprise Institute (BEI), the Policy Research Institute (PRI), and the Economic Research Group (ERG). While ERG was not formally interviewed, one team member attended a two-hour seminar at its facility and met one of the key staff.[71] A site visit was made to North-South University, and a meeting was held with faculty from the Institute for Business Administration.

The think tanks varied considerably in the size of their staff, with the CPD having the largest staff, of 52 persons. The center was established in 1993 by Professor Rehman Sobhan with support from leading civil society institutions in Bangladesh. It has a five-story building with more than 50 computers and extensive space for its activities. Its operating modality is to develop independent research and, while it accepts funds from certain donors, it has a policy of not working with the World Bank or the ADB. Its program initiatives include macroeconomic analysis, trade policy analysis, agriculture and rural development, environment and ecosystems, governance and policy reform, industrial promotion and enterprise development, regional cooperation, population and sustainable development, budget analysis – as well as programs of training, internships, and young scholars seminar series. The CPD reported to the team that their 2007 monetary policy research had a positive impact on policy dialogue and that they continue to provide suggestions for national-level budgetary priorities, some of which have been adopted. The CPD's capacity to undertake economy wide analysis is impressive and greater collaboration by USAID with the CPD should be explored.

BEI was established in 2000. Its mission is to promote an enabling environment for private enterprises. The BEI was founded by Ambassador Faruq Sobhan, a former foreign secretary and ambassador to many leading countries, and has a board of prominent businessmen. The BEI accepts funds from the World Bank and the IFC, and to some extent bids for contract assignments from a wide range of funders. The BEI's own permanent staff is small, but they hire numerous consultants and short-term staff from academia and elsewhere in connection with their various projects. It has special interest in regional, commonwealth, and international trade and cooperation that could fit well with USAID interests in this area. it clearly works with donors on specific studies as evidenced by their current projects.[72] Based on our meeting with the BEI, there was a sense that India-Bangladesh trade and regional trade were current key areas of interest that USAID could consider for collaborative efforts in the near future.

The ERG was established in 1992 but is much more of a bare-bones organization with very modest facilities that belie the high esteem given to it by fellow economists. Its board of directors is chaired by Professor Wahiduddin Mahmood of Dhaka University and is composed of leading

[71] The Bangladesh Institute of Development Studies is also deemed to be an important institution that was not interviewed by the team. A consideration of this institute should be included in any follow-up with think tanks.

[72] Current BEI projects include People Peace Building Program, funded by the Australian High Commission; Toward Developing a Better Counterterrorism Regime in Bangladesh, funded by the Danish Embassy; Establishment of an Effective Bangladeshi Diaspora Network for Economic Transformation of Bangladesh, funded by Asian Tiger Capital; Realizing the Vision of Digital Bangladesh through E-Government, funded by CIDA; and Bangladesh Social Enterprise Project, funded by DFID. It is about to start the Benchmark Bangladesh's Trade Facilitation Systems and Processes project, funded by the Commonwealth Secretariat.

Bangladeshi economists. Many of them are living abroad, and some are affiliated with other think tanks as well. It has a focus on building capabilities of junior researchers and fostering a productive dialogue amongst economists who are undertaking serious analytic work. The list of their current research projects includes several related to food security that would fit well with USAID's programmatic interests.[73]

The PRI is a much newer organization, established in 2008, and is composed primarily of retired Bangladeshis from multilateral organizations. The vice president served as the chief economist and director of Economic Management of the South Asia region of the World Bank. PRI has three senior research fellows and another 10 professional staff. It has a strong emphasis on disseminating information leading to greater understanding of the Bangladeshi economy and its role in the emerging global economy. It has research interests that are governed by those of their leading figures and does vigorous dissemination through the Internet and newspapers.[74] The institute is characteristically aligned with the opinion of the multilaterals.

Another possible area for USAID to have a greater role is in the dissemination of think tank research. An example of a strong dissemination strategy is the PRI, which has an active program of research disseminated through publications, its website, seminars and workshops, and newspaper articles. This may have to do with its connections to the World Bank and that its key individuals have extensive prior involvement in international economic policy organizations. The PRI has a special program of partnership with the *Financial Express*, the leading Bangladeshi financial daily, and with Data International, one of Bangladesh's leading economic and social consulting firms.

The CPD is frequently cited in the newspapers for its analysis of current economic topics. The center has an extensive publication program. It regularly puts out "State of the Bangladesh Economy"— the most recent of which was just issued. It has an extensive program of dialogue and outreach to stakeholders. It is particularly well placed in relation to the present government because of the affiliations of the original organizers. But over the years the high quality of its dialogue programs has attracted a broad audience.[75] It has a vigorous program of outreach that involves not only these elite meetings but also dissemination through the Internet and academic institutions.

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[73] Recent ERG publications include: Measuring Movement Out of Poverty, funded by Microfinance Summit, Impact of Price Increases on Poor Households, Food Security for the Poor, Differences in Poverty Levels and Trends at Sub-National Levels, The Relative Efficiency of Water Use in Bangladesh.

[74] Professor Sobhan, director of the CPD, wrote "The Next Step," an analysis of the prime minister's recent visit to India in the February issue of *Forum*, a monthly magazine of the Daily Star. In the same publication were articles by Dr. K.A.S. Murshid, research director at Bangladesh Institute of Development Studies, and Sadiq Ahmed, vice president of the PRI.

[75] Interestingly, the CPD is the Bangladesh partner for the World Economic Forum's *World Competitiveness Report*.

The ERG, which is impressive for the high-quality research and camaraderie of the group, unfortunately lacks a strong dissemination strategy, even though its website provides a comprehensive list of useful publications. It has a regular weekly seminar series, but the seminars are primarily announced on the Internet, which very few Bangladeshis have access to. It may be advantageous for USAID to explore ways to assist ERG in this area. For example, USAID is cited as a funder for the report Food Security for the Poor: Exploring Policy Options under Alternative Price Regimes. The report is very technical in nature and it would be useful for USAID to assist ERG to disseminate the findings in more widely understood formats.

In general, a USAID strategy to establish and support these think tanks would help to deepen the analytical capacity of the research organizations in areas relevant to USAID interests. Another possibility for collaboration would be to invest in ways to better disseminate the research of these groups to increase the quality of the public dialogue and therefore better influence public-private economic policies. An engagement with the think tanks provides a link to the academic community, as the heads of these institutes wear many hats, often serving in both key public and private financial institutions that would widen USAID's reach in these places.

In addition to the think tanks, interviews were conducted with academic faculty from the North-South University and the Institute of Business Administration. The North-South University was founded in 1992 as the first private university in Bangladesh. The university follows an "American" system with a curriculum developed in consultation with the University of California at Berkeley and the University of Illinois and then approved by the Bangladesh University Grants Commission. The Institute of Business Administration, founded in 1966 in collaboration with the Ford Foundation and the University of Indiana, is a case study–based business school offering MBA and further degrees and since 1992 an undergraduate business program, in both day and evening programs. It is generally considered the best business school in Bangladesh, and reportedly 90 percent of its graduates find employment. From the beginning it has been a research-oriented institution with highly qualified professors and a considerable research output. It has approximately 40 faculty and 200–300 students at each of the graduate and undergraduate levels.

Both of these institutions have strong faculty that are actively conducting analysis and organizing major conferences and seminars. A stronger relationship with these organizations in terms of curriculum development could foster important analytical work for future economic policy reform and help appropriately train a new cadre of business managers with skills in accounting and finance that would expand the growth of the business development services sector in Bangladesh.

RECOMMENDATIONS

Economic policy research organizations can provide the analytical support necessary to influence national reforms. There is an added value to research institutes that are not tied to the interests of specific businesses and enterprises and that can look more broadly and in depth at particular issues of concern to the wider economy. USAID can play a significant role in supporting these groups, which can lead to greater leverage at the level of national policy debates.

- USAID can improve the nature and content of economic dialogue, enhancing public awareness of EG issues by establishing stronger dissemination strategies for policy analysis produced by research organizations.
- The USAID/Bangladesh DG office can coordinate transmittal of specific concerns of the private sector into the political arena through the PROGATI program. DG funding is $22 million a year, plus an additional $17 million a year from DFID and $2.7 million from the U.S. Defense Department (for community policing.) Furthermore, as chair of the Political Governance Consultative Group, USAID has the responsibility to see that the overall donor effort in support of the transparency and governance efforts in DG will allow economic policy reforms to take root.
- Increased support to university research efforts and business schools is in order to provide expertise in areas that can help increase the availability of business development services in the private sector.

7. Programmatic Issues

NEED FOR DEMAND-DRIVEN APPROACHES

It is necessary to associate with partners and stakeholders from a very early stage and in some cases in formal ways. Regular advisory groups or scheduled consultations are good ways to verify that there is understanding and support for what USAID is trying to do. The attitude and commitment of stakeholders supported by USAID are more easily discerned when the group is small, but in many USAID projects the partners and stakeholders are dispersed and special efforts are required to better understand diverse interests and potentially conflicting perspectives.

For example, an issue the team observed in several instances was the insufficient local buy-in for certain projects or activities. The director for value chain development for the PRICE project indicated that a flower collection and assembly center at Gadkhali bazaar in Jessore had been built by the government and a renowned donor. The center has modern facilities, including refrigeration for assembling and storing flowers, but the value chain actors (farmers, wholesalers, retailers) are not using it. In fact, they continue to sort and pack the flowers in open spaces (or in shops) right in front of the center and ship it to Dhaka by truck. The primary reason cited was cost considerations.

Another example concerns the possible disconnect between donor institutional building and the realities of public-private cooperation around trade. The BFTI is a public-private organization supported by the European Union to work with both the Ministry of Commerce and the private sector on trade policy analysis. But both the EU and BFTI's chief executive officer (CEO) indicated that there was little demand from the private sector for WTO and other trade-related training. This may be a case when donor support for such an entity is ahead of its time, given that the private sector does not have a sufficiently coherent vision to tap into the institute's resources. A more thorough review should be undertaken of why the private sector is not requesting assistance with topics pertinent to their interests, so that similar donor efforts do not fall into the same pitfalls.

CHOOSING APPROPRIATE PARTNERS

Team members realized the importance of local credibility in how effective institutions were. The International Business Forum of Bangladesh (IBFB), supported by USAID/DG's PROGATI project, attempts to act as an apex organization for various chambers of commerce associations but seems to be bogged down with contractual difficulties, and it is not clear how well known IBFB is or the extent to which it has been able to fulfill its mandate of representing a broad range of business associations. IBFB has commissioned several studies such as Complexities in the Income Tax Laws: A Quest for a Simpler Taxation System, which addresses an important topic relating to the business environment, but it is not clear how much visibility this study will receive. There is a fairly small elite group of individuals in the Bangladeshi economic and trade sector who have intertwining roles in business, academia, and government. It is hard for newcomers to establish credibility in these circles. On the basis of this reality, it would be advantageous to work with existing reputable organizations rather than creating new ones.

In providing support to government ministries that are perceived to be marginal or ineffectual, it is necessary to be aware of the likelihood that program success could be fairly low. Careful attention to the experience and opinions of national staff is necessary in this regard. For example, the Board of Investment maintains a list of "thrust industries" that are marked for greater investment as emerging industries. However, the list is so long that it indicates a lack of coherency on the part of the board's vision.

COORDINATING WITH OTHER DONORS

Given the plethora of donors in Bangladesh, a local consultative group coordinates donor efforts (http://www.lcgbangladesh.org/). At present there are as many as 20 subgroups, and each donor has the lead in a specific sector. Most of those subgroups are not functional. As various individuals remarked, the consultative group for private sector development (PSD) had been dormant until recently. Donors are trying to meet more frequently. DFID leads donor coordination for PSD, but the EU will be assuming the chair for this sector. DFID was interested in engaging USAID on programs and activities and the ADB was also complimentary of USAID's work in certain sectors, providing opportunities for stronger collaboration. This is particularly a consideration since USAID's activities in PSD are a small part of the donor effort.[76]

[76] A DFID planning document reports, "UK is the largest grant donor to Bangladesh, with existing commitments valued at also 1 billion pounds." Much of this goes through multidonor efforts, so the uniquely DFID effort is much smaller. The technical assistance program for 2009–2011 consists of 31 projects with an annual allocation of about $6.4 million. Only a small portion is for private sector development, but depending on the definition, that too could amount to several hundred million dollars. In addition, ADB's private sector window—comparable to IFC—has significant programs in Bangladesh.

Appendix A. Persons Interviewed

Organization	Name	Designation
Advanced Chemical Industries	Mr. Muallem Choudhury	Executive Director
Asian Development Bank	Mr. Paul Z. Heytens	Country Director & Chief Economist
Asian Development Bank	M. Zahid Hossain	Head, Country Programming
American Chamber of Commerce	Mr. A. Gafur	Executive Director
Apex Adelchi	Mr. Nasim Manzur	Managing Director
Asian Tiger Capital Partners Limited	Mr. Ifty Islam	Managing Partner
Bangladesh Agro-processors Association	Prof. Moslem Ali	Advisor
Bangladesh Agro-processors Association	Md. Taibur Rahman	Secretary
Bangladesh Agro-processors Association	Mr. Tayeb	General Secretary
Bangladesh Bank	Dr. Atiur Rahman	Governor
Bangladesh Bank	Sukamal Sinha Chowdhury,	
Bangladesh Enterprise Institute	Amb Faruq Sobhan	President
Bangladesh Enterprise Institute	M.H. Khaleque	Research Director
Bangladesh Quality Support Program	David Holbourne	Chief Technical Adviser
Bangladesh Shrimp & Fish Foundation	Mr. Mahmudul Haq	Chairman
Bangladesh Tariff Commission	Dr. Md. Mujibur Rahman	Chairman
British American Tobacco	Mr. Mark Drain	Finance Director
Bangladesh Foreign Trade Institute	Prof. M. A.Taslim	Chief Executive Officer
Board of Investment	Mr . Jalalul Hai,	Director (Foreign Investment)
Board of Investment	Abu Reza Khan	Additional Secretary to the Govt.
BRAC Bank	Mr. Mahbubur Rahman	Deputy Managing Director
Chemonics- PRICE	Mr. Jules Lampell	COP
CITI Bank N.A.	Mr. Mamun Rashid	
Centre for Policy Dialogues	Dr. Khondaker Golam Moazzem	Senior Research Fellow
Centre for Policy Dialogues	Dr. Uttam Kumar Deb	Head, Research Division
Credit Rating Agency Bureau	Mr. Hamidul Haque	Managing Director
Dhaka Chamber of Commerce and Industries	Ms. Ferdous Ara	Deputy Secretary
UK Department of International Development (DfID)	Catherine Martin	Sen. Private Sector and Market Development Adviser

Organization	Name	Designation
DfID	Mr. Masrur Reaz	Private Sector Adviser
DfID	Shahnila Azher	Private Sector Adviser
European Union	Andrew Barnard	First Secretary (political and economic)
European Union	Jenni Christensen	Third Secretary
European Union	Rubayat Jesmin	Economic Affairs Officer
European Union	Jean-Claude Malongo	Program Manager
European Union	Zillul Hye Razi	Trade Adviser
European Commission	Rozana Wahab	
Food and Agriculture Organization	Ciro Fiorillo	Chief Technical Adviser
Golden Harvest Ltd.	M. Samad Chowdhury	CFO
Golden Harvest Ltd.	Rajeeb Samdani	Managing Director
Insights & Ideas Ltd.	M. Jahangir Kabir	Managing Director and CEO
International Business Forum of Bangladesh	Mr. Mahmudul Islam Chowdhury	President
IDLC Finance Ltd.	Mr. Salim RF Hussain	Managing Director
Institute Of Business Administration, University Of Dhaka	Mr. Farhat Anwar	Professor
Institute of Chartered Accountants	Mr. Nasir Ahmed, FCA	Ex- President
Intellectual Property Programme	Mr. Mahbubur Rahman	General Secretary
International Labor Organization	T.I.M. Nurunnabi Khan,	Senior Program Officer
International Labor Organization	Ralph Peters	Chief Technical Adviser
Katalyst	Mr. James Blewett	General Manager
Korean EPZ Corporation Ltd.	Dr. Michael Geelhaar	Vice President
BEXIMCO Pharmaceuticals Ltd.	Nazmul Hassan	Managing Director, BEXIMCO Pharmaceuticals Ltd.
Ministry of Commerce	Amitava Chakraborty	Joint Secretary and Head of WTO cell
Ministry of Commerce	Mr. Mustafa Mohiuddin	Additional Secretary
Ministry of Finance	Dr. M. Tareque	Finance Secretary
Nestle Bangladesh	MD. Saiful Islam	Finance Director
North South University	Dr. Fouzal Kabir Khan	Former Secretary of Energy, Power, and Mineral Resources
North South University	Dr. Hafiz Siddiqi	Vice Chancellor
North South University	Dr. Abdul Hannan Chowdhury	Professor, School of Business Director, BBA Program and Career Professional Development Services
Panigram Resort, Cocola	Ms. Kristen Boekhoff	Entrepreneur
Power and Participation Research Centre	Dr. Fariduddin Ahmed	
Power and Participation Research Centre	Dr. Hossain Zillur Rahman,	
Power and Participation Research Centre	Dr. Salehuddin Ahmed	
Pran Foods Ltd.	Mr. Ahsan Khan Chowdhury	Deputy Managing Director
Policy Research Institute of Bangladesh	Dr. Zaidi Sattar	Chairman
PRICE	Jules Lampell	Chief of Party

Organization	Name	Designation
PRICE	M.A. Bani Amin	Director of Value Chain Development
Rahimafrooz Group	Mr. Feroz Rahim	Managing Director
United States Embassy	Alexander Grazis	Second Secretary Economic and Commercial Affairs
United States Embassy	Heather Variava	First Secretary, Economic and Political Affairs
United States Embassy	Md. Yousuf	Trade Promotion Manager
U.S. Trade Center	Md. Yousef	Trade Promotion Manager
University of Dhaka	Selim Raihan, Dept. of Economics	Associate Professor
World Bank	Dr. Zahid Hussain Dr. G.M. Khurshid Alam	Senior Economist Senior Private Sector Development Specialist
YoungOne Group	Joe Falcone	Director, Corporate Social Responsibility
	Mr. Liquat Ali Chowdhury	Former Ambassador of Bangladesh
	Mr. Muhamed Zamir	Former Ambassador of Bangladesh

Appendix B. Definition of Small-Scale Industry

Policy Strategies for the Development of SMEs (2005) defines small manufacturing units as having less than Tk 15 million (under $300,000) of capital, excluding land and buildings, and medium units as having up to Tk 100 million (under $1.5 million). Small enterprises must also have no more than 50 employees, and medium enterprises less than 100. Nonmanufacturing enterprises do not have capitalization limits.

The Bangladesh Bureau of Statistics defines SMEs solely on the basis of employment, as is the international norm. The Bangladesh Bank, however, for financing purposes defines on the basis of capital as well as employment. It recently revised its definition to conform to the policy standard.[77] The Tk 15 million definition has been in force since East Pakistan legislation in 1957.[78]

The new Bangladesh Bank definition is differentiated for small and medium enterprises, and service, trade, and manufacturing sectors. For services and trade, small enterprises have capital of Tk 50,000 to Tk 5 lakhs;[79] manufacturers can have up to Tk 15 lakhs. All figures exclude land and buildings, and all are required to have fewer than 25 employees. Medium enterprises can have up to Tk 1 crore in trade and services but up to Tk 2 crore in manufacturing and 50 employees. None of the eligible firms can be registered companies.

According to the 2001 and 2003 economic censuses, there were 74,629 small enterprises, 5,125 medium-sized enterprises, and 5,673 large enterprises.[80] However, there is some reason to believe that the small enterprise figure may be an underestimate. The number of small enterprises tripled between 1978 and 2001, and the number of medium enterprise increased even faster. Thirty-five

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[77] ACPSD Circular No 8,5.26/2008

[78] Bangladesh Bank, Policy Analysis Unit "A Note on the Contribution of Small and Medium Enterprises to GDP in Bangladesh," Policy Paper 806, June 2008, p. 3-4.

[79] A lakh is Tk 100,000.

[80] Bangladesh Bank, Policy Analysis Unit "A Note on the Contribution of Small and Medium Enterprises to GDP in Bangladesh," Policy Paper 806, June 2008, p. 4-8. Most of the data, but not all, refers to the formal sector, which is a small part of the Bangladesh economy. Since formal sector finance is concerned with that sector this may be appropriate.

percent of small and 45 percent of medium enterprises are in manufacturing. Additionally, 26 percent of small enterprises are in education. This reflects, we presume, the fact that manufacturing and educational institutions are more likely to be counted, because even allowing for the importance of microenterprise, the reported number of retail shops looks low.

Of the data reported in the economic census, 35 percent of employees were in small enterprises, 8.5 percent in medium-sized enterprises, and 55.6 percent in large enterprises. However, the total formal sector labor force counted in the census was under 2.5 million. The total labor force figure provided by the Bangladesh Bureau of Statistics in the latest economic census is roughly 50 million, which includes 10 million unpaid family workers. Of these, 5.2 percent are reported to be in manufacturing. The economic census data for the formal sector appear to be four times as large as the base for the SME labor force used in the Bangladesh Bank publication. Much of this difference is probably accounted for by public sector and other “noncommercial employees,” but further investigation is required to clarify the matter.

According to a study in 2006, gross output per worker was Tk 97,000 for small units, Tk 76,000 for medium enterprises, and Tk 95,000 for large enterprises. It is estimated that SMEs account for 40–50 percent of manufacturing value added. A 2003 study estimated that small enterprises (with fewer than 100 employees) accounted for a quarter of GDP, 77 percent of that generated by units with fewer than 5 employees.

Appendix C. Financial Sector Reform Project (1991–1995)

In 1991 the Government of Bangladesh and USAID/Bangladesh launched the Bangladesh Financial Sector Reform Project (FSRP) to improve the financial viability of the country's banking system. FSRP was the centerpiece of financial sector reform efforts initiated by the National Commission on Money, Banking, and Credit in the early 1980s with support from the World Bank (International Development Association) and USAID.

Under FSRP, seven long-term resident advisers were placed at the nation's central bank, Bangladesh Bank, and at each of the four main nationalized commercial banks (NCBs), all of which are part of the Ministry of Finance. From 1991 to 1996, the resident advisers, assisted by short-term experts, provided technical assistance to help achieve six reform objectives:

- Establish a program of flexible monetary policy instruments to permit a reduction in the inflation rate and limit interventions to broad market impact
- Improve the central bank's use of information on the banking system while reducing the reporting burden on commercial banks
- Strengthen bank supervision by progressive enforcement of loan classification and capital adequacy standards
- Strengthen the NCBs
- Maintain a competitive environment in which foreign banks are licensed to compete
- Prepare for privatization of selected NCBs.

Strengthening the NCBs involved formulating strategies for developing each bank and upgrading skills in functional areas, such as human resource development, management information systems, and accounting, planning and budgeting, computerization, and credit administration. The fundamental challenge was to change the national culture of banking, shifting responsibility for pricing and lending decisions from the government to individual financial institutions. Day-to-day efforts focused on reorienting and preparing central bank officers and commercial bank managers for the new environment. At the same time, the project advanced the central bank's supervisory powers over the financial system by training more examiners and using new loan classification rules and loss provisions to enforce capital adequacy requirements of commercial banks. The project produced important policy research, briefing memos, and development plans on selected financial market issues and innovations such as credit.