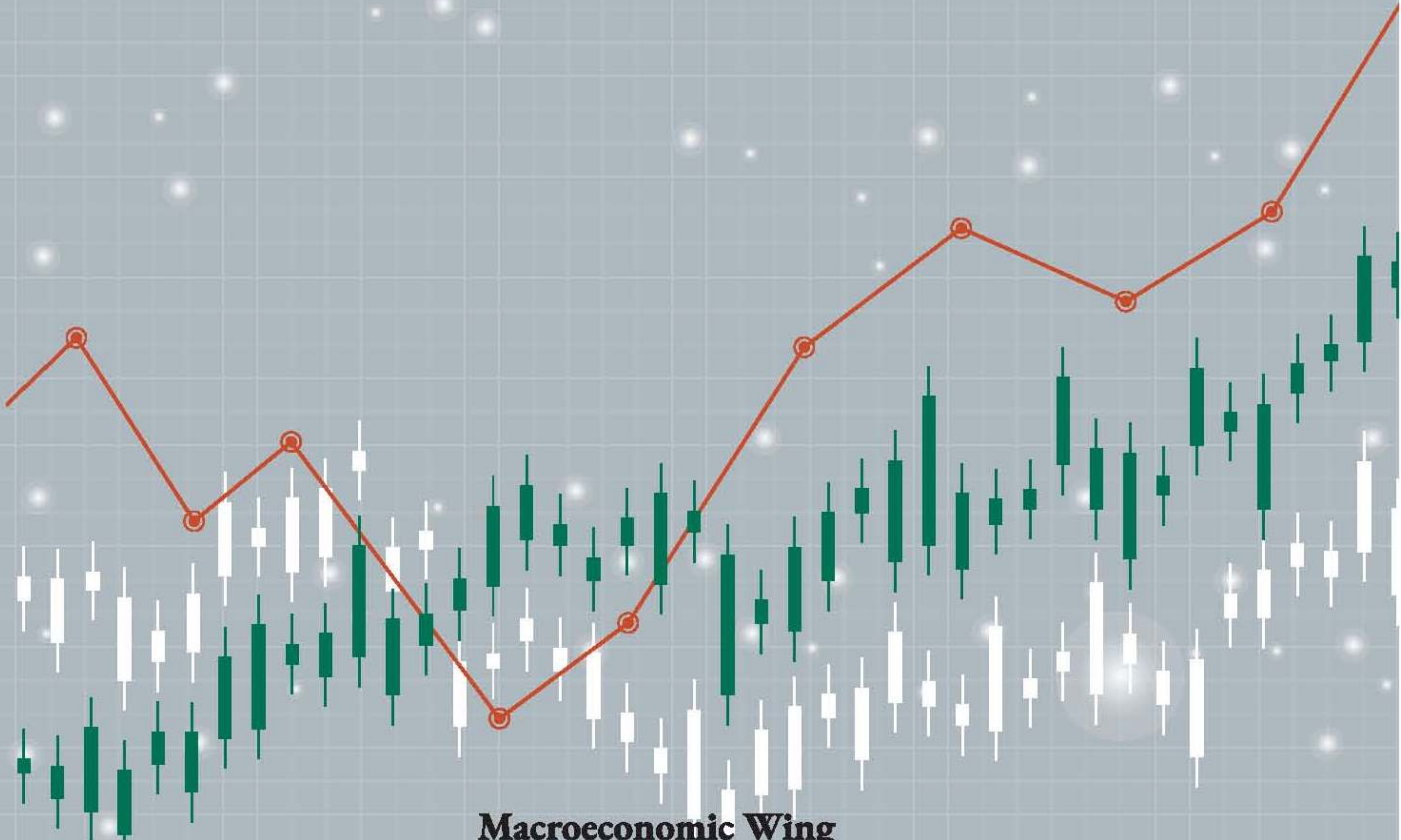
Medium Term Macroeconomic

POLICY STATEMENT

2023-24 to 2025-26



Macroeconomic Wing

Finance Division, Ministry of Finance

Government of the People's Republic of Bangladesh

Medium Term Macroeconomic Policy Statement 2023-24 to 2025-26

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Policy Statement
2023-24 to 2025-26

Placed before the Parliament
in accordance with section 11 of
The Public Money and Budget Management Act, 2009

Macroeconomic Wing
Finance Division, Ministry of Finance
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Foreword

Human beings are the only species on this planet that thrived and evolved through continuous enhancement of intellectual abilities. Our relentless desire to innovate, learn new things and courage to fight difficult odds guided us to reach where we are now. Sometimes this journey is shaped by great people who dedicate their lives to making positive changes so that future generations benefit from their sacrifice and struggle. The greatest Bengali of all time our Father of the Nation Bangabandhu Sheikh Mujibur Rahman was such a leader who profoundly inspired us to fight valiantly to win against Pakistani oppression and secure freedom in 1971. He envisaged building a country that would become a model of development, which he so passionately coined "Sonar Bangla". Bangladesh has passed fifty-two years since then and now Bangabandhu's bold and visionary daughter, our Honorable Prime Minister Sheikh Hasina, is leading the nation towards realizing his dream.

After winning the election of 2009, the Honorable Prime Minister Sheikh Hasina initiated several strides to transform Bangladesh into a happy and prosperous country. The country has already fulfilled all criteria to graduate from the group of the least developed countries (LDC) by 2026 and is aiming to become a smart developed country by 2041. The GDP growth rate of Bangladesh, during the last decade, has been one of the fastest in the world averaging more than 6.5 percent per annum. Remarkably, despite the economy growing so fast, we have been able to keep the inflation under control with an average rate of 6.3 percent per annum during the period FY 2011-12 to FY 2021-22. This shows that we are moving in the right direction to reach our long-term development goals.

To improve living standards and create a conducive business and investment climate within the country, our government is implementing development plans with special emphasis on physical and social infrastructures. The Padma Bridge has been completed solely with our own finance and this has given us the confidence to take forward development initiatives on our own. Once the other large infrastructure projects such as the Rooppur power plant, Metro Rail, Matarbari power plants, Payra deep seaport, Bangabandhu Tunnel under the river Karnaphuli, etc. are completed, the economy will get a tremendous boost and become more vibrant.

The onset of the Covid-19 pandemic in 2020 followed by the Russia-Ukraine war in 2022 inflicted stagflationary pressure on the whole world, with prices shooting in one hand and economies slowing down on the other hand. The combined efforts of both the fiscal and monetary policy authorities in developed as well as emerging and developing countries have not been able to fully tame inflation. However, our policies are on the right track, and we are confident that inflation will come down to the desired level in the coming months. Under the prudent and dynamic leadership of the Honorable Prime Minister Sheikh Hasina Bangladesh has already been able to return to the pre-Covid-19 state and achieved 7.10 percent GDP growth rate in FY 2021-22. We expect this to rise to 8 percent by the end of FY 2025-26.

Every year, the Medium-term Macroeconomic Policy Statement (MTMPS) is published by the Finance Division to fulfil the requirements of the Public Money and Budget Management Act, 2009. This publication also aims to evaluate global and domestic developments to assess their implications on the entire gamut of fiscal operations covering revenue, expenditure, and financing. While preparing this MTMPS, for the first time, the Macroeconomic Wing arranged several consultation sessions to improve the coverage of the content. Hence, in this issue, the reader will find some new areas, such as the analysis of fiscal risks, that will provide additional input for thought.

I hope that this policy statement will provide useful insights to everyone including the Honorable Parliament Members, policymakers, researchers, and entrepreneurs. I sincerely thank everyone in the Finance Division who has worked hard and put their best efforts into publishing this valuable document.

Joy Bangla, Joy Bangabandhu
May Bangladesh live forever.

(A H M Mustafa Kamal, FCA, MP)
Minister
Ministry of Finance

Table of Contents

List of Tables

List of Figures

List of Acronyms

4IR	Fourth Industrial Revolution
AB	Autonomous Body
ADB	Asian Development Bank
ADP	Annual Development Program
AI	Artificial Intelligence
AR	Augmented Reality
BACS	Budget and Accounting Classification System
BAU	Business as Usual
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BCCSAP	Bangladesh Climate Change Strategy and Action Plan
BCCTF	Bangladesh Climate Change Trust Fund
BCIC	Bangladesh Chemical Industries Corporation
BDP	Bangladesh Delta Plan
BDT	Bangladesh Taka
BIDA	Bangladesh Investment Development Authority
BJMC	Bangladesh Jute Mills Corporation (BJMC)
BOP	Balance of Payments
BPC	Bangladesh Petroleum Corporation
BSEC	Bangladesh Securities and Exchange Commission
CAB	Current Account Balance
CDBL	Central Depository of Bangladesh Limited
CMSME	Cottage, Micro, Small and Medium Enterprise
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
COVID-19	Coronavirus Disease 2019
CVF	Climate Vulnerable Forum
DSA	Debt Sustainability Analysis
DSE	Dhaka Stock Exchange
EDA	Emerging and Developing Asia
EDF	Export Development Fund

EFD	Electronic Fiscal Devices
EFT	Electronic Fund Transfer
EGPP	Employment Generation Program for the Poorest
EMDEs	Emerging market and Developing Economies
EPZ	Export Processing Zone
EZ	Economic Zone
FD	Finance Division
FDI	Foreign Direct Investment
EPI	Expanded Vaccination Program
FYP	Five Year Plan
FY	Fiscal Year
FFW	Food for Work
FTA	Free Trade Agreement
G2P	Government 2 Person
GDP	Gross Domestic Product
GED	General Economics Division
GFC	Global Financial Crisis
GFN	Gross Financing Need
GHG	Green House Gas
GNI	Gross National Income
GR	Gratuitous Relief
HDI	Human Development Index
HIC	High-Income Country
HCR	Headcount ratio
HIES	Household Income and Expenditure Survey
IMF	International Monetary Fund
iBAS	Integrated Budget & Accounting System
ICT	Information and Communication Technology
IDA	International Development Assistance
IMF	International Monetary Fund
IoT	Internet of Things
LCs	Letter of Credits
LDC	Least Developed Country
LICs	Low-Income Countries

LMIC	Lower-Middle Income Country
LNG	Liquid Natural Gas
MCPP	Mujib Climate Prosperity Plan
MoU	Memorandum of Understanding
MPS	Monetary Policy Statement
MRT	Mass Rapid Transit
MTBF	Medium Term Budgetary Framework
MTDS	Medium Term Debt Strategy
MTMF	Medium Term Macro Framework
MSME	Micro Small and Medium Enterprises
MTMPS	Medium Term Macroeconomic Policy Statement
MW	Mega Watt
NAP	National Adaptation Plan
NAPA	National Adaptation Program of Action
NBFIs	Non-Bank Financial Institutions
NBR	National Board of Revenue
NDCs	Nationally Determined Contributions
NEER	Nominal Effective Exchange Rate
NHRDF	National Human Resource Development Fund
NSC	National Savings Certificate
NSD	National Savings Department
NSDA	National Skills Development Authority
NSSS	National Social Security Strategy
NTR	Non-Tax Revenue
OMS	Open Market Sale
OSS	One Stop Service
PDB	Power Development Board
PFM	Public Financial Management
PMO	Prime Minister's Office
PPP	Public Private Partnership
PTA	Preferential Trade Agreement
R&D	Research and Development
REER	Real Effective Exchange Rate
RMG	Readymade Garment

RTGS	Real Time Gross Settlement
SD	Supplementary Duty
SDGs	Sustainable Development Goals
SDC	Sales Data Controller
SDLA	Smart Digital Leadership Academy
SDSN	Sustainable Development Solutions Network
SEIP	Skills for Employment Investment Program
SGMP	Strengthening Governance Management Project
SLR	Statutory Liquidity Ratio
SME	Small and Medium Enterprise
SOE	State Owned Enterprise
SOFR	Secured Overnight Financing Rate
SROs	Statutory Regulatory Orders
TCB	Trading Corporation of Bangladesh
TK	Taka
TRS	Time Release Study
TSA	Treasure Single Account
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WEO	World Economic Outlook
WFP	World Food Program
WHO	World Health Organization
UK	United Kingdom
UMIC	Upper-Middle Income Country
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
USD	United States Dollar
VAT	Value Added Tax
VGF	Vulnerable Group Feeding
VR	Virtual Reality
WCO	World Customs Organization
WTO	World Trade Organization

Executive Summary

During the first half of 2022, after the Russia-Ukraine war had broken out, prices of almost all essential items including oil, food and fertilizer increased substantially. To control the rapidly rising inflation, central banks around the world adopted quantitative tightening measures. Although this tightening was necessary, it not only created vulnerability in the global financial sector but also forced the currencies of other countries to depreciate against the US dollar. As a result, imports became costlier and added fuel to the already soaring inflation. After mid-June of 2022, because of the continued supply of grain, fertilizer and fuel from Ukraine and Russia, the prices of essentials started to fall in the global market. However, inflation remained sticky in many countries including Bangladesh.

Soaring inflation, and an unusual spike in imports during FY 2021-22, created unexpected pressure on the balance of payments (BOP) of Bangladesh. Although the foreign exchange reserve reached a record high level of USD 48.06 billion in August 2022, it kept shrinking. The pressure further mounted as the central bank started using the reserve to stabilize the exchange rate of the Taka against the US dollar. To protect the reserve from falling, the government took several steps including the introduction of restrictive measures for unnecessary imports. These measures have already started bringing back stability in the foreign exchange reserve.

Before the current geopolitical crisis and the period of Covid-19, Bangladesh achieved high growth rates. Continuation of the political regime ensured stability and careful planning has helped achieve desired growth. Despite the financial crisis in 2008-09, the Covid-19 outbreak in 2020 and the ongoing Russia-Ukraine war, the economy has successfully managed to fulfill its development objectives. This indicates that the economy perhaps has a built-in resilience that has provided additional insulation from global shocks. Therefore, Bangladesh is confident that with the current political stability continued, the economy will continue to grow, and an 8 percent GDP growth rate will be achieved by FY 2025-26. Building quality physical infrastructures, implementing targeted reforms, removing information asymmetry, ensuring quality education, improving the business climate, development of skills in the context of the fourth industrial revolution, and creating a conducive environment for research and development will be the key drivers of growth in the coming years. Keeping these priorities in sight, the government is making necessary provisions in the budget.

To increase revenue mobilization, which is key for implementing development projects, the government is taking various steps. Currently, more than 87 percent of the taxes are generated from the NBR sources and therefore the planned steps are primarily focused on the NBR. Notable steps that have already been taken include the introduction of online tax return submission system, organization of tax fairs every year across the country, installation of electronic fiscal devices (EFD), modernization of the legal framework related to tax, and introduction of digital systems to integrate a greater number of people in the tax net. These measures will significantly improve revenue collection in the medium term.

As for financing the budget deficit, the government has always been prudent and consistently maintained the budget deficit around 5 percent of GDP. Because of this, the debt stock has remained far below the internationally accepted ceiling. Bangladesh is currently categorized as a “low risk” country in terms of debt distress. However, the government is keeping a keen eye on the risks that may emanate from various sources. To address the fiscal and climate-related risks, the government is formulating necessary policies and implementing targeted action plans.

Bangladesh has a strong track record of growth and development, even in times of elevated global uncertainty. A robust demographic dividend, growing exports, resilient remittance inflows, and stable macroeconomic conditions have supported rapid economic growth over the last decade. With a solid base of hard-working and intelligent people, the government is now determined to further deepen the roots of economic potential and transform the country into a smart and developed one by 2041.

To delineate the medium-term outlook of the overall economy of Bangladesh, the following layout has been adopted in this issue of MTMPS. The first chapter outlines the global and national economic contexts over the past few years and then sketches the Government’s broad macroeconomic priorities/ strategies for the medium-term. Chapter 2 covers the assumptions relating to the sectoral estimates under the Medium-Term Macroeconomic Framework (MTMF), along with an indication and explanation of the divergence between previous years' budget estimates and actual outturns. Chapter 3 discusses revenue performance, reforms, and projections while Chapter 4 covers spending targets, and sectoral priorities of the government in the medium-term. Finally, Chapter 5 discusses fiscal risks originating from various areas like real, external, climate, etc. to give an idea about the potential issues that may undermine achieving the medium-term targets. ■

1 Navigating through a Dynamic Global Landscape

1.1 The past fourteen years have been an era of major upward transformation for Bangladesh, characterized by macroeconomic stability and high economic growth. Bangladesh has consistently recorded high GDP growth and made significant progress in social development, such as improving life expectancy, literacy rates, per-capita food production, calorie intake etc., which resulted in significant reductions in poverty and sustained economic development. According to the World Bank's country classification by income level, Bangladesh became a Lower-Middle Income Country (LMIC) in 2015 and is expected to leave the Least Developed Countries (LDCs) list in 2026. Now, Bangladesh envisions transforming into a "Smart Bangladesh" with the goal of achieving Upper-Middle Income Country (UMIC) status by 2031 and becoming a developed nation by 2041.

1.2 The first ten years of the period FY 2009-2022 witnessed remarkable progress, with an average growth rate of 6.33 percent, which further rose to 7.88 percent in FY 2018-19. As per the Household Income and Expenditure Survey (HIES) conducted in 2022, access to electricity at the household level witnessed a significant increase from 55.3 percent in 2010 to 99.3 percent in 2022. The literacy rate (7 years and above) rose to 74.0 percent in 2022 from 57.9 percent in 2010. In terms of household income, there was substantial growth in nominal terms, with the average monthly income increasing from TK 11,479 in 2010 to TK 32,422 in 2022. In terms of the poverty situation, the national upper poverty line, measured by the Headcount Ratio (HCR), stood at 18.7 percent in 2022. In the same year, the poverty rate was 20.5 percent in rural areas, while in urban areas, it was 14.7 percent. By contrast, in 2010, the national poverty rate was 31.5 percent, with rural areas at 35.2 percent and urban areas at 21.3 percent.

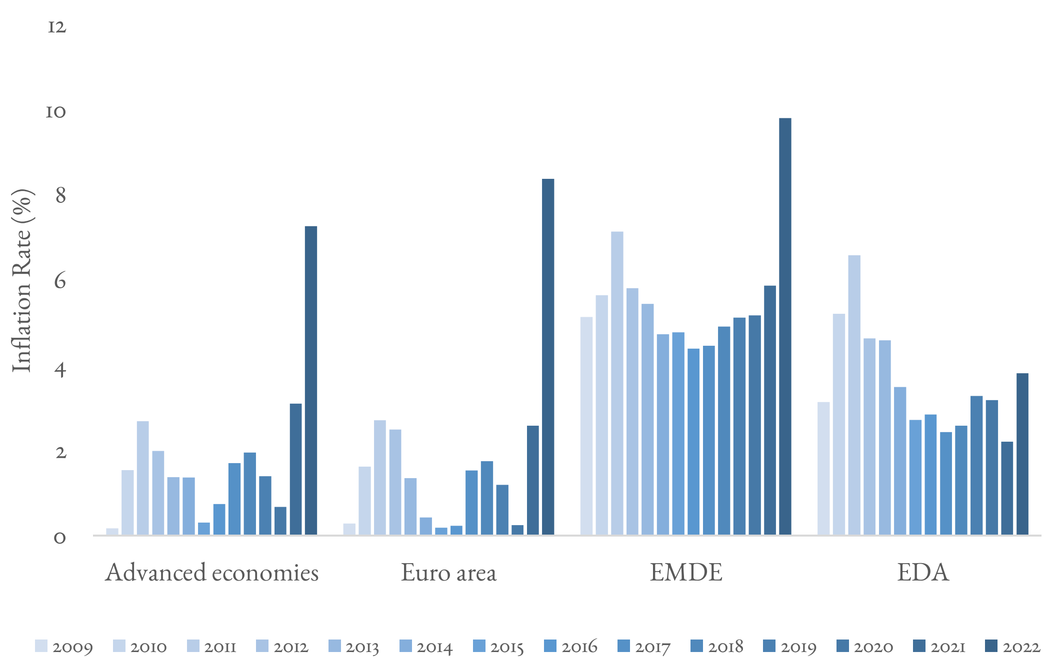
1.3 After the period of sustained growth, the outbreak of COVID-19 posed serious challenges to the domestic economy as the global economy came to an abrupt halt disrupting the supply chains. Yet, the government of Bangladesh successfully managed the adverse impact of the pandemic by implementing a variety of timely and effective fiscal and monetary stimulus programs, which helped to protect both lives and livelihoods. For this, infection and mortality rates were low, and the vaccination rate was high compared to many countries. The efforts helped the country rebound during the second half of 2021 and Bangladesh posted 6.94 percent and 7.10 percent GDP growth rates in FY 2020-21 and FY 2021-22, respectively. This has been almost a V-shaped recovery compared to the growth rate of 3.45 percent in FY 2019-20. However, the ongoing Russia-Ukraine war has brought fresh challenges to the global economy, causing an unprecedented surge in energy, food, and other essential commodity prices in the first half of 2022 due to widespread disruption in international supply chains. The challenges that the economy of Bangladesh is now facing emanated from the consequences of this war. Because of this trade imbalances widened, inflation increased, Taka depreciated, and foreign currency reserves dwindled. The government is now looking at the medium-term spending priorities considering these circumstances and a medium-term macroeconomic framework that fosters inclusive growth, keeps inflation within a tolerable limit, and support stability, has been prepared accordingly.

1.4 To address the issues outlined above, the government will pursue important medium-term macroeconomic policies elaborated in this Policy Statement. The budget for FY 2023-24 and the projections for FY 2024-25 and FY 2025-26 represent a significant translation of these policies.

Global Economic Contexts

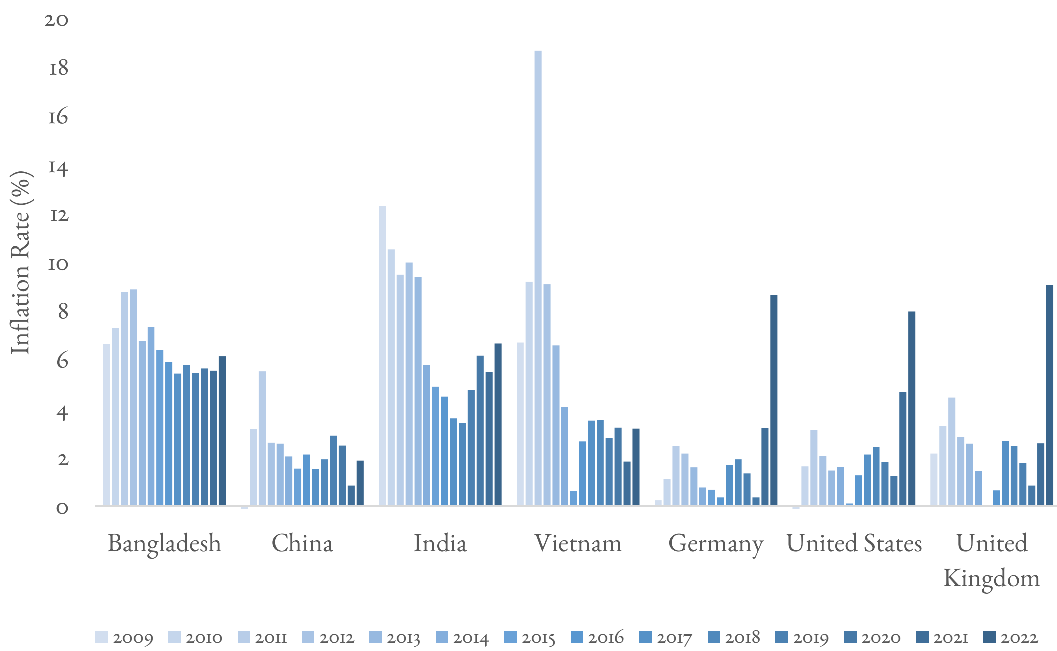
1.5 Prior to the COVID-19 pandemic, the global economy was undergoing a phase of moderate growth and stability. Global economic indicators were mostly positive during this time, although there were some regional variations. Many countries were experiencing a steady economic expansion, with emerging markets and developing economies displaying particularly robust growth rates. Advanced economies, such as the United States and Europe, were also experiencing modest growth. The COVID-19 pandemic and the ongoing Russia-Ukraine war have hampered that state of steady progress. Last year, the war triggered a significant jolt to the global economy, particularly affecting the energy and food markets, resulting in supply shortages and rapid price increases. According to the IMF's primary commodity indices, the weighted index for all primary commodities surged to 238.9 in March 2022, compared to 140.9 in March 2021. Similarly, the weighted index for energy commodities reached a peak of 376.4 in August 2022, up from 183.8 in August 2021. The overall inflation rate in advanced economies surpassed 7 percent in 2022, a significant increase from less than 1 percent in 2020. The Euro area witnessed a rise in inflation from 0.25 percent in 2020 to 8.38 percent in 2022. In Emerging Markets and Developing Economies (EMDEs), the inflation rate escalated from 5.17 percent in 2020 to 9.81 percent in 2022. However, Emerging Developing Asia (EDA) was an exception where the rate of inflation was relatively low. In 2020, the inflation rate in EDA stood at 3.19 percent, which rose to 3.82 percent in 2022.

Figure 1: Inflation in Different Economies in the World



Source: World Economic Outlook, April 2023, IMF

Figure 2: Inflation in Different Countries



Source: World Economic Outlook (April 2023), IMF

1.6 The crises over the past few years have resulted in a deceleration of economic growth. The global economy shrank by 3.30 percent owing to the outbreak of the COVID-19 pandemic in 2020. While economies worldwide started to gradually recover from the pandemic-induced slowdown, the Russia-Ukraine war has introduced fresh uncertainty to global growth prospects. The IMF's World Economic Outlook issued in April 2023 projected global growth to decrease from an estimated 6.3 percent in 2021 to 3.4 percent in 2022 and then to 2.8 percent in 2023. From the data reported by the IMF, it appears that the economic prospects of emerging markets and developing economies, on average, are stronger than those of advanced economies, but these prospects vary more widely across regions.

Figure 3: GDP Growth Rate in Different Countries

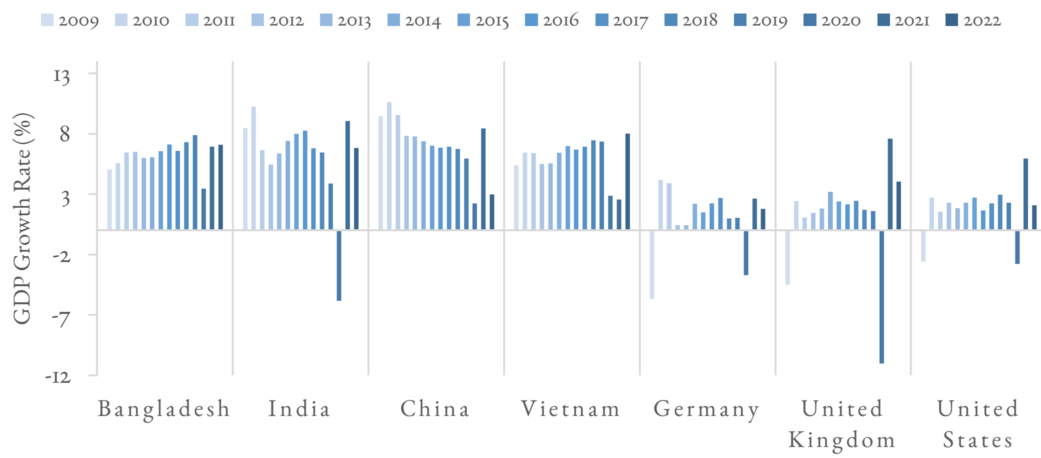
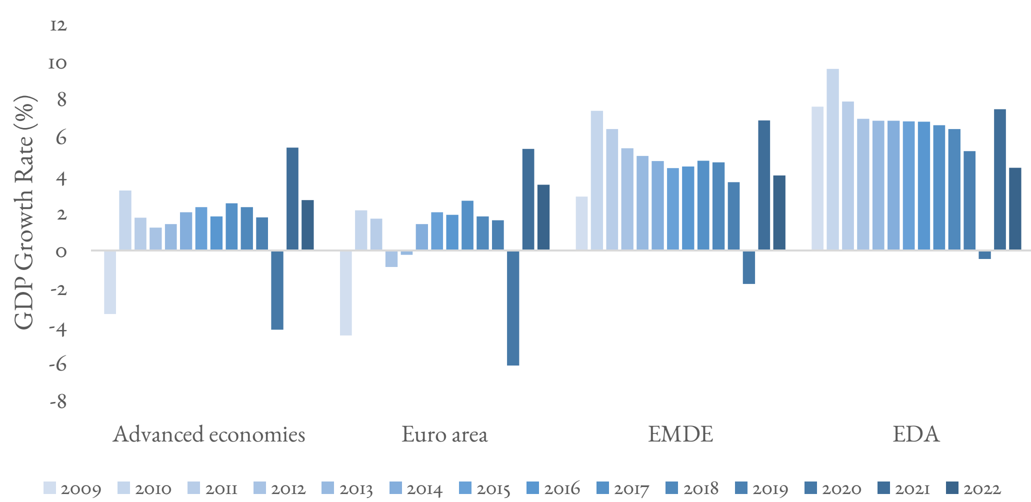


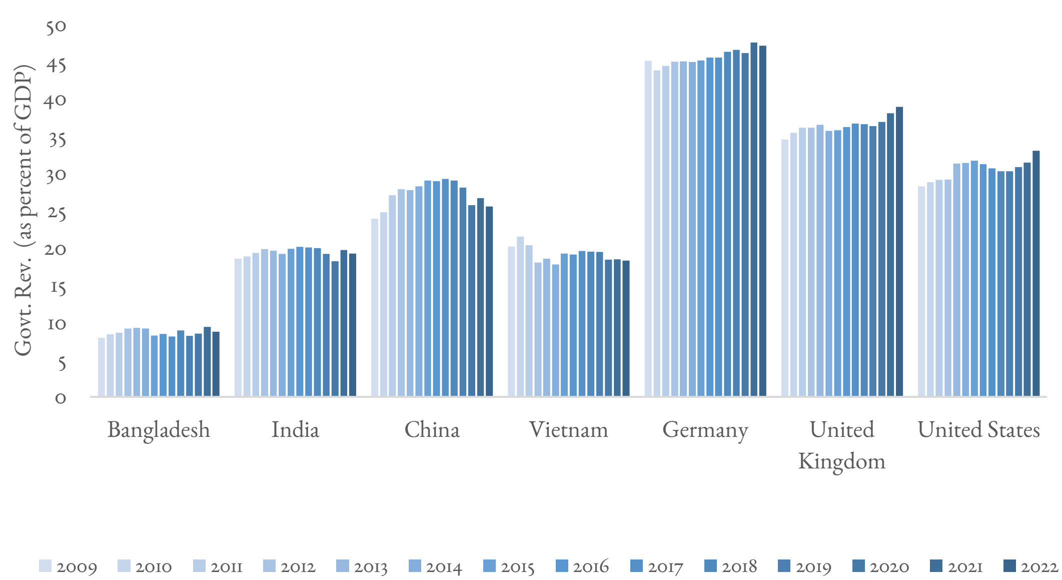
Figure 4: GDP Growth Rate in Different Economies in the World



Source: World Economic Outlook, April 2023, IMF

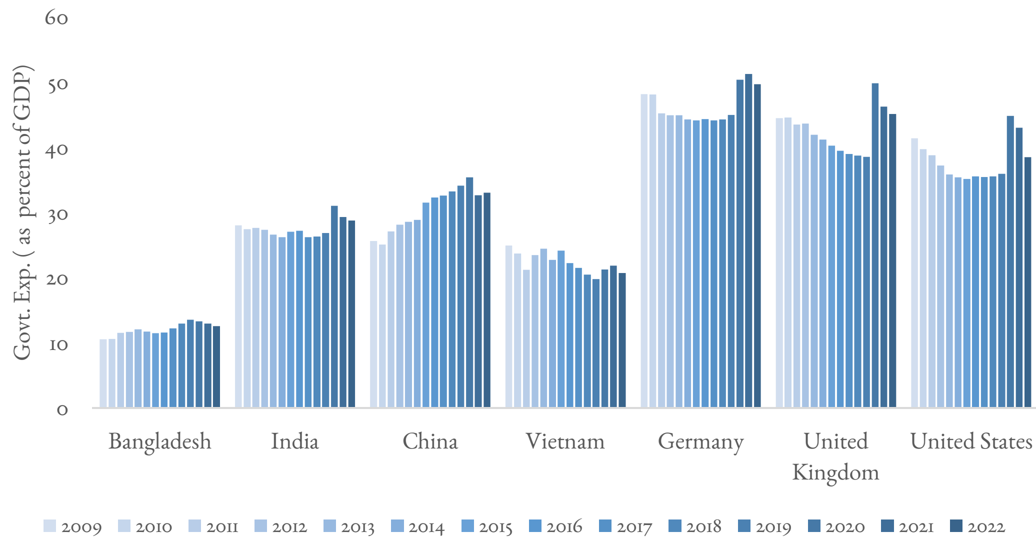
1.7 Fiscal management has become increasingly complex due to elevated and unpredictable inflation that has the potential to undermine the soundness of financial institutions and fiscal operations. The uncertainty surrounding prices, wages, and interest rates influenced inflation through aggregate demand and expectations, which in turn posed challenges to fiscal planning and budgetary preparations. For instance, the IMF Fiscal Monitor report in October 2022 highlighted that, compared to 2019, larger deficits in advanced economies and low-income developing countries could be attributed to increased spending in response to the food and energy crises. In emerging market economies, deficits primarily resulted from sluggish revenue recovery. In Bangladesh, support measures and stimulus packages were also implemented to assist businesses and individuals during the pandemic, leading to increased expenditures in certain areas. In addition, the spillover effects of the Russia-Ukraine war have further exacerbated the situation. The war disrupted the food and energy supply chains, leading to higher costs for essential commodities due to supply contraction as well as currency depreciation. Because of this, many businesses faced difficulties in fulfilling their tax obligations, and the government offered them tax reliefs that led to a decrease in government revenue. Countries with more diversified economies and robust social safety nets, particularly in advanced economies, were better equipped to withstand this situation. According to the Global Economic Prospects, issued by the World Bank in January 2023, economies with deficits exceeding 3 percent of GDP experienced, on average, eight times more depreciation compared to other emerging markets and developing economies (EMDEs).

Figure 5: Government Revenue (as % of GDP)



Source: World Economic Outlook, April 2023, IMF

Figure 6: Government Expenditure Share (as % of GDP)

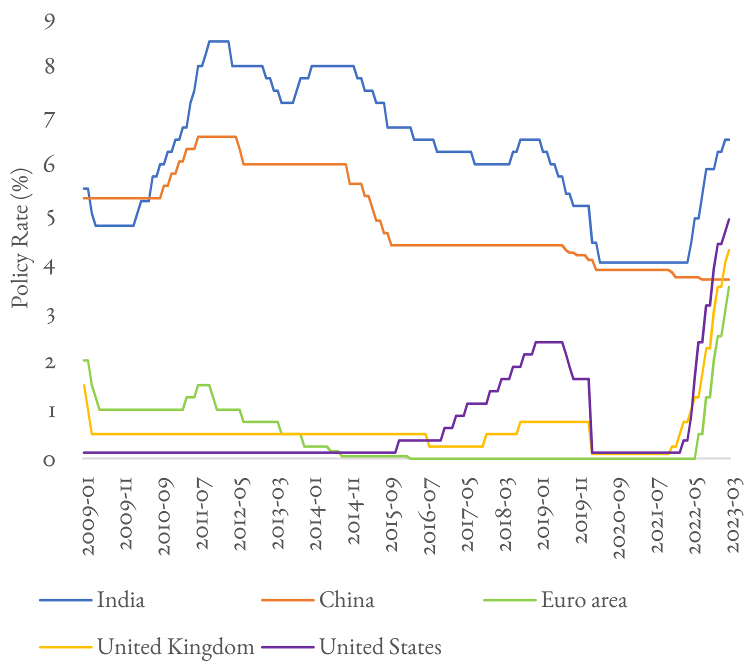


Source: World Economic Outlook, April 2023, IMF

1.8 Prior to the Russia-Ukraine war, the global financial system was experiencing a favorable environment characterized by remarkably low-interest rates, less volatility, and abundant liquidity, which supported stable global growth during the period after the global financial crisis in 2008. However, the emergence of the worst inflation in decades and the ongoing geopolitical tensions in Eastern Europe have intensified threats to financial stability. A sudden and disruptive tightening of financial conditions poses the risk of interacting with existing vulnerabilities amid low market liquidity. The combination of increasing interest rates, fragile economic fundamentals, and significant capital outflows elevated borrowing costs in developing markets, thereby heightening the possibility of defaults. This is evident from the events surrounding a few big banks such as the Silicon Valley Bank and the Signature Bank in the United States, and the Credit Suisse in Europe. The impact of rising interest rates has been pronounced particularly for the energy-importing nations with poor credit ratings, making it more challenging for them to secure required financing.

1.9 Because of persistently elevated inflation, many central banks worldwide adopted monetary tightening policies faster than expected. Long-term government bond yields in the United States and Germany increased very quickly and reached their highest levels since 2007 and 2011, respectively. The European Central Bank also raised interest rates several times since 2022. In the UK, a rapid decline in liquidity brought on by collateral calls on derivative positions held by pension funds forced central bank intervention in gilt markets for the sake of maintaining financial stability. While the bank rate of the Bank of England was 0.1 percent in November 2021, that rate was raised to 4.25 percent in March 2023. The ongoing tightening of monetary policies in advanced economies has had a significant impact on capital flows to emerging markets and developing countries. Many of these economies have experienced a prolonged period of reduced financing and equity flows since the beginning of 2021. Additionally, the U.S. dollar appreciated considerably in 2022, leading to the depreciation of most emerging market and developing economy (EMDE) currencies against the US dollar.

Figure 7: Policy Rates of Central Banks

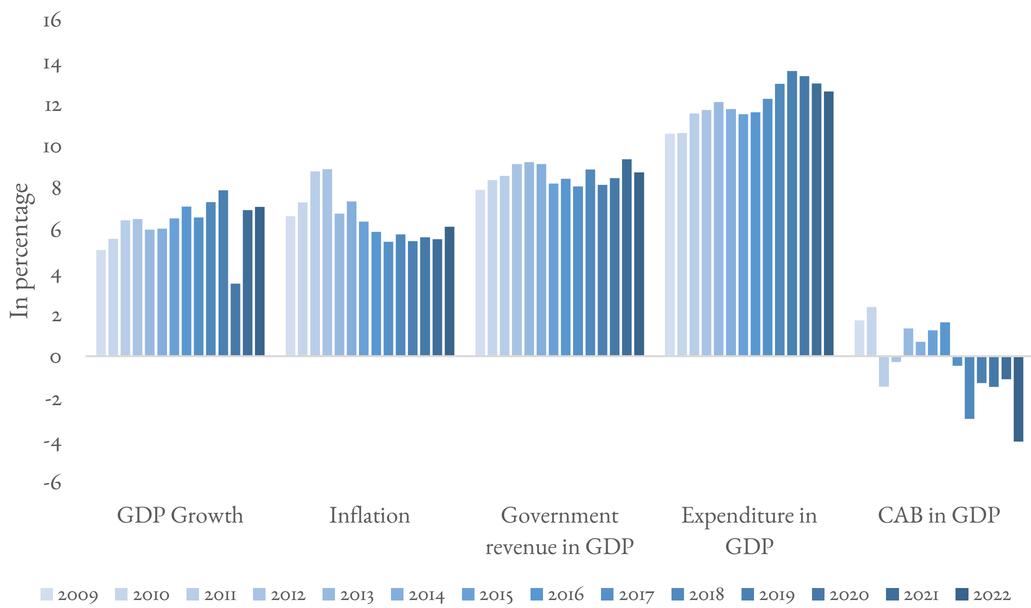


Source: Bank of International Settlement

National Economic Contexts

1.10 Bangladesh was on a trajectory of consistent growth and made significant progress in various sectors before the onset of COVID-19 in 2020. The country was counted among the world's fastest-growing economies and experienced remarkable expansion over the past decade. Except for FY 2019- 20, the GDP growth rate never dipped below 5 percent since FY 2008-09, and the average growth rate from FY 2008-09 to FY 2018-19 stood at 6.5 percent. From FY 2014- 15 to FY 2021-22, the annual average inflation rate remained below 6.0 percent, although it averaged 7.63 percent from FY 2008-09 to FY 2013-14. Historically, government revenue earnings have remained below double-digit figures, while government expenditure as a percentage of GDP consistently reached the double-digit range. On average, government expenditure was more than 12 percent of GDP during the period FY 2008-09 to FY 2021-22. However, there have been fluctuations in the current account balances (CAB) over the years, reflecting imbalances between financial inflows and outflows. In FY 2021-22, the CAB reached a record low of –4.06 percent of GDP.

Figure 8: Different Macroeconomic Indicators of Bangladesh



Source: Finance Division, BBS, Bangladesh Bank

1.11 The combination of reduced investment growth and elevated inflation in advanced economies resulted in lower aggregate demand, putting additional pressure on countries like Bangladesh. Furthermore, disruptions in the global supply chain and currency depreciation contributed to increased import costs, leading to higher inflation rates for both food and non-food items. Because of these factors, Bangladesh experienced a significant rise in point-to-point inflation, reaching 9.33 percent in March 2023, compared to 6.22 percent in March 2022 and 5.48 percent in March 2020.

1.12 Despite implementing measures such as reducing import tariffs and duties in 2022, Bangladesh still faced higher prices for essential items. Even with a reduction in VAT on rice imports, the price of rice continued to rise. Sugar prices saw a significant increase due to export restrictions imposed by certain countries to meet their domestic demand, while wheat prices were affected by import disruptions from Russia and Ukraine. The cost of edible oil also surged because of temporary export restrictions imposed by exporting nations. The reduction of tariffs and VAT on imported goods widened the fiscal deficit, leading to increased domestic bank financing. Net foreign financing declined during this period due to factors such as higher debt-service obligations and currency depreciation. Consequently, there was a rise in current expenditure, primarily driven by subsidies, incentives, and current transfers. The growth rate of subsidies and transfers in FY 2021-22 was 16.2 percent compared to the previous fiscal year, adding pressure to the annual expenditure plan in the pursuit of a swift post-pandemic recovery.

1.13 Amidst a surge in prices for all imported commodities, the increased import of intermediate goods and essential items hugely exceeded export earnings. Simultaneously, the inflow of official remittance slowed down with the global economic slowdown resulting from the COVID-19 pandemic. These factors exerted pressure on the balance of payments, resulting in a significant deficit in FY 2021-22 and a rapid depletion of foreign exchange reserves. As a result, the balance of payments shifted from a surplus of USD 9.3 billion in FY 2020-21 to a deficit of USD 5.3 billion in FY 2021-22. Gross foreign exchange reserves declined to USD 31.14 billion at the end of March 2023, compared to USD 44.17 billion one year earlier. As the central bank was using foreign exchange reserves to stabilize the exchange rate, it caused a liquidity crisis in the financial system at the same time.

1.14 Despite facing numerous challenges in the global and national context, Bangladesh's economy has shown resilience and maintained moderate real GDP growth in recent years. Expansionary fiscal policies were implemented to support economic recovery and mitigate the impact of the pandemic on the vulnerable population. The swift execution of stimulus packages and the adoption of accommodative monetary policies played a crucial role in facilitating the recovery process. Following a decline in GDP growth during FY 2019-20, the economy experienced a sharp improvement, with a growth rate of 6.94 percent in FY 2020-21 followed by 7.10 percent growth in FY 2021-22. This was primarily driven by the expansion of the service sector and increased external demand. The service sector grew by 3.9 percent in FY 2019-20 and by 5.7 percent in FY 2020-21. The growth rate of the service sector further increased to 6.26 percent in FY 2021-22. Exports also witnessed significant growth in FY 2021-22 as major export destinations started to return to normal state. In that year, the export growth rate reached 33.4 percent, more than twice the growth rate of 12.4 percent in FY 2020-21. Imports also grew very fast as the business sector rushed to cover the loss of production during the pandemic period. As a result, imports in FY 2021-22 grew by 35.9 percent.

1.15 To address the challenges faced in recent fiscal years, coordination between fiscal and monetary authorities led to the successful implementation of adopted policies. As inflation rates soared in numerous developed and emerging economies, Bangladesh also experienced an increase in inflation from 5.6 percent in FY 2020-21 to 6.2 percent in FY 2021-22, with a continued upward trend in the current fiscal year. To maintain stability in investment growth and domestic demand, the Bangladesh Bank pursued an expansionary monetary policy, which remained unchanged until the final quarter of FY 2021-22. However, due to rising inflation, the central bank adopted various alternative measures. This included raising the repo rate on four occasions between May 2022 and January 2023, resulting in a total increase of 125 basis points. Additionally, the reverse repo rate was raised by 25 basis points, while the interest rate cap of 9 percent for lending to the industrial sector remained unaltered. Furthermore, the Monetary Policy Statement issued in January 2023 introduced revisions to the lending cap rate, increasing it to 12 percent for consumer credit and eliminating the cap on credit card loans.

Medium-Term Policy Responses

1.16 On top of the immediate policy responses due to the global and national economic contexts, Bangladesh has embarked on a series of medium-term reforms aimed at bolstering macroeconomic stability and promoting long-term growth. These reform initiatives have been developed through consultations and negotiations with the stakeholders. The main objectives of these reforms include enhancing revenue generation, reducing the borrowing costs of the public sector, curbing subsidies, and improving spending efficiency through fiscal institutional reforms. The overarching strategy is to strengthen the external balance and rebuild reserves while gradually easing the measures implemented for demand and import management on a temporary basis. Moreover, fiscal sustainability will be reinforced by maintaining the budget deficit and public debt within acceptable limits. This will be achieved through the introduction of more efficient expenditure management practices and increased investment in priority sectors such as social welfare and development spending.

1.17 Bangladesh will continue to pursue a prudent fiscal policy stance keeping a careful eye on the budget deficit (both primary and overall), financing mix, and public and publicly guaranteed debt level. In the medium term, the policy will be anchored by the target to keep the primary fiscal deficit (including grants) within around 3.3 percent of GDP to contain public debt below 45 percent of GDP. In addition to raising expenditures on development and social safety net programs, there will be initiatives to rationalize subsidies and domestic debt financing costs. The reform initiatives in the governance of social safety net programs, such as improvement in targeting, rationalization of coverage, use of the government-to-person (G2P) systems, the introduction of a universal pension system, etc., will continue in the medium term.

1.18 Bangladesh's tax-GDP ratio is one of the lowest in the world. This is working as a strong constraint in expanding the budget allocation in critical sectors and exploiting the growth potential to the fullest. Hence, the government has initiated several policy and administrative reforms on the revenue side focusing on the modernization of the system of income tax and VAT following the best practices. Key areas for policy reforms include modernizing tax laws, rationalizing tax expenditures, simplifying the tax rate structure, and broadening the tax base as part of an overarching strategy of shifting the tax burden from trade-related taxes toward income and value-added taxes. On the administrative side, key reforms include establishing compliance risk management units within the National Board of Revenue and implementing a compliance improvement plan, strengthening information sharing between the income tax, VAT, and customs wings of NBR, progressively expanding and integrating automation in tax administration, increasing at-source tax collection, etc. The reforms are expected to generate additional revenue by 0.5 percent of GDP annually in FY 2023-24 and FY 2024-25 and 0.7 percent of GDP in FY 2025-26.

1.19 The government has taken steps to rationalize energy subsidies and allocate required funds for social and development expenditures. The increase in petroleum prices in August 2022 was intended to match international prices, and to reduce the amount of subsidy. To ensure a systematic approach, the government is going to introduce a periodic formula-based automatic fuel price adjustment mechanism, which is expected to eliminate the need for subsidies on petroleum products. Moreover, the government is focusing on untapped areas in the tax-revenue sector to enhance overall revenue while also emphasizing non-tax revenue sources. Several reform measures have been implemented including the reduction of interest rates of saving certificates, the introduction of tiered interest rates, capping issuances, and increasing taxes on earned interest, all aimed at reducing the government's interest expenditure. In FY 2021-22, the contribution from national savings certificates accounted for 0.5 percent of GDP, a decrease from 1.2 percent in FY 2020-21. Efficient cash management is also a priority to save public funds by minimizing interest expenditure. To achieve this, the government is strengthening and expanding the Treasury Single Account (TSA), which is expected to facilitate better cash management, reduce interest expenses, and improve commitment controls.

1.20 To strengthen the external sector balance and improve monetary sector performance, Bangladesh Bank is going to implement several reform initiatives in the medium term. There will be reform activities to unify the multiple exchange rates and bring more discipline to the foreign exchange market. Bangladesh Bank will reverse the temporary margin increases for opening letters of credit on nonessential imports.

Box 1: Medium Term Reform Initiatives

To address present crises and ensure resilient, inclusive, and sustainable growth, Bangladesh has adopted several reform initiatives to be implemented in the medium term. The significant reform actions include:

- **Revenue Mobilization:** This includes reforms in tax policy and revenue administration. The plan is to mobilize additional tax revenue of about 1.7 percent of GDP by the end of FY 2025-26.
- **Improved Expenditure Management:** Besides rationalizing the subsidies, there is a plan to bring down the cost of borrowing and bring efficiency in debt management. The net NSC issuance is planned to bring down to below ¼ of total net domestic financing by FY26. The government plans to optimize cash management by expanding the coverage of the treasury single account (TSA) and the use of electronic funds transfer (EFT).
- **Monetary and External Sector Management:** To improve monetary operations, Bangladesh Bank will adopt an interest rate corridor system. Furthermore, to increase exchange rate flexibility, Bangladesh Bank will use market-determined exchange rates for official foreign exchange transactions on behalf of the government.
- **Financial Market Regulation:** With a view to establishing a risk-based banking supervision system, Bangladesh Bank will complete the pilot risk-based supervision action plan. Also, to improve governance and discipline in the financial market, the Government will amend the Bank Companies Act and Finance Companies Act in line with best practices. For better transparency, Bangladesh Bank will publish banks' distressed assets in the annual financial stability report.
- **National Income Accounts:** Bangladesh Bureau of Statistics has taken the initiative to publish quarterly GDP.

Implementation of the 8th Five-Year Plan

1.21 Achieving the 8th FYP goals will be at the center of the Government's development agenda in the medium term. The core themes of the plan include rapid recovery from COVID-19 to restore human health, confidence, employment, income, and economic activities; acceleration of GDP growth, employment generation, productivity acceleration, and rapid poverty reduction; a broad-based strategy of inclusiveness with a view to empowering every citizen to participate fully in and benefit from the development process and helping the poor and vulnerable with social protection- based income transfers; a sustainable development pathway that is resilient to disaster and climate change; sustainable use of natural resources; successful management of urbanization; development and improvement of critical institutions necessary to lead the economy to UMIC status; and attaining SDG targets and coping up with the impact of LDC graduation. The Plan sets to hit the target of 8.51 percent GDP growth by FY 2025 with the gross investment raised to 36.59 percent of GDP by FY 2025, of which 27.35 percent is to be contributed by the private sector.

Table 1: Some Key Indicators in the 8th Five-Year Plan

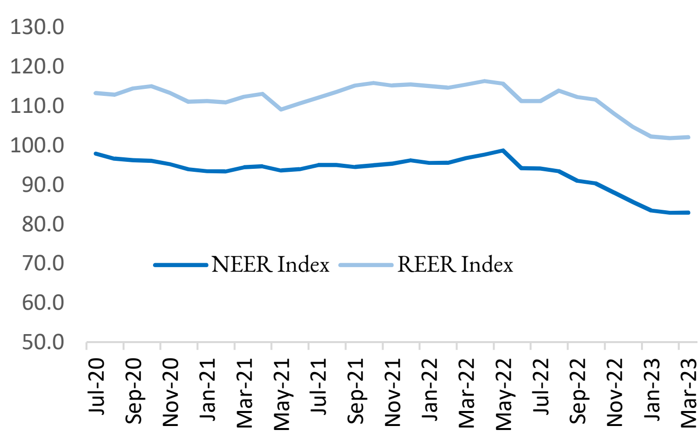
Indicators	FY21	FY22	FY23	FY24	FY25
Real GDP Growth (percent)	7.40	7.70	8.00	8.32	8.51
CPI Inflation rate (percent)	5.10	4.90	4.80	4.70	4.60
Per Capita GNI (in USD)	2170	2345	2555	2790	3059
Gross Investment (as percent of GDP)	32.56	32.73	34.00	34.94	36.59
ADP Expenditure (billion Taka)	1800	2133	2622	3060	3675
Export (million USD)	37755	41643	45995	50870	56339
Import (million USD)	55760	61336	67776	75232	83883
Foreign Direct Investment (million USD)	2948	5239	8141	11859	15808
Forex Reserve (months of imports)	7.7	7.8	8.2	8.7	9.3
Headcount Poverty (percent)	23.0	20.0	18.5	17.0	15.6

Sources: GED, Bangladesh Planning Commission; Note: export and import figures are calculated for f.o.b. (including EPZ)

1.22 Bangladesh is on track to achieve most of the targets set in the 8th FYP. For some indicators, the country is well ahead of the targets. For example: in FY 2021-22, the export volume amounted to USD 49.25 billion against the 8th FYP target of USD 41.64 billion. Despite a revenue constraint, the targets set for ADP allocations were also met. Good progress has been made in achieving various socio-economic targets such as literacy rate, maternal and neonatal mortality rate, access to electricity, safe water, etc.

1.23 Even some very challenging targets set in the 8th FYP have been achieved. For example, the 8th FYP found that the exchange rate appreciated in real terms during the 7th FYP period, which hurt export prospects and stemmed the diversification of exports. Thus the 8th FYP commits to improving the exchange rate management to bring in greater flexibility to correct for the past appreciation of the real exchange rate and then make efforts to avoid real exchange rate appreciation over the coming years. Meanwhile, the recent sharp depreciation of the Taka against the USD has corrected the past appreciation of the real exchange rate. This is likely to add to the export competitiveness of Bangladesh. Furthermore, Bangladesh Bank is expected to adopt a unified market-based exchange rate system which is likely to help avoid real exchange rate appreciation in the coming days.

Figure 9: Monthly NEER and REER Index



Source: Bangladesh Bank

1.24 However, the prolonged impact of the COVID-19 pandemic and the Russia-Ukraine war has substantially affected the implementation of the 8th FYP and posed challenges to achieving many of the targets set in the plan. For example: for FY 2022-23, the target was set to raise the volume of foreign exchange reserves to such a level that could cover the potential import payments for 8.2 months. Also, the GDP growth rates have been slower than what the plan envisaged. The recent rates of CPI inflation have been much higher than the estimates made in the plan and due to the sharp depreciation of the domestic currency, per capita GNI (in USD) has decreased in FY 2022-23 compared to that of FY 2021-22. If the depreciation of local currency continues, per capita GNI will continue to fall behind the targets set in the 8th FYP in the coming years.

1.25 Half of the implementation period of the 8th Five-Year Plan has already passed. Hence, the Government has started the process of conducting a mid-term review of the plan, which will allow the government to take stock of achievements at the midpoint, review the risks and assumptions, and make any necessary adjustments to the remaining years' strategies. Through the process, a comprehensive review of macroeconomic performance, including GDP growth, investment, exports, macroeconomic stability, and poverty reduction, as well as sectoral analysis for the core thematic sectors, will be done. In this regard, a Development Results Framework (DRF) consisting of 104 indicators has already been incorporated in the 8th FYP document.

Implementation of Long-Term Plans

1.26 The implementation of Sustainable Development Goals (SDGs) is halfway through now. According to the Sustainable Development Report 2022, Bangladesh has made remarkable progress in implementing SDGs. Bangladesh ranked 104 among 163 countries in 2022, whereas its ranking was 116 in 2019. According to the report, East and South Asia have progressed on the SDGs more than any other region since their adoption in 2015; Bangladesh, along with Cambodia, is showing the most progress of all countries. The Government of Bangladesh is striving towards the ambitious goal of reaching the furthest behind first through adopting the 'whole-of-society' approach and implementing the 'leaving no one behind' agenda.

1.27 Alleviation of poverty (SDG-1) is at the heart of all development plans of Bangladesh. During the 8th FYP period, the government set a target to bring down the incidence of poverty to 15.6 percent and extreme poverty to 7.4 percent. According to the Household Income and Expenditure Survey (HIES) 2022, the rate of poverty has already come down to 18.7 percent, and the rate of extreme poverty has decreased to 5.6 percent. In the urban areas, the rates of poverty and extreme poverty are even lower than the national rates. The rate of poverty in the urban areas has been found to be 14.7 percent and extreme poverty to be 3.8 percent. The decline in the poverty rate has continued despite the severe impact on income during COVID-19 and other shocks in the economy, including the sharp price hike. Various support packages and social safety net programs implemented during this period played a crucial role in ensuring the fall in the poverty rate.

1.28 Bangladesh is close to achieving the 2025 milepost of reducing the prevalence of undernourishment to 12 percent (SDG-2). The rate was 16.4 percent in 2016, which went down to around 14.7 percent in 2018. According to 'Asia and the Pacific Regional Overview of Food Security and Nutrition 2020' published by the WFP and WHO, the prevalence of undernourishment went down to 9.7 percent in 2020. Similarly, progression in the reduction of wasting decreased from 14 percent in 2014 to 9.8 percent in 2019. Bangladesh has achieved significant success in reducing the maternal mortality ratio as well. A continuous decline is observed in the under-five mortality rate during 1995-2020 and gradually the rate fell to 163 per 100,000 live births in 2020 from 447 in 1995. According to the Multiple Indicator Cluster Survey 2019, around 74.5 percent of children are developmentally on track in health, learning, and psychosocial well-being, with 71.4 percent males and 78 percent females.

1.29 Bangladesh is also making significant progress in other areas of development. Bangladesh has been ranked 71 out of 146 countries in 2022 in the Global Gender Gap Index, while India and Pakistan have been ranked 135 and 145, respectively. According to the Human Development Report 2021-22, Bangladesh ranks 129 among 191 countries in the Human Development Index (HDI). In the previous report published in 2020, Bangladesh ranked 133 out of 189 countries. The 2022 Social Progress Index, which measures a country's performance on a wide range of aspects of social and environmental performance, ranks Bangladesh as 119 across 169 countries. In the basic human needs dimension, Bangladesh ranks 112; in the foundation of well-being dimension, it is 121; and in the opportunity dimension, it is 146. The social progress index for Bangladesh increased to 56.06 in 2022 from 49.78 in 2011. It is noteworthy that, Bangladesh has brought 100 percent of the population under electricity coverage by March 2022.

1.30 However, achieving 17 goals and 169 targets set under the Sustainable Development Goals (SDG) will require a substantial amount of resource allocation. The Sustainable Development Report 2022 recognizes that achieving the SDGs is fundamentally an investment agenda in physical infrastructure and human capital. Hence the report recommends that the G20 should declare clearly and unequivocally its commitment to channel far larger flows of financing to developing countries so that they can achieve economic development and meet the SDG targets. According to the SDG Financing Strategy of the Government, during the period of FY 2016-17 to FY 2029-30, the estimated additional financing need of Bangladesh to fully implement the SDGs amounts to USD 928.48 billion (at 2015-16 constant prices). To meet the financing requirements in the medium term, public, private, and external sources will be tapped suitably.

1.31 The development agenda will continue to be guided by long-term plans such as the Perspective Plan 2021-2041 and the Delta Plan 2100. The Perspective Plan 2021-2041 is designed to be implemented through four Five Year Plans among which implementation of the first one, i.e., the 8th FYP, is now halfway through. The Delta Plan 2100 plan provides an overarching direction for all development plans and actions. The mission is to ensure long-term water and food security, economic growth, and environmental sustainability while effectively reducing vulnerability to natural disasters and building resilience to climate change and other delta challenges through robust, adaptive, and integrated strategies and equitable water governance.

Mainstreaming Climate Change Issues

1.32 Bangladesh is high on the list of countries most vulnerable to climate change, ranking seventh on the 2021 World Climate Risk Index. Keeping this in mind, over the decades, Bangladesh has advanced substantially in building adaptive capacity and resilience through the formulation and implementation of required policies and regulatory frameworks for enabling climate-resilient sustainable development. The Government has adopted the National Adaptation Plan (NAP) of Bangladesh in October 2022 to be implemented during a time span of 27 years: 2023 to 2050. Bangladesh also submitted an updated NDC in August 2021. Now the Government is updating the Bangladesh Climate Change Strategy and Action Plan (BCCSAP, 2009) making it aligned with the NAP and updated NDC. Furthermore, the Mujib Climate Prosperity Plan (MCPP) was launched during Bangladesh's second tenure as president of the Climate Vulnerable Forum (CVF). The plan aims to ensure that Bangladesh's development trajectory evolves from vulnerability to resilience to prosperity (VRP). Under the MCPP, Bangladesh intends to obtain 30 percent of energy from renewables by 2030.

1.33 Under the updated NDC, the targeted reduction of GHG emissions by Bangladesh will be implemented through a set of mitigation actions, including implementation of renewable energy projects, enhanced efficiency of existing power plants, use of improved technology for power generation, improvement of fuel efficiency for transport subsector, increasing energy efficiency in the industry sub-sectors, and enhanced use of solar energy in agriculture, etc. There will be improved technology used in brick kilns and enhanced use of energy-efficient appliances in household and commercial buildings. Besides, there will be a focus on the reduction of emissions from rice fields, fertilizer uses, enteric fermentation etc. Furthermore, prevention of deforestation, reforestation/afforestation, improved municipal solid waste management, and use of the 3R principle for waste management are emphasized.

1.34 On the adaptation front, the National Adaptation Plan (NAP) envisions building a climate-resilient nation through effective adaptation strategies that foster a robust society and ecosystems and stimulate sustainable economic growth. The plan primarily encompasses eight distinct sectors: water resources; disaster; social safety and security; agriculture; fisheries, aquaculture, and livestock; urban areas; ecosystems, wetlands, and biodiversity; policies and institutions; and capacity development, research, and innovation. Total financing requirement to implement NAP amounts to USD 230 billion, 72.5 percent of which is proposed to be mobilized by 2040.

Box 2:
National Adaptation Plan of Bangladesh (2023-2050)

Six national adaptation goals have been set to achieve the broader vision of NAP:

Goal 1: Ensure protection against climate change variability and induced natural disasters;

Goal 2: Develop climate-resilient agriculture for food, nutrition, and livelihood security;

Goal 3: Develop climate-smart cities for improved urban environment and well-being;

Goal 4: Promote nature-based solutions for conservation of forestry, biodiversity, and well-being of communities;

Goal 5: Impart good governance through integration of adaptation into the planning process; and

Goal 6: Ensure transformative capacity building and innovation for Climate Change Adaptation.

1.35 The NAP implementation will seek to realize six goals through 23 broad-scale strategies and 28 outcomes encompassing diverse aspects of safeguarding against climate-induced disasters. It will develop climate-resilient agriculture, infrastructure, and other socioeconomic sectors through implementing inclusive and ecosystem-based adaptation, improved governance, enhanced climate finance and transformative capacity-building, and innovation. The NAP considered 11 climate stress areas in devising 113 interventions based on developed adaptation pathways and sectoral adaptation requirements. These interventions are aligned with the global Sustainable Development Goals (SDGs) and 52 climate adaptation projects of the Bangladesh Delta Plan 2100 (BDP2100). They ensure the inclusion of women and people with diverse gender identities, the elderly, persons with disabilities, youth, ethnic communities, and other socially disadvantaged groups throughout the NAP process. ■

2 Macroeconomic Performance and Medium-Term Outlook

2.1 The economy of Bangladesh has maintained remarkable macroeconomic stability and achieved high growth targets during the last decade. Although the onset of Covid-19 reduced the real GDP growth rate to 3.45 percent in FY 2019-20, the sustained and planned efforts of the government helped overcome the setback quickly by boosting demand and production, creating jobs, and reducing the negative impact on vulnerable groups. In FY 2020-21, the economy, as a result, bounced back and recorded GDP growth of 6.94 percent and further rose to 7.10 percent in FY 2021-22. However, the ongoing geopolitical uncertainty emanating from the situation in Ukraine and rising interest rates everywhere may slow down the growth momentum. The rising inflation in recent times has not only caused significant adverse impacts on living standards in many countries but also exposed the global financial system. Therefore, the main challenge in the coming years appears to be combatting inflation and continuing the growth momentum. To tame the rising inflation, central banks continued to raise interest rates and it appears that the policy has started producing desired impacts as the global commodity prices seem to be decreasing.

2.2 Bangladesh has already fulfilled all criteria to graduate from the group of the least developed countries (LDC) by 2026. The development plans of the country have identified targets to reach the status of upper middle-income country by 2031 and to the status of high-income country by 2041. Keeping these targets in sight, a multi-pronged approach has been undertaken to make progress in key areas including human resource development to meet the requirements of the fourth industrial revolution (4IR), allocate necessary funds to support development priorities and address climate change related issues. Special emphasis on the development of physical and social infrastructure, removing information asymmetry, improving the business climate, and providing policy support to foster business will continue to support the country's economic backbone. Considering that the key global prices are falling and assuming that the global political uncertainty will subside by the end of 2023, the overall outlook of the medium-term appears to be stable and hence the economy of Bangladesh should return to its pre-Covid-19 state.

Domestic Economic Trends and Medium-Term Outlook

Real sector

2.3 Robust demographic dividend, strong ready-made garment (RMG) exports, resilient remittance inflows, and stable macroeconomic conditions have supported the rapid economic growth of Bangladesh over the past two decades. During the last five years, real GDP growth in Bangladesh was quite steady except FY 2019-20 because of COVID-19 pandemic. The growth rate sharply rose to 6.94 percent in FY 2020-21 and then further to 7.10 percent in FY 2021-22. Timely support measures to protect both lives and livelihood resulted into strong rebound of domestic demand particularly of private consumption and private investment. On the other hand, the supply-side growth was mainly attributed to manufacturing and services sectors.

Table 2: Demand Side Contributions to Growth

Components	FY17	FY18	FY19	FY20	FY21	FY22
Private Consumption	4.19	6.28	3.30	1.98	5.27	4.97
Govt. Consumption	0.42	0.31	0.78	0.12	0.41	0.37
Private Investment	1.36	3.42	2.16	0.06	1.91	2.92
Public Investment	1.17	0.31	0.05	1.19	0.68	0.85
Net Exports	-1.16	-3.33	1.35	-0.18	-1.46	-2.19
Statistical Discrepancy	0.60	0.33	0.24	0.28	0.12	0.18
Real GDP growth (percent)	6.59	7.32	7.88	3.45	6.94	7.10

Source: Bangladesh Bureau of Statistics

2.4 Growth in Bangladesh is expected to accelerate over the medium term, as inflationary pressure eases, external conditions improve, and reform implementation gains momentum. The GDP growth target for FY 2022-23 was originally set at 7.5 percent in the Medium-Term Macroeconomic Framework (MTMF) at the time of budget declaration in June 2022. However, owing to Russia-Ukraine conflict and other global uncertainties adversely impacted countries around the globe and hence growth prospects slumped. As a result, real GDP growth is expected to grow modestly by 6.03 percent in the current fiscal year. However, as the political uncertainties and inflationary pressure are expected to subside in the coming years, growth will accelerate in the medium term.

2.5 During the last five years (FY 2017-18 to FY 2021-22), the annual average growth rate of the industrial sector was 9.1 percent followed by the services sector at 5.9 percent and the agricultural sector at 3.3 percent. Despite the global economic turmoil and record-high inflation in the West the manufacturing sub-sector maintained a steady growth of 11.4 percent growth in FY 2021-22 which was 11.6 percent in FY21.

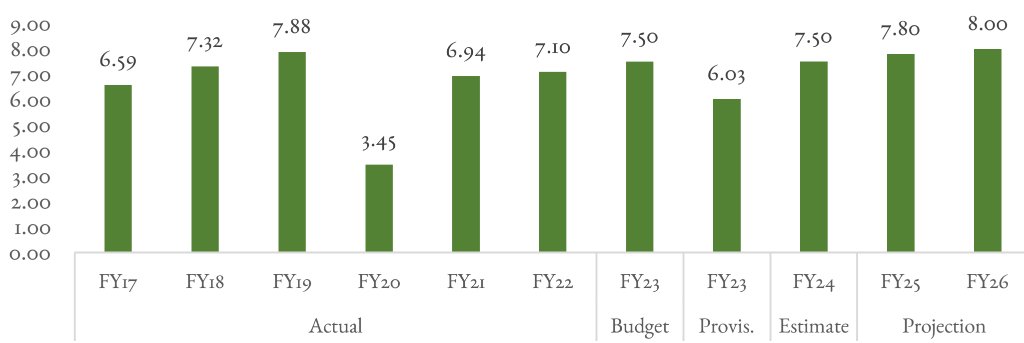
Table 3: GDP Growth by Sector

Sectors	FY18	FY19	FY20	FY21	FY22
Agriculture	3.54	3.26	3.42	3.17	3.05
Industry	10.20	11.63	3.61	10.29	9.86
Services	6.55	6.88	3.93	5.73	6.26

Source: Bangladesh Bureau of Statistics

2.6 BBS has estimated the provisional GDP growth rate for FY23 at 6.03. The Medium-Term Macroeconomic Framework (MTMF) estimates that this growth rate will gradually rise to 7.5 percent, 7.8 percent and 8.0 percent in FY 2023-24, FY 2024-25, and FY 2025-26 respectively.

Figure 10: GDP Growth (percent)



Source: Bangladesh Bureau of Statistics, Finance Division

2.7 Estimates show that agriculture, industry, and service sectors achieved 3.1 percent, 9.9 percent, and 6.3 percent growth respectively in FY 2021-22. This is quite satisfactory considering the global uncertainties prevailing in that period. According to the WEO, the world GDP will grow steadily in the coming years, which is expected to support the medium-term growth targets of Bangladesh. The special emphasis that the Government has put on developing physical infrastructure is expected to function as a critical catalyst for accelerating the economic growth of Bangladesh. Owing to relentless efforts and determination, the daunting task of building the Padma Bridge has been completed with whole financing coming from the government's coffer. This has tremendously boosted the confidence of the country to undertake and implement megaprojects on its own, if required. Several other megaprojects are also ongoing including the Dhaka mass rapid transit line-6 (Metro Rail), Chattogram-Cox's Bazar rail link, Rooppur nuclear power plant, Matarbari 1200MW coal-fired power plant, Bangabandhu Tunnel under the river Karnaphuli, and the Payra deep seaport that are expected to bring about a significant change in quality of the physical infrastructure of the country.

2.8 During 2020-2022 and in the aftermath of the outbreak of Covid-19, the world did not have much time to breathe as the Russia-Ukraine war broke out in February 2022. Because of the continued volatility in the global political and economic canvas, the IMF revised the growth projections and suggested more modest growth globally than what was previously anticipated. Bangladesh also braced for impacts on its economy. However, actual data shows that Bangladesh did impressively even during the height of the Covid-19 outbreak and is expected to return to pre-Covid growth trajectory by the end of FY 2023-24. If everything goes according to plans and assumptions hold, 8 percent of GDP growth rate is expected to be achieved in FY 2025-26. Therefore, the deviation of the actual from the planned growth envisaged in the 8^{th} FYP remained small.

Table 4: GDP Growth Rate (percent)

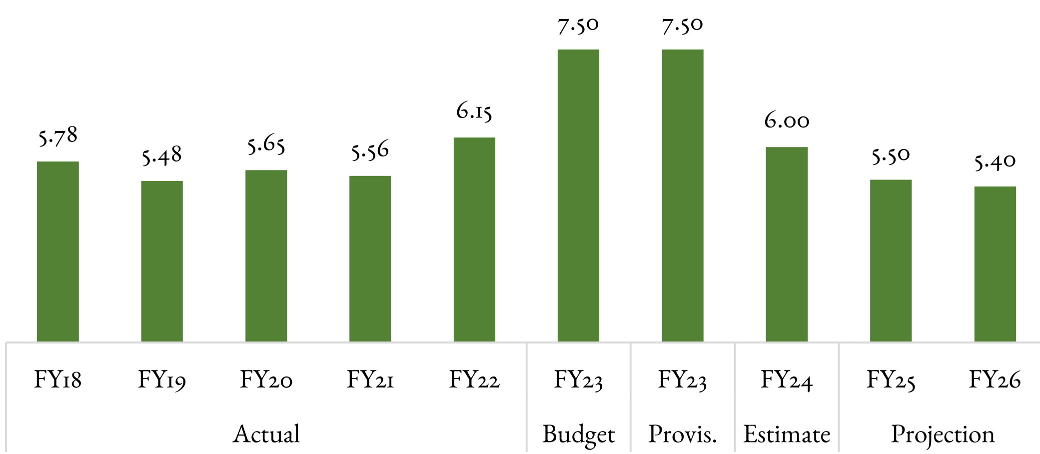
Fiscal Year	8FYP	Actual*/ Projection
FY21	7.4	6.94*
FY22	7.7	7.1*
FY23	8	6.03^P
FY24	8.3	7.5
FY25	8.5	7.8
FY26	-	8

Source: GED, FD, BBS, P=provisional.

2.9 Capital accumulation is key for development and hence the Government aims to foster private investment along with public investment. Total investment in FY 2021-22 stood at 32.0 percent of GDP in which contributions of the private and the public sectors were 24.5 and 7.5 percent, respectively. However, to achieve the long and medium-term growth targets, the level of investment will need to be increased further. There is room to increase the implementation rate of public investment and hence if the pace of implementation of the development projects can be increased, the required level of investment can be attained. Recognizing this, the government has taken steps to bring about some structural changes in both project design and implementation levels.

2.10 Russia-Ukraine war has put global energy supplies at risk. Russia is a major global supplier of energy and hence when the war broke out, commodity prices spiked fast. Bangladesh started to suffer from this like almost all other countries. By December 2022, point-to-point inflation rose to 8.7 percent and then further rose to 9.3 percent by March 2023. However, global commodity prices are already falling, and the central banks have raised policy rates and because of this it is expected that inflation will come down in the coming

Figure 11: 12-Month Average Inflation (percent)



Source: Bangladesh Bureau of Statistics, Finance Division

months. The IMF has also projected that the measures taken by the governments will help reduce inflation in the medium-term. The Finance Division (FD) has projected that average inflation in FY 2022-23 would be 7.5 percent and will reduce to 6.0 percent in FY 2023-24. To cool down inflation and to protect the income of the poor, the government has emphasized increasing the domestic supply of essential items and at the same time keeping the gradual monetary tightening on.

2.11 Food inflation hurts the poor the most. Keeping this in mind, the Government, through various measures, including subsidies and incentives, encouraged growth of the agricultural output. To support production in the agriculture sector, the disbursement of credit has also been increased. By the end of February 2023, the disbursement of agricultural credit and non-farm rural credit amounted to Tk. 210.66 billion, which is 13.66 percent higher than the amount disbursed in the previous year. Owing to supportive policies of the government, the general index of industrial production (medium and large-scale manufacturing) during July-December of FY 2022-23 increased by 8.47 percent (y-o-y) reflecting a slight expansion in industrial production.

Fiscal Sector

2.12 Bangladesh has consistently maintained an expansionary fiscal stance keeping a moderate budget deficit—usually around 5 percent of GDP—to foster economic growth, reduce poverty, and improve social outcomes. However, the tax-GDP ratio in Bangladesh is significantly lower than its peers and hence, the government has taken several initiatives to improve revenue collection. Yet, the fast pace of GDP growth has made it challenging to increase the ratio. The measures that have been undertaken are expected to gradually improve revenue collection by increasing both the tax volume and the number of taxpayers. Finance Division has estimated that total revenue will be 11.2 percent of GDP by the end of FY 2025-26.

2.13 The foremost objectives of the public expenditure policy are to stimulate private investment through building infrastructures and improving the business climate, creating employment opportunities, supporting low-income population through social safety net programs, and reducing poverty through ensuring efficient redistribution of wealth and thus ensuring inclusive development. With the advent of the Covid-19 outbreak, the government started to focus on saving lives while keeping the living standards from falling. To do this, the Government emphasized on retaining jobs, providing income support, keeping supply chains active, reviving the rural economy, and ensuring food supply. For this, the government increased spending and implemented comprehensive recovery programs consisting of twenty-eight stimulus packages. The stimulus efforts worked well and as a result the economy returned to a high growth trajectory fast while other countries continued to struggle. However, as previously mentioned, the Russia-Ukraine war has again posed considerable risks and to mitigate the risks the Government has been pursuing a policy to rationalize public expenditure to stimulate economic growth by inducing domestic productivity growth. While managing the economy to maximize welfare and development, the government is expected to maintain a budget deficit of around 5 percent of GDP over the medium term.

2.14 Historically, the size of public expenditure has been low relative to GDP in Bangladesh because of various limitations in the process of revenue collection and budget implementation. To improve the situation, the government has undertaken certain strategies to increase public expenditure. The target of increasing public expenditure has been set to around 16.2 percent of GDP in FY 2025-26. Moreover, the government is pursuing the Public Financial Management (PFM) reforms process to achieve this target. To improve overall public service delivery, financial control of budget allocations, real-time monitoring of budget execution, and integration of recurrent and capital spending, implementation of the PFM Action Plan (2018-23) is ongoing, and revised PFM Reform Action Plan (2024-2028) has recently been formulated. Under the PFM reforms, pension automation and E-challan automation systems have been introduced with the help of iBAS++ software. This system continues to play a significant role in simplifying the budget management process. At the same time, all beneficiary programs are being brought under Government to Person (G2P) payment system with the help of the iBAS++ software, which brings greater transparency in government expenditure management. In addition, all government allocations from government institutions as well as all semi-government, autonomous, and state-owned enterprises, are being brought under the Treasury Single Account (TSA) through the iBAS++ system in the medium term.

Monetary Sector

2.15 The main objectives of the government's monetary policy are to maintain price stability, achieve targeted economic growth, and create employment opportunities. To realize these goals, Bangladesh Bank (BB) designs the Monetary Policy in a way that aims to control the monetary variables in the best possible way. The BB programs the required limit of expansion of M2 based on the estimates of GDP growth, target CPI and changes in the income velocity of money. The monetary program is then broken down into weekly (and even daily) targets to facilitate regular monitoring of liquidity in the financial system through open market operations. However, the success of this strategy depends on the accuracy of output and inflation forecasts. While sophisticated models have been around estimating the role of money stock in predicting future GDP developments, the transmission mechanism between money supply and prices remains tenuous in developing economies.

2.16 Direct control of liquidity on a day-to-day basis is achieved via the repo, reverse-repo, and weekly auctions, which would, in turn, impact the inter-bank call money rate for overnight transactions. Among other monetary policy tools, the Bangladesh Bank monitors the cash reserve requirement (CRR) and the statutory liquidity ratio (SLR), which also affords control over the rate of monetary growth and serves the prudential requirements. Several preconditions must be met to effectively implement a monetary targeting policy framework, including a stable demand for money, adequate monetary data, financial market development, effective monetary policy transmission mechanism, and macroeconomic stability. In the medium term, these will be prioritized in the government's monetary policy.

2.17 Bangladesh has been following a monetary targeting framework for several years, where the central bank sets a target for the growth rate of the money supply and adjusts its policy instruments to achieve that target. However, from July 2023, Bangladesh Bank has planned to modernize its monetary policy framework and shift from monetary targeting to inflation targeting system. One of the main reasons for this is that the monetary targeting framework has become less effective in recent years due to the changing structure of the economy and financial system. The demand for money has become less stable, and changes in the money supply have had a less predictable impact on economic activity. Therefore, it has become more difficult for Bangladesh Bank to use the monetary targeting framework to achieve its policy objectives. Inflation targeting, on the other hand, allows the central bank to focus on the interest rate as the main policy instrument for managing monetary policy objectives. Under this framework, the central bank sets a target for a short-term interest rate, such as the overnight interbank rate, and adjusts its policy instruments, such as open market operations, to achieve that target. Another reason for the shift is that it is a more transparent and predictable framework that can enhance communication with market participants and the public. By setting a clear inflation target, Bangladesh Bank can provide a clear signal of its policy stance, which can improve the effectiveness of its policy actions and increase market confidence. Overall, the shift from monetary targeting to inflation targeting is a significant step for Bangladesh Bank in modernizing its monetary policy framework and aligning it with international best practices.

2.18 In the revised budget of FY 2022-23, Bangladesh Bank has set the target for broad money (M2) and domestic credit growth to 11.5 percent and 18.5 percent, respectively, for the projected CPI inflation rate of 7.5 percent. According to the latest data available as on May 11, 2023, broad money (M2) recorded 9.03 percent point-to-point growth and domestic credit recorded an increase of 16.21 percent at the end of March 2023. Growth-friendly monetary policy is designed to support micro, small, and medium-sized enterprises (MSMEs) in the manufacturing, agriculture, and service sectors to create jobs.

2.19 Interest rates on both deposits (weighted average) and advances (weighted average) in banks and financial institutions have been increasing slowly over the current fiscal year. The spread between the weighted average interest rate (WAIR) on advances and deposits of all banks and NBFIs inched up to 2.96 percent and 1.15 percent, respectively, in February of FY23 from the previous month. The WAIR on deposits of all banks inched up to 4.31 percent while that of NBFIs to 7.72 percent in February of FY23 compared to the previous month.

External Sector

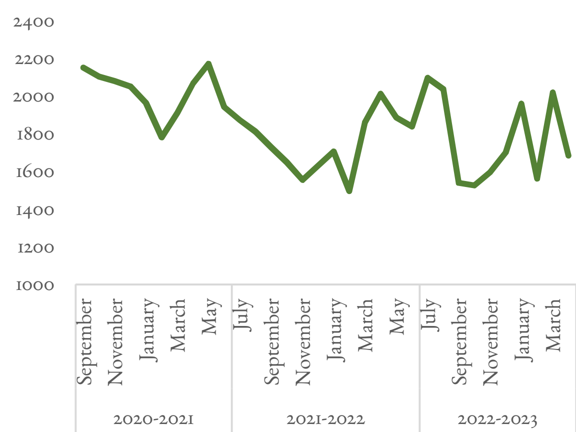
2.20 According to UNCTAD (March 2023), Global trade reached more than USD 32 trillion in 2022, but growth turned negative during the last quarter of 2022. Developing countries' trade was particularly weak during the fourth quarter of 2022, with East Asia and Latin America under-performing. UNCTAD nowcasts suggest continuing trade stagnation for the first quarter of 2023, but the outlook is more positive for the second half of the year.

2.21 After the Covid-19 situation started to subside in early 2022, there was a surge in imports of Bangladesh, because of which the country is now facing pressure on the balance of payments (BOP) and the exchange rate. To address the issue, Bangladesh Bank has started policy interventions such as allowing Bangladesh Taka (BDT) to depreciate gradually, discouraging imports of luxury and non-essential commodities, monitoring the price of imports, supporting import substituting sectors, allowing the mobile financial services to facilitate remittance inflow etc.

2.22 It appears that the recent policy interventions have slowed import growth without sacrificing export growth. Exports increased by 8.07 percent during July-March of FY 2022-23, which was 33.41 percent during July-March of FY 2021-22. Despite global economic turmoil and uncertainty, exports from Bangladesh to North American and European markets have increased in the current fiscal year. It has been observed that exports of woven garments (12.63 percent), knitwear (11.78 percent), leather and leather products (2.56 percent), plastic products (34.07 percent), and miscellaneous products (12.12 percent) have increased significantly during the July-March period of FY 2022-23. However, exports of raw jute and jute products fell by 21.23 percent, engineering products fell by 33.65 percent, and agricultural products fell by 28.31 percent over the same period. Overall import by Bangladesh in FY 2022-23 is showing negative growth after a massive growth of 35.93 percent in FY 2021-22. Up to February of FY 2022-23, imports have reduced by 10.31 percent over the same period of the previous fiscal year.

2.23 Foreign remittances have been playing a significant role in augmenting GDP growth through stimulating domestic demands. Side by side, foreign remittances tend to increase the living standard and savings at the micro-level. To boost remittance, the government is continuously taking measures such as providing cash incentives of 2.5 percent for inward remittances, simplification of related rules and regulations, reducing the administrative cost of sending remittances, exploring new markets for manpower export etc. As of April 2023, the amount of inward remittance stood at USD 17.72 billion, which is 2.34 percent higher than that of the same period in the previous fiscal year.

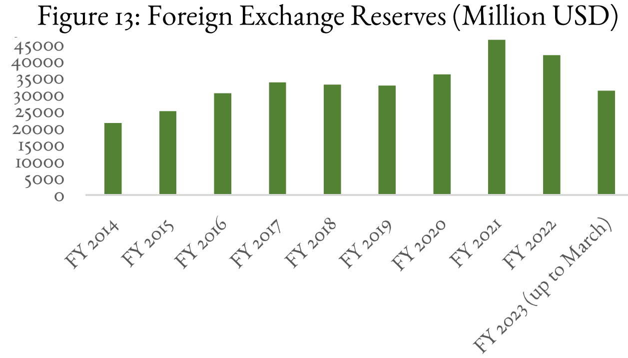
Figure 12: Inflow of Remittance (Million USD)



Source: Bangladesh Bank

2.24 Due to the negative growth of imports in FY 2022-23, the current account balance improved significantly. For the July-March period in FY 2022-23, the current account balance stood at USD -3.75 billion, which was USD -14.35 billion in the same period of FY 2021-22. However, at the same time, financial accounts stood at USD -1.97 billion, which was USD 11.93 billion in the same

Figure 13: Foreign Exchange Reserves (Million USD)



Source: Bangladesh Bank

period of the previous fiscal year. The overall balance, at the end of March 2023, stood at USD -7.95 billion which was USD -3.09 billion at the same time of the previous year. Although the current account balance improved significantly, because of the deficits in the financial account, the gross foreign exchange reserve showed a downward trend in FY 2022-23. As of 10 March 2023, foreign exchange reserves stood at USD 31.14 billion, which was USD 44.95 billion on the same date in the previous fiscal year.

2.25 To maintain stability in the balance of payments (BOP), Bangladesh Bank increased margin requirements, which necessitated higher upfront payments to reduce foreign exchange outflows. Additionally, pre-authorization of Letters of Credit (L.C.s) over USD 3 million has been introduced to check trade-based money laundering. Furthermore, the government deferred or restricted public procurement of vehicles, ships, and aircraft and postponed public investment projects. However, these steps caused disruptions on the supply side. At the same time, several measures have been implemented to boost foreign exchange inflows. The ceiling on fund transfers for remittances through Internet banking has been lifted, and the interest rate ceiling on non-resident foreign currency deposits has been removed. Additionally, the requirement to demonstrate the source of income for remittances exceeding USD 5000 has been eliminated.

2.26 The Finance Division has estimated that in the medium term, the BOP situation will improve further, and the current account balance would return to a positive quadrant by the end of FY 2025-26. By that time, exports are expected to reach USD 78 billion and impots USD 101 billion. Gross foreign exchange reserves are expected to reach USD 48 billion.

Addressing Emerging Macroeconomic Challenges

2.27 It has been more than a year since the Russia-Ukraine conflict began. Still there is hardly any sign that the conflict will subside soon. In the advent of the conflict, global key commodity prices spiked causing inflation to soar worldwide. However, when the central banks raised interest rates and commodity prices in the global market started to fall, inflation also started to decline. This trend has been a source of some relief, but not a confirmed statement that the medium-term outlook is stable. The fighting in Ukraine is expected to get intense during the next few months and if it turns out to be a greater conflict involving other countries, the world economy will most likely enter an unprecedented perilous phase.

2.28 Bangladesh is already tackling pressure emanating from the BOP situation. The measures that are being undertaken to improve the situation will be key and hence will need to be implemented carefully. If the current negative growth of imports continues and export growth remains stable, the BOP problem will eventually fade away. To expedite the recovery phase, inward remittance, and disbursement of foreign loans against projects and budget support will also need to be facilitated.

2.29 Inflation has recently started to subside. According to the IMF, inflation in the advanced economies will fall to 2.6 percent by the end of 2024. However, IMF has also projected that growth in emerging and developing countries will remain strong and so will inflation. Inflation in emerging and developing countries will remain at around 7 percent by the end of 2024. It is likely that taming inflation in Bangladesh will be challenging as well. As of end-April 2023, point-to-point inflation in Bangladesh stood at 9.24 percent, which is quite high.

2.30 As inflation is eroding purchasing power, the government will need to strengthen mechanisms to protect the vulnerable population. In the budget of FY 2022-23, the government allocated Tk. 814.9 billion for subsidies and incentives. However, due to the price hike of fuel and fertilizer in the international market, expenditure on subsidy/ incentives soared and accordingly the revised budget estimates for subsidy/ incentives increased to Tk. 991.5 billion (2.22 percent of GDP). Although the amount of allocation for subsidies and incentives is expected to increase further in the next fiscal year, the government will aim to rationalize fuel and other prices to reduce the burden of subsidies. Hence, in the medium-term the allocation of subsidies and incentives is expected to fall.

2.31 So far, Bangladesh has enjoyed various benefits of being a least developed country (LDC). The country has already fulfilled all criteria to graduate from the LDC group and in 2026 will graduate officially. It is anticipated that after graduation, various benefits related to market access and low-cost financing options will gradually erode. To cope with the changes, Bangladesh will need to drastically strengthen its research and development (R&D), create an environment for high-quality and high-value-added manufacturing, and improve business climate.

2.32 Bangladesh is currently implementing the 2nd perspective plan that aims to make Bangladesh a developed country by 2041, with a per capita income of over USD 12,500 in today's prices, fully in tune with the digital world, and making poverty a thing of the past.

There are many challenges on the way to implementing this ambitious plan such as raising the tax-GDP ratio to around 20 percent of GDP. The recent sharp depreciation of the BDT-USD exchange rate has corrected the past real appreciation of the Taka; however, containing the real appreciation consistently till 2041 will be a challenge.

Key Assumptions for the Next Fiscal Year (FY 2023-24)

2.33 A full-blown war between Russia and the West would be nearly an extinction-level event and hence rationally it should not reach up to that point. In this consideration, it has been assumed that although the situation in Ukraine may remain volatile for years, the situation may not escalate to an extreme level or even negotiations may take place to restore peace.

2.34 Immediately after the Russia-Ukraine war broke out, global commodity prices increased. However, prices started to fall as the grain export deal was agreed among the concerned parties. Exports of natural gas and oil have also been reported to continue albeit sanctions on Russia. It has been assumed that unless the war reaches an extreme level, energy, fertilizer, and grain prices will remain stable.

2.35 To combat inflation, central banks around the world raised interest rates significantly. The effective federal fund rate and secured overnight financing rate both reached above 5 percent by 10 May 2023. It has been assumed that the interest rate hike has peaked and in the medium-term will gradually come down.

2.36 Domestic production of crops and other agricultural items grew significantly over the last decade. People are now actively using unused arable land to increase agricultural production further. Moreover, there is no visible indication that because of climate change the amount of rainfall will reduce or the number of natural disasters will increase in the medium-term. Therefore, it has been assumed that food security may not be a very challenging issue in the medium-term.

2.37 Price of fuel and fertilizer are gradually coming down in the international market. This will help to reduce inflation in the domestic market. However, recently because of pressure on the BOP, Taka has significantly depreciated against the US dollar. This has added fuel to the soaring inflation. Mitigating policies adopted by the government has indicated that the BOP situation will improve in the future and hence the exchange rate will also stabilize. Therefore, it has been assumed that inflation, in the medium term, will fall.

2.38 The tax-GDP ratio of Bangladesh is one of the lowest in the world and hence it has sufficient room to improve. Already the National Board of Revenue (NBR) has taken several steps including automation of the tax collection process and increasing manpower to increase the tax base. Therefore, it has been assumed that these steps will increase tax revenue.

2.39 As the per capita income continues to grow more people will graduate from the low-income to middle-income group. This will boost domestic consumption and hence will have a positive impact on GDP growth. Gross investment will also grow and will affect GDP growth rate positively.

2.40 Bangladesh is currently a top apparel exporter in the world. However, the export basket of the country is highly concentrated. Policymakers are now actively exploring options to widen the export basket as well as to expand the base of destination markets. It has been assumed that in the medium-term exports will continue to grow following usual trends.

2.41 Bangladesh's debt stock is at a very comfortable level. The country actively follows a path of sustainable deficit budget and hence it has been assumed that there will be no debt distress in the medium-term.

Budget vs. Actual Outcome for FY 2021-22

2.42 Looking at the deviation of actual outcome from planned outlay is useful for future policy formulations. In these considerations, for the first time, it has been decided that this section would be included in the MTMPS. Actual fiscal data is available for FY 2021-22 and hence that year has been chosen for this purpose. In the next volumes of the MTMPS, this analysis will cover a wider range of years.

2.43 In FY 2021-22, the actual total revenue was 13.87 percent less than the target. The principal reason for this was that the NBR tax was 11.25 percent less than the target. In the previous year, i.e., FY 2020-21, the NBR tax increased by 20 percent. Therefore, this might be an indication that there is considerable volatility in the NBR tax receipts.

2.44 Total expenditure for that year was also 14.16 percent less than what was planned in the budget. The Government, during that year, was recovering from the Covid-19 shocks and took numerous austerity measures to keep unnecessary spending under control. As a result, the current expenditure was 6.42 percent less than the target. However, although overall current expenditure was less than the target, domestic interest payments went up by 18.09 percent as the Government was relying more on the banking system for financing the budget deficit. The Annual Development Program (ADP) was also affected by the measures of the government and was 17.43 percent less than the target.

2.45 As for financing the budget deficit, there was a major deviation in the net external financing as disbursements of foreign loans were reduced. As a result, net external financing was 33.47 percent less than the target. On the other hand, domestic financing was 1.55 percent more than the target. It may be noted that in that year the government took various measures including mandatory submission of national ID and TIN certificates for purchasing NSCs and at the same time reduced the interest rate of the instruments. Because of these stringent measures, financing from the sales of national savings certificates (NSC) was 36.67 percent less than the target. ■

Table 5: Medium Term Macroeconomic Framework (2023-24 to 2025-26)

Indicators	FY22	FY23	FY23*	FY23	FY24	FY25	FY26
	Actual	Budget	CC	Revised	Estimate	Projection	
GDP growth (%)	7.1	7.5	6.5	6.03**	7.5	7.8	8.0
CPI inflation (%)	6.15	5.6	7.5	7.5	6.0	5.5	5.4
Gross Investment (as % of GDP)	32.0	31.5	30.0	27.8	33.8	35.1	36.0
Private Investment (as % of GDP)	24.5	24.8	24.1	21.8	27.4	28.8	29.4
Public Investment (as % of GDP)	7.5	6.7	5.9	6.0	6.3	6.3	6.6
Revenue (as % of GDP)	8.4	9.7	9.7	9.8	10.0	10.4	11.2
NBR Revenue (as % of GDP)	7.4	8.3	8.3	8.3	8.6	9.1	9.7
Non-NBR Revenue (as % of GDP)	0.2	0.4	0.4	0.4	0.4	0.4	0.5
NTR (as % of GDP)	0.9	1.0	1.0	1.0	1.0	0.9	1.0
Expenditure (as % of GDP)	13.0	15.2	14.8	14.9	15.2	15.4	16.2
of which, ADP	4.7	5.5	5.1	5.1	5.3	5.5	5.9
Budget Deficit (as % of GDP)	-4.6	-5.5	-5.1	-5.1	-5.2	-5.0	-5.0
Domestic Financing (as % of GDP)	2.9	3.3	3.1	3.2	3.1	3.0	2.9
of which, Bank	1.9	2.4	2.6	2.6	2.6	2.5	2.4
Net Foreign Financing (as % of GDP)	1.7	2.2	1.9	2.0	2.1	2.1	2.1
Private Sector Credit (growth. in %)	13.7	15.0	14.1	14.1	15.0	16.0	16.0
Export (growth in %)	33.4	20.0	10.0	10.0	12.0	14.0	14.0
Import (growth in %)	35.9	12.0	-9.0	-9.0	8.0	12.0	12.0
Remittances (growth in %)	-15.1	16.0	4.0	4.0	10.0	13.0	13.0
Current Account Balance (% of GDP)	-4.06	-3.50	-1.52	-1.48	-0.93	-0.62	0.06
Foreign Exchange Reserve (bn. USD)	42.7	45.3	34.3	34.6	35.8	41.1	48.9
Nominal GDP (Crore Taka)	3971716	4449959	4468566	4439273	5006782	5629691	6341391
Nominal GDP (bn. USD)	460.2	468.4	442.4	453.9	481.4	538.5	603.9

* *Provisional estimate by BBS published in May 2023
* Estimates approved by the Coordination Council (CC) in April 2023

Source: Finance Division, BBS

3 Revenue Outlook and Mobilization Strategy

3.1 Revenue mobilization acts as a catalyst to achieve the development outcomes of a country. Bangladesh has envisioned its long-term development trajectory to be a higher middle-income country in 2031 and to be a developed country in 2041. In addition to these aspirations, the 'Perspective Plan of Bangladesh 2021-2041' has targeted to raise the revenue-GDP ratio to 19.55 percent by 2031 and to reach 24 percent by 2041. The spectacular growth Bangladesh registered in the last decades, however, has not been underpinned by concomitant revenue growth. A large share of the revenue comes from the direct (income tax) and indirect taxes (VAT and customs) collected by the National Board of Revenue (NBR). Non-NBR taxes and Non-Tax Revenue (NTR) consists of smaller parts. Although there has been some progress over the years to be less reliant on trade taxes and the share of direct taxes has also increased to some extent, there is still ample room to improve. This chapter will analyze the recent revenue collection trends, composition, and performance in the last year, and focus on different initiatives underway to enhance both tax and non-tax revenue collection in the medium term.

3.2 There is a need to identify the reasons for low revenue collection to move onto the essential next step to correct the course. It is important to understand various issues such as the economic structure (large informality and exemptions), structural weaknesses (complicated processes and information asymmetry), and cultural factors (apathy towards paying taxes) that contribute to significant underperformance in revenue collection. The government, with the support of private sector operators, is keen to make paying taxes easy, tax rules easy to understand and rationalize tax exemptions. Success in revenue collection will be strengthened by making the tax administration easy to approach, increasing digitalization to bring in transparency and predictability and bringing in progressivity in taxation where rich people pay a higher part of the taxes.

Tax Collection Trends and Costs: Country Comparison

3.3 A comparative analysis of tax to GDP ratio in some Asian countries suggests that Bangladesh has some catching up to do. While looking at such comparison, several issues need to be considered in country contexts such as what constitutes a tax, how taxes are defined and the verities of taxes that are collected.

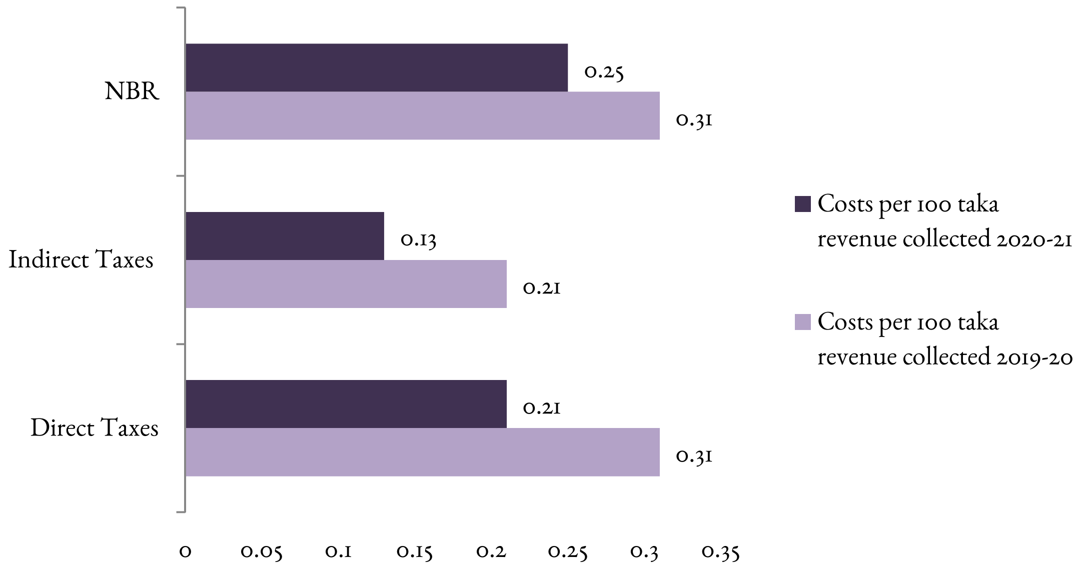
Table 6: Tax to GDP Ratio across Asian Countries, 2000-2022

Country	2000	2005	2010	2015	2020	2021	2022
Bangladesh	4.92	6.14	6.54	7.08	7.00	7.64	7.77
India	14.08	15.66	16.11	16.72	16.13	17.09	16.98
Lao P.D.R.	10.57	9.27	12.64	13.92	9.40	10.25	10.62
Indonesia	8.08	12.37	11.23	11.96	9.52	10.32	11.59
Philippines	13.26	12.77	12.39	13.90	15.01	15.12	15.61
Vietnam	12.98	16.52	17.63	14.57	13.12	13.92	14.03
Thailand	14.70	17.90	16.37	17.72	15.66	15.74	15.57

Source: World Economic Outlook, April 2023, IMF

3.4 Low costs of tax collection in Bangladesh have provided the scope for further investment in revamping revenue administration. Although Bangladesh has much potential in increasing tax to GDP ratio, the corresponding costs of tax collection by the National Board of Revenue is only 25 paisa per 100-taka revenue raised during the FY 2020-2021 which was 31 paisa in the previous fiscal year. A further breakdown reveals that in FY 2020-21, the cost was 21 paisa in direct taxes and 13 paisa in indirect taxes.

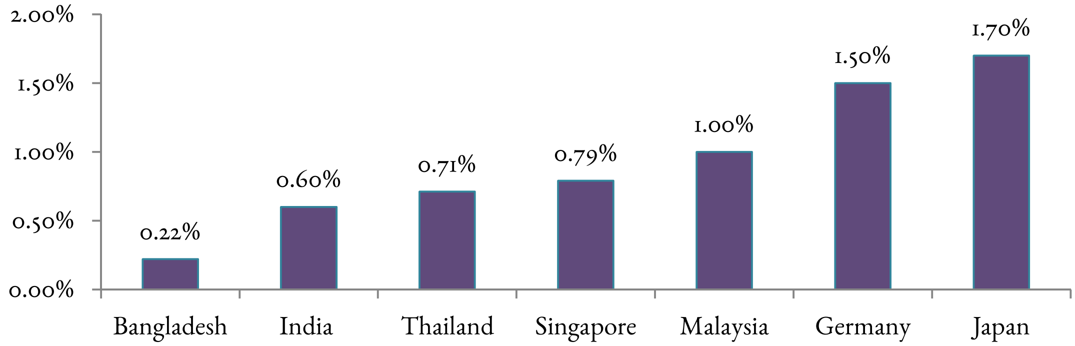
Figure 14: Costs of Tax Collection in NBR



Source: Research & Statistics Wing, NBR

3.5 A comparison of the amount of money spent in some developing and developed countries to raise 100-taka tax shows that Bangladesh spends much less than other countries. Bangladesh ranks at the bottom both in terms of low tax-GDP ratio and in associated tax collection costs. Such a comparison highlights the need for investing in the digital transformation of revenue authority to expand the tax net and improve efficiency.

Figure 15: Cross Country Comparison of Costs per 100-taka Tax Raised



Source: data collected from presentation made in the Revenue Conference of NBR in 2023

Revenue Earning by Sources

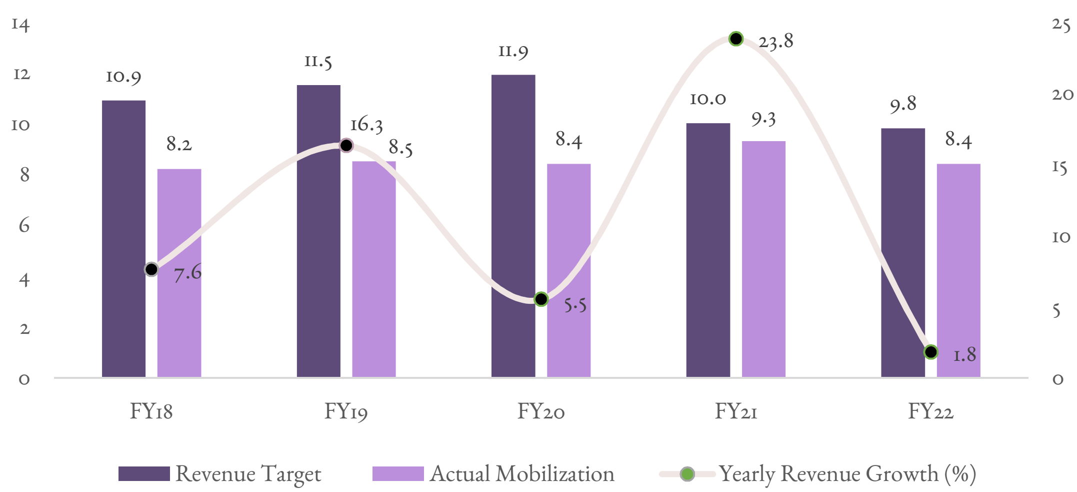
3.6 Growth of revenue collection dipped in FY 2019-20 primarily due to the Covid-19 pandemic and increased again in FY 2020-21. After a 23.8 growth in FY 2020-21, revenue grew at a modest rate of 1.8 percent last year. To meet the development goals set for 2031 and 2041, revenue collection needs to be increased significantly. A closer scrutiny of the composition of total revenue collected will shed light on the tax sources that need more attention.

Table 7: Revenue Collection Performance FY18-FY22 (Billion Taka)

Year	FY18	FY19	FY20	FY21	FY22
Revenue Target	2879.9 (10.9)	3392.9 (11.5)	3778.1 (11.9)	3515.3 (10.0)	3890 (9.8)
Actual Mobilization	2165.6 (8.2) {7.6}	2518.8 (8.5) {16.3}	2658 (8.4) {5.5}	3289.8 (9.3) {23.8}	3350.6 (8.4) {1.8}

Source: Finance Division; Figure in ( ) indicates percent of GDP, { } indicates yearly growth (percent)

Figure 16: Revenue Mobilization Scenario (percent of GDP)



Source: Finance Division

3.7 NBR taxes and Non-Tax Revenue (NTR) are the two major sources of revenue in Bangladesh. The NBR collected 87.4 percent of the total revenue of the Bangladesh government in FY 2021-22. During FY 2019-20 and FY 2020-21 the share of NTR jumped from 10.3 percent to 16.5 percent and 18 percent respectively, which caused the share of NBR taxes in total revenue to decline in those years. The government also collected idle funds from state-owned enterprises and channeled those to the Treasury Single Account (TSA) which resulted in a significant increase in NTR collection during FY 2019-20 and FY 2020-21. The share of non-NBR taxes has remained at around 2.0 percent in the last couple of years. Non-NBR taxes include motor vehicle tax, land development tax, narcotics and liquor duty, non-judicial stamps, surcharge etc. Alongside bringing in reforms and efficiency in revenue administration, NTR may also be thought of as a potential revenue source for augmenting revenue collection. For that, it may be necessary to rationalize the different fees and charges, many of which have not been updated in many years. The government is committed to providing essential services at affordable rates, but the fees also need to be set at realistic levels.

Table 8: Main Sources of Revenue (Billion Taka)

Revenue Sources	Fiscal Year				
	FY18	FY19	FY20	FY21	FY22
(a) Tax Revenue (a1+a2)	1943.3	2259.6	2218.7	2697.9	2995.9
	(89.7)	(89.7)	(83.5)	(82.0)	(89.4)
	{7.4}	{7.7}	{7.0}	{7.6}	{7.5}
(a1) NBR Taxes	1871	2186.2	2159.3	2637.3	2928.8
	(86.4)	(86.8)	(81.2)	(80.2)	(87.4)
(a2) Non-NBR Taxes	72.2	73.4	59.4	60.6	67
	(3.3)	(2.9)	(2.2)	(1.84)	(2.0)
(b) Non-Tax Revenue (NTR)	222.3	259.2	439.3	591.9	354.7
	(10.3)	(10.3)	(16.5)	(18)	(10.6)
Total revenue (a+b)	2165.6	2518.8	2658	3289.8	3350.6

Source: Finance Division; Figure in ( ) indicates percent of total revenue, { } indicates percent of GDP;

NBR Tax Revenue

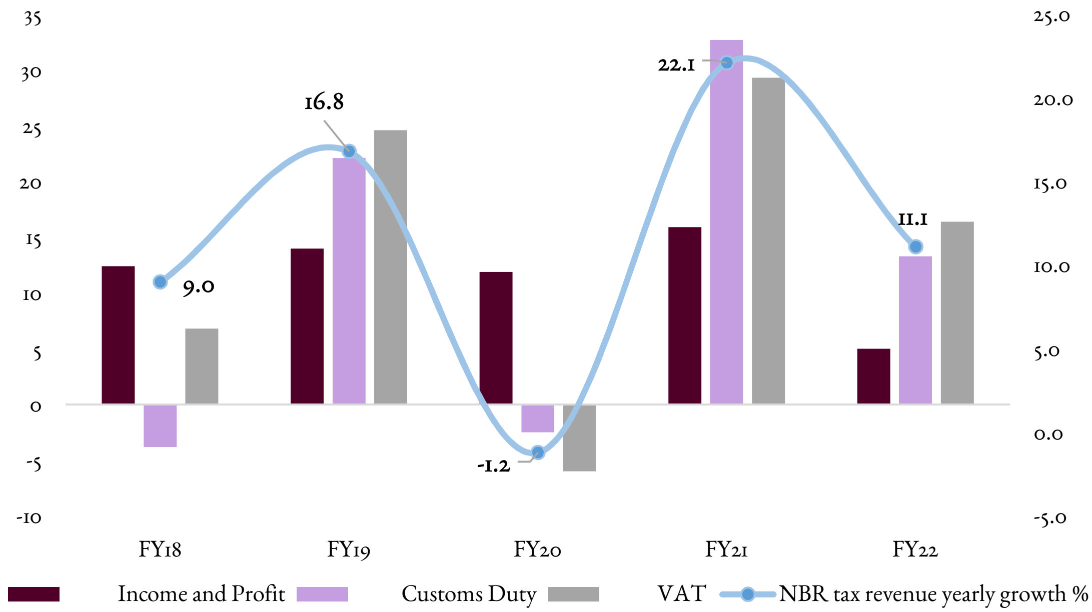
3.8 Income tax, VAT and customs duty are the three major sources of revenue in the NBR tax sources. The average revenue growth in NBR taxes has been 11.6 percent in the last five years. It dipped to −1.2 percent during FY 2019-20 and picked up at 22.1 percent in FY 2020-21. Income tax growth has slowed down from 15.9 percent in FY 2020-21 to 10.1 percent in FY 2021-22, so has VAT from 29.3 percent to 16.4 percent in the same period. The growth of customs revenue has also come down to 8.8 percent last year from a high of 32.7 percent in FY21. In FY 2021-22, VAT & supplementary duty and income tax covered 54.0 percent and 32.8 percent of total NBR taxes, respectively. In the future, income tax and value added tax will continue to be the major sources of revenue.

Table 9: Sources of NBR Tax Revenue (Billion Taka)

Source	FY18	FY19	FY20	FY21	FY22
Income and Profit	590.3	672.9	753.3	873.4	961.2
	(31.6)	(30.8)	(35.1)	(33.1)	(32.8)
	{12.4}	{14.0}	{11.9}	{15.9}	{10.1}
Customs Duty	199.9	244	238	315.9	343.7
	(10.7)	(11.2)	(11.1)	(12.0)	(11.7)
	{-3.8}	{22.1}	{-2.5}	{32.7}	{8.8}
VAT & Supplementary Duty	1047.3	1234.4	1124.4	1419.3	1581.8
	(36.5)	(38.9)	(37.2)	(39.2)	(54.0)
	{6.8}	{24.6}	{-6.00}	{29.3}	{11.4}
Other Taxes	33.6	34.9	32.4	31.2	42

Source: Finance Division; Figure in ( ) indicates percent of NBR tax revenue, { } indicates yearly growth (percent)

Figure 17: NBR Revenue Growth (percent) and Composition



Non-Tax Revenue Composition

3.9 Major heads under Non-Tax Revenue are dividends and profits, interest income, administrative fees, fines, penalties & forfeiture, service fees, tolls, and other receipts. The government has taken the initiative to prepare an online database of all NTR rates and charges. The creation of the database will assist in analyzing the current rates and more importantly in rationalizing the rates. In many instances it has been seen that these rates and service charges have not been increased although several decades have passed. Dividend and profits from state-owned enterprises (SOE) have seen a robust growth of 163 percent in FY 2021-22. The services fee also experienced a growth of 41.6 percent last year. Except for the unusual two years in FY 2019-20 and FY 2020-21 when the share of NTRs jumped due to the channeling of idle funds of the SOEs to the government exchequer NTR's share has remained around 10 percent in total revenue collection. There is, however, much scope and potential in raising NTRs as a major revenue source for the government in the future.

Table 10: Composition of Non-Tax Revenue (Billion Taka)

	FY18	FY19	FY20	FY21	FY22
Dividend & Profits	19.5	26.5	34.7	19.09	50.19
	(-39.8)	(36.4)	(30.8)	(-45.0)	(163)
Administrative fees	25.7	28	23.8	20.4	26
	(-33.9)	(8.8)	(-15.0)	(-14.3)	(27.5)
Interests	19.9	15.1	19.1	80.7	19.5
Fines, Penalties and Forfeitures	6	6.9	6	8.9	12.3
Services fee	35.5	39.6	29.7	32.7	46.3
	(508.2)	(11.8)	(-25.0)	(10.0)	(41.6)
Tolls and levies	6.1	6.8	6.8	7.9	12.6
Non-commercial sales	17.4	9	17.4	18.7	32.3
Capital Revenue	7	2.6	1.8	2.5	3
Other receipts (other than tax)	158.9	79.4	294.3	390.2	151.6
Total Non-Tax Revenue (NTR)	222.3	259.2	439.3	591.9	361.76
	(-4.0)	(16.6)	(63.8)	(34.7)	(-38.9)

Source: Finance Division; Figure in () indicates yearly growth (percent);

Revenue Collection in FY 2022-23 (up to February 2023)

3.10 In FY 2022-23 (up to February 2023) total revenue raised is Taka 2.36 trillion (54.5 percent of the revised budget target for FY 2022-23) which amounts to 1.5 percent growth during the first eight months of the current fiscal year. Higher growth has been observed in income tax at 10.3 percent and in non-NBR tax at 22.5 percent. Although other NBR taxes saw the highest growth at 32.8 percent they comprise a very small fraction of total revenue collection. There is growth in VAT collection as well, but as supplementary duty collected at the import stage took a dip this year the combined figure did not show any growth.

Because of the pressure on the BOP, the government had to take steps to discourage import of non-essential and luxury items and as a result customs revenue generated lower revenue.

Table 11: Revenue Performance in FY2022-23 (Billion Taka)

Items	2022-23		2022-23 (Jul- Feb)		2021-22 (Jul- Feb)	Growth in eight months
	Target	Revised Target	Actual	percent of Target	Actual	(percent)
Total Revenue	4330	4330	2359	54.5	2324	1.5
Tax Revenue	3880	3880	2109	54.4	2103	0.3
a) NBR Tax	3700	3700	2056	55.6	2063	-0.3
Income tax	1221	1221	620	50.8	562	10.3
VAT & supplementary duties	1986.9	1987	1128	56.7	1154	-2.3
Customs duties	440	440	266	60.5	315	-15.6
Other Taxes	52	52	43	81.6	32	32.8
b) Non-NBR Tax	180	180	49	27.2	40	22.5
Non-Tax Revenue (NTR)	450	450	250	55.6	221	13

Source: iBAS++, Finance Division

3.11 The revenue growth has slowed down in the post-pandemic period. As has been seen in the past years, revenue collection picks up in the last quarter of the year. Hence, it is expected that revenue collection will increase in the remainder period of FY 2022-23 and will closely match the target set for this year. However, significant measures need to be taken in revenue administration and collection of NTR by rolling out further digitalization, process improvement to simplify tax payment, interagency cooperation, and rationalizing tax exemptions etc.

Medium-Term Revenue Outlook

Revenue expectations in the medium term

3.12 It is important for the Bangladesh government to estimate how much revenue it can raise in the medium term to finance the planned expenditures. If revenue expectations are unknown, it is not possible to set a realistic budget deficit target. The ability to forecast revenue accurately is crucial to the budget cycle and the management of public finances efficiently. Producing reliable forecasts needs technical skills, sound institutional set up as well as the appreciation and understanding of the complex interrelations between tax revenue and macroeconomic fundamentals.

3.13 Availability of reliable data is very important for correctly estimating revenue forecasts. In many cases proxies are used, such as household income, size of imports, household consumption and GDP, to calculate tax estimates. Elasticity-based models such as tax buoyancy and tax elasticity are often used for forecasting purposes. Skilled human resources, expertise in multidisciplinary fields such as revenue administration, accounting, company laws, research/ academia and an interdisciplinary approach are prerequisites of a good revenue forecasting team.

3.14 Bangladesh government aims to raise 5,000 billion Taka in revenue in FY 2023-24. The revenue administration aims to raise this amount by increasing digitalization and making tax payment simple for companies and citizens. The focus will be on direct taxes and VAT to raise more revenue. In addition to expanding the tax net and increasing the capacity of tax officials' exercises will be carried out to rationalize the current culture of widespread tax exemptions and to bring in heightened transparency in the budgetary discourse.

3.15 The revenue outturns estimated for FY2024 and projected for the next two years show high elasticity and buoyancy implying robustness in revenue mobilization in the medium term. Among the tax and non-tax parts of the revenue, the tax revenue is forecasted to be more buoyant and elastic than the non-tax part. The elasticity data show that the overall revenue is projected to grow 1.65 times higher than the nominal GDP in FY 2025-26. On the other hand, the buoyancy indicates that, in FY 2025-26 the tax revenue in real terms may grow 98 percent higher than the growth of real GDP.

Table 12: Revenue Projection in the Medium Term (Billion Taka)

Items	FY22	FY23	FY23	FY24	FY25	FY26
	Actual	Budget	Revised Budget	Projection		
Total Revenue	3378	4330	4330	5000	5872	7097
		(28.2)	*(28.2)*	*(15.5)*	*(17.4)*	*(20.9)*
Tax Revenue	3015	3880	3880	4500	5343	6462
		(28.7)	*(28.7)*	*(16.0)*	*(18.7)*	*(21.0)*
NBR Tax	2948	3700	3700	4300	5095	6170
		(25.5)	*(25.5)*	*(16.2)*	*(18.5)*	*(21.1)*
Income Tax	1014	1273	1273	1480	1753	2123
		(25.5)	*(25.5)*	*(16.2)*	*(18.5)*	*(21.1)*
Customs	874	1097	1097	1275	1511	1830
		(25.5)	*(25.5)*	*(16.2)*	*(18.5)*	*(21.1)*
VAT	1060	1330	1330	1545	1831	2218
		(25.5)	*(25.5)*	*(16.2)*	*(18.5)*	*(21.1)*
Non-NBR Tax	67	180	180	200	248	292
		(168.7)	*(168.7)*	*(11.1)*	*(24.0)*	*(17.7)*
Non-Tax Revenue	363	450	450	500	529	634
		(24.0)	*(24.0)*	*(11.1)*	*(5.8)*	*(19.8)*

Source: Finance Division; Figure in () indicates yearly growth (percent)

Table 13: Revenue Elasticity and Buoyancy

	FY23	FY24	FY25	FY26
Elasticity				
Revenue elasticity of GDP	0.90	1.28	1.40	1.65
Tax Revenue elasticity of GDP	0.97	1.33	1.50	1.66
Non-Tax Revenue elasticity of GDP	0.37	0.92	0.47	1.57
Buoyancy				
Buoyancy of Total Revenue	0.82	1.43	1.60	1.97
Buoyancy of Tax Revenue	0.94	1.49	1.76	1.98
Buoyancy of Non-Tax Revenue	-0.15	0.87	0.17	1.85

Source: Finance Division

Medium-Term Revenue Mobilization Strategies

3.16 Cognizant of the need to raise sufficient revenue to meet the development goals of the country, the Bangladesh government is planning to bring in appropriate changes and reforms in tax policy and administration to make them both effective and simple in the medium-term. Several initiatives are underway to make tax administration taxpayer-friendly and transparent by expanding the scope of digitalization and automation in tax registration, return submission, and tax payment. It is also understood and appreciated that current tax exemption practices need closer scrutiny and necessary rationalization of them is essential. The government is keen to make tax collection at domestic and import stages conducive to the needs of local industries. The government is also aware that in the absence of adequate revenue collection it will not be possible to create the buffer, the fiscal space, necessary to attend to unusual situations beyond the control of national governments as has been seen in the past few years.

3.17 Alongside the initiatives for reforms in the taxation system, the government has also paid its attention to exploring the potential of revenue mobilization from NTR sources, especially recognizing the expansion of public service delivery and substantial increase in household income with the economic advancement of the country during the last one and a half decade. The government has already introduced a digital payment system so that the public can avail themselves of numerous services by the public from their doorsteps which will improve NTR collection in the medium term. In addition, the government has focused on enhancing dividends and profits from its equity investments in SOEs by transforming them into profitable organizations through numerous initiatives.

Tax Expenditure – the current state of play

3.18 Given Bangladesh's low tax-GDP ratio, how much revenue is collected (or forgone) and whether revenue collection growth is in tandem with GDP growth are important considerations to financing development and investment plans of the government. The Bangladesh government allows various tax benefits to meet social or economic objectives, to spur growth in certain sectors or to attract investment. One tool that can be used to estimate forgone revenue is tax expenditure assessment. Tax expenditures are estimates of amounts of revenue not collected due to preferential tax treatment relative to a benchmark (or reference) tax system, which is supposed to be developed on principles of neutrality, efficiency, and equity. Coverage of tax expenditures is wider than tax exemptions and includes tax exemptions, reduced tax rates, tax credits, tax holidays, tax allowances, tax deferrals etc. Tax expenditure estimates help to identify potential avenues to ramp up revenue collection and increase transparency in the tax system by analyzing the cost-benefit analysis of different special tax treatments. Many countries have made tax expenditure assessments a part of their yearly budgetary exercise.

a) Income Tax:

Although Bangladesh is yet to formally start making tax expenditure estimates, the National Board of Revenue made a modest start in 2021 by conducting a tax expenditure analysis for the personal and corporate income taxes on a pilot basis. Despite a small sample size and methodological limitations, the findings of that analysis were significant: about 36 percent of GDP in 2018-19 FY was excluded from direct taxes, which translated to roughly 58 thousand crore Taka worth of forgone taxes. If one adds tax expenditure on the transfer of land, a major item under capital gains which is not covered in GDP calculation, another 8 thousand crore taka is lost as forgone revenue. The figures added up to approximately 2.6 percent of GDP for FY2018-19. Although tax expenditures are granted to meet certain desired social and economic objectives such as employment generation, greater access to health and education, reduced inequality, tax expenditure assessments shed light on the need to understand the tradeoff between accrued benefits and loss of revenue.

b) Value-Added Tax:

In the case of VAT, several sectors such as agriculture, livestock, fisheries, education, public administration, defense, and social work activities (total 21.2 percent of GDP) are outside the purview of value-added tax. In the case of manufacturing, many industries including light engineering, household electrical goods & consumables, medicine, computer items and peripherals, export-oriented industries etc. are given preferential treatment to promote local industries, export growth and to attract investment. That's another 23 percent of GDP. At the retail and wholesale stage (15 percent of GDP) a substantial part is VAT exempt. A significant part of transportation services (7.5 percent of GDP) has been kept intentionally outside the VAT net to make transport costs affordable to the common masses. At this year's Revenue Conference of the National Board of Revenue, a presentation estimated that no VAT is collected on goods and services on almost 50 percent of Bangladesh's GDP.

c) Customs:

Although Customs' contribution to revenue collection may decrease in the future, it still contributes a significant portion to the government exchequer. A closer look at the composition of Bangladesh's imports in FY 2020-21 reveal that 15 percent of all imports were done by 100 percent export-oriented bonded factories, 7.4 percent by factories in Export Processing Zones (EPZs) and 19.8 percent of all imports benefitted from special tax treatment under SROs/orders. In total, no customs duty was collected on 42.3 percent of total imports during FY 2020-21.

3.19 The above discussion on tax expenditure highlights the need for closer scrutiny and stock taking of the tax benefits given to different sectors, agencies, and individuals. To initiate tax expenditure analysis the first step would be to clearly define the benchmark tax rate and base for income tax and VAT. The collection of sufficient and accurate data would be the next step for which interagency cooperation would be essential. It is also necessary to create an exhaustive list of all different types of benefits and preferences given in VAT, income tax and customs. Rationalizing tax expenditures will play a useful role in collecting more revenue and ensuring forgone revenue (i.e., indirect public expenditure) is made to good use.

Reforms Initiatives in the Revenue Mobilization

3.20 The National Board of Revenue is adopting a three-pronged approach to significantly increase revenue collection from domestic sources: digital transformation, expansion of tax net and enhancing administrative capacity. The core idea is to make tax payments easy and transparent to improve taxpayer services which in turn will help NBR to collect more revenue. Major reform measures taken by the government in this regard are highlighted below:

A. Formulation of new laws and regulations

Implementation of the VAT Act: The VAT & Supplementary Duty Act 2012 has been implemented in July 2019. With the implementation of the new VAT Act, the collection of VAT and supplementary duty is expected to receive a significant boost in the medium term. After the initial hiccup and the shortfall due to the outbreak of COVID-19, revenue collection accelerated in FY22.

New Customs Act: The National Board of Revenue has finalized the draft of the new Customs Act, which will replace the existing Customs Act 1969. International best practices in customs including that of the World Customs Organization (WCO), the revised KYOTO Convention and the WTO Trade Facilitation Agreement have been incorporated here. The law aims to harmonize and simplify customs processes to facilitate the collection of custom duties. The draft of the Customs Act 2023 has been vetted by the Legislative and Drafting Division under the Ministry of Law. After vetting, the draft Customs Act has been sent back to NBR with some observations. Currently, NBR is working on the observations to check whether the vetted draft would serve its purpose.

New Income Tax Act: The new Income Tax Act has already been passed by the Cabinet Committee and is ready to be placed in Parliament. The Act has gone through extensive stakeholder consultation. The new law is expected to create an enabling environment for taxpayers, streamline income tax assessment and collection and facilitate domestic and foreign investment.

B. Structural reform and modernization of the NBR

Automation of the VAT systems: To implement the new VAT law, the NBR has undertaken the 'VAT online Project (VoP)' which was in operation since 2013 and concluded in June 2021. Under the VOP, three important automation measures have been completed. First, the Online VAT Registration began in March 2017. Again, the central registration system has been in force since July 2019. The NBR has introduced online return submission in July 2019. The digital filing system has been introduced in the form of online submission of VAT returns.

E-payment of Customs, VAT and Income Tax: The NBR has rolled out the electronic payment (e-payment) of customs duties in 2017, Income Tax in 2012 and VAT on 16 July 2020. Income tax can be paid through MFS (mobile financial services) as well. Firms and companies that have accounts with 12 commercial banks are now able to pay VAT electronically without even physically going to banks. Under the process, firms send instructions to their banks to clear VAT. Then, banks deposit money to Bangladesh Bank using RTGS (Real Time Gross Settlement). Bangladesh Bank sends transaction information to NBR's Integrated VAT Administration System (IVAS). Taxpayers get payment confirmation from IVAS.

Introduction of A-Challan: To facilitate real-time deposit of government money to the national exchequer, the government has launched the Automated Invoice Portal. This Automated Challan (also known as A-Challan) will act as the receipt window of the government. The payment of income tax has already been brought under the A-Challan system on a pilot basis. Rule 26A of the Income Tax Rules, 1984 has made A-Challan mandatory for all types of tax payments. The NBR now plans to expand its use for payment of VAT and Customs duties. The A-Challan will ensure the timely deposit of money including the prevention of fake return submission and revenue evasion. Moreover, the discrepancy between the amount of revenue collected by the NBR and the accounts given by the Accounting Offices will be eliminated.

Online submission of Tax Returns: Individual taxpayers can now submit their tax returns online at etaxnbr.gov.bd. More than 0.3 million people have submitted their tax returns online this year. It has been made a part of the law through an SRO.

eTDS Environment: The NBR has successfully launched eTDS Environment for easy and hassle-free processing of Income Tax at the source. With the introduction of this system taxpayers' time, cost and visits have been reduced to almost zero. Taxpayers can now submit fourteen reports in the eTDS environment at etds.gov.bd/login.

Introduction of Electronic Fiscal Device: To stop evasion in VAT and enhance VAT collection, the government has introduced Electronic Fiscal Devices (EFD) with a sales data controller mechanism. The government has already installed 9270 EFD/SDC (Sales Data Controller) machines. NBR has selected 24 sectors, including residential hotels, bakeries and fast foods, decorators and caterers, sweet meats etc. for this purpose. To broaden the coverage, the government has decided to outsource the installation of EFD/ SDC machines with a target of 60,000 EFD/ SDC in the first phase and 3,00,000 in five years, if the first phase brings good results. Besides, to prevent tax evasion and to bring transparency in VAT record keeping, the government has made the use of NBR-prescribed VAT software mandatory in VAT-registered industries with annual turnovers of TK. 5 crore or above.

Enabling Non-Resident Companies to pay VAT through Authorized VAT Agents: The NBR has made provision to enable internet-based companies, such as Google, Facebook, Microsoft etc. to pay their VAT on online sales. This allows these companies to pay their VAT through their authorized VAT agents without opening their office in Bangladesh.

Establishing a Central Risk Management Unit: The NBR plans to operationalize the risk management system to ensure that no more than 10 percent of the import consignments are subject to physical examination. To that end, the NBR has established a Central Risk Management Unit/Commissionerate for Customs.

Automating the Bond Management System: To streamline the bonded warehousing system, reduce its misuse and make it transparent, the government has taken a project that aims to automate the bond management system by June 2023. Meanwhile, the licensing module has started operation and other modules will become operational soon.

Time Release Study (TRS): Bangladesh Customs will soon be conducting Time Release Study in the major custom houses to take stock of the actual time taken in the release of imported consignments. The objective of the TRS will be to identify bottlenecks in customs clearance and to take measures to reduce clearance time.

Programs to expand the number of taxpayers: The NBR strives to expand the number of taxpayers and has made the return submission mandatory for all TIN-holders with a few exceptions. As of April 2023, the total no. of TIN-holders is about 9 million. Again, as of April 2023, the total no. of tax returns has been 3.2 million, with an increase of 23 percent over that number in the previous year. To further expand the number of taxpayers in the coming years, the NBR has undertaken surveys and arranged numerous tax fairs across the country.

Other reforms: Other reform efforts by the NBR include – i) implementation and activation of Online National Single Window, Post Clearance Audit, Advance Ruling, Authorized Economic Operator, and thereby increasing dynamism in international trade; ii) full implementation of online income tax return submission under SGMP project; iii) implementation of "Individual Source Tax Deduction Monitoring Zone" to strengthen income tax deduction monitoring; iv) expansion of the e-Payment system in income tax; v) activation of transfer pricing and anti-money laundering activities; and vi) strengthening ICT infrastructure construction and automation activities. Administrative expansion of the income tax department is underway.

Introduction of the Document Verification System (DVS): DVS has brought financial discipline and positively contributed to boosting tax collection both in income tax and VAT by increasing transparency.

C. Tariff rationalization in preparation for LDC graduation & WTO compliance

To align Bangladesh's tariff regime in line with the bound rates that Bangladesh has agreed to at the World Trade Organization, an exercise has been carried out by NBR and customs duty has been reduced on 6 items. NBR has also identified 60 tariff lines where the addition of customs duty and other duties & charges exceed the bound tariff. These rates will be gradually rationalized and brought under the bound rate by 2026. The government has also decided to abolish minimum import price and has developed a plan to gradually drop them. The minimum import price on 55 items has already been withdrawn and will be dropped from the rest of 130 products by 2026. Instead of drastic cuts, customs duty and other duties & charges at the import stage will be rationalized gradually over a period so that local industries and revenue mobilization don't get adversely affected. Preparing a gradual tariff reduction plan, keeping in mind the interests of domestic industry and export competitiveness is underway.

D. Exploring the hidden potentials of NTR

Establishment of inventory of NTR items with rate: There are thousands of public services against which the government levies fees or charges, but there is no complete listing of such fees and charges and when those were imposed. The government has partially set up an online database[1] of all NTR items with the fees, charges or prices and their dates of imposition. This partial database has opened the scope with the hope of increasing NTR income manifolds from administrative fees.

Digitalization of Public Service Delivery: The government is not only focusing on enhanced revenue mobilization from NTR by raising fees or charges, but also putting its best effort to ensure efficient and satisfactory service delivery. The government has taken numerous initiatives to make service delivery systems paperless and to minimize human deployment in this system. This is one of the key features to building Smart Bangladesh by 2041.

[1] NTR Database URL: http://tdmtraining.finance.gov.bd/ntr

Record keeping of equity investments and sources of dividends and interest: The government has multiplied public investment during the last one and half decade, of which the SOEs/Autonomous Bodies (ABs) have enjoyed capital support either in the form of loans or equities. Loans are registered under government accounts through Subsidiary Loan Agreements (SLAs) and thereby interest is charged. However, there is no consolidated database for equity investments of the government and therefore there is no precise estimate for dividend income. The government has taken the initiative to create an exhaustive database for equity investments in the SOEs/ABs as well as establish a Financial Reporting Council for setting standard financial statements to ensure proper assessment of these organizations.

Exploring new avenues for NTR income: With the economic advancement of the country the scope and volumes of public services have evolved and expanded. Government organizations are engaged in delivering various new services in new forms to the public. The government has taken initiatives to explore such novel and voluminous services against which fees/charges may be collected through organizing stakeholders' consultation workshops, seminars, etc.

3.21 Bangladesh is perhaps no different in terms of tax share in GDP than modern high-income countries at a similar stage of development[2]. However, a comparator country analysis in revenue collections shows the scope of significantly enhancing revenue collection in Bangladesh in the future. A combination of factors contributes to low tax generation by the revenue collecting agencies in Bangladesh. The government is taking steps to make tax payment easy, hassle-free and without any ambiguity. Making tax regulations easily understood by taxpayers and bringing a client-friendly approach to revenue collection will help to improve voluntary tax compliance in the country.

3.22 Better coordination and information sharing across different tax collecting agencies, judicious and strategic use of tax expenditures, and appropriate use of technology and digitalization will enhance the capacity to collect more revenue. Increasing domestic resource mobilization will nonetheless require a collective effort of the government, the private sector, individual taxpayers, and other actors. Bangladesh government has started a holistic stock-taking process of the revenue administration to improve efficiency, raise more taxes and be taxpayer friendly.

[2] Besley, Timothy, and Torsten Persson. 2014. "Why Do Developing Countries Tax So Little?" Journal of Economic Perspectives, 28 (4): 99-120

4 Government Spending, Sectoral Priorities and Debt Management

4.1 Bangladesh has already graduated to a Lower Middle-Income country and is working on becoming an upper middle-income country by 2031. To achieve the planned development targets, the government sets spending and sectoral priorities in line with the 8th Five Year Plan (July 2020 to June 2025). During the 2016-2019 period, Bangladesh was amongst the fastest growing countries in the world and this fast pace of growth pushed the transformation of the economy to reach the take-off stage of development. As the adverse impacts of Covid-19 appear to be subsided and the initial impacts of the Russia-Ukraine war are fading, the government is now aiming to return to the pre-Covid growth momentum and embark on a journey towards becoming a developed country by 2041. To achieve that, the government has formulated a medium-term government expenditure strategy to ensure pro-poor and inclusive growth through efficient allocation and distribution of resources in the priority areas.

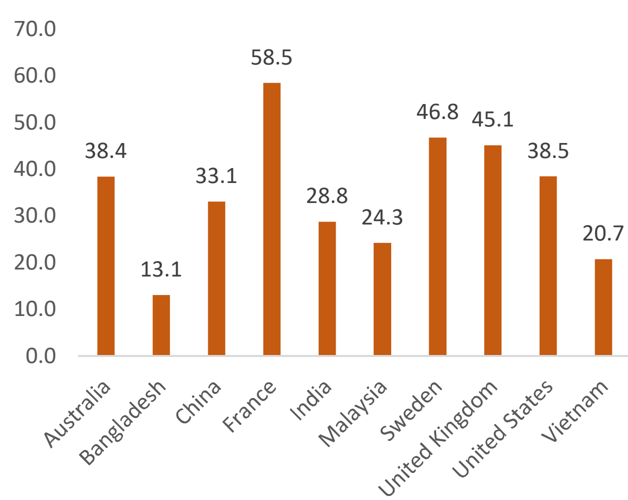
4.2 During the Covid-19 period, the government gave the highest priority to protecting lives and also kept a close eye on protecting livelihood. Striking a balance between these two was challenging. The government adopted an expansionary fiscal policy and accordingly additional allocations were provided in critical sectors like health, agriculture, social welfare, food, disaster management, and employment protection. Eventually, by the end of FY 2021-22, the economy bounced back to its normal growth trajectory. However, in the revised budget of FY 2022-23, the government rationalized its spending and went for a more prudent budgetary allocation due to the global political turmoil and pressure on the BOP. Owing to measures already taken, the pressure seems to be easing and hence it is expected that the government will adopt policies to boost growth in the near future. The government's main objectives in the upcoming budgets are to adopt strategies to accelerate pro-poor and inclusive growth, mobilize domestic and foreign private investment, strengthen public investment efforts, reduce inflation, generate employment, and ease pressure on the BOP.

4.3 This chapter provides an account of public expenditure, recent trends in sectoral spending trends, priority areas of various sectors and allocation of resources to prioritized sectors. It also illustrates the deficit financing and debt management policies considering composition of debt. This includes rationalizing expenditure, enhancing revenue collection, and improving debt management practices, managing the cost and risk of borrowing, monitoring the maturity of debt, and diversifying the sources of financing. The chapter focuses on the possible pattern of spending and projections from FY 2023-24 to FY 2025-26.

Public Sector Outlays

4.4 The priority of the government now is to ensure inclusive and high growth and accordingly medium-term government expenditure strategy (FY 2023-24 to FY 2025-26) has been conceptualized. In the strategy, the focus has been given to allocating resources in the priority programs in line with Vision 2041, the 8th Five Year Plan, and the SDGs. In formulating the budget, the government has been focusing on spending in priority sectors, such as improving physical infrastructure, increasing industrial production, ensuring food security, creating jobs, strengthening healthcare, developing human resources, alleviating poverty etc. through equitable distribution of resources, expanding social safety net programs and adapting to climate change. Necessary allocations have been made in human resource development, including education and skills development to meet the needs of the 4th Industrial Revolution (4IR). However, it may be noted that compared to other economies, in Bangladesh, size of the government expenditure as percentage of GDP is still significantly lower. In this situation, the biggest challenge for the government is to increase public expenditure to facilitate sustained private sector growth.

Figure 18: Govt. Expenditure as Percentage of GDP in 2022

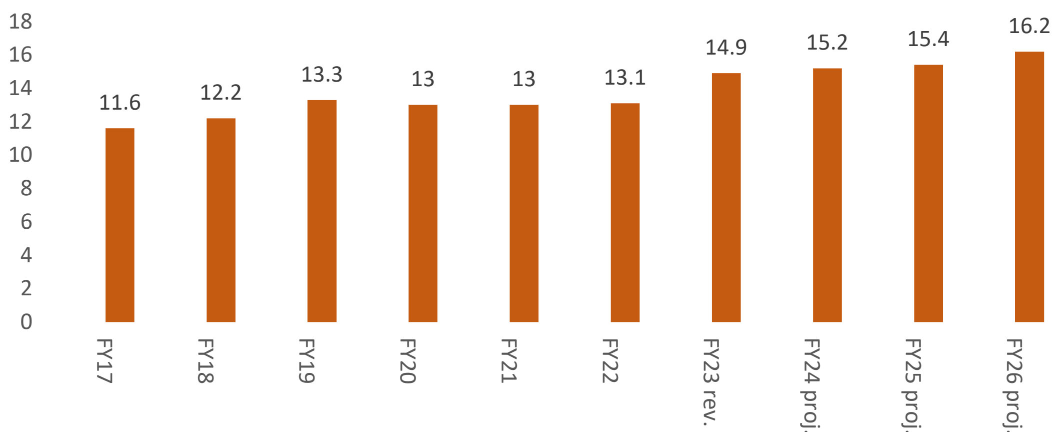


Source: WEO, IMF (April 2023), Finance Division

Medium-Term Outlook of Government Spending

4.5 In FY 2016-17, government expenditure was 11.5 percent of GDP. To enhance the growth rate of GDP and to uplift the standard of living, the government aims to increase its expenditure considering the successful implementation of reforms in Public Financial Management. Over time, government expenditures have been increasing gradually with respect to GDP. However, as the government has been very diligent to keep the budget deficit at sustainable level, total debt stock has remained at a comfortable level.

Figure 19: Total Govt. Expenditure as Percentage of GDP



Source: Finance Division, Ministry of Finance

Recurrent and Capital Expenditure

4.6 According to budgetary classification, budget allocation is broadly divided into two categories- recurrent expenditure and capital expenditure. Recurrent expenditure broadly includes wages and salaries paid to the government employees, purchase of goods and services, subsidy and transfer payments, interest paid for domestic and foreign loans and expenditures on 'food account operation' while capital expenditure comprises the addition to, and creation of, productive assets. The Annual Development Program (ADP) and Non-ADP capital expenditure are the two major categories of capital formation through government expenditures. Moreover, capital expenditure includes loans and advances, development programs financed from the revenue budget, non-ADP projects and Non-ADP FFW (Food for Work) and transfer.

4.7 Considering both the growth prospect and the social welfare generated from government expenditure, it is critical to obtain a balance between recurrent expenditure and capital expenditure in the budgetary allocation. Regarding the spending priorities of the allocation against recurrent expenditure, studies have shown that developed countries focus more on transfers and subsidies, while developing economies pay more attention to social and community services. In addition, government efforts on improving the lives of its citizens through income channeled into transfers have yielded growth[3]. However, capital expenditure needs to be expanded to meet the growing demand for public investment and thereby create productive assets. The table below depicts an increasing trend in capital expenditure as a percentage of the total expenditure with some fluctuations, whereas a decreasing trend can be observed in the recurrent expenditure. As per the revised budget for FY 2022-23, recurrent expenditures consisted of 59.1 percent of the total budget, which is expected to be reduced to 58.7 percent by FY 2025-26. On the other hand, capital expenditure in the same fiscal year was 40.9 percent of the total budget, which is projected to increase to 41.3 percent by 2026.

Table 14: Composition of Public Expenditure (% of budget)

Items	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
	Actual					Revised	Budget	Projection	
Recurrent Expenditure	55.5	55.6	56.7	57.9	59.4	59.1	57.3	58.3	58.7
Capital Expenditure	44.5	44.4	43.3	42.1	40.6	40.9	42.7	41.7	41.3

Source: Finance Division, Ministry of Finance

4.8 Table 15 shows the composition of total public expenditure as a percentage of GDP. It may be observed that recurrent expenditure was gradually increased from FY 2017-18 to FY 2021-22 due to various stimulus package to support the vulnerable during the crisis that evolved from the twin shocks of COVID and the Russia-Ukraine war. In FY18, ADP, the main head of capital expenditure, was 4.5 percent of GDP, but slightly increased to 4.7 percent of GDP in FY 2021-22. The revised estimate for ADP in FY 2022-23 stands at 5.1 percent of GDP.

[3] Obi, C. K. (2020). Government recurrent expenditure effect on economic growth: evidence from expenditure on some selected variables. *Acta Universitatis Danubius. Œconomica*, *16*(1), 228-237.

Table 15: Composition of Public Expenditure (% of GDP)

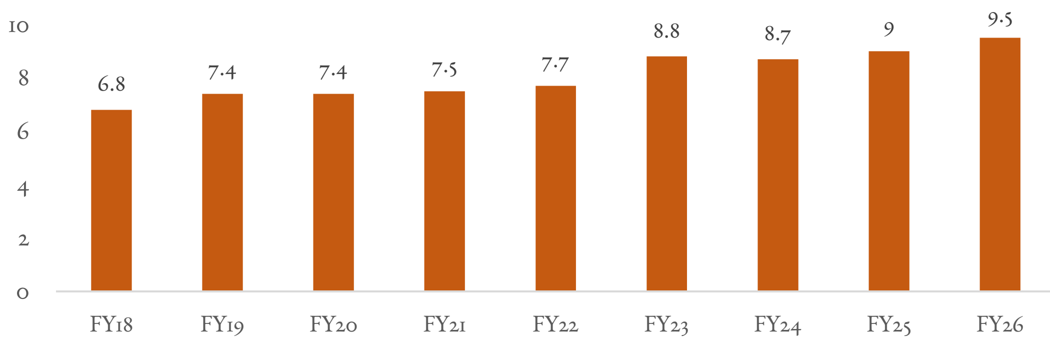
	FY18	FY19	FY20	FY21	FY22	FY23
	Actual					Revised
Recurrent Expenditure	6.8	7.4	7.4	7.5	7.7	8.8
Pay & Allowances	1.8	1.8	1.7	1.7	1.6	1.6
Goods & Services	0.9	1	0.9	0.9	0.8	0.9
Interest Payments	1.6	1.7	1.8	2	2.0	2.0
Domestic	1.4	1.6	1.7	1.9	1.8	1.8
External	0.1	0.1	0.1	0.1	0.1	0.2
Subsidies & Transfers	2.5	2.9	2.9	2.9	3.4	4.2
Block Allocations	0	0	0	0	0.0	0.1
Food Account Balance	0.3	0.1	0.1	0.1	0.1	0.1
Annual Development Program	4.5	5	4.8	4.5	4.7	5.1
Non-ADP Capital & Net Lending	0.6	0.8	0.7	0.8	0.6	0.9
Non-ADP Capital Spending	0.6	0.8	0.8	0.8	0.7	0.9

Source: Finance Division, Ministry of Finance

Trends and Medium-Term Outlook of Recurrent Expenditure

4.9 The recurrent expenditure averaged 7.4 percent of GDP during FY2017-18 to FY 2021-22. However, as per the revised budget for FY 2022-23, it has increased to 8.8 percent. For FY 2025-26, it is estimated to be 9.5 percent of GDP.

Figure 20: Trends and Outlook of Recurrent Expenditure

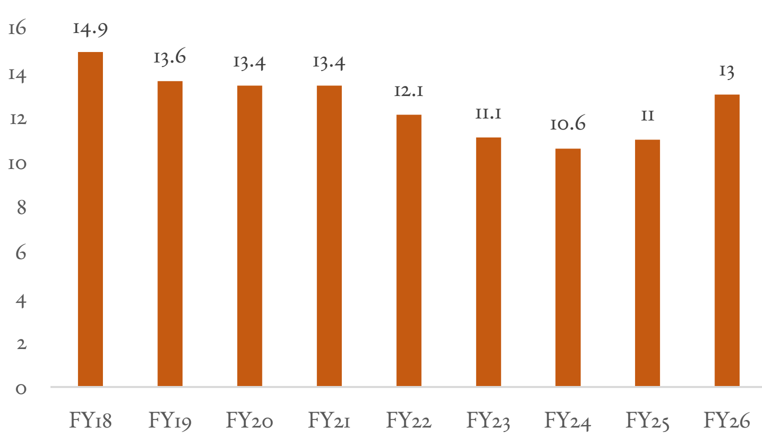


Source: Finance Division, Ministry of Finance

Pay and Allowances

4.10 The Government is constantly putting efforts to rationalize the pay and allowances expenditure keeping in mind effective and efficient public service delivery. Due to the implementation of Electronic Fund Transfer (EFT) for payment of all pay and allowances including pension benefits, the payment system has become robust and free from unseen leakages. As a result, expenditure on salaries and allowances as a percentage of total expenditure shows a declining trend, as it was 14.9 percent of the total budget in FY 2017-18 and steadily declined to 12.1 percent by FY 2021-22. It is expected to further decline in the medium term. In FY 2023-24, expenditure on pay and allowances is expected to be 10.6 percent of the total budget.

Figure 21: Pay and Allowances (as percent of Total Expenditure)



Source: Finance Division, Ministry of Finance

Goods and Services

4.11 Goods and services include all government payments in exchange for goods and services used to produce market and nonmarket goods and services. The government has taken numerous measures including e-GP system for procurement of public goods and services, piloting digitalization of inventory management for government offices, EFT system for payment against travel and other e-payment mechanisms. These initiatives result in an efficient procurement management of goods and services. Therefore, the average expenditure on goods and services as a percentage of total spending gradually declined between FY 2017-18 and FY 2021-22. The expenditure on goods and services has been revised to 5.9 percent for FY 2022-23. In the medium term, the allocation to these heads is projected to follow a slightly increasing trend. In FY 2023-24, the amount is estimated to be 5.8 percent of total expenditure, while this will be 7.6 percent in FY 2025-26.

Table 16: Spending on Goods and Services

	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
	Actual					Revised	Budget	Projection	
Goods and Services (in billion TK)	234.8	285.9	284.4	304.6	317.7	389.5	442.3	636.2	780.0
Percent of Tot. Exp.	7.3	7.3	6.9	6.6	6.1	5.9	5.8	7.3	7.6

Source: Finance Division, Ministry of Finance

Subsidy and Transfer

4.12 Considering the objective of inclusive and pro-poor growth in the economy, in the 8th Fiver Year Plan the government set priority to increase spending on subsidy and transfer programs. In line with this target, the government is focusing on rationalization of subsidy spending by allocating more resources in livelihood support programs for vulnerable groups of society and gradually decreasing the subsidy on energy through regular price adjustments. Subsidies are also given on food accounts, fertilizers, rural electrification, and some other sectors. On the other hand, transfer payments are directly payable to households or non-profit institutions serving households. Besides, cash assistance in the form of net loans and advances is provided to Bangladesh Jute Mills Corporation (BJMC). Since the government is setting formula-based fuel prices for regular price adjustment, the subsidy against energy and fuel will be narrowed down gradually. However, this amount will remain consistent in the next few years due to the energy subsidy arrears of the previous years.

Table 17: Cash Loan and Subsidy (Billion Taka)

Items	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
	Actual							Revised
Cash Loan								
PDB	27.94	39.94	35.50	-	-	-	-	-
BJMC & Others (loan)	1.13	11.79	0.02	33.75	54.47	21.04	42.90	22.34
Total Cash Loan	29.07	51.73	35.52	33.75	54.47	21.04	42.90	22.34
Percent of Total Exp.	1.21	1.92	1.10	0.86	1.32	0.46	0.83	0.34
Subsidy								
Food	9.04	26.43	14.15	66.30	41.70	36.60	46.41	67.77
PDB	-	-	-	79.66	74.39	89.45	119.63	230.00
Gas & Others	1.82	3.00	36.05	25.14	35.16	52.97	114.87	213.00
Total Subsidy	10.86	29.43	50.20	171.10	151.25	179.02	280.91	510.77
Percent of Total Exp.	0.45	1.10	1.56	4.37	3.66	3.90	5.42	7.73
Total Cash Loan and Subsidy	39.93	81.16	85.72	204.85	205.72	200.06	323.81	533.11
Percent of Total Exp.	1.66	3.02	2.66	5.23	4.98	4.35	6.25	8.07
Percent of GDP	0.19	0.35	0.32	0.69	0.65	0.57	0.82	1.20

Source: Finance Division, Ministry of Finance

4.13 Both the 2nd perspective plan and the 8th Five Year Plan suggested providing adequate fiscal incentives as an effective instrument for export growth and diversification, enhancement of remittance, advancement of agriculture, promotion of Green Technologies in the RMG Sector and export of ICT services, and for sustainable development of hybrid technologies & electric vehicle. Being the economy's driving force, agriculture and exports are getting special attention every year. To encourage remittance through the banking channel, a 2.5 percent cash incentive as well as a higher exchange rate for expatriate workers have been introduced. Incentives for remittance have been estimated to be Tk. 62 billion in FY 2022-23.

Table 18: Fiscal Incentives (Billion Taka)

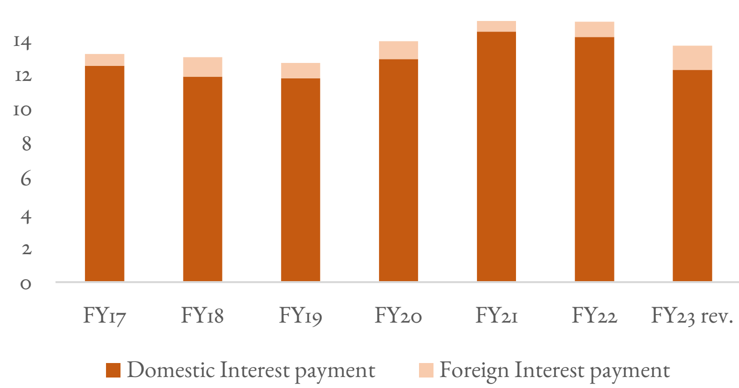
Items	FY17	FY18	FY19	FY20	FY21	FY22	FY23
	Actual						Revised
Agriculture	36.1	52	73.36	72.5	76.32	118.64	260
Export	40	40	40	60.44	58.46	78	78.25
Jute Goods	3.95	4.81	4.81	50	8	10	12
Remittances	-	-	-	30.6	39.78	44	62
Total Fiscal Incentives	80.05	96.81	118.17	213.54	182.56	250.64	412.25
(As percent of Total Govt. Exp.)	2.98	3.01	3.02	5.16	3.97	4.84	6.24
percent of GDP	0.34	0.37	0.40	0.67	0.52	0.63	0.93

Source: Finance Division, Ministry of Finance

Interest Payment

4.14 Interest payment is one of the most important components of the government's recurrent expenditure. The size of this component depends on the financing mix of external and domestic sources. Although the government is heavily dependent on domestic debt to finance the deficit, the country is always putting its best effort to arrange concessional loans from external sources to reduce the burden of interest payment. The government has taken a policy to reduce borrowing NSD instruments to decrease the liability of interest payment. Interest payments as a percentage of total spending decreased from FY 2016-17 to FY 2018-19. From

Figure 22: Interest Payment (as % of Total Expenditure)



Source: Finance Division, Ministry of Finance

FY 2019-20 onward, however, it increased due to increases in the interest rates in both global and local markets.

Trend and Medium-Term Outlook of Capital Expenditure

4.15 To achieve sustained economic growth there is no alternative to increasing capital expenditure which has profound impacts on the production level of the economy. The government allocates capital investment through either Annual Development Program (ADP) or the non-ADP capital expenditure. It was 6.09 percent of GDP as per the revised budget for FY 2022-23. In the medium term, capital expenditure has been targeted to increase to 6.68 percent of GDP by FY 2025-26.

Table 19: Trends in Capital Expenditure and Medium-Term Outlook (% of GDP)

FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Actual					Revised	Budget	Projection	
5.42	5.89	5.65	5.49	5.30	6.09	6.50	6.41	6.68

Source: Finance Division, Ministry of Finance

Annual Development Program (ADP)

4.16 The focus of the ADP will be to sharply improve and strengthen infrastructure, build a social protection system, and alleviate infrastructure constraints to private investment by fast-tracking nationally important projects. The ADP is the main source of public sector capital formation. Data shows that ADP implementation varies in different fiscal years. Between FY 2016-17 and FY 2021-22, ADP implementation as a percentage of budget allocation was between 76.0 and 88.6 percent, and implementation as a percentage of GDP ranged from 3.6 to 4.7 percent. The government has taken various steps to increase the implementation efficiency of relevant agencies. The government has also launched the iBAS++ digital platform, bringing all the line ministries together on this platform, and has simplified the process of managing and releasing funds. In addition, in the last fiscal year, project directors were given the power to release all instalments of government funds. These initiatives will play an important role in ensuring maximum utilization of project funds, reducing wastage, and expediting project implementation. In the medium term, the size of ADP will be aligned with that of the 8th Five Year Plan.

Table 20: ADP Allocation and Implementation (Billion Taka)

	FY18	FY19	FY20	FY21	FY22	FY23
Budget Allocation	1,533.8	1,730.0	2,027.2	2,051.4	2,253.2	2,460.7
Revised Budget	1,483.8	1,670.0	2,011.9	1,976.4	2,099.8	2,275.7
Actual	1,195.4	1,472.9	1,507.8	1,604.0	1,860.6	1149.9*
Implementation (as percent of GDP) *	4.5	5.0	4.8	4.5	4.7	2.6
Implementation against revised budget (percent) *	80.6	88.2	74.9	81.2	88.6	50.5

Source: Finance Division & IMED; *Implementation up to April 2022

Agriculture[4]

4.17 Agriculture, the largest employer in the country, plays a vital role in the prosperity of a large population, especially for improving the living standard of the rural poor. Despite the gradual reduction of its contribution to GDP, the agriculture sector is one of the key driving forces towards achieving food security and balanced growth in Bangladesh. Keeping this in mind, the government has taken various initiatives for the advancement of the agriculture sector. Total spending for this sector is projected to grow on an average of 10 percent annually to Tk. 385 billion in FY 2025-26.

4.18 To increase food production and ensure food security, the government is implementing numerous interventions for the invention of high-yielding and adversity-tolerant crop variety, innovation in agriculture technology, mechanization of agriculture, expansion of irrigation area, supply of seeds and fertilizer at a reasonable price, production of transgenic crops etc. The government has continued its support by providing subsidies, cash incentives, rehabilitation assistance, rebate on electricity bills, agricultural loan at subsidized rate, agricultural machinery at subsidized price and implementing numerous projects for establishing self-reliant, sustainable, and modern agriculture by innovating and adopting appropriate technology. In the medium term, the Ministry of Agriculture sets its priority to increase the usage of surface water instead of underground water for irrigation, use more renewable energy for irrigation, use remote sensing technology for crop monitoring, adopting environment-friendly and cost-effective agricultural technology, and continuous research for the invention of more high yielding crops through various development projects.

[4] Covers the activities of the Ministry of Agriculture, Ministry of Fisheries and Livestock, Ministry of Environment and Forest, Ministry of Land and Ministry of Water Resources

4.19 Fisheries and Livestock subsector has been contributing significantly to economic development as well as creating a healthy population by meeting the increasing demand for protein by supplying an abundant amount of meat, fish and milk. The Fisheries subsector is contributing 2.53 percent to GDP and providing direct and indirect livelihood support to more than 12 percent of the population whereas livestock subsector contributes about 1.91 percent to GDP. With continuous support from the government, Bangladesh achieved self-sufficiency in the production of fish, meat, and egg. Also, self-sufficiency in milk production is expected to be achieved soon. Exceeding the domestic demand this subsector is contributing to earning foreign exchange through the export of fish and fish-related products. In the medium term, the Ministry of Livestock and Fisheries has plans to implement various development projects to increase the production capacity, adopt modern technologies in livestock and fisheries management system, preservation of jatka and creation of alternative employment opportunities for jatka fishermen, and enhancement of research facilities for this subsector.

4.20 Water resource management is a key component for sustainable agricultural development. The demand for water is growing rapidly from households and other production interventions, especially agriculture is showing more and more demand for water with increased production trend. To make irrigation sustainable, now surface water management has been given the key priority. The government has set its priority to ensure the supply of surface water through taking initiatives for excavation and re-excavation of rivers and canals, construction and re-construction of embankments and other water infrastructures, and afforestation in coastal areas. In addition, the country has continued its efforts for establishing the rights of a fair share of the water resources of joint rivers entering from bordering countries.

4.21 Bangladesh is facing catastrophic impacts of climate change that might result in a 6.8 percent loss in GDP per year by 2030. Therefore, the government has given the highest importance to addressing climate change to sustain economic development by maintaining a sustainable environment and conservation of forest resources & biodiversity. The government has formulated Mujib Climate Prosperity Plan which aims to counteract climate-induced damages and losses by equipping vulnerable communities and industries supported by financing tools that will reduce risk and ensure resilience and stability.

Power and Energy

4.22 With the target of transforming Bangladesh into a Developed Country by 2041, the government has put the highest emphasis on the power and energy sector. Short-, medium-, and long-term plans have been formulated to ensure sufficient power generation transmission capacity. During the last one and a half decades, power generation capacity has increased to 27,361 MW (including captive and renewable) from 4,942 MW, the transmission and distribution line increased to 14,672 km from 8,000 km, and the distribution line increased to 6,28,562 km from 2,60,000 km. In line with the target of the 8th Five Year Plan for generating 10 percent of total electricity through renewable energy, the current capacity of such power generation stands at about 900 MW. Besides, 26 solar power plant projects with a total capacity of 1149 MW are being implemented by the government, and 2570 solar irrigation pumps with a total capacity of about 50 MW as well as 6 million solar home systems for people living in off-grid regions have already been established.

4.23 To meet the growing demand for energy various programs on both the production and supply side have been implemented. Since 2009 around 19 gas exploration wells have been drilled and daily gas production capacity has increased by 984 million cubic feet. In addition, the government has taken initiatives to complete the drilling of 46 more exploration wells by 2024 which may add 618 million cubic feet daily gas production capacity. At the same time, initiatives have been taken to construct several LNG terminals which will enhance LNG storage re-gasification daily capacity by 2500 million cubic feet.

4.24 To ensure cost efficiency in both the power and energy sector, the government emphasizes on the construction of a regional pipeline for inter-country fuel transport, regular price adjustment of fuels based on international market price, capacity expansion of fuel refinery, installation of prepaid meter for both electricity and gas, and domestic gas exploration through both onshore and offshore surveys. Besides, energy efficiency and system loss reduction will also be on the priority list.

Transport and Communication

4.25 Cost effective and integrated transport and communication system is vital to economic development, trade and social integration. In addition, the existence of efficient transport and logistics system ensures a smooth channel for supply chain management and thereby acts as an absolute imperative to combat global competition. While Bangladesh sets the target of being an Upper Middle-Income Country by 2031 and a Smart Developed Country by 2041, the government will continue to focus on expanding public investments in road, rail, bridge, shipping, civil aviation, and telecommunication sector in the medium and long term. Total spending for this sector is projected to grow on average by 10 percent annually in the medium term to Tk 421.3 Billion in FY 2025-26.

4.26 To establish an advanced and sustainable road transport system Road Transport and Highways Division has been implementing development projects/ programs for the construction of highways with 4 or more lanes, elevated expressways and new bridges, for establishing high-speed transport modalities, and for construction of highways of regional road connectivity (e.g., SASEC projects). The government has set medium-term targets of repair & maintenance of 1250 km of highways, widening of 1100 km of highways, reconstruction of 450 km of highways, and reconstruction of 7300 meters bridges and culverts to strengthen the road transport system. A top priority of the government at this moment is to reduce traffic congestion in Dhaka City by implementing metro rail lines.

4.27 Under the 30-year master plan for railway development, the government has been implementing various initiatives to turn the railway into dependable, affordable, modern and people-friendly public transport. Bangladesh Railway has set its priority to connect every district of the country with railway network through the construction of new railway track, upgradation of the single track into a double track, unification of different gauges, construction of inter-country railway track, collection of modern locomotives and compartments, modernization of signaling system etc. The government set its target to construct 275 km of new railway track and to reconstruct 210 km of existing railway lines by FY 2025-26.

4.28 Water transport system is one of the key components in the integrated multi-modal transport system since it is considered the most convenient and reasonable transport system for moving goods within and along the boundaries of the country. The Ministry of Shipping has undertaken massive initiatives for safe and uninterrupted inland waterways, for the modernization of seaports and land ports, and dredging programs to maintain the navigability of the rivers.

4.29 In line with the economic development of the country, the demands for both domestic and international flights from both citizens of Bangladesh and foreigners are increasing rapidly. To meet this increasing demand as well as to establish Bangladesh

'Regional Hub' for international passengers' transport, the Ministry of Civil Aviation and Tourism has been implementing various projects/programs for the enhancement of passenger handling capacity and improving the facilities in both domestic and international airports. The government has set its priority to open the third terminal at Hazrat Shahjalal International Airport by the end of 2023.

Social Security and Welfare[5]

4.30 The extent of the social safety net is constantly being expanded to reduce poverty and inequality for inclusive development. In addition, multi-faceted programs are being conducted simultaneously to meet the basic needs of the vulnerable population. The government has formulated the National Social Security Strategy (NSSS)-2015 to reform the country's social security system by realigning programs and developing delivery systems along a life-cycle framework. The Action Plan, Phase-2 of NSSS has also been prepared for the period 2021 to 2026. The government has introduced "family card" to distribute essential items and a G2P payment system for easy cash transfer so that the safety net schemes can benefit the right population.

4.31 To empower women, the government has taken numerous initiatives. The government is providing food assistance through vulnerable group feeding (VGD) program for distressed mothers, allowances for pregnant mothers, and allowances for lactating and working mothers. The government is also disbursing microcredit to create a financing window for women. The government is also providing various support, among others, to the freedom fighters and the people affected by natural disasters.

Employment Generation in Smart Bangladesh

4.32 Having a huge pool of young and intelligent population and considering the inevitable change in the job market in the backdrop of the 4IR, the government has put high importance on skill development and employment generation, especially in the ICT sector. At present, more than two-third of the population of Bangladesh is included in the workforce and the government is implementing several activities to transform this huge manpower for the future job market. According to the Labor Force Survey 2022, the current unemployment rate is 3.6 percent which was 4.2 percent during FY 2016-17. To reduce the

[5] Covers the activities of the Ministry of Social Welfare, Ministry of Women and Children Affairs, Ministry of Liberation War Affairs, Ministry of Food and Ministry of Disaster Management and Relief.

unemployment rate further, under the Skills for Employment Improvement Program implemented by the Finance Division, more than 600,000 people have been trained.

4.33 Owing to the successful implementation of numerous initiatives including skills training, employment generated for about 2 million people in IT freelancing, software & hardware industry, e-commerce, ridesharing, fintech, edutech, and ISP sector. The government has set its target to increase IT professionals from 2 million to 3 million by 2025 to create Smart Bangladesh. In line with this target, skill training is being provided in the areas of artificial intelligence, the internet of things, augmented reality, virtual reality, big data, blockchain, cyber security etc. In addition, more than 13000 Sheikh Rasel Digital Labs and 300 Sheikh Rasel Schools of Future have been established countrywide.

4.34 To compete in the global IT market, the Bangladesh Hi-tech Park Authority is putting efforts to create IT skilled professionals. The Authority has set a target to convert more than 60,000 youths into IT professionals by 2025 and 100,000 youths by 2030. Under this target, 37,800 youths have already completed training programs. The implementation of Digital Bangladesh is empowering the country to exploit the potential of the 4IR and to build a cost-effective, sustainable, innovative, intelligent, and knowledge-based 'Smart Bangladesh' by 2041. The ICT Division has formulated the "Smart Bangladesh: ICT 2041 Master Plan" considering four pillars – Smart Citizen, Smart Government, Smart Economy, and Smart Society. These pillars will guide the country to reach the next stage of development.

4.35 To realize the vision of Digital Bangladesh, the government has taken some remarkable initiatives which are as follows:

- Ensure 20 percent contribution of the ICT sector to GDP by 2041;
- 100 percent of government services will be digitized and also the services will be so accessible to the people;
- Increase ICT exports to USD 5 billion and ICT employment to 3 million by 2025;
- Professional mentorship will be provided to 1000 Bangladeshi startups by 2025;
- Establishment of 10 innovation hubs in 10 top universities;
- Building at least 5 unicorns worth USD 1 billion in startups
- Establishment of 4IR-based specialized labs including Robotics, AI, IoT, Big Data, Blockchain, Augmented Reality, and AR/VR in each university;
- Smart Digital Leadership Academy and Center for Fourth Industrial Revolution (4IR Centre) will be established.

Education, Science and Technology

4.36 To achieve the targets of Vision 2041, the government is giving top priority to the education sector. In the medium term, the ongoing activities will continue to guarantee the overall quality of education by eliminating inequalities, imparting training for teachers, developing the necessary infrastructure for digital education, expanding vocational education, encouraging activities related to creative talent exploration, etc.

4.37 To provide quality education at the primary level, the government will continue its spending on developing infrastructure, distributing free textbooks, modernizing classrooms, improving curriculum, etc. A total of 12 projects (6 old and 6 proposed) are planned to be implemented in the coming fiscal years. The proposed Primary School Feeding Program is planned to be implemented from July 2023- June 2028. It has been decided to conduct the Skill Focused Literacy for Out of School Adolescent pilot project in 3 selected Upazilas in Cox's Bazar district by 2024.

4.38 As Bangladesh will soon graduate officially from the group of LDCs, it has become a top priority for the government to build a science and technology-savvy nation. In the medium term, the government will continue increasing the capacity of Bangladesh Oceanographic Research Institute with the aim of achieving the success of the Blue Economy; expanding information technology, enriching information-repository using e-service technology for decision-making; building the capacity of the Institute of Nuclear Medicine and Allied Sciences; etc. In addition, the application of biotechnology, selection of suitable cultivars for industrial use, identification of common genetic diseases by molecular method, field testing of vaccines to prevent diseases in livestock production, and production of fish through gene engineering are under consideration.

Local Government and Rural Development

4.39 The government has given the utmost priority to strengthening the local government by taking various initiatives. The most notable among them is the 'My Village, My City' program adopted as per the Election Manifesto of 2018. The government plans to construct 18,360 km of new roads, 66,800 meters of bridges & culverts, 28,170 km of paved roads, and maintenance of 77,000 meters of bridges & culverts in the rural sector, development of 415 Growth Centers in the medium-term. Moreover, the construction and expansion of 74 upazila complex buildings and 340 cyclone shelters are also under consideration in the same time frame.

4.40 In order to manage wastage in 12 city corporations and 329 municipalities, initiatives have been taken to produce bio-fertilizers through incineration or burning waste to generate energy in an environmentally friendly manner. The government is also committed to ensuring safe water and bringing every house under a hygienic sanitation system in rural areas. To achieve the objective of developing a safe water supply and sewage system by Dhaka WASA 6 projects are planned to implement by 2025.

Protecting Lives and Strengthen Healthcare[6]

4.41 The government is committed to providing better health care facilities for developing human capital. To achieve a healthy nation, the government takes initiatives to provide affordable quality health, nutrition, and family welfare services. The health care facilities are aligned with Vision 2041, the 8th Five Year Plan (2021-2025), National Health Policy 2011, Bangladesh Population Policy 2012, and National Nutrition Policy 2015. This is one of the key sectors where the government has continued to provide essential health services by allocating budget to the health sector on a priority basis and has been increasing the quality and scope of these services every year. The Ministry of Health and Family Welfare is implementing the 4th Health, Population, and Nutrition Sector Program at an estimated cost of around Tk 1 lakh 46 thousand crores during the period 2017 – 2023, 87 percent of which is financed by the government of Bangladesh. Under the competent and dynamic leadership of the present government, the pharmaceutical industry is moving forward. The country is now capable of producing world-class medicine. About 98 percent of the total demand for medicines in the country is produced locally and exported to more than 150 countries of the world including Europe and America.

4.42 Bangladesh has successfully tackled the waves of Covid-19 and won worldwide acclaim. Bangladesh is among the top 5 countries in the world in providing the vaccine for Covid-19. The government took quick steps to protect lives and deliver more than 1 crore vaccines in 1 day. As a result of the government's well-calculated measures, as of 17 May 2023, the rate of infection is 13.23 percent and only 1.44 percent of the infected people died. These rates are quite low compared to even many of the developed countries.

[6] Covers the activities of the Health Services Division and the Medical Education and Family Welfare Division

Table 21: Programming Expenditure by Sector (FY 2020-21 to FY 2025-26) (Bn. Tk.)

Ministry / Division	Actual 2020-21	Actual 2021-22	Revised 2022-23	Budget 2023-24	Projection 2024-25	2025 -26
Public Services	565.8	755.1	1248.2	1678.8	1762.7	1850.9
Local Government and Rural Development	354.8	369.4	480.7	493.4	523.0	554.4
Defense Services	354.8	352.7	362.8	417.3	459.1	505.0
Public Order and Safety	244.1	262.0	279.0	322.7	345.2	369.4
Education	594.8	604.3	705.1	881.6	1013.9	1165.9
Science & ICT	124.5	167.1	143.8	159.8	183.7	211.3
Health	216.5	250.3	297.4	380.5	456.6	547.9
Social Security and Welfare	269.4	329.7	390.8	403.5	464.0	533.6
Housing	64.2	65.3	87.0	74.3	81.0	88.3
Recreation, Culture and Religious Affairs	40.2	51.4	77.3	55.7	60.7	66.2
Energy and Power	228.4	227.5	271.4	348.2	383.0	421.3
Agriculture	170.4	253.5	393.9	318.2	350.0	385.0
Environment, Climate Change & Water Resource	87.2	104.5	149.1	118.8	130.7	143.8
Industrial and Economic Services	30.0	35.9	42.9	55.9	61.5	67.6
Transport and Communication	502.2	602.0	729.5	876.3	963.9	1060.3
Total:	3847.3	4431.3	5658.8	6584.9	7239.0	7970.8

Source: Finance Division, Ministry of Finance

Deficit Financing and Debt Sustainability

4.43 The government has always been maintaining a prudent deficit financing policy to avoid debt distress. To this end, the government has kept the deficit at around 5 percent of GDP, which has helped to maintain the debt level stable at around 33 percent of GDP in recent years. In this way, the government is making a deliberate effort to balance the benefits and risks associated with deficit financing, while also prioritizing sustainable economic development.

Deficit Financing

4.44 To minimize borrowing costs, traditional external creditors remains as the preferred funding sources for the government and are expected to borrow from them. However, external concessional financing falls short of the total financing needs and the government needs to borrow from domestic sources, such as the issuance of government securities. To promote a healthy domestic debt market, the government is focused on increasing the share of marketable securities in the medium term. While the government plans to continue issuing Islamic securities Sukuks, it is not currently considering Eurobond issuances in the global market as a desirable option. The financing scenario and its medium-term projections are presented in the table below:

Table 22: Deficit Financing in FY 2020-21 – FY 2025-26 (Billion Taka)

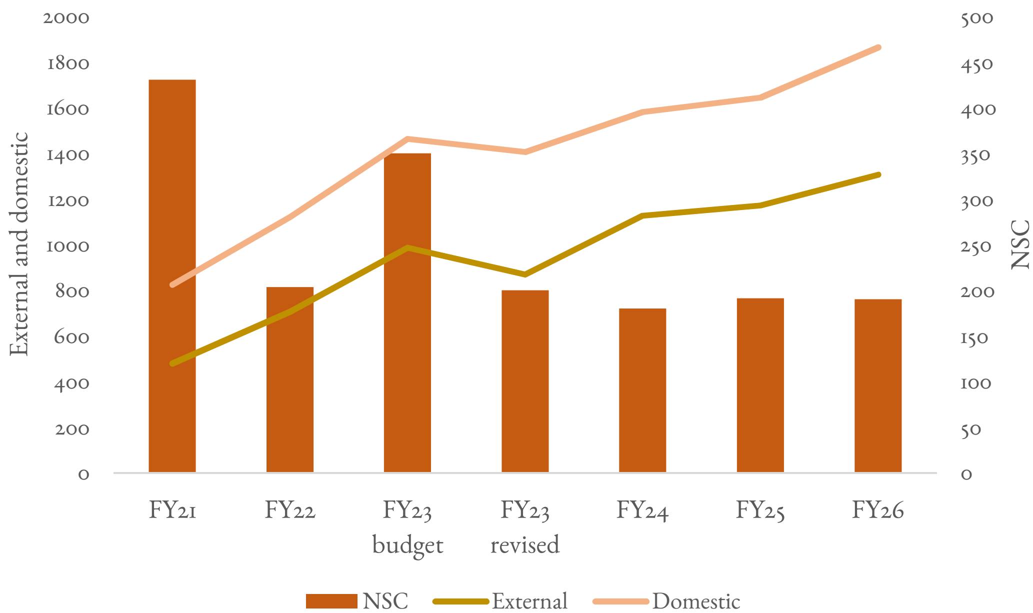
Indicators	Actual	Actual	Budget	Revised	Estimate	Projection	
	FY 21	FY 22	FY 23	FY 23	FY 24	FY 25	FY 26
Total Financing	1305.6	1835.7	2450.6	2275.1	2617.9	2792.3	3170.7
	(3.7)	(4.6)	(5.5)	(5.1)	(5.2)	(5.0)	(5.0)
External (Net)	480.4	707.4	987.3	870.8	1063.9	1200.3	1306.4
	(1.4)	(1.8)	(2.2)	(2.0)	(2.1)	(2.1)	(2.1)
Domestic	825.1	1121.9	1463.4	1404.3	1554.0	1677.7	1864.4
	(2.3)	(2.8)	(3.3)	(3.1)	(3.1)	(2.9)	(2.9)
Bank	326.7	755.3	1063.4	1154.2	1323.9	1384.9	1547.3
Non-Bank	498.4	366.5	400.0	250.0	229.6	292.8	317.1
NSCs	430.4	203.7	350.0	200.0	180.0	191.4	190.3
Others	68.0	162.9	50.0	50.0	49.6	101.3	126.9

Source: Finance Division; Figure in ( ) indicates percent of GDP

Domestic Financing

4.45 In the medium term, it is expected that the government's borrowing from domestic sources will be stable at 2.9 percent of the GDP. In nominal terms borrowing from marketable securities will increase significantly. Notably, the growth of borrowing from high-cost National Savings Certificate (NSC) instruments will be minimal, and its contribution to the total financing mix will diminish gradually.

Figure 23: Sources of Deficit Financing (Bn Taka)



Source: Finance Division

External Financing

4.46 It is predicted that financing from external sources will remain steady at approximately 2.1 percent of the GDP. In nominal terms, there will be increased external financing between FY 2023-24 and FY 2025-26 due to greater disbursement for large projects and higher budget support. Although concessional loans with low-interest rates, lengthy grace periods, and extended repayment periods are preferred, this financing flow is highly dependent on project implementation progress. However, in recent years, Bangladesh has received a substantial amount of budget support from the external sources, which is expected to persist in the medium term.

Cost of Financing

4.47 In FY 2020-21, the government allocated 15.4 percent of its total expenditure towards interest payments. However, it is expected that this percentage will decrease to 13.5 percent by the end of FY 2025-26. Domestic interest payments are projected to decrease to 11.8 percent in FY 2023-24 from 14.4 percent in FY 2020-21 and then further decrease to 11.6 percent in FY 2024-25, followed by a return to 11.8 percent in FY 2025-26. External interest payments, which accounted for 0.9 percent of the total government expenditures in FY 2020-21, are expected to increase to 1.6 percent in FY 2023-24 due to the depreciation of the Taka against the US dollar and increased external financing. External interest payments are expected to rise slightly to 1.7 percent in FY 2024-25 and remain stable in FY 2025-26.

Table 23: Interest Payment in FY 2020-21 – FY 2025-26 (Billion Taka)

(Billion Taka)

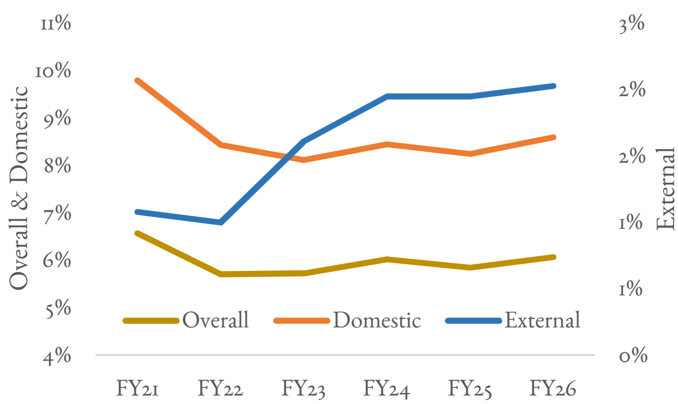
Interest payment	Actual		Budget	Revised Budget	Estimate	Projection	
	FY 21	FY 22	FY 23	FY 23	FY 24	FY 25	FY 26
Total	706	708	804	900	943	1154	1383
	(15.4)	(13.6)	(11.9)	(13.6)	(12.4)	(13.3)	(13.5)
Domestic	663	663	732	807	820	1008	1205
	(14.4)	(12.7)	(10.8)	(12.2)	(10.8)	(11.6)	(11.8)
External	43	46	72	93	124	146	178
	(0.9)	(0.9)	(1.1)	(1.4)	(1.6)	(1.7)	(1.7)

Source: Finance Division; Figure in ( ) indicates percent of total budget

4.48 The high prevalence of National Savings Certificates (NSC) in the debt portfolio has resulted in an elevated average interest cost. However, as the share of NSC instruments decreases, the implicit interest rate of domestic financing is expected to decline.

4.49 The domestic implicit interest rate in Bangladesh is expected to improve from 10 percent in FY 2020-21 to 8 percent in FY 2023-24, and then remain stable at 9 percent in FY 2024-25 and FY 2025-26. The country has been receiving external borrowings at a combination of semi-concessional and market rates, which has led to increased borrowing costs. Furthermore, the depreciation of the local currency and global benchmark interest rate hikes will result in an increase in the external implicit interest rate from 1 percent in FY 2020-21 to 2 percent in FY 2025-26. The current yield of marketable securities is high due to inflationary pressures, which has contributed to an overall implicit interest rate of around 6 percent. This rate is projected to remain stable over the medium term.

Figure 24: Implicit Interest Rate Movement



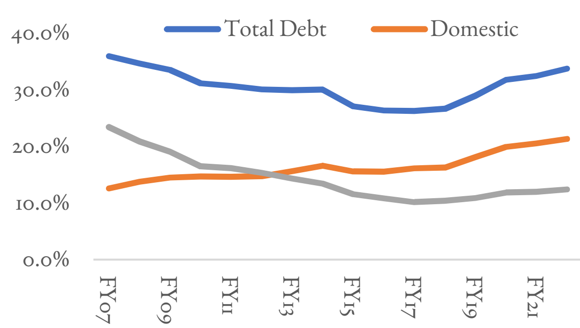
Financing Strategy

4.50 Marketable securities in the form of T-bonds and T-bills and non-marketable NSC instruments are major domestic sources of deficit financing. On the external front, financing is available from both bilateral and multilateral sources, either in concessional or non-concessional terms. To decide the preferred borrowing sources for the medium term, the government has approved the Medium-Term Debt Strategy (MTDS) for FY 2021-22 to FY 2023-24. The financing mix will largely follow the MTDS. The most preferred strategy, Strategy 2 of the MTDS, aims to increase external financing, covering 36 percent of the Gross Financing Need (GFN) by the end of FY 2023-24, with a small reduction in NSC. It is expected that concessional financing and semi-concessional financing shares increase 5 percent in FY 2023-24. In the longer term, the government plans to focus on deepening the domestic debt market to reduce foreign currency exposure risk and reform NSC, resulting in lower interest costs as suggested Strategy 4 of the MTDS. The set strategy may face challenges due to unanticipated flows in NSC and liquidity positions in the financial market.

Debt Profile

4.51 As of the end of the fiscal year 2022, the debt portfolio in Bangladesh was primarily composed of domestic debt, which constituted 64 percent of the total debt stock. Marketable securities accounted for 50 percent of the total domestic debt, while National Savings Certificates (NSCs) accounted for 43 percent. The remainder was financed through the provident fund. Prior to fiscal year 2012, the external debt stock was higher than the domestic portion, but in recent years, its relative share has declined. More than two-thirds of external debt is multilateral, although new bilateral creditors have emerged and are providing semi-concessional loans. Over the past 15 years, the total debt-to-GDP ratio has never exceeded 40 percent.

Figure 25: Government Debt-GDP Ratio



Source: Finance Division

Medium Term Outlook of Debt Stock

4.52 Expansionary fiscal policy will continue in the medium term to ensure recovery from the negative impact of the COVID-19 pandemic. This will help the debt-GDP ratio grow from 32.4 percent in FY 2020-21 to 38.5 percent in FY 2025-26. Both the domestic and external debt stock, in percentage of GDP, will continue to grow in the medium term. The external debt stock will grow faster than the domestic debt stock. At the end of FY 2025-26, external debt stock will reach 14.8 percent of GDP and will constitute 38.6 percent of total debt stock.

Table 24: Debt Stock in FY 2020-21 – FY 2025-26 (Billion Taka)

Indicators	Actual	Actual	Budget	Revised	Estimate	Projection	
	FY 21	FY 22	FY 23	FY 23	FY 24	FY 25	FY 26
Total Debt	11443	13390	15778	15697	18329	21180	24388
	(32.4)	(33.7)	(35.5)	(35.1)	(36.6)	(37.6)	(38.5)
Domestic	7239	8479	9974	9917	11393	13071	14972
	(20.5)	(21.3)	(22.4)	(22.2)	(22.8)	(23.2)	(23.6)
	{63.3}	{63.3}	{63.2}	{63.2}	{62.2}	{61.7}	{61.4}

Indicators	Actual	Actual	Budget	Revised	Estimate	Projection	
	FY 21	FY 22	FY 23	FY 23	FY 24	FY 25	FY 26
External	4204	4911	5804	5780	6936	8109	9415
	11.9	12.4	13.0	12.9	13.9	14.4	14.8
	{36.7}	{36.7}	{36.8}	{36.8}	{37.8}	{38.3}	{38.6}

Source: Finance Division; Figure in ( ) indicates percent of GDP and { } indicates percent of total debt stock

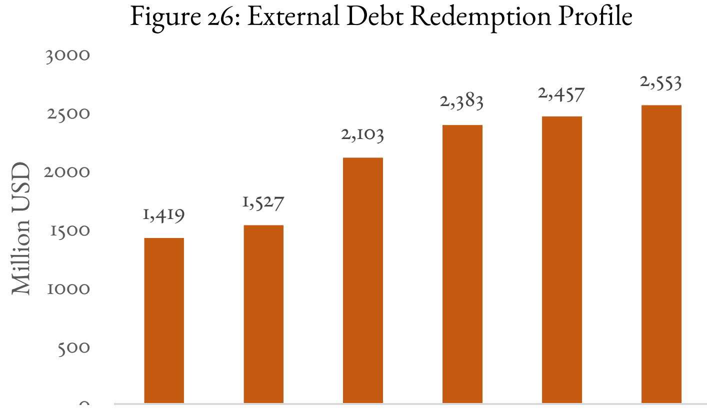
Debt Sustainability

4.53 The Finance Division's recent exercise of a home-grown Debt Sustainability Analysis (DSA) using national data marks a significant milestone for Bangladesh. Previously, the country had relied on the DSA conducted by the IMF and World Bank. The new analysis was based on the DSA-LIC template provided by the IMF and World Bank, with additional technical support from these institutions. The findings demonstrate that the country's public debt is sustainable and well within safe thresholds, even in the face of extreme scenarios. The report also identifies areas for improvement in the country's debt management strategies and provides recommendations for future action. This increased transparency and accountability in the management of public debt in Bangladesh will boost investor confidence in the financial system and contribute to the country's long-term economic growth.

Redemption of External Debt

4.54 The management of external debt redemption is a crucial aspect of debt management in Bangladesh. The country's external debt comprises both concessional and non-concessional loans, which have varying maturity periods. At the end of FY 2021-22, the government paid back USD 1.5 billion in principal repayment for external debt, and this

Figure 26: External Debt Redemption Profile



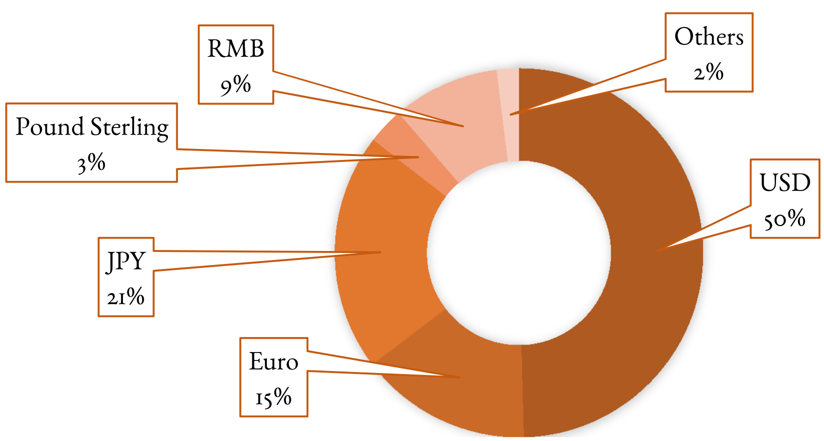
Source: Economic Relations Division

amount is expected to rise to USD 2.1 billion in FY 2022-23. The principal repayment in FY 2023-24 is projected to be USD 2.4 billion, and it will further increase to USD 2.6 billion by the end of FY 2025-26. Managing the debt service obligations is essential for ensuring financial stability and preventing liquidity crises. Despite the increasing amount of external debt repayment, it is expected to remain within tolerable limits due to the government's efforts to diversify funding sources and build up foreign exchange reserves.

External Debt Currency Mix

4.55 The majority of the external debt is denominated in US dollars, which accounts for around 50 percent of the total external debt stock as of FY 2021-22. Other significant currencies include the Japanese yen, which accounts for 21 percent of the total external debt, and the euro, which accounts for around 15 percent. The remaining external debt is denominated in other currencies such as the RMB, the British Pound. The currency mix of external debt is a key consideration for the government as fluctuations in exchange rates can significantly impact the cost of servicing the debt.

Figure 27: Currency Mix of External Debt



Source: Economic Relations Division

Contingent Liabilities & SOE Liability

4.56 As of the end of March 2023, the outstanding guaranteed amount in Bangladesh was TK. 1,024. 43 billion. In the current fiscal year 2023, the government has issued TK. 360.65 billion in new sovereign guarantees to State Owned Enterprises (SOEs) for borrowing purposes. These guarantees were primarily issued to entities such as Bangladesh Biman, power sector investments, fertilizer production plants, and TCB. In the medium term, the government plans to amend the existing guidelines for guarantee to streamline the process and mitigate fiscal risks associated with sovereign guarantees. As of the end of June 2022, the total liabilities of SOEs in Bangladesh amounted to TK. 4,31,3.04 billion, which accounts for 10.85 percent of the country's GDP. This represents a 14 percent increase compared to the figure of TK. 3,776.09 billion recorded in June 2021. Additionally, the outstanding balance of government on-lending to SOEs was TK. 4,180.22 billion at the end of June 2022, compared to TK. 3,537.27 billion at the end of June 2021.

Reforms and Transparency

4.57 The Finance Division of the Government of Bangladesh has taken steps to improve the efficiency and transparency of the country's financial system. One such initiative is the introduction of secondary market transactions of government securities through a Memorandum of Understanding (MoU) signed among BB, BSEC, DSE, CDBL, and CCBL. The move enables institutional and household investors to participate in the transaction of government securities, thus increasing the scope and depth of the secondary bond market. This will not only help the government finance its deficit more efficiently but also contribute to the development of the capital market and overall economic growth.

4.58 The automation of the NSC issuance process is another crucial step towards efficiency and reduced paperwork. This reform facilitates the smooth implementation of different policy measures such as slab-based interest rates and individual investment ceilings, resulting in reduced investment in NSC and aligning with the Government's financing strategy. Additionally, the publication of the Debt Bulletin ensures transparency in debt data, benefiting various stakeholders, including other ministries, research organizations, the business community, the international community, and citizens in general.

Challenges

4.59 Though Bangladesh has a moderate level of public debt and remains at a low risk of external debt distress due to its buoyant growth and prudent macroeconomic management it is not free from significant challenges that require attention. One of the key challenges is the low revenue collection, which is limiting the government's capacity to invest in infrastructure and other developmental projects. A lower share of revenue to GDP also impacts debt sustainability. This issue is further exacerbated by the LDC graduation deadline in 2026, which will affect the country's access to concessional financing from international sources.

4.60 Another challenge is the high-interest rate regime both domestically and in the international market, which is increasing the government's borrowing costs and putting a strain on public finances. This situation is further compounded by the increasing financing needs of the government to fund critical infrastructure projects, social safety nets, and other development initiatives. Moreover, the segmented debt offices within different offices and agencies have led to coordination challenges in debt management, which could potentially affect the country's overall fiscal sustainability. To address these challenges, the government needs to adopt a comprehensive and integrated approach to debt management, improve revenue collection, and explore alternative financing mechanisms to reduce reliance on debt. It is crucial to address these issues promptly to ensure that the country's public debt remains sustainable and supports the long-term development goals of Bangladesh.

5 Fiscal Risks and Way Forward

5.1 This chapter features the concluding statements of this medium-term macro policy outlook with highlights on the risks that evolve around the major fiscal activities of the government. Identification of the sources of fiscal risks is conducted following the IMF framework[7] whereas the ex-post analysis method is used to find out the factors prompting the fiscal risks of the country. The medium-term macroeconomic outlook has been considered while conducting quantitative forecasting of outcome variables under different risk scenarios. Expert opinions through consultation workshops have been accumulated to identify potential fiscal risks. This chapter ends with the mitigation strategies for the identified fiscal risks.

5.2 Fiscal risk is defined as the possibility of short- to medium-term deviations in fiscal variables compared with what was anticipated in the government budget or other fiscal forecasts (IMF 2008). It has been an issue of increasing attention over the last three decades. The financial crises of the 1990s, the extensive use of guarantees by transition economies, and the global financial crisis (GFC) and sovereign debt crisis have all revealed that even apparently sound budget and debt positions could be subject to large hidden risks from off-budget or off-balance sheet fiscal activities and implicit liabilities. The need to reduce budget deficits and debt continues to induce some governments to shift activities off-budget or off-balance sheet in ways that often increase cost and risk. In general, fiscal risk has been defined to include three situations: risk, uncertainty, and ignorance. Fiscal outturns sometimes differ from the budget or other fiscal projections. These differences can be large and may result from a variety of shocks such as deviations of macroeconomic variables from expectations (e.g., shocks to economic growth, interest rates, exchange rate, and the terms of trade),

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[7] International Monetary Fund. Fiscal Risks: Sources, Disclosure, and Management, 2008. http://www.imf.org/external/pp/longres.aspx?id=4265

natural disasters, calls on government guarantees, and from institutional weaknesses. Public sector assistance to troubled financial institutions, and risks stemming from more-uncertain-than-usual economic growth projections, have renewed the importance of proper fiscal risk disclosure.

5.3 Disclosing fiscal risks and enhancing transparency more generally invite additional scrutiny of fiscal activities and their implications. In turn, improved quality of information on fiscal risks builds support for prudent fiscal policies, leads to better risk mitigation, and promotes better policy responses. Policies can be adjusted more quickly when risks increase, and better strategies can be established for how fiscal policy should react to shocks. Procedures can be put in place to limit risks (e.g., parliament can set and approve yearly ceilings on the guarantees to be issued). And policymakers can weigh increased exposure to risks (e.g., new guarantees) against other expenditure proposals, thereby improving the prioritization of budget decisions. The disclosure also pays off by strengthening confidence in the public sector accounts, thereby reducing borrowing costs and improving market access. Hence, identifying the fiscal risks can be considered one of the most important tasks of the finance authority of a country.

Sources of Fiscal Risks in Bangladesh

5.4 Fiscal risks may arise from various sources including natural disasters, macroeconomic shocks from home and abroad, and institutional failures. Like other conventional cash-basis government systems, the budgeting and accounting system of Bangladesh suffers from several well-documented weaknesses in its treatment of fiscal risk, including a lack of information on assets and liabilities and incomplete or inadequate coverage of current transactions. It will be helpful to organize fiscal risks into a framework that differentiates between: (a) general economic risks, such as those arising from shocks to macroeconomic variables (e.g., commodity prices, GDP growth, exchange rates); (b) specific fiscal risks, mainly from contingent liabilities, whether explicit or implicit; and (c) structural or institutional risks, such as weak institutional capacity and spending rigidity. The overall fiscal risks may be classified into two categories: expenditure side risks and revenue side risks.

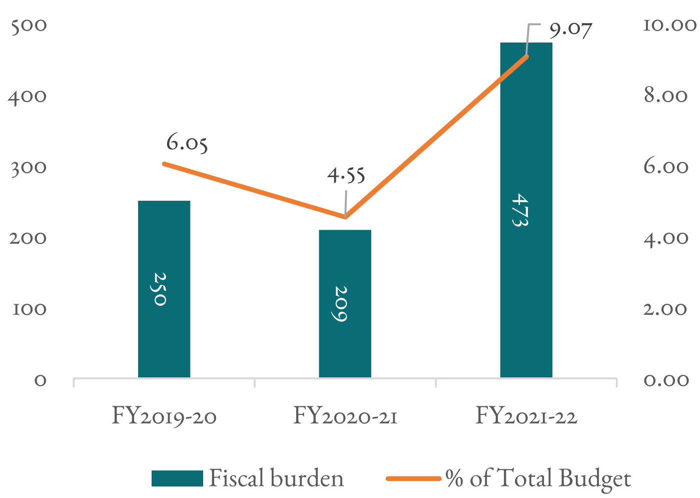
Expenditure Side Risks

5.5 General economic risks arising from unanticipated macroeconomic developments such as shocks to GDP growth, inflation, exchange rate, interest rates and commodity prices (specially price of oil, energy and fertilizer affect expenditures e.g., through the subsidy bill), revenues, and consequently the stock and dynamics of public debt. In the following sections, a few such sectors are identified which may create fiscal risk as they increase government expenditure to a large extent.

A. Covid Shock:

5.6 COVID-19 pandemic jeopardized people's lives and livelihoods and affected the country's long-standing macroeconomic stability and socio-economic developments in many ways which necessitated different fiscal treatments. The Government of Bangladesh formulated an overall program with short, medium, and long-term targets to address the crisis arising from the COVID-19 pandemic and overcome the potential adverse effects of the pandemic on the economy. This plan was taken based on the four policy interventions– increase public expenditure, introduce stimulus packages, expand social safety net programs, and increase the money supply. The Bangladesh government has undertaken a comprehensive economic recovery program containing 28 fiscal and stimulus packages amounting to Tk. 2376.79 billion (USD 26.9 billion). The total fiscal costs to implement the stimulus packages stood at Tk. 250 billion in FY2019-20, Tk 208.91 billion in FY2020-21 and Tk. 472.69 in FY2021-22.

Figure 28: Fiscal Burden (Billion Taka) of Government



Source: Finance Division

5.7 Out of the total announced allocation of Tk. 2376.79 billion for the 28 packages, Tk. 1839.08 billion has been implemented till March 2023, which is 77.38 per cent of the total allocation. These fiscal and stimulus packages are still in place. Moreover, at the beginning of the FY2022-23, an additional Tk 300 billion has been added to the working capital facility package for the affected industries and service sector institutions, and Tk 200 billion has been added to the working capital loan facility package for small (including cottage industries) and medium industries. The fiscal and stimulus packages have been designed, planned, and coordinated to ensure that the maximum number of people in the country can benefit. So far, the beneficiaries under the 28 packages are 7,65,32,053 individuals and 2,36,861 institutions.

B. Climate Change Extreme Event Impact:

5.8 Climate-induced disasters such as tropical cyclones and storm surges, monsoon floods, flash floods, droughts, sea-level rise, salinity intrusion, ocean acidification, etc. are exacerbating stresses on the country's otherwise tremendous development trajectory, impeding socioeconomic progress and human well-being. According to the Global Climate Risk Index 2021, published by Germanwatch[8], Bangladesh stands as the 7th among the countries most affected during 2000 to 2019 from climate extreme events. Economic losses due to climate change over the past 40 years have been an estimated USD12 billion, suppressing GDP annually by 0.5-1 percent. According to Bangladesh Disaster-Related Statistics 2021 published by the Bangladesh Bureau of Statistics, on average, 1.32 percent of annual GDP loss from 2016-2021 occurred due to climate change-induced disasters. The climate extreme events also put serious pressure on the fiscal management of the Government as the Government has to mobilize additional resources for the reconstruction of roads, bridges, culverts, houses and other infrastructures besides running relief works and providing increased social safety net benefits to the affected people. The fiscal risks posed by

Box 3: Fiscal Impact of the flash floods in the *Haor* Region

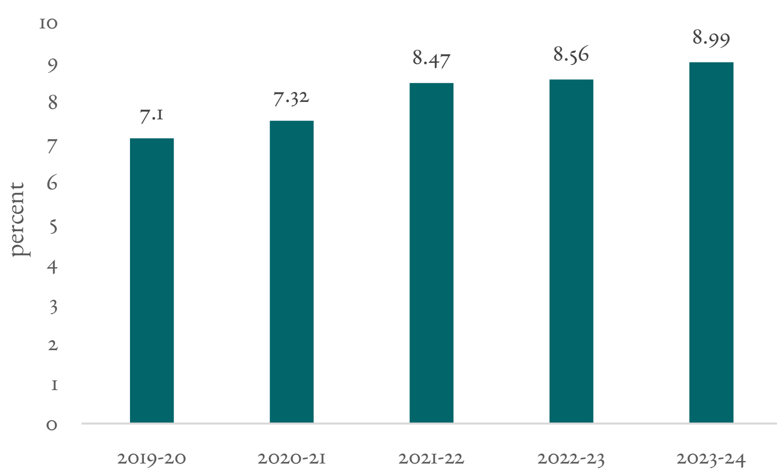
During May-June 2022, there was a flash flood in nine districts of the *Haor* region. Almost all sectors of the economy have been damaged due to the floods. There has been irreparable damage to all types of infrastructure and human life, including the agricultural sector, communication, and transport systems. In total, 2.7 million people and 10 percent of the country's land area have been affected. According to the preliminary estimate received from the relevant agencies, the government requires Tk. 7,196.77 crore to overcome the flood damage. The government has spent Tk. 1,700 crore (USD 170 million) to deal with the adverse effects of the flash floods in form of relief operations for the victims and provided some allocation for emergency relief and rehabilitation as well as infrastructure renovation and repair. The efforts taken by the government to address the negative impacts of flood creates additional fiscal burden for the government.

[8]Germanwatch. Global Climate Risk Index, 2021, https://www.germanwatch.org/en/19777

these natural disasters generally leave governments reliant on ex-post budget reallocations, emergency borrowing, and donor assistance.

5.9 The Government of Bangladesh presently spends approximately 6-7[9] percent of its annual budget on enhancing climate resilience through adaptation initiatives, among which seventy-five percent cost comes from domestic resources. The Government is fully committed to addressing the climate change-induced risks and vulnerabilities because of their significant impact on our development pursuit. Bangladesh has been estimating climate change budget expenditures and publishing climate budget reports since FY 2017-18. Now, the report covers 25 Ministries/Divisions with accounts on both budget allocation and actual expenditure. In the budget of FY 2022-23, a volume of Tk. 32,408 crore was allocated for climate mitigation and adaptation activities run by 25 ministries/ divisions of the Government which amounted to 8.56 percent of the budget. In the budget of FY 2023-24, this allocation has been increased to Tk. 37052 crore which is 8.99 percent of their budget.

Figure 29: Climate Budget of 25 Ministries/Divisions (% of Budget)



Note: Number of FY 2022-23 and 2023-24 indicate percent of budget whereas number of the other FYs indicate percent of actual expenditure

Source: Finance Division

C. Exchange Rate Risk:

5.10 Exchange rate fluctuations may create fiscal risks through diverse channels. For example, the recent depreciation of Taka in the face of reduced export and remittances due

[9] Government of Bangladesh. Bangladesh National Adaptation Plan 2023-2050, 2022. http://www.moef.gov.bd/site/news/110358e4-670c-4058-b20f-e7ab6c89feb9/National-Adaptation-Plan-of-bd-2023-2050

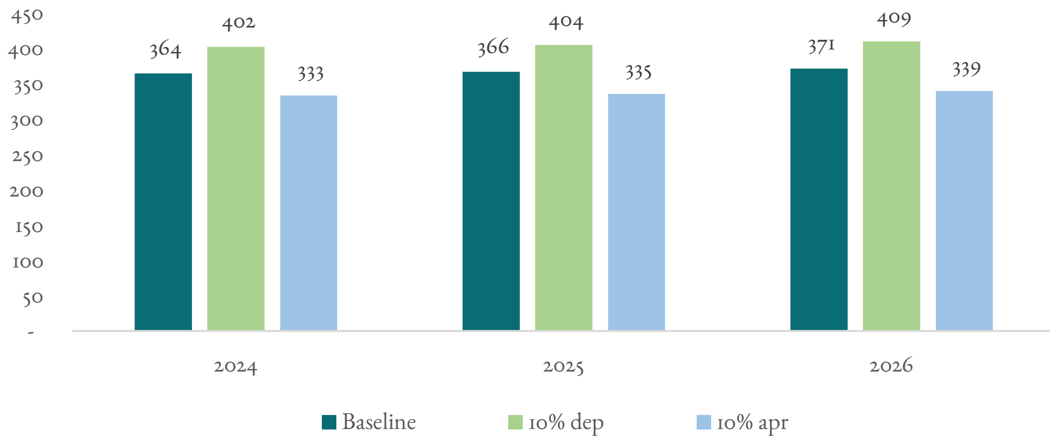
to the COVID-19 pandemic and the Russia-Ukraine war has resulted in increased expenditures for imports (the pass-through effect) and repayment of foreign-denominated debt. In fact, the public debt may shoot up if the local currency suddenly depreciates against the foreign currency, say the US dollar. Although, the exchange rate has been very stable in the past few years in Bangladesh, but recent sharp depreciation of the Taka may affect the fiscal balance and debt stock through a variety of channels. This depreciation has a direct impact on both revenues and expenditures. In the case of revenues, the impact is associated with import-related taxes. On the spending side, the main items affected are: (1) the fertilizer subsidy bill; (2) payments to BPC for oil imports (constant volumes assumed); (3) the externally financed portion of the Annual Development Program (capital spending); and (4) interest payments on external debt. Additionally, there's a valuation effect on external debt.

5.11 The upward movement of the foreign exchange rate may increase the subsidy expenditure of the government to a large extent. Due to a sharp depreciation of Taka-USD exchange rate plus fuel and commodity price hikes in the global market, Bangladesh had to increase its budget allocation for subsidies for food, fuel, power, etc. to Tk. 40,265 crore in the budget of FY23. This allocation even needed further increase; in the revised budget for FY23, this has been raised to Tk. 50,926 crore. The impact is not over yet; in the budget of FY24 a total of Tk. 66,762 crore has been allocated to make the potential subsidy payments. An assessment by the Bangladesh Power Development Board reveals that, in FY24 a Taka devaluation against one USD is likely to escalate the subsidy payment in power sector by Tk. 473.6 crore. Besides this increase in subsidy expenditure, the devaluation of the Taka may result in significant hike in project cost run by the Government. Many of the government projects, especially the mega projects, are heavily dependent on the imported items. Thus, depreciation of exchange rate may result in cost escalation of the projects creating additional fiscal burden.

5.12 The public sector debt burden may have a tremendous impact on exchange rate fluctuation. The public and publicly guaranteed debt of Bangladesh is estimated to reach Tk. 364 billion in FY 2023-24; with a projection of rising to Tk. 366 billion in FY 2024-25 and to Tk. 371 billion in FY 2025-26. An assessment has been conducted at the Finance Division to see how this debt level may be impacted by exchange rate volatilities. To assess the impact, two shocks have been given: a 10 percent depreciation and a 10 percent appreciation of the Taka/USD exchange rate. It seems that, at 10 percent depreciation of Taka, the public and publicly guaranteed debt will reach Tk. 402 billion at the end of FY 2023-24. On the contrary, at 10 percent appreciation the debt level will go down to Tk. 333 billion in FY 2023-

24. Overall, the exchange rate depreciation may raise fiscal burden to some extent in the medium term. However, despite such shocks, the debt level will remain within the sustainable ceiling.

Figure 30: PPGD Scenario due to Exchange Rate Fluctuation
(In Billion BDT)



Source: Finance Division

D. Contingent liability:

5.13 Fiscal risks are often associated with government contingent liabilities. Recent history has brought many examples of contingent liabilities that challenge government finances. Privatization and reduction of the explicit financial role of the state allowed many governments to cut their budgeted expenditures, but required either explicit or implicit promises that the government would come to the rescue should the private sector fail to deliver expected outcomes. Such guarantees and promises, in turn, have increased the uncertainty of future public financing. That is mainly because the conventional approaches to public finance analysis fail to reveal hidden government obligations and the associated fiscal risks. Realizations of contingent liabilities (that is, obligations triggered by an uncertain event), can also create substantial fiscal risks. A contingent liability can be explicit or implicit. In the first case, the conditions are stipulated in policies or legal obligations, while in the second case the obligation arises from the expectation that the government will provide support should a particular event occur. Fiscal risk analysis has traditionally focused on explicit contingent liabilities arising from contractual or legal obligations of the government.

5.14 Non-contractual commitments are also critical for fiscal sustainability, particularly those emanating from the financial sector. A feature of implicit contingent liabilities is that their hidden and/or uncertain nature may tempt governments to avoid dealing with them in a timely fashion. However, this may exacerbate the problem when they are eventually realized, as the size of the liabilities may have grown in the meantime. The fundamental explicit contingent liabilities of the government relate to SOEs and PPP projects. The government of Bangladesh customarily provides guarantees against loans contracted by the different state-owned financial and non-financial enterprises. Most loans finance the implementation of diverse public policies and programs. If the contracting organization fails to pay the loan in time, the guarantees are invoked and the liabilities for payment are passed on to the government. Consequently, these guarantees could eventually turn into outright government debt.

5.15 Public-Private Partnership projects (PPPs) may also be a source of fiscal risks. PPP is now one of the main financing mechanisms for infrastructure investment in the South Asian region. The concept is getting popular in Bangladesh as well. But PPPs can give rise to fiscal risks for governments because of direct costs and explicit and implicit contingent liabilities, and this may constrain the government's capacity to mobilize development finance. Construction projects are characterized as unpredictable, high-risk dynamic, and change-prone. Furthermore, many governments don't have long-term budget frameworks, so PPP spending in future years is often not recognized. Hence, any sudden need of Viability Gap Funding (VGF) in the case of PPPs can impose extra-budgetary pressure on the fiscal authority of a country. Currently, the Finance Division has obligations for two PPP projects namely 'Upgrading of Joydevpur-Debogram-Bhulta-Madanpur (Dhaka Bypass) Road into 4-Lanes', which has a VGF obligation amounts to TK. 2.24 billion and the second one is 'Construction of Dhaka Elevated Expressway' with a VGF obligation of USD 305.55 million. Hence, the second project also poses some exchange rate risk as well. However, currently there is no other application for VGF which indicates less fiscal risk in this regard. On the other hand, any unexpected phenomenon similar to COVID-19 or inflation can raise the project cost and can increase the need for VGF.

Revenue Side Risks

5.16 On the revenue side, the fiscal risks comprise compliance risks and regulatory risks. It is essential to take a wide-angle view of why due tax is not paid by taxpayers. Ignorance about tax liability or tax evasion is two reasons at opposite ends why due tax is not paid. A good grasp of what causes non-payment of taxes will help to rectify and address the underlying reasons. Segregation of taxpayers based on risk categorizations and the level of risk appropriate strategy can be adopted to increase revenue collection. Taxpayer education can be a starting point to help taxpayers understand the tax regulations and their tax liability. Making the registration process simple and easy to complete will encourage better compliance. Taxpayers need to be informed about when tax return submission is due and what information is necessary to be included in the return. If some parts of the return/ form can be pre-filled by the tax administration with information that they already have that will encourage the taxpayer to fill out the remaining part. Facilitating payment of taxes and making it hassle-free will also increase tax collection. There will be cases where the risk is high and that will warrant greater scrutiny and fact-checking by conducting formal audits and investigations.

5.17 Tax expenditures are indirect costs to the government. Unwarranted exemptions increase fiscal risks of the government and may disrupt fiscal stability. To quantify the amount of forgone revenue from exemptions it is essential to set the benchmark tax rates first. A stock taking of the existing tax exemptions, rebates, special treatment, deferred payments etc. given to taxpayers is necessary to justify the rationale and efficacy of such decisions. Ensuring data availability and data sharing through increased collaboration across tax wings and with other related offices will be necessary to make good estimates of revenue loss from tax exemptions. Although much of the tax breaks given to different sectors, such as health, education etc., are essential to meet socio-economic objectives, there are other industry-specific exemptions where such tax benefits should be offered for a specific period and a thorough cost-benefit analysis of such exemptions needs to be done before these are offered and also at the regular interval after the exemptions come into play.

Other Fiscal Risks

5.18 Besides the risks mentioned above, there are a variety of other factors that may cause fiscal outturns to diverge from forecasts. The fiscal balance may show significant sensitivity to other macroeconomic shocks arising from factors such as commodity prices and interest rate. The commodity price hike may require additional mobilization of social safety net programs which will increase the fiscal burden of the government. On the other hand, interest expenses now form a significant share of total fiscal expenditure in Bangladesh. In

FY 2022-23, the total estimated interest payment amounts to Tk. 90,013 crore which is 13.6 percent of the total expenditure. Thus, the shocks to interest payments may have a significant impact on the fiscal balance.

5.19 Some specific issues such as the recapitalization of state-owned banks and institutional weakness could also negatively impact fiscal aggregates. Structural or institutional weaknesses, in fact, can constrain the effectiveness of overall fiscal risk management. Especially, the absence of clear demarcation of duties and lack of proper coordination among different levels and agencies of the government can decrease the government's ability to implement the desired fiscal policy or undermine its ability to identify and respond to shocks. The absence of necessary data could also add to the risks as the likelihood of policy errors may increase in such cases. On another note, the weak balance sheets of state-owned banks and their outstanding nonperforming loans may necessitate capital injection which may add to the government's fiscal burden. Again, the demographic issue of the aging population may cause additional fiscal cost in the form of pension payment to the public servants.

Way Forward

5.20 To mitigate fiscal risks, the government has adopted various risk mitigation strategies which include: transfer and reduction of risks, creating fiscal buffer against potential risks, and diversifying risks through various measures. However, there are scope for further improvements including: the incorporation of fiscal risks in fiscal analysis and budgeting, updating fiscal risk sources through institutional measures, and rationalization of tax expenditure underpinned by quantitative analysis.

5.21 Transferring the liability is an effective strategy for risk reduction. Recently, the government has raised the petroleum prices broadly in line with international prices which has decreased some of its fiscal burden. The government will introduce a periodic formula-based fuel price adjustment mechanism which is very likely to help ensure no structural subsidies for petroleum products. However, the government is yet to adopt any such policy for power or gas sector subsidies.

5.22 Creation of a buffer against potential risk can be a good mitigation strategy. Currently, the government keeps block allocation in its budget that helps address unexpected expenditures. Added revenue mobilization activities along with a reduction of expenditures such as subsidy payments may create additional fiscal space which may help mitigate the potential fiscal risks.

5.23 On the revenue side, diversification of revenue sources can be used as a tool to mitigate risks. In FY 2022-23, up to February 2023, a major portion of the NBR tax comes from indirect taxes. Out of the total NBR tax, 40.50 percent was collected from VAT, 30.21 percent from Income Tax, 14.37 percent from Supplementary Duty, 12.83 percent from Import Duty, and the rest from Excise, Export Duty, and other Taxes. The connection of tax collection in some specific items may add to risks. To avoid it, new avenues of revenue need to be explored.

5.24 There is much scope for institutional improvement to address the fiscal risks more effectively. The analysis of fiscal risks can be incorporated in the budget preparation process and allocations may be made accordingly. Besides, the sources of fiscal risks can be stock taken and updated regularly through institutional measures. Furthermore, rationalization of tax expenditures can reduce risk and add to fiscal space of the government.

5.25 Bangladesh economy has intended to surpass the pre-covid growth path in the medium term. Robust demand side and public sector-driven supply side developments are the key to this high growth trajectory. Inclusive growth through impressive poverty reduction acts as an important growth driver for the economy. Investment bottlenecks are gradually being eliminated to boost private investment. Revenue mobilization has been considered an important policy strategy that will underpin the growth trajectory of the country. The road ahead is full of potential, and challenges and Bangladesh is preparing accordingly. With careful planning and the firm will of the people, the country is now ready to take off to fulfill the goals of sustainable development and build a smart society for future generations.

Macroeconomic Wing

Finance Division, Ministry of Finance

Government of the People's Republic of Bangladesh

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