

## **Bangladesh: Joint Staff Advisory Note on the Poverty Reduction Strategy Paper**

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INTERNATIONAL MONETARY FUND AND  
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BANGLADESH

**Joint Staff Advisory Note on the Poverty Reduction Strategy Paper**

Prepared by the Staffs of the International Monetary Fund (IMF)  
and the International Development Association (IDA)

Approved by Masahiko Takeda and Peter Allum (IMF)  
and Isabel Guerrero (IDA)

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**I. OVERVIEW**

1. **Bangladesh's Sixth Five Year Plan (SFYP)—*Accelerating Growth and Reducing Poverty*—provides a framework for implementing the Government's development agenda during FY11–FY15.**<sup>1</sup> The SFYP lays out the strategic directions and policy framework for achieving the main socio-economic targets set out in the first five-year period of the Government's Perspective Plan 2010–2021. These targets are also articulated in Vision 2021, which envisages Bangladesh reaching middle-income economy status by the beginning of the next decade. Published in July 2011, the SFYP was prepared by the current Awami League government and serves as Bangladesh's current Poverty Reduction Strategy Paper (PRSP).<sup>2</sup>

2. **This Joint Staff Advisory Note (JSAN) provides feedback on strengthening the SFYP as a poverty reduction strategy (PRS) in keeping with Bangladesh's development objectives.** Staffs of the World Bank and the International Monetary Fund also identify priority areas for improving the SFYP during its implementation.

3. **All levels of society were consulted during the preparation of the SFYP.** Discussions took place with line ministries, local governments, development partners, academia, civil society organizations, labor union organizations, environmental activists, and the private sector. Ten national level dialogues comprising relevant ministries and stakeholders were conducted, in addition to two regional level dialogues. Meetings with the development partners (DPs) were also held for consultations on the draft plan. In this respect, it is noteworthy that the SFYP makes reference to the signing of a joint cooperation strategy in June 2010 toward strengthening the partnership between the Government and its DPs.

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<sup>1</sup> The fiscal year is July 1–June 30, with FY11 commencing in 2010.

<sup>2</sup> It replaces the previous PRSP, *Steps Towards Change: National Strategy for Accelerated Poverty Reduction II*, which was submitted to the Executive Boards of the World Bank and IMF and discussed in the previous Joint Staff Advisory Note dated April 2010.

## II. MACROECONOMIC FRAMEWORK AND POLICIES

4. **In staffs' view, the growth targets set out in the SFYP's medium term macroeconomic framework are ambitious, with a high growth baseline anchoring Bangladesh's PRS.** The thrust of the macroeconomic framework is broadly in line with the reform scenario outlined in the IMF staff report for the Government's request for three-year arrangement under the Extended Credit Facility (ECF), which was approved in April 2012.<sup>3</sup> Under the Government's ECF-supported program, raising medium-term growth to 7-8 percent a year hinges on higher investment rates, including additional public investment financed from increased tax revenues. The SFYP emphasizes raising growth and employment as the primary means for reducing poverty by 10 percentage points by the end of the plan period. In staffs' view, the SFYP poverty target of 22 percent by 2015 is consistent with the SFYP growth target of 8 percent given the success the Government has had in reducing the poverty rate to 31.5 percent from 49 percent between 2000 and 2010. However, staffs find both targets to be overly optimistic. Staffs view a poverty rate of 26 percent as a feasible target if growth averages 6 percent over 2010–2015, with average growth of 6.5 percent achieved in FY11–FY12.

5. **So far, the SFYP has underperformed in meeting its growth targets, given lagging investment growth and a challenging external environment.** Now entering its third year of implementation, the SFYP's projected growth trajectory—averaging 7.3 percent annually during the plan period and rising to 8 percent by the end of the period—should be revisited to make the SFYP a truly living document. A key challenge to raising growth to the targeted level is to increase the investment rate from the below-plan 25 percent of GDP in the past two years to 32.5 percent by the end of the plan period. On the sectoral targets, increasing agricultural growth from 2.5 percent in FY12 to 4.4 percent in FY13–15 despite the ongoing loss of arable land would hinge on an infusion of new technology and substantial rise in total factor productivity. While some adjustments to the macroeconomic framework to account for the deviation of actual from planned performance are shown in the medium-term budgetary framework (MTBF) documents prepared with the Government's budget each year, the growth trajectory in the FY13–FY17 MTBF remains as optimistic as in the SFYP.

6. **Staffs note that the SFYP recognizes that the targeted increases in public and private investment entail adopting bold strategies to break away from the past, and would urge clear timelines for specific policy approaches.** The areas identified for reforms—developing vital infrastructure and human resources, deepening financial markets and access to finance for the poor, expanding trade opportunities—indeed constitute some critical constraints to investment growth. The Plan is, however, short on specifying the time path of the key policy instruments. It does not go beyond stating the principles that will guide the choice and timing of alternative policy instruments. Notably, the SFYP could define time paths for rationalizing tax rates and exemptions, targeting official subsidies, and reducing quasi-fiscal losses—all key to creating more fiscal space to raise pro-poor social and development spending. The same holds for easing trade protection, undertaking institutional reforms, and taking other steps to improve the trade and investment climate to strengthen Bangladesh's competitiveness and engender more export-led growth.

7. **Staffs welcome the commitment in the SFYP to maintain macroeconomic stability, which is underpinned by a prudent fiscal and monetary framework in the Plan.** Average

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<sup>3</sup> See IMF Country Report No. 12/94.

headline inflation in FY11 and FY12 at 8.8 percent and 10.6 percent were markedly higher than the 7 percent on average envisaged during the SFYP period, as expansionary monetary and fiscal policy increased pressures, against the backdrop of rising international commodity prices. Notwithstanding, the targeted inflation rate should be achievable beginning from FY13, based on aggregate demand policies and commodity price trends which have already had an impact, as inflation decelerated to 7.3 percent in September. Fiscal policy is also on track. A fiscal deficit (excluding grants) within 5 percent of GDP in FY12, accompanied by rising tax revenue as a share of GDP, should underpin performance, with tax revenue already exceeding 10 percent of GDP for the first time in FY11, supported by gains in tax administration and modernization. More restrained policies together with a strengthened commitment towards exchange rate flexibility noted in the SFYP would also serve to help Bangladesh manage external pressures and achieve an average reserves cover of 3.5 months of imports during the plan period.

8. **In staffs' view, the financing of public investment under the SFYP requires intensifying domestic revenue mobilization while encouraging non-bank financing sources and being more aggressive in unlocking external financing on concessional terms.** The SFYP envisages heavy reliance on domestic sources of financing, many of which (public savings, capital receipts, self-financing by state owned enterprises) have limited potential as sources of funds, and may crowd-out financing for private investment. The projected increase in public saving by about 2 percentage points of GDP during the plan period requires that the strategy for revenue mobilization is realized and current expenditures and net lending, particularly related to subsidies and transfers, are contained. The external financing strategy commits to maintain the current strategy of borrowing as much as possible on concessional terms while at the same time diversifying the sources of external financing. Staffs urge that such financing be focused on high return projects. However, the gross external disbursements target—at 2 percent of GDP on average per annum during the plan period—is not ambitious enough, being only marginally higher than historic trends. In the event, the reliance on external financing would decline and that on domestic financing would increase. While the relatively high cost of domestic debt is unlikely to pose any debt sustainability issues in the medium term because of the initial low domestic debt (as a share of GDP), it still reduces the fiscal space needed for undertaking priority operations and maintenance and new public expenditure programs. To alleviate this problem, the SFYP appropriately envisages debt management reforms to reduce the cost of domestic borrowing and develop the domestic debt market. Staffs advise that all borrowing be undertaken within the context of a comprehensive debt management strategy that also considers contingent liabilities.

### III. GROWTH AND INCLUSION: PRIORITIES AND CRITICAL AREAS FOR SUCCESS

#### A. Charting a Country-specific Course for Economic Growth

##### Finance and Private Sector Development

9. **Overall staffs welcome the focus of SFYP on strategies, policies and institutions that stress the private sector as the spearhead for industrial development and exports.** The Plan emphasizes the creation of high productivity jobs and efficiency gains through increased competition. Staffs also support the SFYP's focus on the need to increase the share of manufacturing in GDP—particularly export-oriented manufacturing—coupled with productivity increases in the agriculture and services sectors.

10. **Staffs agree with the SFYP's identification of regulatory bottlenecks as major obstacles to growth and support the Plan's intention to address industry-specific barriers to competitiveness.** Staffs also welcome the Government's commitment to engage the business community on policy issues through Public Private Dialogue (PPD). However, the Plan is unclear on how these bottlenecks will be addressed. Staffs suggest that in addition to the infrastructure and power bottlenecks, overarching and sectoral investment policies and strategies should also be developed. Staffs encourage the Government to take up a well-designed and structured program to identify regulatory barriers and undertake regulatory reforms with the prioritization and sequencing of such reforms. In order to institutionalize regulatory reform, staffs encourage the use of the Private Sector Development Policy Coordination Committee, housed under the Prime Minister's Office, as a coordinating and driving force for wider reforms to improve the business environment. The Government should also take advantage of the newly formed private sector-led PPD platform, Business Initiative Leading Development (BUILD), in order to hold regular, structured, and evidence-based policy dialogue with the private sector. Public awareness campaigns to disseminate the participatory approach will also strengthen the watchdog role of stakeholders, including stakeholders outside the private sector, and thereby increase transparency and accountability.

11. **Staffs concur with the SFYP's recognition of public-private partnership (PPP) as an important tool to supplement government resources.** Recognizing the role of PPP in bridging the infrastructure gaps and in improving service delivery in social sectors is a pragmatic step. However, the Plan could be strengthened by: (i) detailing a credible financing strategy; (ii) outlining a concrete strategy or action Plan for PPP capacity development in different ministries; (iii) detailing the resources necessary for sector/project-wise feasibility studies and transaction advisory services; and (iv) explicitly specifying the functions of the PPP Office to ensure effective coordination between the line ministries and the PPP Office.

## **Trade and Investment Policies**

12. **Staffs endorse the Plan's endeavor to achieve the transition to the higher growth path through a strategy that transforms Bangladesh from a rural agro-based economy toward an urban manufacturing-based economy.** The Plan aims to deepen the labor-intensive export-oriented manufacturing sector, together with a more diversified, commercially viable agricultural sector. The intention is to create more jobs in the manufacturing and organized services sector while raising productivity and incomes for the remaining but substantially lower percentage of labor force engaged in the farm sector. The Plan's strategy will be implemented through an array of reforms encompassing macroeconomic management, tax and public expenditure policies, trade policy, financial sector policies, policies for infrastructure development, and policies for the development of a skilled labor force. Staffs concur with the SFYP that human development, infrastructure and power are the top priorities for investment.

13. **Staffs are concerned with the recent reversals in trade liberalization, which may have an adverse impact on regional integration.** Earlier progress with trade liberalization has served Bangladesh well in accelerating growth and reducing poverty. Although the SFYP envisages a review of the trade protection regime to support the growth of a labor intensive, export oriented manufacturing sector, the expansion of a range of para-tariffs during last three years is worrisome. These have offset all the reduction in average nominal rate of protection while the real effective rate of protection has increased since 2006. The current trade regime undermines export competitiveness and impedes export diversification that harnesses domestic and external resources to their best

advantage. Staffs encourage a strategy for deepening efforts for regional South Asia cooperation and trade through liberalization of trade policies and development of logistics and transport corridors with neighboring countries.

## **Agriculture and Rural Development**

14. **Staffs support the pivotal role of agricultural and rural development as set out in the SFYP in order to improve food security and enhance income earning opportunities.** The Plan identifies concrete measures to address land productivity, diversification of agricultural production, access to markets, adaptation to climate change, the role of technology for agricultural information dissemination, and the nutrition dimension of food security. The Plan also provides the legal institutional framework for a more decentralized agricultural extension system and is further strengthened with reference to the National Food Policy. Staffs recommend that the proposed policies and strategies would need to be further prioritized and sequenced, including an institutional capacity analysis and development of a policy and strategy for stimulating overall agricultural performance. In addition, the Plan could also have benefited from putting more emphasis on the recently revised National Agricultural Extension Policy.

15. **However, staffs are of the view that specific policies and strategies could have been developed to address emerging issues and challenges.** This includes strategies and policies for: (i) promoting crops requiring less water, encouraging water recycling and location specific surface water harvesting and conservation; (ii) improving access to land and land security, especially for vulnerable groups; (iii) institutional capacity strengthening of producer organizations; and (iv) promoting stronger economic partnerships and contract farming amongst key actors for strengthening the competitiveness of the sector.

## **Infrastructure and Urban Development**

16. **Staffs welcome the proposed strategies for the energy sector, together with targets and a timeline, which clearly recognize the issues that are hindering growth in the sector.** The SFYP has assumed extensive participation from the private sector in power generation with the assistance of Independent Power Producers (IPPs). With this action, the Government has managed to reduce load shedding during summer in the last two years. In addition, there has been some progress in awarding contracts to the private sector, but raising finance from the international market is still a concern because of the perception of the sector's poor governance. Furthermore, although the SYFP stresses the need for sector reform and further unbundling of generation and distribution operations of the Bangladesh Power Development Board, given the multitude of challenges, staffs observe that reform is presently facing strong resistance. With the Government already behind schedule in some of these planned activities, staffs are concerned that the targets are too ambitious, with the implementation of these targets within the timeline posing significant challenges.

17. **Staffs conclude that, going forward, for the energy sector the challenges are significant and the investment requirements to implement the SFYP are sizeable.** Some of the challenges are: (i) delay in the implementation of large base-load power plants as listed in the SFYP making the sector dependent on the substantial subsidy for payments to the private generators; (ii) the availability of natural gas for supporting the Government's ambitious power generation expansion Plan in SYFP; (iii) the need for more exploration work to be undertaken quickly to cover the immediate energy shortfall; (iv) the below-cost gas price, which needs to be gradually increased and

indexed to the international fuel oil price to attract more investments in the sector; (v) the country's ample coal reserves, which remain underutilized in the absence of a coal policy so as to reduce the country's high dependency on gas for power generation as planned in the SFYP; (vi) limited collaboration between gas and power sectors; and (vii) relatively poor governance of the energy sector.

18. **Staffs welcome the explicit discussion in the SFYP of rapid urbanization and the challenges it creates for Bangladesh.** The Plan also provides some background on the past policies and programs for the management of urbanization as well as the institutional arrangements in the urban sector, together with an urbanization strategy which focuses on the development of sound urban institutions, improves city governance, and emphasizes urban resource mobilization. However, staffs suggest that the Plan could have presented a more dynamic picture of urban development, integrating the growth dynamics of the Bangladesh economy into the urbanization process. Further, the SFYP promotes the balanced development of urban centers but is short on articulating on its implementation and that of the urbanization strategy in general. In staffs' view, beyond what is proposed in the SFYP, some innovative solutions are needed to create an integrated and coherent approach to urbanization under the aegis of a separate ministry for urban development.

19. **Staffs are of the opinion that the SFYP has established extremely ambitious targets for the water supply and sanitation sector, particularly in the urban settings.** Although the SFYP shows a commitment to enhancing the levels of access to water supply and sanitation facilities, the centralization of service delivery of water and sanitation is at odds with the considerable focus on decentralized service delivery throughout the SFYP. Staffs recommend that legal and social instruments are developed to enable local governments to effectively coordinate the provision of services by both governmental and non-governmental providers.

## **Knowledge Economy**

20. **Staffs welcome the detailed discussion in the SFYP on the strengths, weaknesses, and opportunities that Bangladesh faces for it to transition into a knowledge economy.** However, as the Plan does not propose any prioritization of activities or policies to bring this to fruition, staffs suggest that policies be prioritized along the following key pillars: (i) an appropriate economic and institutional regime that provides incentives for the efficient use of existing and new knowledge and the flourishing of entrepreneurship; (ii) an educated and skilled population that can create, share, and use knowledge; (iii) an efficient innovation system of firms, research centers, universities, think tanks, consultants, and other organizations that can tap into the growing stock of global knowledge, assimilate and adapt it to local needs, and create new technology; and (iv) information and communication technologies (ICT) that can facilitate the effective communication, dissemination, and processing of information.

## **B. Promoting Human Development**

### **Education**

21. **Staffs welcome the SFYP's analysis of the key constraints facing the education sector and endorse the Government's vision for education in Bangladesh.** The Plan details how students from poor households continue to be at a disadvantage and cites the notable progress made on early marriage for girls and low female participation in the labor market, but acknowledges that



more progress is needed. Staffs are of the view that while a number of proposed activities to address these constraints are discussed in the Plan, it does not elaborate on the implementation of the strategy. Moreover, the Plan does not divulge the operationalization of performance indicators, which are key to measuring the success of the strategy.

**22. Staffs are of the opinion that the Plan needs strengthening in addressing important aspects of the education sector in Bangladesh.** The Plan's discussion of the education sector needs to address the following: (i) a more detailed discussion on higher education and early childhood development; (ii) separation in the discussion on the issue of equity across gender and socio-economic perspectives given that while there is a reversal of the gender gap in favor of girls in primary and secondary education, at tertiary level, girls are still lagging behind; (iii) the linkages between the labor market and reforms in the education system to address the skills mismatch; and (iv) the returns to quality of education given that the quality of education is highlighted in the SFYP as a significant development challenge.

### **Health, Nutrition, and Population**

**23. Staffs concur with the SFYP's assessment that there is need to strengthen governance in the health sector to sustain Bangladesh's impressive health gains over the last decade.** The SFYP acknowledges that improvements in governance are still needed. Specifically, improvement in governance related to absenteeism, postings/vacancies, procurement, management of medicines, and resource allocation are needed. Staffs also support the Plan's recommendation that focused leadership at the Ministry of Health and Family Welfare (MOHFW) and better governance over healthcare provision require strong coordination across the various departments at the MOHFW, building partnerships with NGOs and improving monitoring and evaluation. Staffs caution that, going forward, it will be essential to develop practical and realistic strategies for overcoming governance obstacles stemming from misaligned individual and institutional incentives. Staffs also recommend that a mixed health care system will require accelerated development of well-designed health PPPs to ensure equity so that the poor are able to access services.

### **C. Reducing Poverty, Ensuring Inclusion, and Providing Social Protection**

#### **Poverty Diagnostics**

**24. In staffs' view, the poverty diagnostic in the SFYP is well prepared and of high quality, demonstrating that the foundation of the SFYP is based on a solid understanding of the issues and challenges the country faces.** The Plan provides a clear and comprehensive overview of the evidence detailing the great progress Bangladesh has made in reducing poverty and highlights the challenges the country faces. It also gives a good overview of where Bangladesh stands today in terms of the MDGs and the economy as a whole. Staffs believe that while all stated goals are desirable, the Plan should set clear priorities and well-defined targets.

**25. Staffs note that the SFYP reveals some persistent gaps that are of critical importance to assessing progress and designing policy to reduce poverty.** Data limitations have some adverse impact on the reliability of price data, as faced by the poor and by households in general, in the calculation of the consumer price index (CPI). As such, there exists some divergence between the measure of inflation used to calculate the official poverty estimates and the CPI. Reliable data on the labor force also remains scarce. This adversely affects the analysis of the supply- and demand-side

constraints to generating more and better jobs. Not only do these data constraints limit the monitoring of progress under the SFYP but also curtail the ability of the Government to design appropriate policies to reduce poverty. Notwithstanding, staffs acknowledge the efforts underway by the Bangladesh Bureau of Statistics (BBS) to increase the frequency of the Household Income and Expenditure Survey to a three-year cycle.

## **Social Empowerment, Inclusion, and Protection**

26. **Staffs welcome the SFYP's integration of the different groups of vulnerable communities into its program for social inclusion and empowerment.** Firstly, the Plan recognizes that the development of ethnic communities has created a challenge regarding the allocation and use of land. Staffs are of the opinion that resolution of this issue is only possible through a participatory process. However, the SFYP describes no such participatory processes. Secondly, the Plan's targets and strategies for inclusion and empowerment of women, while admirable, are not prioritized and, as such, may be difficult to achieve. Staffs are also of the view that the social inclusion agenda is weakly articulated and lacks clarity on the questions of how the proposed actions will be implemented or funded given very limited budget space.

27. **Staffs welcome the emphasis on broadening the scope of social protection expenditures, which have historically supported primarily safety net programs.** In this vein, staffs concur with the new emphasis placed on the importance of social protection for the urban poor, the elderly, women, children, and disabled persons in the delivery of safety net benefits. The SFYP focuses on developing a comprehensive, well-targeted and cost-effective social protection system to include in a range of social insurance programs. To provide such a system, staffs recommend a consolidation, integration, and rationalization of the numerous overlapping safety net programs in Bangladesh. Further, a clear focus on an equity-based approach will be more cost-effective given limited resources. Improving the administrative capacity of programs and delivery mechanisms based on technological innovations will also help to reduce leakage. Staffs also recommend that the National Social Protection Strategy, currently being planned by Government, builds on these policy priorities to develop a social protection system composed of harmonized safety nets, social insurance, and labor market programs.

## **Regional Disparities**

28. **The SFYP correctly recognizes that analyzing spatial differences in poverty is key to better understanding why poverty differences persist and suggests how to concretely address and correct the situation.** In staffs' view, the SFYP aptly identifies spatial differences and vulnerable groups, and the analysis and strategy to address existing regional gaps is well integrated into the overall Plan. Notwithstanding the possible positive agglomeration effects of firms congregating in urban poles, staffs suggest that the SFYP needs to place more emphasis on regional development and incentivizing industries to relocate to lagging regions in part given the severe urban infrastructure constraints, which are exerting a limiting effect on potential agglomeration benefits. One strategy is the mapping of land fertility across the country to lay out a better land use policy. Staffs recommend broadening the understanding of the regional disparities by going beyond the East-West division line, placing more emphasis on understanding the urban/rural differences across districts and regions.

29. **Staffs recommend a more systematic collection of reliable data on spatial gaps and disparities.** A key problem with monitoring progress on regional disparities is that the current gaps are somewhat disputed due to questions about credible measures of spatial differences in prices and cost of living. For example, the construction of a CPI that can be disaggregated by geographical areas would allow for the proper tracking of the macro- and micro-developments taking place at the regional level. In addition, the SFYP could utilize the expertise developed by BBS in partnership with the World Bank in the usage of the powerful small area estimation tool, which is used for tracking malnutrition and poverty.

#### **D. Addressing the Governance and Institutional Challenges**

30. **Staffs support the SFYP's focus on improving governance by strengthening government institutions and by addressing corruption.** The list of governance related policy priorities is comprehensive and indicates a large and challenging reform agenda. Staffs welcome the Plan's strategy of enhancing transparency and increasing the use of ICT-enabled provision of services to reduce opportunities for corruption. Given that Bangladesh's governance challenges have deep roots, achieving improvements across the board will necessarily require a long-term effort. The specific actions identified include those to address issues of performance evaluation, political influence, corruption and code of conduct, and pay-scale decompression in the civil service. Staffs recommend that actions should be prioritized and sequenced, and suggest that the institutional reforms move forward in tandem with the proposed actions to build the administrative capacity through civil service reform, in order to improve public sector efficiency.

31. **Staffs welcome the Plan's strategy of improving the efficiency and quality of service delivery through decentralization.** The SFYP also increases the devolution of responsibility with respect to financing to local governments. The Plan also acknowledges the need to address first of all the legal framework and the capacity of local authorities, especially the planning and budgeting capacity that would need to be in place for this strategy to successfully improve services at the local level. Staffs recommend a clearer articulation in the SFYP of the actions that will be implemented to improve the capacity of local governments.

32. **In addressing on-going challenges in public financial management (PFM) reform, staffs commend the Plan's recognition of the need for further reforms of the planning and budgetary processes and for enhancing monitoring and evaluation.** The Plan highlights the importance of strengthening the line ministries' capacity to improve the budget process within the context of the Medium-Term Budget Framework. Staff recommend that to provide a more comprehensive view on PFM reform, the suggested actions could include: (i) a specific roadmap for improving coordination between the development and non-development budgets, (ii) actions to finalize the enhancement and roll-out of an integrated budget and accounting system to improve financial accountability; and (iii) actions towards full independence of the Comptroller and Auditor General's Office and improvements in external scrutiny from audit and legislature.

#### **Digital Bangladesh and E-Governance**

33. **The SFYP has documented the potential use of ICTs to enhance the quality of governance and delivery of services.** Bangladesh has taken great strides in telecommunication sector reforms, improving telecommunications access during the previous planning period. Bangladesh now has the opportunity to develop a nationwide wireless high-speed broadband