Covid-19: Structuring a Stable and Inclusive Economic Recovery for Bangladesh

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Executive Summary

The Pandemic-led Twin Crises: The global community, faces unprecedented twin crises, intertwining both health and economy, that stem from the COVID-19 pandemic and the subsequent restrictions on economic and social activities. Bangladesh, as a member of the global community, is also seeing the early signs of a possible exponential outbreak, which has compelled the Government to impose a quasi-lock down till the 30th of May. Prior to this pandemic-induced economic shock, Bangladesh experienced a robust economic performance under the AL-led Government between 2009 and 2019 – with per capita income expected to reach $2000 in FY20, while lifting more than 10 million people out of poverty during the last one decade.

Major Economic Shock Affecting Global, Asian, and Bangladesh Markets – culminating in Lower Growth, Higher Unemployment and Rise in Poverty: Severe slowdown is being projected in Global and Asian economies due to massive slump in production, consumption, and investments**.** IMF projects global growth to fall to minus 3% in 2020 while Asia's growth is likely to be zero, a first-time in last 60 years. Closer to home, growth in South Asia will have no respite and will dwindle to a range of 1.8 to 2.8 percent in 2020. Bangladesh, having displayed a robust average growth of more than 7% over last decade, will also fall victim to the severe slowdown with growth rate falling between 2 to 3 percent in 2020. Consequences will be devastating with loss of jobs, income, remittances, trade and investment. World Bank estimates that for each $1 million in foregone domestic demand in service sector, Bangladesh will lose 125 jobs. The demand shock is also expected to push millions into poverty – which requires immediate unemployment and poverty impact assessments of Covid-19 in Bangladesh.

Financial Sector will be Key to Economic Recovery and Requires Special Attention: The design and implementation guidelines of the Bangladesh COVID- 19 stimulus packages makes the role of financial institutions a critical**.** It is imperative that the financial sector, particularly the banks, are able to minimize the adverse impact of COVID-19 on their operations and financial health, which in turn, will also require addressing some of the challenges facing the sector in the run up to the pandemic. Among others, the sector is braced for risks such as increase in credit risk, deterioration of credit quality, with potential increase in loan loss provision for private commercial banks, reduced risk appetite and expected lower new lending volume. These would significantly reduce profits for the banking sector and some banks may incur loss on a pre-tax basis.

Adverse Impact on SMEs will Lead to Unemployment and Increase in Poverty: Hardest impact of the 'lockdown' is expected to fall on the SMEs as they are dependent on a short cash cycle which has been affected as a result of supply chain disruption and loss of sales**.** SMEs' capacity to absorb shock is limited, and any disruptions in production and sales beyond few weeks can wreak havoc to these firms' capacity to survive. A recent survey shows about 50% SMEs have halted operations, and 68% will have to permanently wind up business in case of prolonged lockdown. Prolonged constraints in demand and supply will lead to many small firms to shut down, intensifying the unemployment problem. Lack of ability of these firms to service payment obligations such rent, debt-servicing, and VAT raises the risk of contracted enterprise base in the economy.

Strengthening the Policy Response for Greater Impact: Government of Bangladesh also announced a seemingly generous stimulus of more than BDT 1.4 lac crore economic stimulus package with several components targeting different parts of the private sector, agriculture, and vulnerable population. The assistance program was quick to be put in place, bold in size, and inclusive in objective. That said, there exists a number of improvement opportunities to make the package deliver higher impact than what it may do in its current form.

Key Recommendations

1. **At least 2% of GDP as Investments in the Health Sector:** The Government must make heath sector – a priority sector - to contain the crisis as much as possible. Given the health crisis is intimately intertwined with the economic crisis, keeping the pandemic under control will be fundamental to reopening the economy. In this context, the Government must use the upcoming National Budget FY21 to mobilize higher resources for the health sector.

2. **Maintaining a Budget Deficit of 7 - 8% for FY21 (and even FY22):** The forthcoming National Budget will be prepared against the backdrop of two central uncertainties: {i} whether Europe and the US will experience a "V-shaped" economic recovery or not; {ii} how the virus will itself unfold in Bangladesh over the next six months. Consequently, it is prudent to expect weak revenue mobilization performance in FY21 (and even FY22), which necessitates that the GoB relies on bold monetary policy initiatives to support critical fiscal expenditures, such as supporting SMEs, providing income transfer to the poor, and stabilizing the financial sector.

3. **Financing the Stimulus Package Through Concessionary Multilateral Borrowing and Re-allocation of Resources in GDP:** The Government should seek at least $5 billion of financing from the World Bank, IMF, ADB, EU and the JICA to ensure that its stimulus does not create a high domestic debt burden, which is usually more expensive than foreign loans. Bangladesh faces a low public debt to GDP ratio, which gives it some cushion to devise a stronger stimulus. Government must also reallocate resources from development budget by withholding and/or cancelling non-urgent development projects.

4. **Subsidize Interest Rate Waiver in the Banking Sector:** The Government can consider turning cumulative interest payments from the previous loans – for the period between March to August – into long-term liabilities with manageable interest rates – perhaps at 6.5%. This also might require subsidization for the banking sector – as they are increasingly under the pressure to service short term deposits with long-term loans. The exact amount of the subsidization might vary between Taka 15000 to Taka 20000 cr. – as loan defaults will make it difficult to service existing depositors for the months between April and September.

5. **Delivering Direct Assistance to Poor through Digital Financial Service**: The Government must consider direct income transfer to 10 million poor through digital financial service for two months – perhaps Taka 5000 to each family per month for the month of July and August – when economic activities es expected to remain lukewarm due to the after effects of the lockdown. This will only cost the government Taka 10000 crore in FY21. Furthermore, to enhance better targeting – GoB, should consider one-to-one mapping of NIDs and Mobile Telephone Numbers – and use transactional history from DFS operators and Mobile operators to screen economically vulnerable individuals. The creation of an accurate "data bank" of the poor is absolutely fundamental – and the process must allow citizens to offer feedback to regularly correct the beneficiary list.

6. **Broaden the Health Coalition to Involve Non-government Actors:** The Government should immediately involve private hospitals and NGOs in its current response framework, so that their capacities can be used to deal with the patients. The Government should also involve the NGOs to identify the poorest families, so that a better framework of targeting guides its distribution of relief and aid. BRAC, in this context, has a long history in both devising support for the poor and undertaking public health programmes.

7. **Adjusting the Stimulus Package for Greater Impact:** Success of the stimulus package will require pragmatic design, effective implementation, and robust monitoring and feedback mechanisms. Credit support to enterprises through banks require more than re-financing through central bank, and will benefit from at least 50% of the fund being contributed by the

government as interest subsidies, wage protection support, partial credit guarantee investment etc. The package needs to offer incentives for employers to sustain employment. One of the devastating effects of the COVID 19 lockdown/slowdown is loss of enormous number of jobs, the most critical driver of development and poverty reduction in Bangladesh. It will be prudent for GoB to consider inclusion of cash and non-cash incentives to motivate employers retain employments. The policy makers should consider developing appropriate monitoring and feedback mechanisms to constantly assess, and if necessary, adjust the design and implementation mechanics of the stimulus. This is critical as an effective consultative process allows the “response framework” and stimulus to harness more adaptive efficiency.

8. **There is a Need for Greater Forbearance of Regulatory Compliance in the Short Run:** Countries around the world have offered temporary time-bound relief to companies about regulatory compliance such as tax filing, tax and utility payments, and loan servicing. While Bangladesh has announced few such supports, there is room for and need to expand such relief measures e.g. extending time period for VAT filing, property tax by businesses, utilities payment, longer time horizon to furnish corporate taxes etc. There are also opportunities to look into further relaxation of interest and loan obligations, and also waiver/reduction of different government fees with regard to issuance and renewal of various permits/licenses/registrations.

9. **Tailored Policy and Financing Support to SMEs:** Support to SMEs, are going to be critical to bring back broad-based dynamism in the private sector and rural economy. Some of the key measures required include : i) Concessional financing: through soft loans/working loans of up to 50 lacs for firms, and 25 lacks for women entrepreneurs , ii) Tax reductions and grants: The government can consider reducing the tax rate and offering grants to businesses in hard-hit sectors, iii) Digital Transformation: Within the scope of the government’s financial assistance, the SMEs should try to digitize their business operations to the best of their ability. Since the lockdown is forcing people to stay inside homes, it is imperative that businesses switch to online channels.

10. **Bangladesh must enhance Private Investment (including FDI) to Revive Dynamism in Employment and Exports to Diversify Economic Base:** Bangladesh must capitalize on the emerging advantage of many investors contemplating relocation from China - but to do so it requires to put in place a targeted investment promotion strategy and its operationalization at the soonest. Countries such as Vietnam, Indonesia, India, and Philippines are all expected to put in a strong effort. This makes it imperative for the Government of Bangladesh to prepare and position Bangladesh as a strong candidate for hosting the investors. This calls for preparing and implementing a targeted, time-bound, and focused investment promotion plan by putting in place an effective investor facilitation and after care process.

11. **Develop Area-Specific Lockdown Plans and Draw Lessons from Success Stories:** The Government should develop a medical and economic response framework for the medium term to address the possibility that this pandemic might keep reoccurring and a vaccination is not developed in the next few years. In such circumstances, the Government must internalize the lessons from South Korea, Vietnam and Taiwan to understand their experiences and approaches.

12. **Develop and execute "three" separate Health Protocols for - (a) "High Density" work places, such as RMG - (b) "Medium Density" work places; and (c) "Low Density" work places:** The GoB should only gradually open up when the timing is right; and it must embrace a scientific approach to easing the lockdown, which necessitates the implementation of three separately tailored health and safety protocols for work places harnessing different degree of employee-service recipient densities. There is also a need to develop professionalized task force – which can monitor the implementation of the health protocols across the major economic sectors.

1 Background

The world has not experienced what it is experiencing due to COVID-19 pandemic in any episode of its recorded history. A global pandemic of this intensity and pace that has reached every corner of the world was never possible before, because mankind has never been this interconnected and inter-dependent as it is now. And while we might be better prepared than our ancestors who faced the Spanish Flu a century ago or the Bubonic Plague in the 14th century, which killed approximate 80 to 200 million people – the present pandemic has a much wider geographic spread touching nearly every sovereign state in the world; infecting more than three million people and claiming more than two hundred thousand lives.

The epicentre for the virus was initially in Wuhan, Hubei Province, China, but since the beginning of March, 2020 the number of cases increased more than thirteenfold and the number of affected countries has tripled. On March 11, 2020, the World Health Organization (WHO) declared a global pandemic, as the coronavirus rapidly spreads across the world. As of May 18, 2020, the outbreak has resulted in an estimated 4.53 million cases and more than 307,000 deaths across 212 countries and territories around the world. Thus, the world is collectively navigating a new storm, something that was never been experienced in the recent past.

As the world changed dramatically in the last three months, Bangladesh being member of the global community, is also seeing the early signs of a possible exponential outbreak, which has compelled the Government to impose a quasi-lock down until May 30. These measures, nonetheless, are associated with profound economic consequences – as it has nearly collapsed the demand for exports and halted most economic activities. Prior to this pandemic-induced economic shock, Bangladesh experienced a robust economic performance under the AL-led Government between 2009 and 2019 – with per capita income expected to reach $2000 in FY20, while lifting more than 10 million people out of poverty during the aforementioned period. Consequently, this policy paper aims to offer specific policy directions to make the economic recovery as stable and inclusive as possible, so that the Government can re-start the economy in the immediate future - and remain committed to its broader objectives of transforming Bangladesh into an Upper Middle-Income Country by 2031 and a High-Income Country by 2041.

2 Covid-19 and The Bangladesh Economy

CVOID-19 will have severe adverse impact on Bangladesh's growth drivers. Closer to home, growth in South Asia will have no respite and will dwindle to a range of 1.8 to 2.8 percent in 2020. Bangladesh, having displayed a robust average growth of more than 7% over last decade, will also fall victim to the severe slowdown with growth rate falling between 2 to 3 percent in 2020. Consequences will be devastating with loss of jobs, income, trade and investment, culminating in higher poverty. World Bank estimates that for each $1 million in foregone domestic demand service sector, Bangladesh will lose 125 jobs. Global trade is expected to contract by between 13 to 30 percent and consequently Bangladesh Ready-made Garment (RMG) producers' sector could lose up to $6b worth of export orders due to production and supply disruptions. Prolonged suspension of production and operations due to movement restrictions will render many firms bleeding financially. Such problem will be exacerbated by the looming risk of falling domestic consumption to stem from fall in remittances, expected to go down by 14 to 20 percent. The hardest of the impact would involve marginalized low-income people, many of whom are daily wage-earners and self-employed.

A major casualty of the downfall will likely be private investment, particularly Foreign Direct Investment (FDI). UNCTAD assessment suggests that the global FDI will contract by large margin of 30 to 40 percent, the magnitude of the fall being one of the largest in last many decades. Such grim forecasts come at a time when Bangladesh was in need to enhance FDI more than ever before. There are host of compelling reasons - to step up the pace of growth to that of 8% plus, moving towards upper-middle income/developing country status, attaining much needed technology and market access for economic diversification, and, most importantly, to create better employment opportunities for about 2 million youths who enter labour market every year.

2.1 Impact on Export, Domestic Sectors, Banking, and Revenue Mobilization

In order to restrict spread of Covid-19, Government has declared general holiday since 25 March 2020 which is still underway. Banks are open on a limited scale to support essential transactions. Majority of other businesses/ industries are also closed to in an effort to contain spread of the virus. This would certainly have significant adverse impact on all business, large as well as small, which would in turn have an adverse impact on the overall economy.

2.1.1 Impact on Export and Remittances

Key markets for Bangladesh's export products are Europe and Americas, regions heavily affected by Covid-19. Restoration of demands for these products post Covid-19 may take time due to mass job loss, loss of valuable lives as well as the ongoing concern of being infected as well as losing jobs until a permanent cure is developed. This means Bangladesh's export may continue to suffer for longer period till an effective vaccine is developed. Falling exports will surely lead to loss of jobs and drop in consumption in domestic economy due to loss of income. To put things into perspective, total exports up to March 2020 amounted to $29 billion – which indicates that there was an average monthly inflow of $3.2 billion dollars. In April, nonetheless, exports have reduced to approximately $500 million, which shows a steep downward turn in our earning from exports.

Moving forward, the recovery in export sector is sharply contingent on whether the US and the EU experiences a "V-shaped" recovery - and whether or not the West faces a second wave of infection after Autumn. The trend in remittances are also not very encouraging – as for March 2020 - the inflow was $1.25 billion, which is lower than $1.45 billion received in February and $1.64 billion received in January. Dropping exports coupled with lower remittances will likely create pressure on current account in the Balance of Payment, until unless an offsetting pressure is also witnessed for imports.

2.1.2 Impact on other Economic Sectors and Aggregate Demand

Due to continued lockdown and social distancing requirements, many other economic sectors would also be hit badly. These include airlines and tourism sector, retail, entertainment industry, local fashion brands, shops, SMEs, Self-employed professionals, Day labourers, etc. Due to significantly reduced economic activity, many people employed in the affected industries may lose jobs, at least temporarily. This may lead to drop in domestic demand which would push down the utilization of existing production capacities. Moreover, if this downward demand spiral remains unaddressed, it can culminate in a weaker economic recovery.

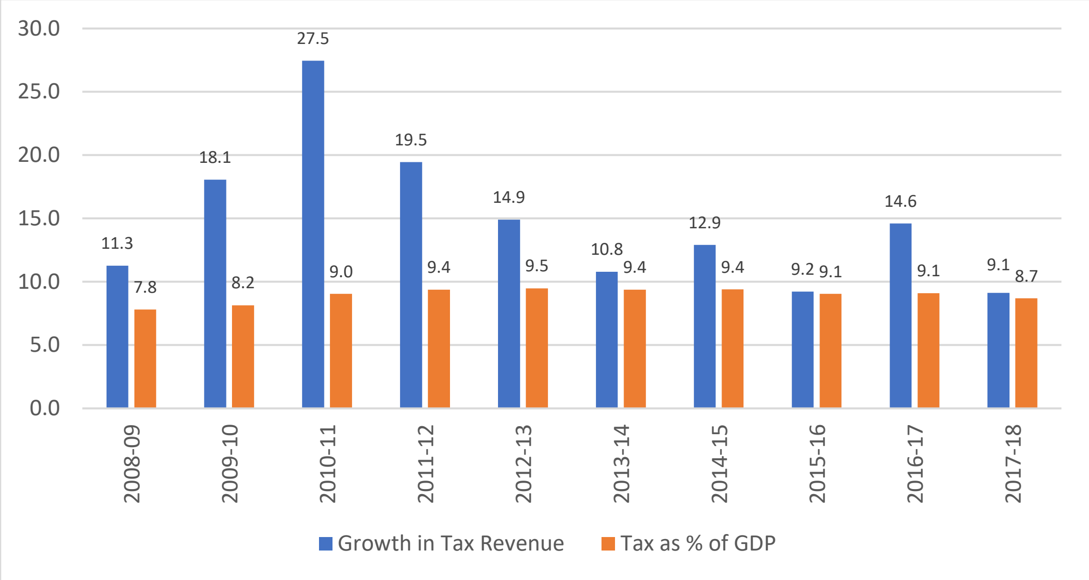
2.1.3 Increase in Credit Risk and Vulnerability of the Banking Sector

With most businesses closed and struggling with cash flows, borrowers would increasingly find it difficult to repay loans to Banks and financial institutions. This may result in increased credit risk for the lenders. Banks, already adversely hit by the 9% lending cap, faces further risks due to COVID-led deterioration of credit quality, with potential increase in loan loss provision for private commercial banks, reduced risk appetite and expected lower new lending volume. These would significantly reduce profits for the banking sector and some banks may incur loss on a pre-tax basis. All these may lead to capital shortfall in the banking sector. We may see some commercial banks struggling to repay customer deposits. Prudent customers may start looking for assets which would be safer e.g., govt. bonds, and may move their money to relatively stronger banks to protect their capital. This may result in comparatively weaker banks struggling to stay afloat and may find it difficult to survive – without tailored and effective support from the Government.

2.1.4 Lower Revenue Collection

Tax – to - GDP ratio has remained an area of concern for Bangladesh as it recently experienced going below the 9% threshold. National Board of Revenue’s resource mobilization performance – even in pre Covid-19 period - has been weak, with revenue registering less than 7% growth as of December 2019. Moving forward, it is unlikely that fiscal policies – in terms of using existing and new tax instruments to expand the revenue space – will be useful in FY21 (or even FY22). Hence, there is a need for Government to rely on its monetary policy instruments to support its expenditure on the fiscal front, that are needed to expand aggregate demand and “re-start” the economy. Especially, it is advisable, that Government should explore expanding its budget deficit to 7 to 8 percent of GDP for FY21 to support economic activities that are closely associated with poverty reduction through well targeted income transfer programmes, rejuvenating the SME sector, and supporting the resilience of the Banking sector to navigate increasing loan defaults in FY21. It is, nonetheless, essential to underscore that without fundamental reforms to enhance revenue generating capacities – after we enter a stabilized economic space - Bangladesh has a very remote to chance to sustain critical investments in human capital, infrastructure and institutions are necessary for long-run growth.

Figure 1: Tax Revenue Evolution in Bangladesh FY09 to FY18



Source: MoF

3 Policy Approach under Health and Economic Uncertainties

Traditionally, an economic crisis of such order – where there is stagnant demand, deflationary pressure and underutilized production capacities - demand a neo-Keynesian economic response, which should follow three basic principles: (i) the families with low incomes must receive income support, so that their abilities to maintain basic livelihoods are not jeopardized. In such context, the inability to maintain their basic livelihood would also lower their incentives to follow the quasi-lockdown prescriptions– resulting in low compliance of the Government's instructions. (ii) the Government cannot allow businesses to go bankrupt in such circumstances, as it can turn an economic slowdown into a recession or a recession into a depression. Hence, cheap loans must reach entrepreneurs in the manufacturing and service sectors within the next two months, so that they do not lose their capital to unproductive expenses; (iii) banks should not face closure as the entrepreneurs increasingly fail to service their debts – which necessitates that the Government subsidize failed interest payments or finance/channel cheap loans to the private sector by buying Treasury Bills sitting within the banking sector.

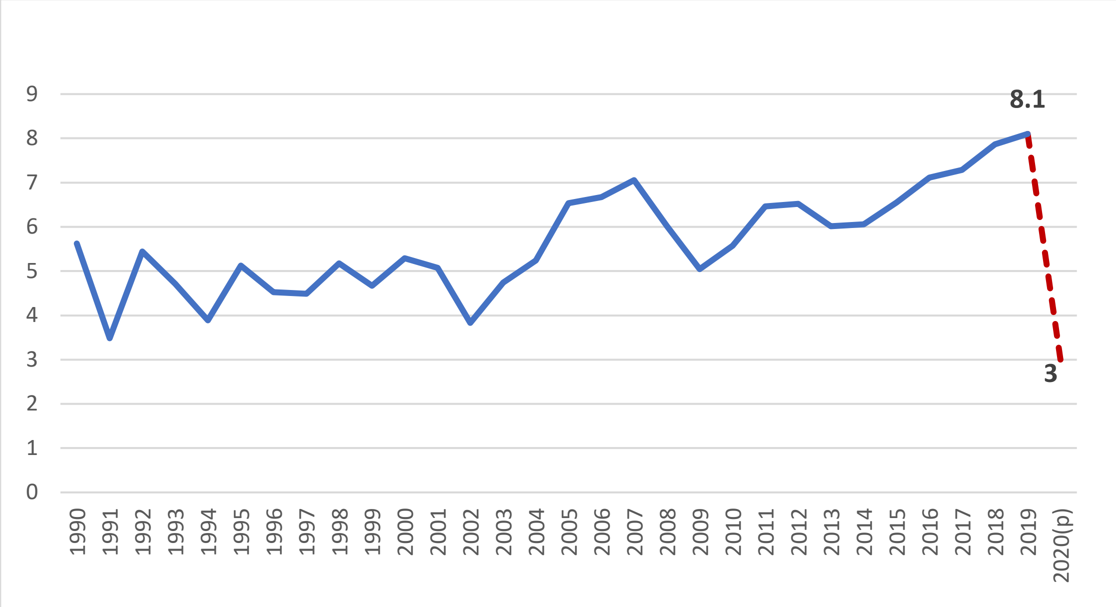
The fundamental aim of a policy response should be to rejuvenate aggregate demand in the economy as much as possible. This is important given Bangladesh is likely to experience both underutilized production capacities and a possible downward inflationary pressure due to wage cuts and unemployment. Moreover, as Keynesian macroeconomic insight vividly demonstrates, government interventions are fundamental for ensuring output expansions, so that the economy is pushed out of a "low output" equilibrium to a "high output" equilibrium, culminating in more employment and higher standards of living.

In Bangladesh, the robust and sustained economic growth performance is likely to see a reverse trend in the coming days. Bangladesh, which has maintained one of highest growth rates in the World over the last one decade has gone through a noticeable structural change over time - depicted in Figure-1 and Table-1. Unfortunately, this economic transformation is likely to take a considerable hit due to this current pandemic. World Bank has already downsized the growth forecast for the South Asian region from 6.3% to 2.8% - and it predicts that countries like Maldives, Pakistan, Sri Lanka and Afghanistan is likely to experience modest to high economic contraction. Bangladesh and India, on the other hand will experience a growth deceleration as growth is expected to fall to 3% and 2.8% respectively - as predicted by the World Bank. IMF predicts that World growth is expected to fall to (-)3% (See: Table-2).

This, in some sense, throws policymakers in Bangladesh in a complicated crossroad. First, how do you design policies when so much is uncertain? For instance, how will this virus unfold in Bangladesh over the next six months? Will it become a recurring phenomenon till a vaccine is invented? And if yes, will the resurgence be as rapid as its initial outbreak or will the population at large enjoy some degree of herd immunity? There is no doubt that our collective understanding of this virus is still in its embryonic form. Second, will Europe and the United States experience a "V-shaped recovery" or will it take years before demand and employment in Europe and the US reaches pre-Covid-19 levels?

Looking back at the recovery from the global financial crisis in 2008, it took advanced economies approximately 7 years to reach pre-crisis employment levels. For this year, according to IMF growth in advanced economies is projected at (-) 6.1 percent. Emerging market and developing economies with normal growth levels well above advanced economies are also projected to have negative growth rates of -1.0 percent in 2020, and -2.2 percent if we exclude China. Hence, the global scenario will very much determine how we navigate this economic storm - as Bangladesh critically depends on exports and remittances to ensure stability in its balance of payments. Nonetheless, there is also a need to get the basics of a prudent economic response right, so that the economic recovery as stable and as inclusive as possible - which necessitates we review the existing policies and suggest any alterations that might improve its strength to address this pandemic-induced economic crisis.

Figure 2: Bangladesh GDP Growth (Annual %)



Source: World Bank; BBS

Table-1: Structural Changes in the Economy

Sectors	FY80	FY90	FY00	FY18
Agriculture	33.2	29.5	25.3	14.2
Industry	17.1	20.8	25.7	33.7
Of which Manufacturing	11.1	12.5	15.4	22.9
Services	49.7	49.7	48.7	52.1
GDP at Constant Prices	100	100	100	100

Source: BBS

Table 2: IMF Growth Projections

Regions		Projections
	2019	**2020**
World Output	2.9	−3.0
Advanced Economies	1.7	−6.1
Emerging and Developing Asia	5.5	1
Emerging and Developing Europe	2.1	−5.2
Middle East and Central Asia	1.2	−2.8

Source: IMF

4 Review of Existing Policy Initiatives Undertaken

The stimulus package which has been recently declared by the Government of Bangladesh remains (broadly) to be quite comprehensive in nature – given it aims to reenergize and inject much needed cash into all the important sectors of the economy. In particular, the policymakers have planned to implement a combination of fiscal and monetary stimulus – collectively amounting to more than Tk 100,000 crore – or 3.7% of our GDP – and it aims to ensure that the workers in the manufacturing and the service sectors receive their salaries and basic income or food support for low income families to maintain their most essential consumptions. This stimulus package consists of six key components (for the purpose of being brief – only the most essential stimulus instruments are being highlighted in this section):

a) It involves Taka 5,000 crore worth of cheap working capital loans at interest rates of 2%, so that the RMG owners can pay the salaries of their workers. This ensures the four million low-wage earners involved with the RMG sector do not suffer an income shock over the next month – caused by a loss of orders.

b) The Government is also offering Tk 30,000 crore as working capital loans to entrepreneurs in the manufacturing and service sectors at an interest rate of 9.0% – out of which half, i.e. 4.5 per cent, will be borne by the facility enjoying entity and the other 4.5 will be paid by government as subsidy. This is to ensure that the workers involved with large industries in the manufacturing and service sectors do no face corona induced unemployment.

c) The Government is also offering Tk 20,000 crore in working capital loans to entrepreneurs in the SME sector at an interest rate of 9% – with the Government giving 5% as subsidy. If implemented effectively, it is likely to help the small entrepreneurs survive the economic downturn by offering them access to cheap working capital that can help them maintain their operational expenses.

d) The Government is expected to expand its social safety net coverage, which will work as a cushion for the low marginalized people who depend on daily wages – and assist their socio-economic survival during these tough times. Notable programmes include distributing rice at Taka 10 per kg, cash amongst the targeted communities, widening the coverage of the Old-Age Allowance, Widow Allowance and allowance for the women oppressed by husbands in 100 most poverty-prone Upazilas of the country.

e) The package also involves Tk 9000 crore working capital loans at 4% interest rate for the agricultural sector, which is expected to face lower disruptions in comparison to economic agents in the manufacturing and service sector.

f) Lastly, the Government is preparing food assistance for more than 10 million people living under the poverty line with the help of ration cards and is currently providing Tk 2500 to 5 million poor in the month of May 2020.

Collectively, the overall stimulus is pro-poor in design, and it aims to protect workers who are the most vulnerable to the economic shock; and it is also coherent with the key principles of a classic Keynesian response to move output to a better equilibrium.

The design and implementation guidelines of the stimulus packages makes the role of financial institutions a critical one for successful delivery and impact of the packages. It is imperative that the financial sector, particularly the banks, are able to minimize the adverse impact of COVID-19 on their operations and financial health, which in turn, will also require addressing some of the challenges facing the sector in the run up to the pandemic.

5 Financial Sector: Key to Economic Recovery and Requires Special Attention

The Bangladesh financial sector has grown significantly in recent decades, helping to provide financial intermediation for industrial growth and socio-economic development. There have been several notable patterns. First, the financial sector is dominated by banks and microfinance institutions, with banks accounting for about 90 percent of total financial system assets.[1]

Second, the banking sector was liberalized in the late 1980s, and new banks could come into existence. The share of private banking grew considerably, eclipsing state banking, leading to efficiency gains and greater financial intermediation. However, share of state banks has stabilized in recent years. Third, the financial sector has been providing liquidity to finance the country's industrial expansion with high rates of private sector credit growth, (although still lower than South Asian comparators) although the allocation of credit has not been efficiently managed in terms of both credit misallocation by state banks and high costs. Fourth, it has helped in the successful intermediation of the large volumes of remittances, where there has been a secure and well-managed flow by the formal banking sector.

Despite this success, financial inclusion gaps persist, especially among the middle segment of enterprises. However, despite increasing geographical penetration, private banks and state banks are mostly concentrated in urban areas and target the larger corporates; although banks usually give loans to the corporates in major sectors in bulk, the state banks' default loans are much higher than the private and foreign ones in all the sectors. On the other hand, microfinance targets the poor microenterprises. While the contribution of the SMEs to GDP is 25% (ADB, 2018), their share of bank portfolio is much less. The gap between the funds they have and what they require to run operations and grow is about $2.8 billion (World Bank, 2019). Although SME's account for more than 98 percent of non-farm enterprises in the country and bank lending to SMEs has tripled between 2010 and 2016, the large majority of MSMEs have limited access to formal finance. While access to formal financial services has increased almost doubling from 20 percent to 47 percent between 2013 and 2018 and

[1] The sector comprises four categories of banks – state-owned Commercial Banks (SCBs), private commercial banks (PCBs), foreign commercial banks (FCBs), and state-owned development financial Institutions (DFIs). PCBs and SCBs hold most of banking sector assets. While PCBs' share of banking sector assets progressively increased since 2003, the share of the six SCBs declined from 51 percent in 2001 to 26 percent in 2017.

financial inclusion of rural poor has grown faster than among the population as a whole – 34 percent in 2017 compared to 30 percent in 2016, yet, 35 million people remain excluded under the modern financial industry.

Recently, a number of concerns has emerged regarding soundness of the banks and quality of banking governance. While for years the banking sector had provided capital and resources for the growing manufacturing and services sector, in recent years the sector has been affected by a series of problems – including rising NPL's, weak oversight at the Bangladesh Bank, deteriorating capital adequacy, especially of the state banks as well as decline in private sector credit growth and tightening liquidity. By early 2020, NPLs accounts for 10.41 percent of the total loans given. There has been a wave of defaults by influential firms, affecting both the capital adequacy and loan loss provisioning. According to some recent estimates, the actual size of bad loans is more than double the officially recognized figure, suggesting that the true situation of problem assets seems much more serious.

Another challenge has been the conspicuous absence of long-term finance and of a vibrant capital market. First, long-term finance is difficult as the banking sector depends heavily on short term-deposits (roughly 75 percent are for less than one year), with asset-liability mismatches limiting commercial banks' ability to lend long term. Second, the capital market is still in the infancy with ongoing efforts to kick-start corporate bond market. Third, while capital market can be a solution for large corporates, banks and microfinance institutions are the main financing sources for SMEs and Micro and Cottage industries. Fourth, although the equity market has grown rapidly, with market capitalization close to 20 percent of GDP, it is lower than many comparator countries - India, Thailand, or Vietnam at 80, 96, and 55 percent respectively. Finally, important segments of the financial sector are almost non-existent. There is a manifest shortage of project finance, venture capital, private equity, and underexploited role of fintech. Out of 11 venture capital organizations licensed, very few are active, while there are only a few private equity players.

Grappled with such challenges already in the run up to the COVID-19 crisis, the sector's risks get exacerbated with the impact of the 'Great Lockdown' that brings slump to both aggregate demand as well as in supply. This risk both successful implementation of the economic stimulus announced by the government, and also further intensifies the governance-led performance challenges facing the financial sector. Having taken these risks into considerations, the policymakers were quick to offer a number of supportive measures to the financial sector, particularly banks.

5.1 Monetary measures taken by Bangladesh Bank to improve market liquidity.

For banks to continue to extend much needed funding to its clients, BB has taken the following measures to support banks with liquidity:

a) Reduced CRR requirement, from 5.5% to 4%. This has freed up ~BDT20,000 crores in the banking system, which can be useful as it injects more liquidity into the market.

b) AD ratio limit increased from 85% to 87% for conventional banks and from 90% to 92% for Islamic Banks. This would increase banks' ability to lend within the limit.
c) Reduced repo rate from 5.75% to 5.25%. This would make borrowing by banks from BB cheaper.
d) Bangladesh Bank would purchase government securities from the secondary market which is in excess of SLR requirement. This would give liquidity back to the market.

5.2 Impact of a Mitigation Plan for the Financial Sector

5.2.1 Significance of the Banking Sector

In absence of a meaningful bond and equity market, the banking sector is synonymous with financial sector, which is also evident from the declared stimulus packages as the successes of the declared packages are heavily reliant on banking sector's risk appetite and effectiveness in deploying the increased liquidity orchestrated by Central Bank through monetary policy intervention and liquidity support programs. With elevated risk over and above the pre-existing challenges of high non-performing loan, coupled with lower shock absorption capacity of the banks as a result of regulatory-imposed depressed profitability, banks might find it profitable to shy away from lending that is necessary to rejuvenate the economy. This will be contrary to Government's objective of increased liquidity to hands of those who need it most. Additionally, drop in CAR due to higher NPL and low profitability, may lead to drop in credit rating for the banking sector in Bangladesh. This will likely to have negative impact on Sovereign Rating as real economic sector's overreliance on banking sector. This would mean that the cost of borrowing would go up sharply and would also reduce the borrowing capacity from external lenders. Impact of government's mitigation actions on the banking sector is stated below:

a) **Increased NPL and Need for Re-Capitalization:** Banking sector were already struggling with high NPL level of over 10% with no sign of improvement, which compelled policymakers to reschedule Taka 30000 crore in April 2020. COVID-19 aggravates the situation further. Under such context, a prudent bank would be very conservative in extending new credit and would also be very selective in supporting existing clients. Given that under the stimulus package the credit risk would remain with banks, the incremental lending would further deteriorate the already higher NPL in the Banking sector and would in turn adversely affect the profitability of the Banks. Furthermore, if existing loans fail to receive a large share of the interest payments between April and September, then Banks will find it difficult to meet their obligations on deposits – which can require subsidization – of between Taka 15000 to Taka 20000 cr. – as loan defaults will make it difficult to service existing depositors.

b) **Lower Profitability for the Banking Sector:** With significant adverse impact of implementation of 9% interest rate cap starting 01 April 2020, Banking sectors' profitability is expected to fall further for lending BDT5,000 crores under the package to export oriented industries at 1.6% service charge, net of 0.4% payable to MFS companies, for 24 months+ tenure. Whilst BB will provide funds at zero costs for this lending, 1.6%

fees for 24 months would not even cover the banks' operational expenses. Therefore, lending under this package would result in net loss for banks.

c) **Impact of Reversal of Interest on Loans and holding it in Interest Free Block Account:** As per BRPD circular 11 issued on 03 May 2020, Gross Interest income from 1 April 2020 to 31 May 2020 cannot be charged in or collected from client and the same interest income should also not be recorded as income in the profit and loss account of the bank. The amount is to be held in an interest free blocked account until further guidance. This may be recovered from clients or reimbursed by the government or to be borne by the banks, or combination of all. In case this interest reversal is to be borne by the banks, this will incur lost interest income for two months amounting to approximately 16500 cr., while the Banks remain obligated to pay around Tk 10000 crore on those deposits.

d) **Capital Shortfall and Solvency Issue:** Some of the Banks were managing Capital adequacy ratio (CAR) marginally. With New Off-shore Banking Unit (OBU) guidelines which require capital to be maintained for OBU too, the requirement increased further, and the CAR would be even tighter. Economic condition has already become difficult with COVID 19. Difficult economic condition means the credit rating of the borrowers would decline, which would push up the RWA even for the existing exposures, which would in turn increase the capital requirement. Additional lending under the stimulus scheme would contribute to further increase in RWA and capital requirements. With significant increase in debt charge, reduced profits, or potential loss during 2020 due to probable waiver of interest for two months, there could possibly be capital shortfall for many banks in the sector. This may also mean that many banks may not be able to repay their depositors' money.

5.2.2 Impact on Depositors and Stock Market

Given that the 90% of funds in the banking sector belongs to the depositors and a large portion of the deposits comes from individual sources, risks if lower profitability, for reasons outlined in 5.1.1.b, will lead the banks to reduce the interest (profit rate in Islamic banking) on the deposits. Such downward shifts in returns on money market deposits will reduce earnings to citizens, many of whom manage their living from such earnings (e.g. retirees, elderly population etc.). Moreover, possible drop in money market return may create a disincentive towards savings in formal sector, something Bangladesh needs to improve significantly in the coming years. While Stock market is shallow in Bangladesh, banks account for almost $1/5^{th}$ of the market cap, and any potential poor performance of the sector and individual banks are likely to adversely impact market value of bank stocks. This can adversely impact not only the investors holding banking stocks but also the overall market scenario as bank stocks have significant influence on the Bangladesh stock market directions.

5.2.3 Lower Tax Revenue from the Banking Sector

Banks account for a large portion of tax collected by Large Taxpayers' Unit as profits made by the banks are taxed at 37.5% (Listed Banks) or 40% (Unlisted and Foreign Banks). Corporate tax from banks contributed BDT 8072 crore in FY 17-18, and BDT 8780 in FY 18-19. With profits for the banking sector dropping significantly due to both rate cap and COVID, Govt.'s revenue collection would drop significantly.

5.2.4 Challenge for the Marginalised/Weaker Banks

COVID-19 and resulting difficult market conditions would adversely affect the fourth generation / relatively weaker banks. With increasing credit risk, drop in profitability or loss, and the potential failure by these banks to repay customer deposits, customers may start withdrawing funds from vulnerable banks and move to relatively stronger banks, which may further aggravate the health of the existing banks that are struggling with high NPL.

6 Impact on SMEs and Role of Investment

Hardest impact of the 'Great Lockdown' is expected to fall on the SMEs as they are dependent on a short cash cycle which has been affected as a result of supply chain disruption and loss of sales. The economic distress has added to existing problems such as lack of access to finance, poor market linkage, absence of skilled labour, and lack of export market. According to the Asian Development Bank, the SMEs in Bangladesh account for 70 to 80% of the non-agricultural sector employment. About 40% of the manufacturing output are also generated the SMEs. Presently more than 6 million SMEs and micro-enterprises are operational in Bangladesh and they are constantly striving to upgrade the lives of many.

SMEs' capacity to absorb shock is limited, and any disruptions in production, sales, and cash cycle beyond few weeks can wreak havoc to these firms' capacity to survive. Prolonged constraints in demand and supply will lead to many small firms to shut down, intensifying the unemployment problem likely to stem from the pandemic. Ability of these firms to service payment obligations such rent, debt-servicing, and VAT raises the risk of firm closure and contracted enterprise base in the economy

Bangladesh, to-date, lack robust assessment of impact on SMEs but one recent survey (Light Castle Partners April 2020) outlines the following shock to the SMEs:

- Half of the respondents had to completely halt their business operations
- Zero output due to the unavailability of raw materials and lack of scope to sell their outputs.
- 28% of the respondents have seen a drastic decrease in their revenue by over 50%
- Cash reserves are running dry or with their debtors.
- Services industry took a heavy hit as they are unable to provide their services which are primarily handled through human interaction and generate revenue.
- About half of the SMEs (46%) will lay off more than 50% of their staff in a bid to cut costs
- An aggregate 31% of the enterprises will likely go some level of layoff (1 to 50% of staff) to minimize cost and keep businesses from demise
- 68% SMEs reported that they will have to permanently shut down their business if the lockdown persists for more than 4 months.

- 42% of enterprises have cut back their marketing expenditure while 23% have done the same in distribution. This implies businesses are taking initial cuts on these two fronts to save some funds.

Performance of SMEs in Bangladesh will also take further adverse impact should investment, particularly FDI, continue to remain weak. The ability of SMEs to operate and grow is largely determined by their participation in supply/value chain linkage created and/or dominated by large firms, both foreign and domestic. Bangladesh has already been struggling with a sluggish FDI performance. Such grim forecasts come at a time when Bangladesh was in need to enhance FDI more than ever before. There are host of compelling reasons - to step up the pace of growth to that of 8% plus, moving towards upper-middle income/developing country status, attaining much needed technology and market access for economic diversification, and, most importantly, to create better employment opportunities for about 2 million youths who enter labour market every year.

These unforeseen turns also come at a time when there was consensus among government and private sector that private investments growth has been sluggish, and that there exists significant room to enhance flow of FDI in Bangladesh. Private investment to GDP ratio continues to remain stagnant at around 23% while FDI remains little over 1.1%, faring much lower than FDI into comparator countries such Vietnam and India.

7 Additional Instruments and Policy Measures for Consideration

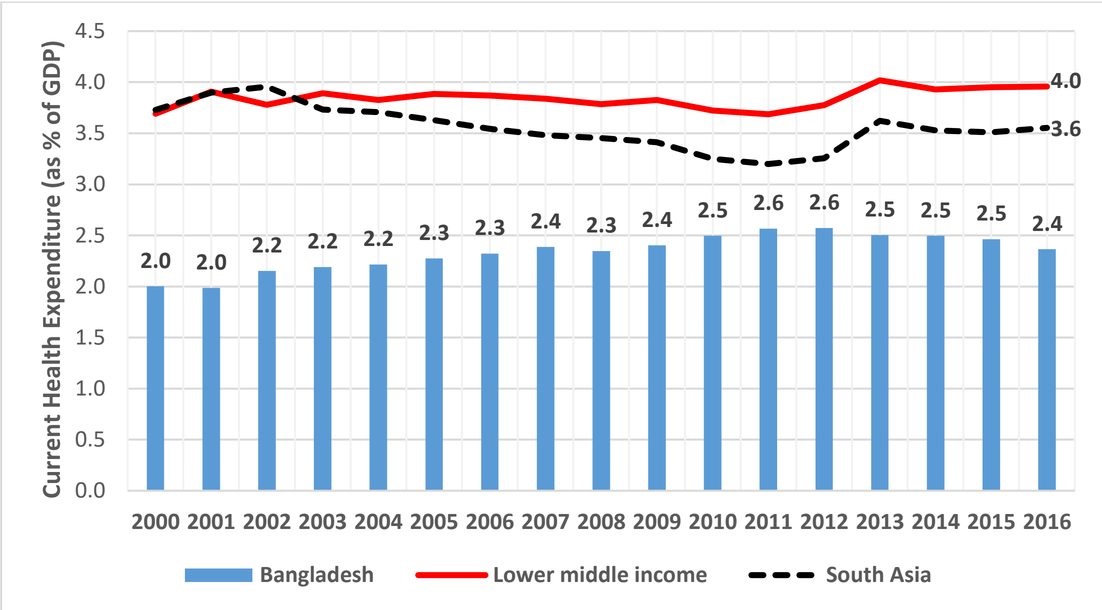
Going forward, the Government can add more instruments to this package and/or finetune some of the measures already announced to make the economic recovery inclusive. Some issues that policymakers can take under consideration are as follows:

A. Given the health crisis is intimately intertwined with the economic crisis, keeping the pandemic under control will be fundamental to reopening the economy. In this context, the Government must make the health sector its priority sector for the next three years, followed by food security. And there is no harm in it, because adapting to the needs of the time is central to being a responsive government.

In 2009, when the Government inherited an acute energy crisis – it made investments in the energy sector the most priority sector over the last one decade. That is why it is not surprising that load shedding and electricity outages has now become a thing of the past. Hence, the post-Covid 19 World would now require a rearrangement of economic priorities in Bangladesh as we are dealing with a new threat – and greater investments and comprehensive reforms in healthcare will not only make us more resilient to such threats, but such human capital investments can deliver long-run dividends for the country.

Bangladesh, at present, has one of the lowest public sector allocations for the health sector. Total health expenditure in the country has been lower than the average in low-middle income countries (LMIC) and in the South Asia region in all years with available data. Going into the future, this needs bold corrections – **with health sector receiving at least 2% of GDP in public investments**. In particular, making the provision of Universal Health Care a key agenda for Vision 2041 should become a new priority for policymakers. It is also essential that the Government **recognizes the use of anti-body testing kit** to complement the more complex PCR testing. This is a strategy that has been proven successful in Germany and is now embraced by the UK, mostly because such cheap anti-body testing is the only mechanism through which one can **support decentralized heath surveillance** - as factories can keep a basic health surveillance over their workers to ensure safety. This, nonetheless, requires a law and a monitoring task force to enforce implementation of the health surveillance by undertaking at least undertake one (or two rounds) of anti-body testing every month for all their staffs.

Figure-3: Current "State and Non-State" Health Expenditure (as % of GDP)



Source: BBS

Table-3: State Expenditure on Health as % GDP

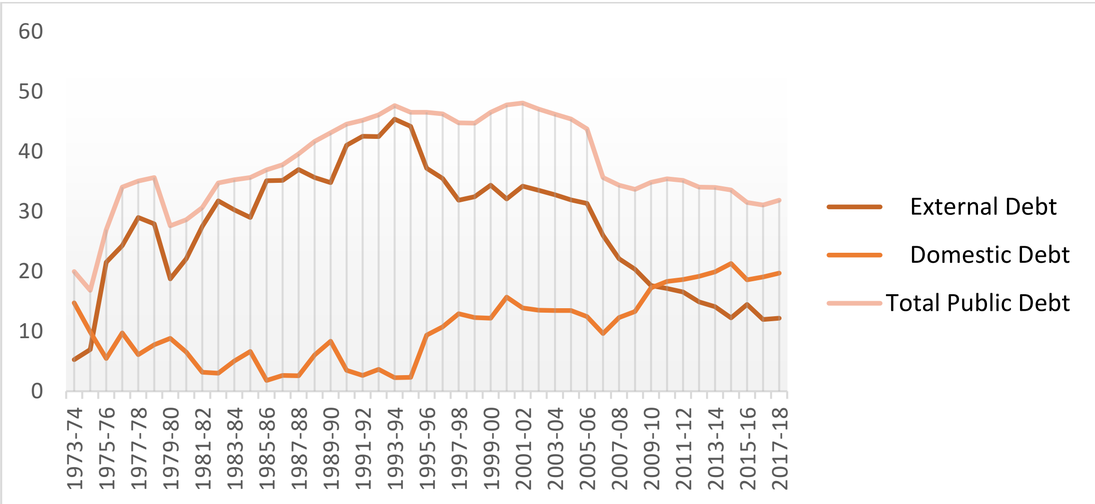
	2005	2016/18
Bangladesh	0.62	0.7
India	0.84	1.2
China	0.63	2.99
Note: The estimates for India are derived by adding central government allocations for health and education with state level allocations in 2016. B		

Source: IMF; GoB

B. The forthcoming National Budget FY21 will be prepared against the backdrop of two central uncertainties: {i} whether Europe and the US will experience a "V-shaped" economic recovery or not; {ii} how the virus will itself unfold in Bangladesh over the next six months. Consequently, it is prudent to expect weak revenue mobilization performance in FY21 (and even FY22), which necessitates that the Government relies on bold monetary policy initiatives to support critical fiscal expenditures, such as supporting SMEs, the stability of the financial sector and providing income transfer to the poor. This might necessitate that government considers a **budget deficit of 7 - 8% for FY21, and even FY22** – to support economic activities that are critical for **re-starting the economy**.

C. The Government should try to **seek at least US$5 billion of financing from development partners** to ensure that its stimulus does not create a high domestic debt burden which is usually more expensive than foreign loans. At present, it is currently negotiating a support from the IMF, World Bank, and the ADB which we feel is a good starting point. Bangladesh also faces a low public debt to GDP ratio (under 36% of GDP), which gives policymakers a short-term cushion to devise a stronger stimulus. The challenge here is that we need to inject sufficient short-term capital by creating sustainable long-term debt – which requires careful fiscal and monetary manoeuvring; especially a strong focus on revenue mobilization in the near future to service the additional debts the GoB is expected to incur.

Figure 4: Debt as Percentage of GDP



Source: Ministry of Finance, Bangladesh

D. The Government can consider **turning interest payments from the previous loans – for the period between April to September – into long term liabilities with manageable interest rates** – perhaps at 6.5%. This would require consultations with the economic stakeholders in the private sector, so that the private entrepreneurs do not face bankruptcy. This also requires sizeable subsidization for the banks – as they are under the pressure to service short term deposits with long-term loans. The exact amount of the subsidization might vary between Taka 15000 to Taka 20000 cr.– as high loan defaults will make it difficult to service existing depositors for the months between April and September.

E. The Government must seriously consider **direct income transfer to 10 million poor through digital financial service for two months – perhaps Taka 5000 to each family per month for the month of July and August** – when economic activities are expected to remain lukewarm due to the after effects of the lockdown. This will cost the government Taka 10000 crore, which is a small sum relatively to the resource base it enjoys in the present economic scenario. The rationale behind this is quite plain and simple. Both the spread risk and the logistical challenges in the delivery of food are just too much to handle, given the scale and likely duration of the problem. On the other hand, the usage of Digital Financial Services like Bkash, Nagad, etc. will help expediate the process much more smoothly provided National Identification Data (NID) is used for account opening. **The usage of single (or at maximum two) NID(s) against one telephone numbers is essential to minimize leakages. As an additional filter, total talk time of worth Tk 500 or more for the month of April 2020 can used as a screening mechanism for deciding which individual will receive the income transfer**.[2] **Past transactional history of the DFS operators can also be used as additional filters to improve targeting.** The Government should also make the identities of the cash transfer recipients a public information, so that **people can provide feedback to the central authority to improve and correct the list – so that non-poor are identified and removed from the beneficiary list** – culminating in an useful "data bank" of the poor that could be routinely cleaned for additional income transfer objectives.

F. The Government should immediately **involve private hospitals and NGOs in its current response framework**, so that their capacities can be used to deal with the patients. The Government should also involve the NGOs to identify the poorest families, so that a better framework of targeting guides its distribution of relief and aid. BRAC, in this context, has a long history in both devising support for the poor and undertaking public health programmes. To avoid fragmentation, the list of identified poor can be provided by these NGOs as necessary along with the list made by the Government.

G. The economic stimulus announced can be further fine-tuned to deliver a greater impact. The package generated much excitement as well scrutiny regarding whether the package is sufficient and /or agile enough to address the key challenges and if it prioritizes the groups which need it most. The assistance program was quick to be put in place, bold in size, and inclusive in objective as it provides specific window for small and medium enterprises, the likely hardest-hit segment of the private sector. That said, there seems to be a number of improvement opportunities to make the package deliver higher impact than what it may do in its current form. These are:

I. **The design of the package needs to take into consideration banking sector challenges:** Success of the stimulus package will require pragmatic design, effective implementation, and robust monitoring and feedback mechanism. The details provided by the Central Bank/GoB on the first component of the package, the 30 thousand crore working capital facility, raises many eyebrows regarding the design and operating principles. The initial guideline put the onus of mobilizing funds on commercial banks by stipulating that the banks will have to use their own funds to

[2] Especially because a person who can spend Taka 500 or more on mobile bills in one single month most probably does not need the low-income support.

finance this component of the stimulus. However, a subsequent circular indicates that the GoB will provide 50% of the fund required for the large, services, and CMSMES through a Bangladesh Bank re-financing window. Such arrangement still remains fraught with multiple problems. This is likely to be marred by uncertainly about the liquidity required. In the run up to the COVID crisis, the banking sector in Bangladesh has already been grappling with several challenges including many banks having inadequate liquidity and capital. Hence, putting the responsibility of managing the fund/finance with individual banks, including through refinancing from central bank, is likely to lead to less than optimal disbursement of assistance under this package.

The guidelines also create greater risk-aversion by banks which is somewhat inevitable in an economic crisis/slowdown, thereby creating risk of cherry picking in selecting loan candidates. Given business/market/credit risks amplify significantly during any economic slowdown, banks take more stringent measures to analyze credit applications than they do during normal economic settings. With significant slowdown in economy already confirmed/anticipated by government and international agencies such as IMF and World Bank, it is almost certain that banks in Bangladesh will take a greater risk averse position which will deny access to credit to many firms, who on hand will require boost in finance to recover from slump but on the other hand will likely be struggling to recover from the ‘great lockdown’. Given the aforementioned risks, and to better reflect fundamental features of government stimulus package announced around the globe- government financing of the stimulus, government could consider providing part or all of its financing as direct government contribution, particularly in providing employment protection and loan instalment payment subsidies.

II. **Secondly, current package needs to offer incentives for employers to sustain employment:** One of the devastating effects of the COVID 19 lockdown/slowdown is loss of enormous number of jobs. Most economic stimulus packages announced in countries in Asia and beyond include incentives that will help/incentivize employers not to retrench employees. For instance, in India, the government will pay both employers’ and employees’ contribution to the Employee Provident Fund (EPF) for three months, covering 48 million employees. Singapore will pay up to 75% of local employees’ salaries, and USA will provide tax credit for up to $5000/employee for employers who retain their employees. In light of criticality of employment in Bangladesh’s context, and its likely impact on social stability, it will be prudent for GoB considers inclusion of cash and non-cash fiscal incentives/support to help employers retain employments.

III. **The stimulus needs to think of bolder steps to ensure access to credit to Small and medium enterprises (SME):** Such firms, in general, are characterized as risker than large firms across the globe. This often leads to both a higher cost of credit and /or a lack of motivation on the part of financial institutions to prioritize credit to SMEs. Risk /Credit guarantee schemes, where governments share potential losses in case of default proven tool globally to address this challenge. The current package does not include any such support. GoB could add a part to the stimulus to create a credit guarantee/risk sharing program for financial institutions to provide adequate access to finance to SMEs.

IV. **Supporting self-employment:** A significant number of Bangladeshi working age population are engaged in self-employment activities. While many of them are micro and informal, hard to target through business support stimulus, there are many who operate self-employment activities through formal channels. Currently, the package does not include any support for such group. Several economic stimuli around the globe are offering such support e.g. USA providing deferral of social security tax, Singapore providing upto S$ 9000 over nine months to each such self-employed individuals. Cash and non-cash fiscal support for self-employed merits strong attention in order for the package to support this important group in the workforce.

V. **The policy makers should consider developing appropriate monitoring and feedback mechanism**: To constantly assess, and if necessary, adjust the design and implementation mechanics of the stimulus package. This is important as the pandemic scenario is still evolving (e.g. length of potential lockdown), and so will the economic impact. Many adjustments will have to be made as and when we get clearer sense of the economic shocks. Inclusion of private sector and other relevant stakeholders from outside the government in such institutional mechanism will help policy makers receive timely feedback and pragmatic advice to strengthen effectiveness of the much-coveted stimulus package. This is critical as an effective consultative process allows the "response framework" to harness more adaptive efficiency. While critically important in the COVID context, some of the aforementioned remedies are also fraught with risks, particularly with regard to moral hazard and distribution to unintended target audience (e.g. employment/interest subsidies, employment protection grants). This makes the issue of regular and effective monitoring, together with strict operating procedures and accountability mechanism, an absolute must-have. It is also important that public interventions in the form credit guarantee, interest and/or employment protection schemes are rolled out in a time-bound manner.

H. There is a need **for greater forbearance with regard to regulatory compliance in the short run**. Countries around the world have offered temporary time-bound relief to companies with regard to regulatory compliance such as tax filing, tax and utility payments, and loan servicing. Singapore, for instance, have waived the levy for approval/renewal of foreign workers while Pakistan has allowed payment of utilities in three instalments over a several months period with India extending tax return till June 30, 2020. While the Bangladesh has announced a few such support, there is room for and need to expand such relief measures e.g. extending time period for VAT filing, property tax by businesses, utilities payment, longer time horizon to furnish corporate taxes etc. There are also opportunities to look into further relaxation of interest and loan obligations, and also waiver/reduction of different government fees with regard to issuance and renewal of various permits/licenses/registrations. That said, one will have carefully differentiated the forbearance relevant in this context from the ones which led to regulatory capture and deterioration in financial sector governance due to ‘managed’ relaxation of supervision. These supports will have to be designed and seen through the lenses of temporary relief from tough payment obligations, and in some cases relief from non-critical compliance requirements. Once again, it is imperative that such reliefs are strictly time-bound and temporary in nature, and operates on the basis of effective targeting mechanism.

I. **Tailored policy and financing support to SMEs** are going to be critical to bring back broad-based dynamism in the private sector and rural economy. Some of the key measures requires include:

I. **Concessional financing:** Policymakers should support soft loans/working capital loan, so that SMEs are able to survive the crisis. Banks and financial institutions may sanction up to BDT 25 lacs to women entrepreneurs against personal guarantee. Entrepreneurs’ credit limit may be ranged from BDT 50,000 to BDT 50 lacs. However, current stimulus packages that are applicable through banks depend on existing relationships with SMEs, which many of the smaller players will lack. That means they might not be able to avail these concessional loans. Moreover, the banking sector is going through a liquidity crisis with many of them having stretched NPLs (Non-Performing Loans); hence they might not be able to fully disburse the stimulus. Furthermore, they would be more willing to fund their existing clients rather than SMEs which require the support most. Here again, we need a more ecosystem-centric approach, where MFIs whose current portfolio consists of 37% SME loan and has a wider reach, can come into play.

II. **Tax reductions and grants for SMEs:** The Government can consider reducing the tax rate and offering grants to businesses in hard-hit sectors in an effort to help reduce costs and boost the bottom line. Moreover, specifically for SMEs, VAT exemption on revenue and expenses for current and next fiscal year, exemption (or deferral) of withholding tax payments can be a timely initiative. By lowering/exempting tax and providing grants, the impact of plunging aggregate demand as a result of the recession could be minimized.

III. **Digital transformation**: Within the scope of the government’s financial assistance, the SMEs should try to digitize their business operations to the best of their ability. Since the lockdown is forcing people to stay inside homes, it is imperative that businesses switch to online channels. Linking up with mobile wallets, MFS (Mobile Financial Service), DFS (Digital Financial Service), and Digital Supply Chain Management will help towards achieving medium-term solutions to tackle the extent of the crisis.

IV. **Digital financial services**: Cashless transactions could transform the way SMEs conduct business. It widens the possibilities of reaching customers across the country. Mobile financial services opened new doors in transferring, transacting and storing money digitally instead of cash. Mobile Application & Web-based financial services of banks provide faster and secured transactions with little or no human intervention. It solves the limitations of MFS as online-based banking services have greater transaction limits suitable for SMEs trading in large volumes.

V. **Digital supply chain management**: Supply chains having web-enabled capabilities render enterprises the ability to source and sell on digital platforms. This not only increases the potential market by folds but also ensures a seamless transaction and traceability from the factory to the consumers' doorstep.

VI. **Alternate credit assessment and digital credit**: Traditionally, large banks have controlled capital investments in Bangladesh. Most financial institutions have been reluctant to lend beyond large corporates. One prevalent reason is complexities associated with assessing the creditworthiness of SMEs. To address this issue - financial sector policy makers could consider introduction of digital methods of credit assessment and disbursement of loans. Many countries have successfully used mobile applications that help gather thousands of data points about a consumer and this allows one to assign a financial identity to an unbanked person, allowing mobile phone or gateway-based money lenders to lend them, often within five minutes of an assessment. Many successful examples now exist in Southeast Asia and in Africa including Philippines, Kenya, and Tanzania, which concerned authorities can explore.

VII. **Reviving dynamism in employment and exports, diversifying economic base, and provide the much-needed lift to the SMEs, enhancing private Investment, particularly FDI, will be critical**: Bangladesh must capitalize on this emerging advantage of many investors contemplating relocation from China - but to do so it requires to put in place a targeted investment promotion strategy and its operationalization at the soonest. Countries such as Vietnam, Indonesia, India, and Philippines are all expected to put in a strong effort. This makes it imperative for Bangladesh government to prepare and position Bangladesh as a strong candidate for hosting the investors. This calls for preparing and implementing a targeted, time-bound, and focused investment promotion plan that will help identification and targeting of the investors group, outreach with Bangladesh's value proposition, and putting in place an effective investors facilitation and after care process.

J. There is a need to develop a medical and economic response framework for the medium term to address the possibility that this pandemic might keep reoccurring and a vaccination is not developed in the next few years. In such circumstances, the Government must internalize the lessons from South Korea, Vietnam and China to understand their experiences and approaches, which were effective. **Such lesson drawing initiatives will help the GoB develop a flexible but effective response framework**, which does not necessarily depend on imposing a nation-wide lock down every time the virus reappears.

K. The **Government should develop and execute "three" separate Health Protocols for: (a) "High Density" work places, such as RMG - (b) "Medium Density" work places; and (c) "Low Density" work places;** so that a scientific approach to easing the lockdown is embraced in a coordinated manner. There is also a need to develop professionalized task force and IT-based infrastructure – that can help authorities track Covid-19 outbreaks in high-density work places and monitor the implementation of the heath protocols across key economic sectors. The only health and safety rule that has so far produced dividend in countries that has managed to contain this virus is - increased “social distancing, testing and tracing”; so, authorities must develop mechanisms and processes to get these basics right.

On the whole, Bangladesh is currently experiencing an economic storm from this “Black Swan” event, and it has so far prepared a sound pro-poor economic stimulus to support a gradual economic recovery. Moving forward: the challenge lies in fine-tuning the stimulus package and few other critical policies to make the economic recovery both *stable* and *inclusive*. This economy recovery can, nonetheless, only happen when we have contained the heath crisis firmly, so the Government should only consider gradually opening up when the timing is right.It is also essential to mention that the recommendations in this policy brief aims to take forward the policy agenda by offering specific policy directions, but in no way is an exhaustive summary of all the measures needed to tame this once in a lifetime crisis.