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Bangladesh: 2001 Article IV Consultation—Staff Report; Staff Supplement; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Bangladesh

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with Bangladesh, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **November 18, 2001,** with the officials of Bangladesh on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 8, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of **April 25, 2002** updating information on recent developments.

- a staff statement of **April 29, 2002** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its April 29, 2002 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Bangladesh.

The document listed below will be separately released.

Selected Issues and Statistical Appendix Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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BANGLADESH

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the 2001 Consultation with Bangladesh

Approved by Steven Dunaway and Shigeo Kashiwagi

April 8, 2002

The 1999 Article IV consultation was concluded on January 24, 2000. At that time, Directors noted with concern that the recovery that had ensued following the government's effective response to the 1998 floods, could be threatened by an ongoing loosening of policies and signs of weakening investor confidence and donor support in the face of governance and political problems. Directors welcomed the authorities' interest in an arrangement under the PRGF and noted that this should be based on firm measures to maintain macroeconomic stability, including a market-based exchange rate system, and bold steps to revive and speed up well-sequenced reforms to address the high levels of poverty.

Consultation discussions in 2000 due to take place at the end of that year were delayed because of scheduling conflicts. The 2001 Article IV consultation discussions were held over three missions, February, July, and November 2001, and involved three governments: the one led by the Awami League (AL) that resigned on July 13, 2001 as envisaged in the constitution; a three-months interim government, whose main task was to call parliamentary elections; and a coalition led by the Bangladesh National Party (BNP) that took office on October 10, 2001 after winning the elections with a two-thirds majority.

The February and November discussions were framed in the context of program negotiations, as both the AL and the BNP-led governments requested that the respective missions also initiate discussions on a stabilization and reform program that could be supported with Fund resources. In the event, the completion of the discussions with the AL government was delayed owing to the elections. The November mission substantially completed the Article IV discussions, but program negotiations took another two missions (January and February 2002). At this time, the authorities arrived at a decision that they would need until next fiscal year which starts July 1 to adopt a comprehensive set of measures to be supported by a Fund arrangement. Meanwhile, they requested the staff to present the 2001 Article IV consultation discussions for the consideration of the Fund Executive Board.

The missions met with Prime Minister Zia, Finance and Planning Minister Rahman, Bangladesh Bank Governor Ahmed and former Governor Farashuddin, officials from the previous governments, and private sector and donor representatives. Mission teams included Messrs. Valdivieso (Head), Orsmond, Hussain, Heenan, Pani, and Senhadji, and Ms. Liu and Ms. Sun (all APD), Mr. Konuki (FAD), and Mr. Nallari (PDR). Messrs. Hicks and Verhoeven, resident representatives, assisted the missions. Messrs. Kelkar (ED) and Bhaskar (OED) and World Bank staff attended key policy meetings.

Bangladesh reports core economic data on a regular basis. However, there remain significant weaknesses, notably in the areas of government finance, external debt, and balance of payments statistics. Bangladesh completed the steps necessary for participation in the General Data Dissemination System when metadata were posted to the Fund's Dissemination Standards Bulletin website on March 29, 2001.

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Executive Summary

During the 1990s, Bangladesh recorded robust output and export growth, low single-digit inflation, improved literacy and health indicators, food self-sufficiency, lower population growth, and an impressive decline in extreme poverty levels. Despite these achievements, the economy became progressively more fragile, especially after the mid-1990s, as fiscal policy became expansionary and the structural reform agenda stagnated. Growing domestic imbalances created pressures in the foreign exchange market and led to a marked decline in international reserves. These trends were exacerbated by the global slowdown and the September 11 events. Throughout the period, the authorities adopted a partial policy approach, including sporadic step adjustments of the exchange rate, use of trade and exchange restrictions, nonconcessional external borrowing, and delay in the payment of some obligations which have recently been regularized.

Policy discussions focused on identifying a policy mix to address the growing domestic imbalances in a comprehensive manner, and on the policies to promote a high and sustainable rate of income growth consistent with a substantial reduction in poverty. The immediate policy challenge is to limit inflationary and exchange market pressures, and that will require the adoption of decisive measures to rein in the consolidated central government deficit. Fiscal efforts in the remainder of FY01/02 will more likely fall on development expenditures, but the authorities have indicated their willingness to adopt a comprehensive fiscal policy framework in FY02/03. Bangladesh Bank has started to tighten domestic liquidity conditions.

To improve economic efficiency and the ability of the economy to weather external shocks without resorting to administrative controls, the authorities agreed that it would be desirable to move toward more flexible interest and exchange rates. Regarding *interest rates*, it is important to liberalize the treasury bill market and promote development of a secondary market, and to link other interest rates to the treasury bill rate. Strengthening the independence of Bangladesh Bank is also necessary. While not disagreeing with the need to move to a more *flexible exchange rate* regime, the authorities were uncertain regarding the timing and the technical ability of Bangladesh Bank to handle such a regime. They were particularly concerned about the magnitude of any potential overshooting of the rate in a more liberalized environment, but the staff noted that the likelihood of a sizable overshooting would be minimized if the move to a flexible exchange rate were accompanied by strong and credible fiscal and monetary policies, and if Bangladesh Bank were given the independence to conduct monetary policy and to smooth fluctuations in the foreign exchange market.

To ensure sustainability over the medium term, discussions made it evident that in addition to ensuring macroeconomic stability, additional efforts will also be needed to strengthen the banking sector (especially in government-owned banks and institutions), and the financial performance of nonfinancial state-owned enterprises, and to lower trade distortions. These policies will be at the center of a poverty reduction strategy that the authorities are developing in the context of an I-PRSP. On completion, the I-PRSP could serve to catalyze significant international assistance, which in conjunction with sound domestic efforts could help to increase growth and reduce the current high poverty levels, within a reasonable period of time.

I. Recent Economic Developments and Near-Term Prospects

1. **Bangladesh's key economic and social indicators improved steadily in the 1990s, but poverty remained pervasive**. Backed by prudent macroeconomic policies and an initial strong drive for structural reforms in the context of successive SAF and ESAF arrangements, the country in the 1990s recorded robust output and export growth, low single-digit inflation, improved literacy and health indicators, food self-sufficiency, and lower population growth. The level of extreme poverty was reduced by 20 percent during the decade, although it remained relatively high at about 34 percent of the population.

2. **Despite these achievements, the economy became progressively more fragile after the mid-1990s**. Following a prolonged period of political strife, the momentum for reform dissipated, and financial discipline started to erode. Although economic policy was deftly handled during the 1998 floods, monetary and fiscal policies subsequently remained expansionary, and structural reform stagnated (Figure 1 and Table 1). The central government deficit, which was around 4 percent of GDP in FY95/96–FY97/98 (on a cash basis), climbed to 5–6 percent of GDP in FY99/00–FY00/01.[1] Losses of nonfinancial state-owned enterprises (SOEs) also rose sharply. Direct budgetary support, including roughly equal amounts of equity financing and net lending, increased from 0.2 percent of GDP in FY97/98 to 1.4 percent of GDP in FY00/01, covering around one-half of total SOE losses.

3. **Rising domestic credit demands of the government, the SOEs, and the private sector were accommodated by monetary policy**. Two-thirds of the fiscal deficit was financed from domestic sources in the two years through end-FY00/01, and credit from the banking system to the central government grew at annual rates of 30–35 percent. As a result, broad money increased at an annual rate of 17–19 percent in the two years through end-FY00/01. Over this period, the Bangladesh Bank (BB) lending rate was held constant.

4. **After falling sharply over most of the 1990s, during the last four years public and publicly guaranteed external debt increased by around 4 percentage points, to around 36 percent of GDP in 2001 or $16½ billion** (Figure 2 and Table 2). Most of the increase was accounted for by government-guaranteed nonconcessional foreign supplier credits to SOEs which rose by 2 percentage points of GDP over the same period. However, due to the high degree of concessionality of Bangladesh's total external debt,[2] the net present value of external debt is still manageable at about 20 percent of GDP and 120 percent of current foreign exchange receipts. Debt service also remains moderate at about 7½ percent of current foreign exchange receipts and 17 percent of fiscal revenues.

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[1]The fiscal year begins July 1.

[2]Medium- and long-term concessional public external debt accounts for over 90 percent of the total, with about three-fourths owed to multilateral creditors.

5. **Growing domestic imbalances were reflected in pressures in the foreign exchange market and a marked decline in international reserves.** In response, the authorities opted for sporadic step adjustments of the exchange rate.[3] Moreover, instead of supporting these devaluations with appropriate macroeconomic policy actions, the authorities intensified administrative controls.[4] Despite these controls, gross international reserves fell to less than 1½ months of imports of goods and services by mid-2001.

6. **The policy-induced fragility was exacerbated by the global slowdown and the September 11 events, but the government's policy responses have been partial and have had limited results.** While some measures have been steps in the right direction (such as the broadening of tax bases and reduction in the high interest rates offered on savings certificates), in general fiscal and monetary policies have remained expansionary. Despite the government's efforts to rein in the budget, the central government deficit is expected to be 6 percent of GDP in FY01/02, roughly the same as its level in the first half of the year (Figure 3, Table 3, and Box 1). With foreign financing for the budget declining, public sector demands for financing from domestic sources continue to rise. Moreover, while the government instituted increases in the prices of electricity, gas, and fuel effective January 2002, more comprehensive reforms of the nonfinancial SOEs were not introduced to contain their losses. In October 2001, BB reduced its lending rate from 7 percent to 6 percent, and this action, along with reductions in administered lending rates for agriculture and exports, has stimulated private credit demand (Figure 4 and Table 4). In the twelve months to end-January 2002, broad money continued to expand at a rapid rate (16 percent). Recognizing the need to tighten monetary conditions and reduce the vulnerability of base money to unanticipated changes in the currency composition of banks' reserves, BB in February 2002 made it compulsory for banks to meet their legal reserve requirements only in local currency and increased the size of treasury bill auction to reduce its direct credit to the government.

7. **Further recourse was made in late 2001 to administrative controls to limit exchange rate pressures.** In November 2001, margin requirements on the opening of letters of credit were increased to 100 percent for some products, and import surcharges and duties were increased by up to 25 percent in December 2001. In addition, some external payment obligations to multinational energy companies under joint-venture agreements were delayed. It was not until January 2002 that the exchange rate was devalued by 1.5 percent.

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[3]The taka was devalued by 5.9 percent in August 2000 and by 5.5 percent in May 2001, to offset the appreciation of the real effective exchange rate that occurred prior to these adjustments (Figure 2; see also accompanying Selected Issues paper).

[4]At end-2000, mandatory margin requirements on the opening of new letters of credit were set at 50 percent for most commercial imports. These restrictions, which are in addition to other longstanding restrictions on current payments as described in Annex VI, constitute an exchange restriction that is subject to approval by the Fund under Article VIII.

8. **On current policies, the outlook for FY01/02 is not encouraging**. Real GDP growth is estimated to slow from 5¼ percent in FY00/01 to 3¾ percent in FY01/02. With world demand for Bangladesh's exports falling rapidly, industrial production declined, and exports have registered a sharp drop.[5] Nevertheless, declining goods imports and net service payments (reflecting the slowdown in domestic activity and the impact of intensified exchange restrictions) and larger worker remittances are expected to contribute to a reduction in the external current account deficit from about 2½ percent of GDP in FY00/01 to 1½ percent in FY01/02. However, net aid flows have declined and substantial net private capital outflows are continuing, putting additional pressures on official international reserves. By end-FY01/02, reserves are expected to be only slightly more than one month of a compressed level of imports of goods and services.

II. Report on the Discussions

9. **The discussions focused on identifying a policy mix that would effectively address growing domestic imbalances, and work toward fostering the conditions necessary for high and sustainable growth consistent with a substantial reduction in poverty over the medium term**. The immediate policy challenge is to improve the budget balance and to reduce the burden of nonfinancial SOEs on public resources. Such actions are key in the near term to limit inflationary and exchange market pressures. To improve economic efficiency and the ability of the economy to weather external shocks without resorting to administrative controls, discussions were also held on the desirability of moving toward flexible interest and exchange rate arrangements. In addition, the authorities and the staff exchanged views on developing a poverty reduction strategy, and the authorities explained the preparatory steps that they have taken toward developing an I-PRSP.

A. Fiscal Policy

10. **The authorities agreed that regaining and maintaining control of public finances is essential to managing aggregate demand, restoring macroeconomic stability, and building credibility in public policy**. The authorities noted that the immediate problems that they faced in trying to rein in the cash budget this year stemmed from a large carryover of expenditure from the previous fiscal year and by additional, unclassified expenditure undertaken during the period of the first quarter (totaling over 1 percent of GDP).[6] Since coming to office, they had sought to hold the deficit down by the introduction of a number of measures (see Box 1), and they felt that they would be able to keep the deficit to no more than 5½ percent of GDP in FY01/02. The staff suggested that a more ambitious

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[5]Preliminary estimates indicate that even with a moderate recovery in the rest of the year, exports in FY01/02 could fall short of trend by about $450 million (almost 1 percent of GDP).

[6]The unidentified expenditure includes the discrepancy between the below-the-line financing and the above-the-line revenue and expenditure estimates.

deficit target should be set. In particular, the government could aim for a budget deficit in FY01/02 roughly 1 percentage point lower than the authorities' target, which would be consistent with the level of concessional financing likely to be available in the absence of a comprehensive stabilization and reform program.[7]

11. **The staff and authorities agreed that at this late stage in the fiscal year, room for revenue enhancing measures was very limited and that fiscal adjustment would need to fall primarily on the expenditure side**. However, the authorities felt reductions in recurrent expenditure would be difficult to achieve, so they are likely to focus on cuts in the very large development expenditures in the original budget. The authorities did not provide the staff with any specific development expenditure-reducing measures. Moreover, rather than presenting a revised budget to the parliament now, the authorities intend to rely on the discretion granted to the Minister of Finance to keep actual expenditure below budget.

12. **The authorities have also taken steps to improve the deficit financing strategy and the management of contingent liabilities**. New commercial borrowing through suppliers' credits to meet obligations of the SOEs, a practice which had become more widely used, was suspended, and efforts are being made to cancel contracts for undisbursed commercial credits from foreign suppliers that carry a government guarantee. Delayed payment obligations in foreign exchange, which as of end-December 2001 amounted to 0.2 percent of GDP, have been regularized.

13. **The authorities noted that a more comprehensive fiscal policy framework would be adopted in formulating the budget for FY02/03 as an important first step in establishing a medium-term strategy to foster more rapid and sustainable levels of economic growth**. They assured the staff that there will be no large carryover of expenditures into next year and further efforts to reconcile the below-the-line financing of the budget with the above-the-line estimates will be pursued. They also have taken significant steps to strengthen the monitoring of fiscal developments, public debt, and activities of the SOEs which impact the budget (Annex V). A fiscal ROSC and assessment of public expenditure management is planned for mid-2002.[8] To improve financial management, and consistent with the recommendations of the ongoing public expenditure review by the World Bank and the Asian Development Bank (AsDB), the government is planning to establish a Public Expenditure Commission in mid-2002, which could help to address governance problems, especially in the area of procurement, and provide guidance on addressing infrastructure bottlenecks.

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[7]Under a program, the staff would have proposed a deficit in FY01/02 of 5 percent of GDP, as additional external financing was ready to be activated in support of a more decisive adjustment and reform effort.

[8]A review of technical assistance provided by the Fund was conducted and is outlined in Annex III.

B. Monetary and Exchange Rate Policies

14. **The authorities and the staff agreed on the need to move toward flexible interest and exchange rates and, to meet this objective, on the need to strengthen the capacity of BB to conduct monetary policy.**[9] In this regard as noted, BB recently made it compulsory for banks to meet legal cash reserve requirements in local currency only and not by using foreign exchange holdings, as was commonly the practice. Recently, BB has also increased the size of its treasury bill auctions to rein in the expansion of base money, and the associated increase in interest rates has forced the government to face more directly existing market conditions. The staff has also suggested the implementation of repo operations in the foreseeable future to enhance their ability to control monetary aggregates.

15. **Particular attention is being paid to the liberalization of treasury bill auctions.** The staff has recommended for some time the gradual phasing-out of the statutory liquidity ratio, which creates a captive market by forcing banks to bid for all treasury bills offered, and the discontinuation of the use of cut-off rates that are below market rates in the auctions. Steps are also needed to discontinue BB's standing offer to purchase treasury bills from commercial banks at any time, which inhibits development of a secondary market. In order for interest rates to provide appropriate signals for market-based activity, the staff also noted that the interest rates on national savings certificates should be linked to a market rate, such as treasury bill rates, and the ceiling on the interest rates for credits to the export sector should be removed. The authorities noted that these two steps are politically sensitive and, while they agreed with the thrust of the measures, they would have to proceed with caution.

16. **Efforts to strengthen the independence of BB are being undertaken.** To this end, the authorities are following a two-step approach. First, greater de facto independence in the setting of monetary policy is being given to BB by allowing it to exercise greater discretion in fixing terms and conditions for its auctions of treasury bills. The second step involves the preparation of amendments to the Bangladesh Bank Order to remove in particular the discretion of the government over central bank financing of the budget, and its right to control day-to-day management of the exchange rate. Amendments to the central bank act are expected to be submitted to parliament in the second half of 2002.[10]

17. **On the exchange rate, the authorities accepted the idea of moving to a flexible arrangement but questioned the timing of such an action.** On the basis of traditional REER indicators (i.e., PPP- or ULC-based indices), the taka would not appear to be grossly misaligned (Figure 2). However, such an assessment must be qualified because net international reserves has steadily declined in recent years despite the widespread use of exchange

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[9]To assist the authorities, technical assistance has been provided to BB, and the Fund is currently making arrangements to provide BB with an itinerant advisor on monetary and foreign exchange operations.

[10]LEG is currently providing technical assistance on the drafting of these amendments.

and trade restrictions. Moreover, there are indications that the cost of conducting business in Bangladesh is quite high compared with other neighboring countries (see Selected Issues paper), which suggests that the external competitiveness of Bangladesh firms remains impaired by the current policy environment. Against this background, the authorities agreed that moving to a flexible exchange rate arrangement will provide more appropriate price signals, enhance the effectiveness of monetary policy, depoliticize exchange rate policy, and place the country in a stronger position to face the impending phasing-out of the Multi-Fiber Agreement at end-2004 which affects Bangladesh's main exports. They also indicated that such a move would be accompanied over time by the removal of all remaining exchange restrictions that affect Bangladesh's Article VIII status (see below).

18. **The authorities were uncertain regarding the technical ability of BB to handle large variations in the exchange rate under a flexible exchange rate arrangement**. In particular, they were concerned about the magnitude of any potential overshooting of the exchange rate. While acknowledging the difficulties in judging the appropriateness of the exchange rate level given the presence and variability of exchange restrictions, the staff indicated that the likelihood of a sizable overshooting would be minimized if the move to a flexible exchange rate was to be accompanied by strong and credible fiscal and monetary policies. Regarding BB's preparedness for a shift to a more flexible exchange rate, the staff noted that many of the required technical elements were already in place and BB was working to remedy remaining deficiencies. It is also critically important for BB to have the freedom to manage liquidity without relying on exchange restrictions and to let interest rates play a more central role.[11]

C. Structural Policies and Reforms

19. **Additional efforts must be made to strengthen the financial system, especially the nationalized commercial banks (NCBs) and the development financial institutions (DFIs)**. For a number of years, the banking system has been characterized by a high level of nonperforming loans, low capital, and weak management, particularly in the government-owned financial institutions (Box 2; see also Selected Issues paper). While the average share of classified loans to total lending stood at 31 percent at end-2001, the highest shares were recorded in the NCBs (37 percent) and DFIs (62 percent). Capital adequacy ratios were at 7 percent, and actual provisioning was equivalent to 48 percent of the required level in the banking system at end-2001, compared with ratios of just 4 percent and 35 percent, respectively, in the NCBs. The discussions focused on the need to arrive at a comprehensive assessment of banks conditions, the potential fiscal implications of restructuring, and the actions needed to accelerate the reform process. Such actions would include broadening BB's supervisory and regulatory powers to include the NCBs and DFIs,[12] strengthening prudential

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[11] A joint MAE/LEG mission in January 2002 provided technical assistance to BB on these issues.

[12] Currently, BB has the authority to supervise NCBs, but only the Ministry of Finance has the power to take these institutions over or require corrective action in case of problems.

standards, developing a plan to reduce nonperforming loans (including the abolition of insider lending) and meeting minimum capital adequacy ratios. The authorities noted that they look forward to the FSAP scheduled for May 2002 to assist them in this task.

20. **Reform of the nonfinancial state-owned enterprises would make an important contribution to enhancing the economy's growth prospects.** Despite accounting for a small share of GDP (around 3 percent), this sector imposes a significant burden on the budget, and indirectly on the economy through the level of nonperforming loans that it receives from the banking sector and the growing level of inter-enterprise arrears. The authorities acknowledged that the approach followed in recent years, which focused on simply increasing subsidies to SOEs and the government assuming the bad debts to SOEs without securing improvements in their performance, had reduced fiscal discipline (Box 3; see also Selected Issues paper).

21. **As first steps in a renewed reform effort, the government in January 2002 raised utility prices primarily on the basis of longstanding automatic pricing formula adjustments that had been discontinued for the last 18 months.**[13] More recently, the Cabinet has agreed in principle to start to sell profitable as well as unprofitable public enterprises. The staff suggested that the authorities should: (i) conduct an assessment of the depth of the SOEs' financial imbalances; (ii) develop a system that allows for the regular monitoring of the financial situation of the largest enterprises; (iii) develop and implement a plan to contain SOE losses and restrain their demands on the NCBs for financing; and (iv) set utility price in line with border prices or long-run marginal cost principles, but tie authorizations to SOEs to use the higher revenues thus generated to the formulation and implementation of business plans aimed at improving their financial performance. It was generally agreed that further restructuring and privatization of SOEs will be needed, including closure of nonviable enterprises. In particular, the authorities acknowledged the need to address the poor governance, inefficiency, and large system losses in the energy sector, and to develop a timetable to adopt market-based gas and oil product prices, rationalize product pricing, improve billing and collection, and develop a legal framework that would allow for an independent regulatory structure in the power sector.

22. **The authorities agreed that the recent rising trend in trade restrictiveness and the heavy reliance on exchange controls must be reversed.** After considerable progress in rationalizing its trade regime during the first half of the 1990s, increases in tariffs in December 2001 marked a significant step backward.[14] The combined average tariff is

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[13]Prices were increased for gasoline (by 22 percent), diesel and kerosene (10 percent), commercial use of gas (5 percent), household use of gas (6–31 percent depending on monthly usage), commercial use of electricity (2–6 percent depending on the size of the company and the time of use), and household use of electricity (up to 7 percent depending on monthly usage).

[14]Specifically, the government imposed regulatory duty on imports of 30 items of daily use at four rates ranging from 10 percent to 25 percent (for details see Annex VI).

26 percent (compared to 13 percent for all Fund members). Nontariff barriers also exist, including QRs on sugar, salt, and woven and knitted fabrics. Accordingly, Bangladesh is rated eight on the Fund's ten-point scale of overall trade restrictiveness (Annex VI). The authorities indicated their willingness to adopt a phased reduction in the level of trade restrictiveness, including by gradually reducing the maximum tariff rate to about 15 percent in accordance with Bangladesh's bilateral and multilateral commitments. They expressed concern, however, about prevailing restrictive practices in neighboring countries as well as in major export destinations.[15] Furthermore, it was noted in the discussions that liberalization of gas exports and restructuring of industry will be especially important to help reduce the country's heavy dependence on ready-made garment exports, which will lose privileged access to Western markets after end-2004 with the phase-out of the Multi-Fiber Agreement. About half of Bangladesh's total exports enter the European Union (EU) countries, primarily under the EU's duty- and quota-free access.

23. **The imposition of margin requirements on letters of credit introduced in December 2000 and thereafter constitutes an intensification of exchange restrictions that are subject to the Fund's approval under Article VIII**. The authorities indicated that they would phase out the margin requirements on letters of credit by end-June 2002. As a first step, in February 2002, administrative controls have been loosened somewhat.[16] Regarding other existing exchange restrictions as specified in Annex VI, the staff is currently finalizing a comprehensive review with the authorities and will report its findings and recommendations to the Board in a supplement to the staff report to be issued prior to the Board discussion of the 2001 Article IV consultation. The authorities also noted their intention to liberalize other aspects of the exchange and trade regime, including an initial unification of the rate on export surrender requirements and to later phase them out, and to review the existing cash drawback scheme for exports (see Annex VI).

D. Development of a Poverty Reduction Strategy

24. **Although poverty has declined in the last decade and social indicators such as literacy, immunization rates, and access to clean water have shown substantial improvement, about one-third of Bangladesh's population are still very poor and one-half are poor**. To address this problem, preparation of an I-PRSP is under way. Despite a

[15]Bangladesh is a member of several regional trading arrangements, including the SAARC Preferential Trading Arrangement, the Bangkok Agreement, the Bangladesh-India-Myanmar-Sri Lanka-Thailand Economic Cooperation, and the Developing Countries-8 Group. The authorities indicated that recorded trade with neighboring countries had increased steadily since the 1980s, but given prevailing restrictive practices in the region, there has been a concomitant increase in unrecorded trade.

[16]Banks were authorized to freely negotiate with importers the margin requirements on letters of credit for imports of inputs to industrial production, and margin rates for imports of rice and wheat were reduced from 100 percent to 25 percent.

slow start due to staffing problems and weak institutional capacity, several background papers have been completed in recent months by government consultants and a first round of consultations with civic groups has been held. With financial support from Japan, in February 2002 the government, the IMF, and the World Bank held a conference to elaborate on the I-PRSP process in Dhaka that was attended by over 150 government officials, representatives of civil society, participants from the region, and donors. A progress report was presented at a development forum in mid-March, where the government again committed to reestablish macroeconomic stability, undertake reforms in SOEs and the financial sector, make improvements in the education and health sectors, and to address governance concerns. The government intends to align the I-PRSP with the budget for FY02/03 and to complete its preparation during the third quarter of 2002, after integrating it in a medium-term macroeconomic framework and identifying, costing and, if possible, securing financing for specific structural and social reforms. In the view of the staff, this timing appears to be ambitious given the scale of issues that need to be addressed.

25. **The authorities agreed that achieving a substantial reduction in poverty will require significantly higher rates of economic growth than those achieved in recent years**. The staff has estimated that to bring per capita income levels in Bangladesh to a level equivalent to the current IDA ceiling of $885 per capita within the next generation, GDP growth would have to average around 6–7 percent per year, up from its average of about 5 percent in the decade ending FY00/01 (see accompanying Selected Issues paper).

26. **The authorities agreed on the broad thrust of policies needed to move the economy to a higher growth path and the need for such policies to be an integral part of the I-PRSP** (see Annex I). In general, policies will have to foster a stable macroeconomic environment and promote the full and efficient use of the country's resources. Although Bangladesh's public debt and debt service remain manageable, fiscal policy will have to be prudent as the budget has been a major source of macroeconomic imbalance. There is a need for a tax reform to raise revenue while reducing distortions; similarly, expenditures will need to be properly prioritized and tailored to address poverty and structural issues. It will also be central to strengthen governance and deal with the weak institutional capacity, both of which lie at the core of the low revenue performance, inefficiencies in the use of concessional assistance, and problems in the SOE and banking sectors. The public expenditure review under preparation will assist in this task. Monetary and exchange rate policies should focus on enhancing market signals in order to direct factors of production to their most efficient use. SOEs and the banking sector reforms and liberalization of trade and financial markets would also enhance economic efficiency and stimulate growth. The authorities indicated that actions in all of these areas would be part of the poverty reduction strategy being developed. The government also noted that, with support from the World Bank and the AsDB, they are continuing to implement projects in rural development, energy, judiciary, education, micro-finance, HIV-AIDS prevention, and air quality improvement (see Annexes VII and VIII).

III. STAFF APPRAISAL

27. **The macroeconomic situation in Bangladesh has become increasingly fragile in recent years largely owing to persistently expansionary fiscal and monetary policies.** At the same time, there has been a progressive loss in the momentum of efforts to reform the structure of the economy. The adverse external environment Bangladesh faced in late 2000 and in 2001 aggravated this fragility and made clear the limited room for policy maneuver available to the authorities, as pressures increased on the exchange rate, international reserves declined, and real interest rates (until recently) remained high.

28. **The government's policy actions since taking office in October 2001 have in part been positive, but the staff is concerned that the measures taken so far represent only a partial policy response and that there has been significant reliance on administrative controls.** The authorities have indicated that they need additional time to form political consensus in support of a more comprehensive policy approach and to prepare for its successful implementation. They believe the adoption of such an approach would be better framed in the context of the budget for FY02/03. In the interim, the staff welcomes the authorities' intention to take steps to avoid further deterioration in the fiscal position and to implement recommendations from recent Fund technical assistance. Bangladesh's participation in a FSAP and a fiscal ROSC in the next few months is also important.

29. **Regaining and maintaining strict control over public finances will be key in reducing domestic imbalances.** Current fiscal trends are worrisome, and the government's self-imposed deficit target of 5½ percent of GDP in FY01/02 will be difficult to achieve. New revenue-enhancing measures are not likely to have significant effects in the few remaining months of the fiscal year. Thus, concrete measures to reduce expenditures need to be identified. Such measures should be directed at reducing low-priority recurrent spending and should not be concentrated solely on the development projects. It also will be important to avoid incurring and, if possible, to reduce arrears on payments of government obligations, and to minimize the size of carryover expenditure into next year's budget.

30. **The adoption of a prudent fiscal stance will serve to diminish inflationary and exchange rate pressures.** Furthermore, there is a need to move toward greater flexibility in interest and exchange rates, which in turn will increase the effectiveness of monetary policy. The capacity and independence of BB will also have to be enhanced. Some useful steps have already been taken with, for example, BB being given more discretion in determining terms and conditions of treasury bill auctions and the drafting of amendments to the Bangladesh Bank Order which will soon be introduced in parliament to grant BB greater operational independence, but additional progress is required. Actions recommended include further liberalization of the treasury auctions, making interest rates on national savings certificates market-determined, and eliminating the interest rate ceilings on loans to the export and agricultural sectors. Greater exchange rate flexibility, by providing better price signaling than sporadic adjustments to a fixed rate, would help to allocate the economy's resources to their most productive use, and when coupled with appropriate macroeconomic policies, would improve the economy's ability to weather external shocks.

31. **The improvement in the average vulnerability indicators of the banking sector since 1999, albeit slow, is encouraging, but it is troublesome to see the growing disparity in performance between publicly owned financial institutions and private banks.** It is important to give BB the same supervisory and regulatory authority over the NCBs and DFIs as it has over the other banks. It will be equally important to develop a plan to orderly reduce nonperforming loans of the publicly owned financial institutions, improve their business practices, and to take additional steps to strengthen and enforce prudential standards.

32. **Addressing the problem of the nonfinancial SOEs will require development of a plan to stem the ongoing sizable losses of the largest of these enterprises.** The government should make all budgetary assistance to these enterprises, including debt assumptions and extension of commercial guarantees and authorizations for adjustments in their administered prices and tariffs, subject to strict regular reporting requirements and to the formulation and implementation of a business plan to improve the enterprises' financial performance. At the same time, the government should proceed expeditiously to implement restructuring and privatization plans, including closure of nonviable enterprises.

33. **The main challenge for the medium term is to develop a strategy to lift and sustain the rate of economic growth to a level sufficient to significantly reduce the high incidence of poverty in Bangladesh over the medium term.** The staff commends the authorities' recent efforts to accelerate the pace of the development of a comprehensive I-PRSP, which will help forge a consensus on economic reforms and provide the framework for the development of such a strategy. Beyond establishing a sound and stable macroeconomic environment, government policies will have to be directed at promoting the full and efficient use of resources. This will entail fiscal policy reform to remove distortions in the tax system and direct spending to higher priority needs, particularly in infrastructure and human capital investment. Monetary and exchange rate policies will need to enhance market signals. Structural reforms in the SOEs and the banking sector and further liberalization of international trade are also essential to raising the level of GDP growth on a sustainable basis. It will be equally important to strengthen governance and institutional capacities, and to ensure the country's ownership of the strategy that is pursued.

34. **The authorities have recently removed some of the mandatory margin requirements imposed on letters of credit for imports.** They have also stated their intention to remove all of the remaining margin requirements in the period immediately ahead. The staff strongly urges the authorities to remove other longstanding restrictions. As noted above, the staff will make its final recommendations to the Board on whether or not to approve the existing restrictions in a supplement to the staff report, once the ongoing review of the exchange system is finalized. The staff also urges the authorities to continue their efforts at liberalizing other areas of the exchange system such as export surrender requirements and the cash export drawback scheme, and to take decisive steps at reversing the recent rising trends in trade restrictiveness, including by developing a plan for moving expeditiously toward a more simplified tariff structure, with a much lower average import tariff and minimal reliance on nontariff barriers.

35. **The success in the implementation of any effort at stabilization and reform hinges also on the ability of the government to monitor developments and account for the conduct of its policies.** In this light, it is commendable that the authorities have completed the steps necessary for participation in the GDDS. To continue the progress being made, recent efforts at improving the informational base for economic decision-making, particularly in the fiscal area and in identifying the financial situation of the SOEs, should be intensified and replicated in other areas such as external debt.

36. It is proposed that the next Article IV consultation with Bangladesh take place on the standard 12-month cycle.

Box 1. Bangladesh: Fiscal Developments in FY01/02

The consolidated central government deficit during the first half of FY01/02 was running at an annual rate of over 6 percent of GDP. Weak economic activities contributed to lower-than-expected customs duties and lower dividends to the budget. At the same time, expenditures increased due to a large carryover of expenditure from the previous fiscal year (0.7 percent of GDP) and additional, unclassified spending (0.4 percent of GDP).

After taking office in October 2001, the current government introduced a fiscal package which was expected to yield Tk 12.5 billion (0.5 percent of GDP) in FY01/02 budget savings. Revenue enhancing measures (Tk 6.7 billion) included: (i) increasing the withholding tax rate for some sectors; (ii) broadening corporate taxes to local authorities; (iii) widening the VAT base through regulatory duty on selected domestic consumer goods; (iv) enhancing stamp duty collection on cigarettes; (v) improving monitoring/collection through the introduction of computerized assessments, appointing independent auditing firms, and establishing large taxpayer units for both the income tax and VAT; and (vi) strengthening the trade clearance system and reducing smuggling. The changes in expenditures envisaged by the authorities included reductions as well as increases, resulting in a net saving of Tk 5.8 billion. Specifically, the authorities have: (i) switched away from nonessential expenditure items toward social spending; (ii) provided extra payments for underbudgeted items; (iii) increased utility charges due to price adjustments with consequent containment of SOE transfers; and (iv) adjusted prices for food operations to generate budgetary savings.

More recently, the authorities have announced that annual development program expenditures will be cut by Tk 27 billion (1.0 percent of GDP) from their budgeted level. Projects focused on poverty alleviation and growth, especially those with a high rate of external financing and a low dependence on imports, will be given priority. However, no details have been provided on which projects will be cut.

Based on staff assessment, however, these proposed measures may be sufficient only to offset expected revenue shortfalls during the remainder of FY01/02 and to meet part of the expenditure overrun that has already taken place. In the absence of additional measures, the staff estimates that consolidated central government fiscal deficit in FY01/02 would remain at 6 percent of GDP.

Box 2. Bangladesh: The Banking Sector

At present there are 51licensed banks, of which 30 are local private commercial banks (PCBs), 12 are foreign commercial banks (FCBs), 4 are nationalized commercial banks (NCBs), and 5 are government-owned specialized development banks (DFIs) for the agriculture and industrial sectors. The system continues to be dominated by the NCBs and DFIs, accounting for more than one-half of total banking assets, although their market share has been declining in recent years.

The level of nonperforming loans in the portfolio of banks has remained high, although efforts have been made to reduce the level both by the authorities and the banks. The share of classified loans in total loans increased from 31 percent in 1996 to a peak of 41 percent by June 1999, before declining to 31 percent by December 2001 (tabulation below). The share of classified loans is largest in the NCBs and DFIs, constituting 43 percent of total bank lending or about 8 percent of GDP. Their share of classified loans has been declining in recent years due to tighter lending and monitoring criteria, incentive schemes for collections, and some rescheduling of overdue loans. Current regulations allow a classified loan to be upgraded as performing for a six-month period after 10 percent of the amount overdue is repaid.

The high default rates of the domestic banks can be attributed in part to political interference, institutional bottlenecks (including an ineffective legal system), and legally sanctioned insider lending. Fixed property, particularly land, constitutes the main form of collateral of borrowers. Given that land registration procedures are inadequate to define property rights, it is difficult for banks to seize, and dispose of, collateral on defaulted debts.

The capital adequacy ratio for the banking system fell from 7.4 percent in December 1999 to 6.7 percent in December 2001. Over this entire period, capital adequacy ratios fell for all types of banks, with the exception of the FCBs. It should be noted that capital adequacy ratios for the NCBs and DFIs overstate their capital because of inadequate loan provisioning. In particular, actual provisioning averages just 35 percent of required provisioning for the NCBs (with no change in recent years), compared to 77 percent in the PCBs and 124 percent in the FCBs. An FSAP mission scheduled to take place in the second quarter of 2002 is expected to provide the framework for the development of a comprehensive strategy to deal with the banking sector problem.

Trends in Classified Loans to Total Loans as of End-December
(In percent; includes interest suspense)

Year	NCBs	PCBs	FCBs	DFIs	All Banks
1996	32.55	34.77	4.72	...	31.49
1997	36.57	31.42	3.58	65.72	37.49
1998	40.38	32.72	4.14	66.70	40.65
1999	45.62	27.09	3.80	65.02	41.11
2000	38.56	22.01	3.38	62.56	34.92
2001	37.02	16.98	3.33	61.80	31.49

Source: Banking Regulation and Policy Department, Bangladesh Bank.

Trends in Capital Adequacy Ratios as of End-December
(In percent)

Year	NCBs	PCBs	FCBs	DFIs	All Banks
1996	5.6	7.1	17.8	6.2	6.6
1997	6.6	8.4	16.5	6.0	7.5
1998	5.2	9.2	17.0	7.0	7.3
1999	5.3	11.0	15.8	5.8	7.4
2000	4.4	10.9	18.4	3.2	6.7
2001	4.2	9.9	16.8	3.9	6.7

Source: Banking Operation and Development Department, Bangladesh Bank.

Box 3. Bangladesh: The Role and Performance of the Nonfinancial State-Owned Enterprises

The relative importance of the nonfinancial state-owned enterprises (SOEs) in the real economy is modest and on a declining trend. The 43 corporations comprising the SOE sector directly accounted for less than ½ percent of total employment in FY00/01, and less than 3 percent of total GDP.

However, the SOEs pose a significant burden on the economy. The aggregate cash deficit of the ten main SOEs[1] amounted to 2.8 percent of GDP in FY00/01, up from 1.6 percent in FY99/00, and it is budgeted to rise to nearly 5 percent in FY01/02 (tabulation below). The SOEs put further pressure on national resources through the accumulation of payment arrears, of which 85 percent are related to debt-service obligations to the budget from previous on-lending. Total intra-SOE arrears and overdue payments to nationalized commercial banks amounted to over 3 percent of GDP at end-2001. External arrears to international oil companies for natural gas purchases by a state-owned oil company amount to about 0.2 percent of GDP at end-December 2001, although these are now being regularized.

The SOEs' poor financial performance is driven by inefficiencies and uneconomic pricing policies. The large losses in the energy sector, which account for 85–90 percent of total operational losses of the SOEs, reflect high losses in the production and distribution system, theft, and low administered prices. In the manufacturing sector, losses are mainly the result of excess and inefficient capacity in the production of jute and low administered prices and operational inefficiencies in the production of fertilizer.

Pricing policies in the SOE sector cause distortions in resource allocations. The World Bank has calculated that natural gas used for power generation, fertilizer production, and by residential households was subsidized by an average of 40–50 percent in FY99/00, while other industrial and commercial users had a lower subsidy of 9–15 percent. The pricing of the electricity distribution company (BPDB) has an even larger element of subsidization; in FY01/02, commercial users are estimated to pay a 23 percent premium over the marginal cost of electricity production, while residential users receive a 39 percent subsidy, and irrigation, 53 percent.

No progress has been made recently divesting SOEs, although steps have been made toward more use of privatization in the future. The World Bank has advised the government to move forward with a phased approach, including liquidation of nonviable SOEs and the divestiture of others, along with monitoring the performance of SOEs that remain in state hands, while imposing hard budget constraints and introducing economically rational pricing policies.

SOE Finances
(In percent of GDP)

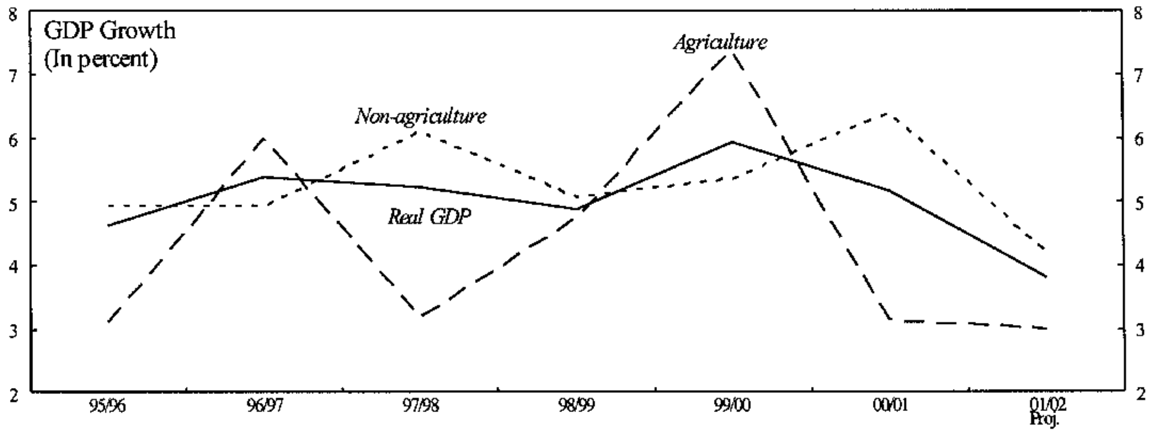
	Actual		Budget Est.
	FY99/00	FY00/01	FY01/02
Cash balance after tax and dividend (- deficit)	-1.6	-2.8	-4.8
Net financing from budget (loans and equity injections)	1.0	1.4	1.9
Net bank financing	0.0	0.4	0.0
Other financing (including arrears accumulation)	0.6	1.0	2.9
Memorandum item:			
Outstanding stock of arrears (end-period)	…	17.7	…

Sources: Ministry of Finance, SOE Monitoring Cell; and the World Bank.

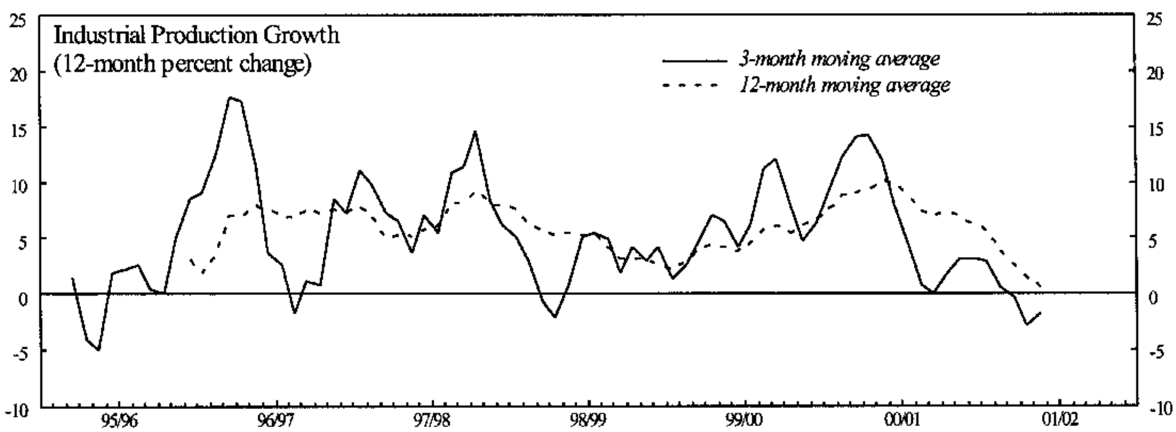
[1]These ten corporations account for about 85 percent of operating revenue of the SOE sector and all of the losses. They include energy and manufacturing corporations and the national airline Biman.

Figure 1. Bangladesh: Real Sector Indicators, 1995/96–2001/02

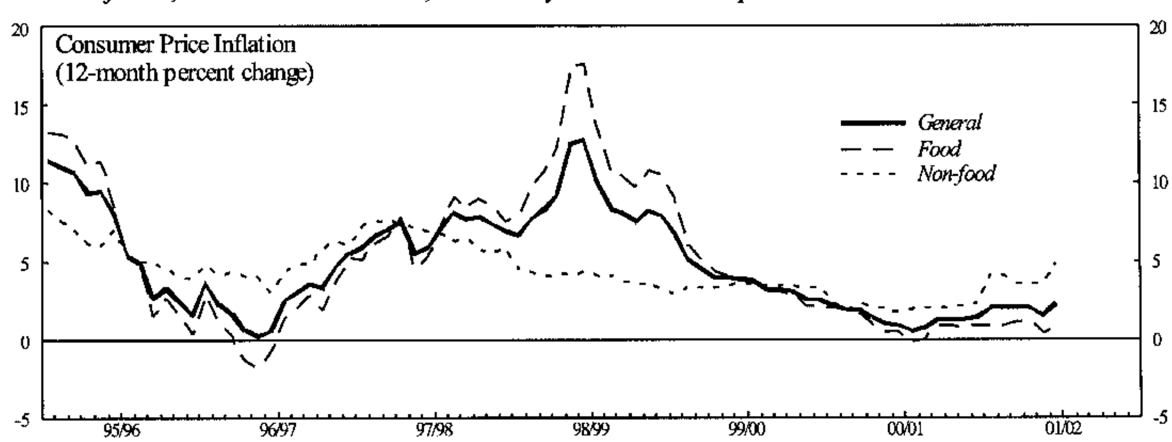
Output growth has slowed in FY01/02...



... led by declining industrial production following earlier strong growth...



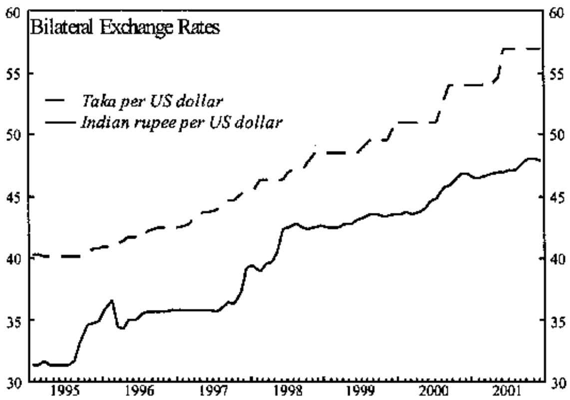
... while inflation, which has been subdued, has recently shown a modest up tick.



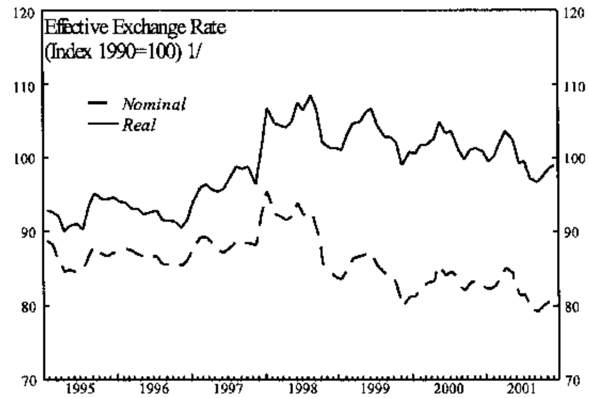
Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

Figure 2. Bangladesh: External Sector Indicators, 1995/96–2001/02

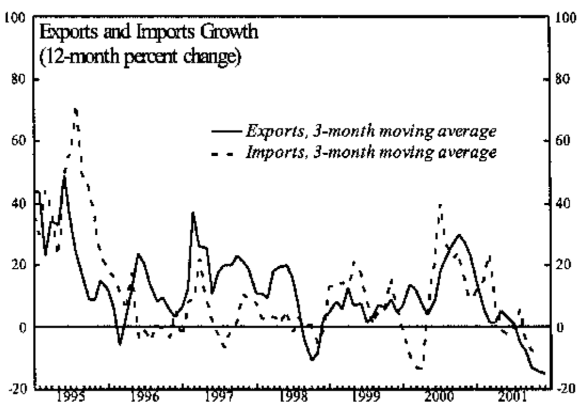
The nominal exchange rates have been periodically adjusted…



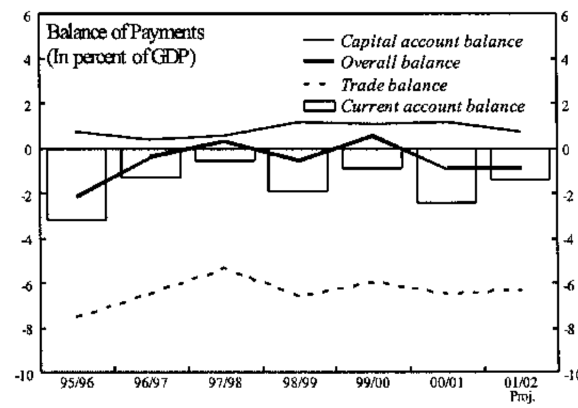
…to limit real exchange rate appreciation.



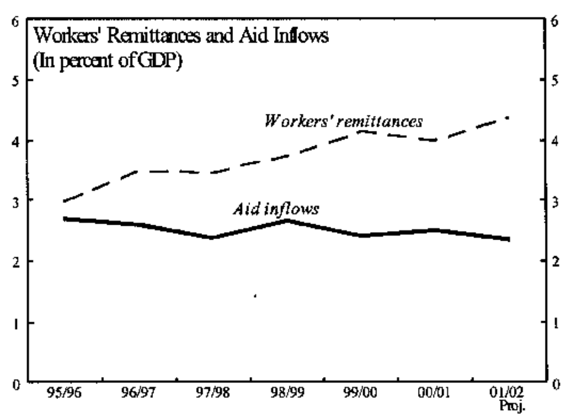
Exports have declined sharply in 2001 while administrative measures have helped contain the growth of imports.



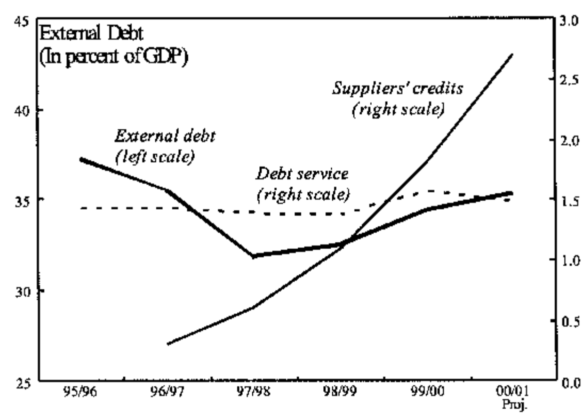
The trade deficit is very high although the current account is low…



…being limited by the increase in workers' remittances as aid flows gradually decline.



After a sharp decline, external debt as a share in GDP has started to increase, with most debt at concessional terms, with the exception of suppliers' credits.

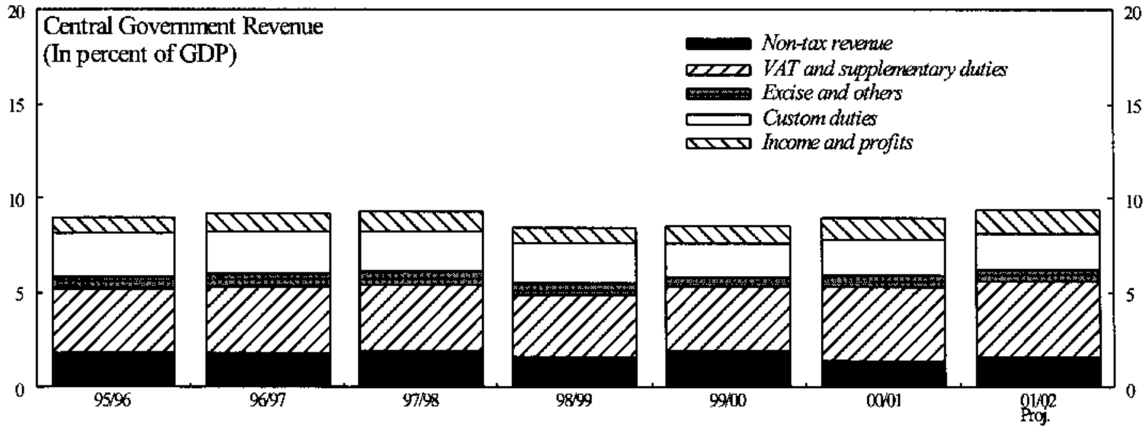


Sources: Data provided by the Bangladesh authorities; IMF, Information Notices System, International Financial Statistics; and Fund staff estimates and projections.

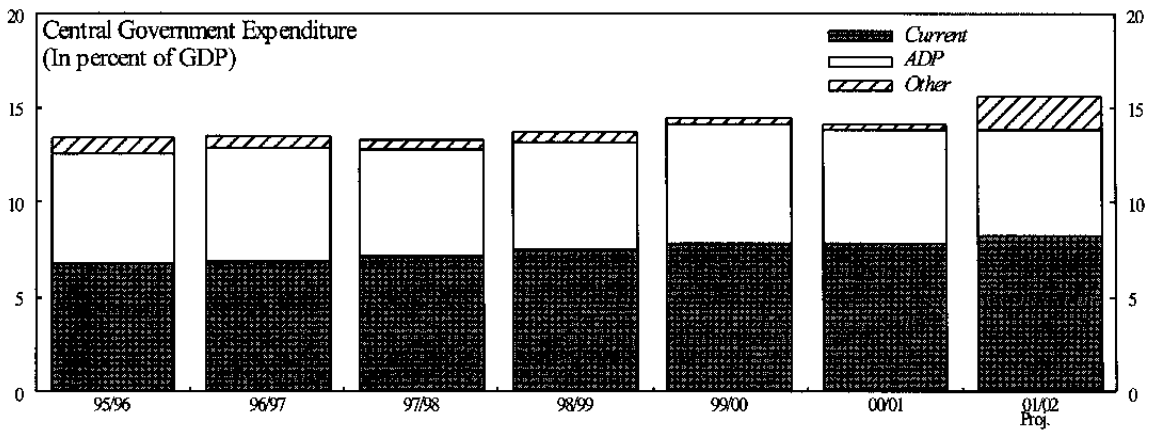
1/ Downward movement indicates depreciation.

Figure 3. Bangladesh: Fiscal Sector Indicators, 1995/96–2001/02

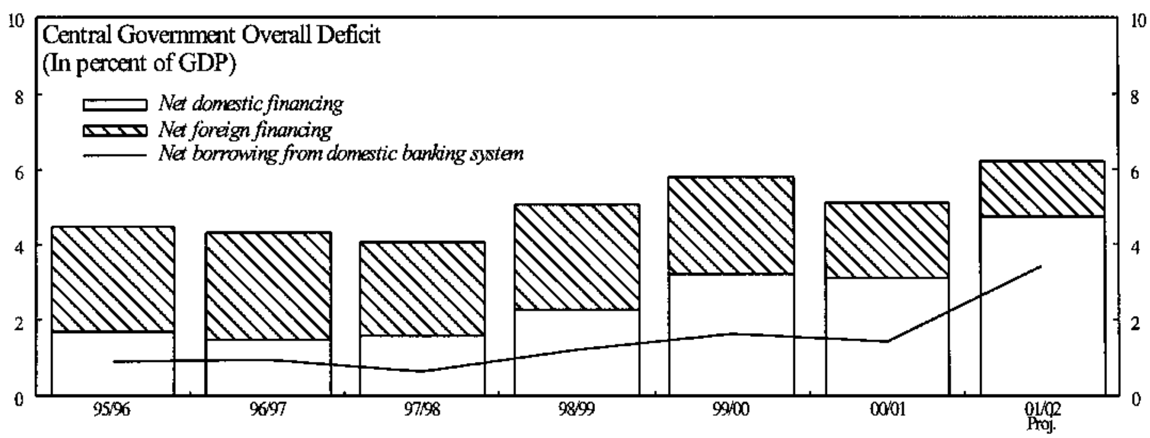
Government revenue has failed to improve…



…accompanied by gradually rising expenditure…



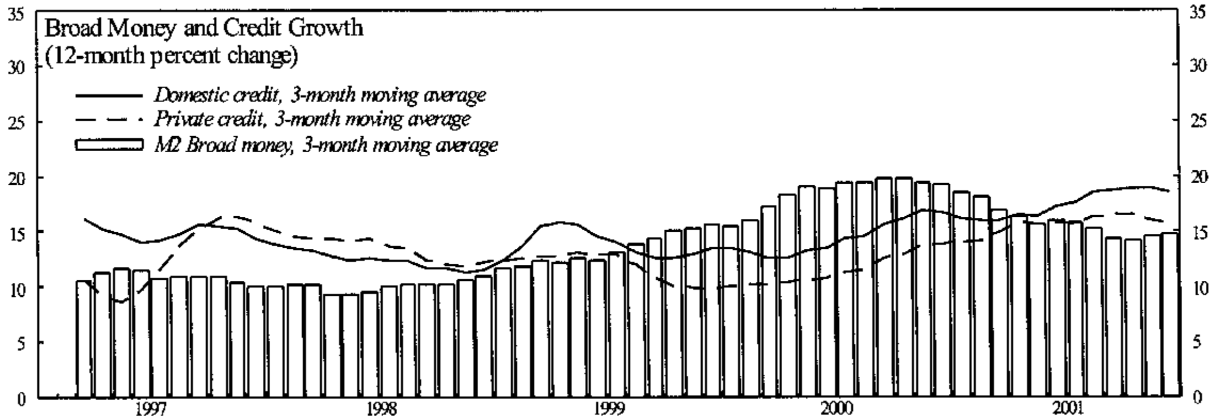
…resulting in high fiscal deficits, increasingly financed from domestic sources.



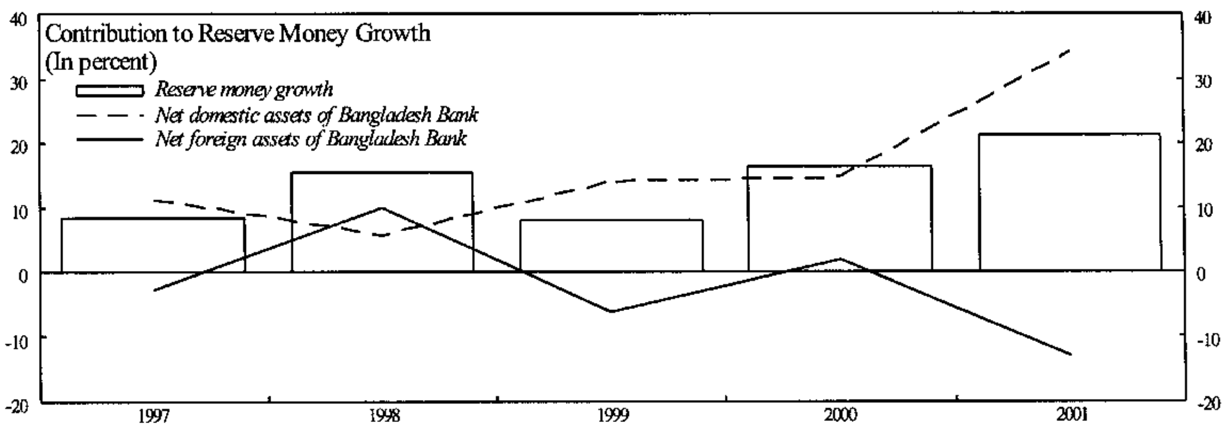
Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

Figure 4. Bangladesh: Monetary Sector Indicators, 1995–2001

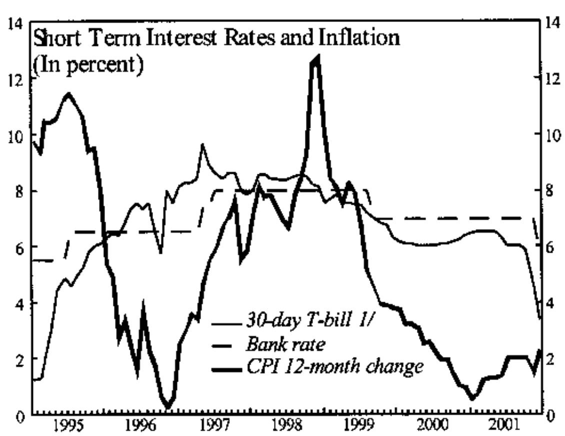
Broad money growth has been fueled by public and private sector credit…



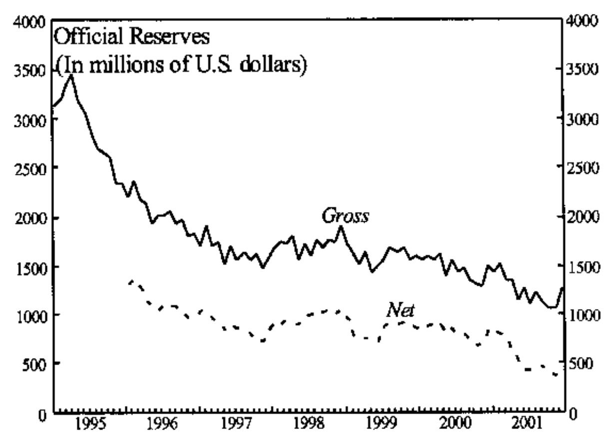
…while the central bank's domestic assets grew and foreign assets fell.



Nominal interest rates were recently sharply reduced...



... even as gross and net reserves fell precipitously.



Sources: Data provided by the Bangladesh authorities; and Fund staff estimates.

1/ Bangladesh Bank bill rates until October 1998. Interest rates have been determined in a controlled auction since October 1995.

Table 1. Bangladesh: Selected Economic and Financial Indicators, 1997/98-2001/02 1/

	1997/98	1998/99	1999/00	2000/01 Est.	2001/02 Official Jun. 01	2001/02 Official Mar. 02	2001/02 Baseline
National income and prices (percent change)							
Real GDP 2/	5.2	4.9	5.9	5.2	6.0	4.8	3.8
Inflation (annual average) using GDP deflator	5.3	4.7	1.9	1.6	4.0	2.2	3.1
Inflation (annual average) using CPI	7.0	8.9	3.5	1.5	4.0	2.2	3.0
Saving and investment (percent of GDP) 2/							
Gross invesment	21.6	22.2	23.0	23.1	...	23.2	21.2
National savings 3/	21.7	21.1	22.7	21.1	...	22.4	20.5
Central government budget (percent of GDP)							
Total revenue	9.3	8.6	8.6	9.0	9.7	9.6	9.4
Of which: Tax	7.3	7.0	6.7	7.5	7.8	7.7	7.8
Total expenditure	13.3	13.7	14.4	14.1	15.2	15.0	15.7
Current expenditure	7.2	7.6	7.8	7.8	7.9	8.2	8.3
Food account surplus (-)/deficit (+)	0.2	0.3	0.0	0.3	0.1	0.1	0.4
Annual Development Program	5.6	5.6	6.4	6.0	6.7	6.3	5.5
Other capital and net lending 4/	0.4	0.2	0.2	0.0	0.6	0.4	1.5
Overall balance	-4.1	-5.1	-5.8	-5.1	-5.5	-5.4	-6.2
Primary balance	-2.9	-3.7	-4.2	-3.5	-3.9	-3.7	-4.4
Financing (net)	4.1	5.1	5.8	5.1	5.5	5.4	6.2
Domestic	1.6	2.3	3.2	3.1	2.8	2.8	4.7
External	2.5	2.8	2.6	2.0	2.8	2.6	1.5
Money and credit (end-year, percent change)							
Domestic credit	13.3	14.0	13.2	18.6	15.7	10.4	15.7
Private sector	14.7	13.0	10.5	16.3	16.7	10.6	7.4
Broad money (M2)	10.2	12.8	18.6	16.6	16.0	10.0	13.7
M3	...	13.3	19.7	18.3	...	...	14.4
Interest rate (treasury bill yields, yearly average)	8.6	7.5	6.1	6.1	...	...	...
Balance of payments (US$ millions)							
Exports, f.o.b.	5,172	5,324	5,762	6,477	7,183	6,150	5,884
(Annual percent change)	16.8	2.9	8.2	12.4	10.9	-5.0	-9.2
Imports, c.i.f.	7,524	8,342	8,566	9,524	10,025	9,129	8,846
(Annual percent change)	5.1	10.9	2.7	11.2	7.1	-2.5	-7.1
Current account (excluding capital grants)	-253	-846	-416	-1,116	-666	-228	-637
(Percent of GDP)	-0.6	-1.9	-0.9	-2.4	-1.4	-0.5	-1.4
Current account (including capital grants)	51	-499	-133	-939	422	...	-313
(Percent of GDP)	0.1	-1.1	-0.3	-2.0	...	...	-0.7
Aid disbursements (loans and capital transfers)	1,052	1,215	1,132	1,174	1,564	1,219	1,106
Overall balance	127	-228	278	-429	...	138	-391
External reserves and debt							
Gross official reserves (US$ millions)	1,751	1,522	1,599	1,302	1,587	1,350	872
(In months of imports of goods and nonfactor services)	2.6	2.0	2.0	1.5	1.7	1.6	1.1
Medium- and long-term external debt (US$ millions)	13,418	14,354	15,727	16,227	...	...	16,903
Total external debt (percent of GDP)	31.8	32.5	34.4	35.3	...	...	36.9
Debt service (percent of current earnings) 5/	8.0	7.8	8.4	7.5	...	...	7.7
Memorandum items:							
Nominal GDP (Tk billions)	2,002	2,197	2,371	2,533	2,818	2,711	2,710
Exchange rate (Tk/US$; period average)	45.4	48.1	50.4	53.9	...	...	...
Nominal effective rate (1990=100) 6/	90.9	87.1	83.5	77.7	...	...	...
Real effective rate (1990=100) 6/	101.7	104.1	102.5	101.0	...	...	...
Terms of trade (percent change)	1.7	2.4	2.1	1.5	...	...	-2.5

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1. Baseline projections assume unchanged policies.
2/ National accounts based on 1995/96 benchmark and prices.
3/ National savings includes official transfers.
4/ Including errors and omissions.
5/ Current earnings are defined as the sum of exports of goods, nonfactor services, and private transfers.
6/ IMF, Information Notice System.

Table 2. Bangladesh: Balance of Payments, 1997/98-2001/02 1/

(In millions of U.S. dollars, unless otherwise indicated)

	1997/98	1998/99	1999/00	2000/01 Est.	2001/02 Baseline
Trade balance	-2,352	-3,017	-2,804	-3,047	-2,961
Exports	5,172	5,324	5,762	6,477	5,884
Imports	7,524	8,342	8,566	9,524	8,846
Net services	82	-66	-284	-365	-61
Receipts	798	798	946	869	984
Payments	716	864	1,230	1,234	1,045
Of which : Interest payments	158	160	170	178	218
Transfers	2,017	2,237	2,672	2,296	2,385
Official current transfers	267	262	443	196	203
Private transfers	1,750	1,975	2,229	2,100	2,182
Of which : Workers' remittances	1,526	1,706	1,949	1,882	2,059
Current account balance 2/	-253	-846	-416	-1,116	-637
Capital account balance	272	539	526	536	354
Net aid flows	744	874	736	760	676
Aid disbursements 3/	1,052	1,215	1,132	1,174	1,106
Concessional debt amortization	-308	-341	-396	-414	-430
Short- and medium-term loans, net	-50	-30	104	5	0
Foreign direct and portfolio investments	252	671	487	419	308
Trade credits and other short- and long-term loans	-674	-975	-800	-648	-630
Errors and omissions	108	80	167	151	-107
Overall balance	127	-228	278	-429	-391
Financing items	-127	228	-278	429	391
Bangladesh Bank	-176	275	-117	329	161
Assets (- increase)	-14	210	-79	302	430
Liabilities 4/	-162	65	-38	27	-270
Fund credit, net	-107	27	-85	-86	-65
Fund disbursements	0	138	0	0	0
Fund repayments	-107	-111	-85	-86	-65
Commercial bank clearing account	-45	56	47	103	-75
Commercial banks, net	49	-47	-161	100	232
Financing gap	0	0	0	0	0
Memorandum items:					
Current account balance (percent of GDP) 2/	-0.6	-1.9	-0.9	-2.4	-1.4
Current account balance (percent of GDP) 5/	0.1	-1.1	-0.3	-2.0	-0.7
Gross official reserves (US$ millions) 6/	1,751	1,522	1,599	1,302	872
(In months of imports of goods and nonfactor services)	2.6	2.0	2.0	1.5	1.1
Medium- and long-term external public debt (US$ millions)	13,418	14,354	15,727	16,227	16,903
(In percent of GDP)	30.4	31.4	33.4	34.5	35.9
(To exports of goods and nonfactor services)	2.3	2.4	2.4	2.2	2.5
Debt-service ratio 7/	8.0	7.8	8.4	7.5	7.7
Exchange rate (taka/US$, annual average)	45.4	48.1	50.4	53.9	...
Nominal GDP (US$ millions) 8/	44,092	45,694	47,059	47,008	47,135

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1. Baseline projections assume unchanged policies.

2/ Excludes official capital grants.

3/ Includes ADP and non-ADP external financing and capital grants.

4/ Includes Asian Clearing Union balances.

5/ Includes official capital grants.

6/ Gross foreign reserves of Bangladesh Bank, including resident foreign currency deposits.

7/ In percent of current earnings defined as the sum of exports of goods, nonfactor services, and private transfers.

8/ Evaluated at current exchange rates.

Table 3. Bangladesh: Central Government Operations, 1997/98-2001/02 1/

	1997/98	1998/99	1999/00	2000/01 Est.	2001/02 Budget	2001/02 Baseline
			(In billions of taka)			
Total revenue	185	189	204	228	275	255
Tax	147	153	158	191	220	212
Of which:						
Taxes on income and profits	20	22	23	31	41	35
VAT and supplementary duties	70	71	82	97	108	110
Taxes on international trade	44	46	42	48	54	50
Nontax	39	36	45	37	54	43
Total expenditure	267	301	342	357	430	424
Current expenditure	143	166	184	197	223	224
Of which:						
Wage payments and allowances	46	41	56	59	61	63
Interest	23	31	38	41	46	47
Subsidies and transfers	41	44	47	56	53	75
Food account surplus (-) / deficit (+)	3	7	0	6	4	10
Annual Development Program (ADP) 2/	113	123	152	153	188	150
Non-ADP capital and net lending 3/	8	5	5	1	16	40
Overall balance	-81	-112	-138	-130	-155	-169
Primary balance	-58	-81	-101	-90	-109	-122
Net financing	81	112	138	130	155	169
Domestic	32	50	77	79	78	128
External	50	62	62	51	78	41
Central government debt	889	1,015	1,191	1,274	1,559	1,480
			(In percent of GDP)			
Total revenue	9.3	8.6	8.6	9.0	9.7	9.4
Tax	7.3	7.0	6.7	7.5	7.8	7.8
Nontax	1.9	1.6	1.9	1.5	1.9	1.6
Total expenditure	13.3	13.7	14.4	14.1	15.2	15.7
Current expenditure	7.2	7.6	7.8	7.8	7.9	8.3
Food account surplus (-) / deficit (+)	0.2	0.3	0.0	0.3	0.1	0.4
Annual Development Program (ADP) 2/	5.6	5.6	6.4	6.0	6.7	5.5
Non-ADP capital and net lending 3/	0.4	0.2	0.2	0.0	0.6	1.5
Overall balance	-4.1	-5.1	-5.8	-5.1	-5.5	-6.2
Primary balance	-2.9	-3.7	-4.2	-3.5	-3.9	-4.5
Financing	4.1	5.1	5.8	5.1	5.5	6.2
Domestic	1.6	2.3	3.2	3.1	2.8	4.7
External	2.5	2.8	2.6	2.0	2.8	1.5
Memorandum items:						
Central government debt	44.4	46.2	50.2	50.3	55.3	54.6
Domestic	12.6	13.7	15.8	15.0	19.1	18.7
External	31.8	32.5	34.4	35.3	36.3	35.9
Social expenditure 4/	3.5	3.5	3.7	3.9	3.7	4.3
Military expenditure	1.5	1.3	1.3	1.3	1.3	1.0
Nominal GDP (in billions of taka)	2,002	2,197	2,371	2,533	2,818	2,710

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1. Baseline projections assume unchanged policies.

2/ The central government component of ADP spending consists of capital spending, net lending, and some current spend

3/ Includes spending such as the Food-for-Work Program, and errors and omissions.

4/ Includes education and health expenditure.

Table 4. Bangladesh: Monetary Survey, 1997/98-2001/02 1/

	1997/98	1998/99	1999/00	2000/01	2001/02	
					Official	Baseline
	(In billions of taka; end-of-period)					
Bangladesh Bank						
Net foreign assets 2/	46	35	44	25	...	16
Net domestic assets	82	100	111	137	...	167
Domestic credit	91	112	121	150	...	173
Central government (net)	39	51	64	92	...	115
Deposit money banks	37	46	43	44	...	44
Nonfinancial public enterprises	2	2	2	2	...	2
Nonmonetary financial insititutions	12	13	12	13	...	12
Other items (net)	-10	-11	-10	-13	...	-5
Reserve money 2/	127	135	154	162	...	184
Currency in circulation	91	97	113	128	...	137
Deposits of deposit money banks	37	38	42	34	...	46
Monetary survey						
Net foreign assets 2/	69	64	86	76	83	59
Net domestic assets	490	566	662	796	875	932
Domestic credit	579	660	748	887	929	1,026
Public sector	147	172	208	259	275	353
Of which:						
Central government (net)	72	93	125	162	...	255
Other public	75	79	82	97	...	98
Private sector	432	489	540	628	654	674
Other items (net)	-89	-94	-86	-91	-53	-94
Broad money (M2)	559	630	748	872	959	991
Of which:						
Currency outside banks	82	87	102	115	...	129
Deposits	477	543	646	757	...	862
	(Annual percentage change; monetary survey)					
Net foreign assets	4.0	-6.5	33.9	-11.8	12.5	-22.4
Net domestic assets	11.1	15.5	16.9	20.3	9.8	17.1
Domestic credit	13.3	14.0	13.2	18.6	10.4	15.7
Public sector	9.5	17.1	20.9	24.7	10.0	36.4
Of which: Central government (net)	...	29.0	34.5	29.4	...	57.3
Private sector	14.7	13.0	10.5	16.3	10.6	7.4
Broad money (M2)	10.2	12.8	18.6	16.6	10.0	13.7
	(Percentage contribution to broad money, 12-month growth)					
Net foreign assets	0.5	-0.8	3.4	-1.4	0.9	-1.9
Net domestic assets	9.7	13.6	15.2	18.0	9.1	15.6
Domestic credit	13.4	14.6	13.8	18.6	4.8	16.0
Public sector	2.5	4.5	5.7	6.9	1.9	10.8
Of which: Central government (net)	...	3.7	5.1	4.9	...	10.6
Private sector	10.9	10.1	8.1	11.7	3.0	5.3
Other items (net)	-3.8	-0.9	1.3	-0.7	4.3	-0.4
Memorandum items:						
M2 multiplier	4.1	4.3	4.4	4.6	...	4.6
M3 (Tk billions)	670	759	908	1,075	...	1,229
Of which: National savings certificates	111	129	161	203	...	238
Velocity						
GDP/M3	3.0	2.9	2.6	2.4	...	2.2
GDP/M2	3.6	3.5	3.2	2.9	2.9	2.7
Treasury bills of the banking system (e.o.p. stock, Tk billions)	123	146	190	220	...	...

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1. All data are as of June 30. Baseline projections assume unchanged policies.

2/ NFA includes commercial banks' clearing accounts held at the Bangladesh Bank, which are denominated in foreign exchange and until recently were included as part of cash reserve requirements.

Table 5. Bangladesh: Vulnerability Indicators, 1999/00-2001/02 1/

	1999/00	2000/01	2001/02 Baseline
Financial sector risk indicators			
Central government debt to GDP	50.2	50.3	54.9
Broad money (percent change, 12 months to end of period)	18.6	16.6	13.7
Private sector credit (percent change, 12 months to end of period)	10.5	16.3	7.4
Share of deposits in broad money (M2)	86.4	86.8	87.0
Share of foreign currency deposits in total deposits (held in commercial banks)	1.4	1.4	1.4
Share of nonperforming loans (percent of total loans) 2/	39.7	33.7	...
State-owned commercial banks	44.6	37.7	...
State-owned specialized development banks	63.1	62.0	...
Domestic private banks	25.7	20.8	...
Foreign banks	3.7	3.8	...
Risk-based capital asset ratio (capital as a percent of risk-weighted assets)	7.5	6.5	...
State-owned commercial banks	5.1	4.5	...
Domestic private banks	11.3	9.5	...
Foreign banks	16.8	15.0	...
Market assessment indicators			
Stock market index (1994-95=100, end-of-period)	561	716	...
External indicators (as percent of GDP)			
Exports	12.2	13.8	12.5
Imports	18.2	20.3	19.0
Current account balance (excluding capital grants)	-0.9	-2.4	-1.4
Capital account balance	1.1	1.1	0.7
External reserves and debt data (end of period unless otherwise indicated)			
Gross official reserves (US$ millions)	1,599	1,302	872
Central bank short-term foreign liabilities, incl. ACU liabilities (US$ millions)	749	860	...
Central bank foreign exchange availability guarantees (US$ millions) 3/	...	...	257
Short-term foreign assets of commercial banks (US$ millions)	1,408	1,368	...
Short-term foreign liabilities of commercial banks (US$ millions)	575	547	...
Gross official international reserves (percent of imports of goods and nonfactor serv	2.0	1.5	1.1
Gross official international reserves (percent of broad money)	10.9	8.5	...
Short-term debt 4/	0.8	0.9	0.9
Gross official international reserves (percent of short-term debt)	133.7	122.6	...
Total external debt	34.4	35.3	36.9
External interest payments (percent of exports of goods and services)	1.5	1.5	1.8
Debt service (percent of current earnings) 5/	8.4	7.5	7.7
Exchange rate (taka per U.S. dollar, period average)	50.4	53.9	...

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year ending June 30.
2/ Includes interest suspense.
3/ As of February 15, 2002.
4/ Includes external debt payments due within the year.
5/ Current earnings are defined as the sum of exports of goods, nonfactor services, and private transfers.

Bangladesh: Medium-Term Scenarios

Two scenarios have been prepared by staff to illustrate alternative medium-term policy paths for Bangladesh. The first illustrates the implications of a continuation of recent policy trends, while the adjustment scenario reflects the adoption and implementation of a comprehensive policy package in line with recent staff recommendations.

The principal assumptions and policy parameters for the recent policy trends scenario **(baseline scenario)** are presented in Table I.1. Real GDP is expected to grow at around 4 percent per annum in the medium term, a rate that is too low to reduce poverty within one generation. This low growth rate can be attributed to low efficiency of investment, continued price distortions, monopolies, and poor governance. The inflation rate rises to 6 percent in the medium term as a result of accommodative monetary policy and supply bottlenecks. The exchange rate is adjusted occasionally and only after prolonged periods of overvaluation. Fiscal reforms are limited to small improvements in tax administration. The deficit rises to over 6 percent in FY01/02 and ranges between 5–6 percent of GDP over the medium term. The share of external financing declines significantly while recourse to domestic (bank and nonbank) financing increases, giving rise to pressures on prices and the exchange rate. Bangladesh Bank continues to rely on limited instruments for monetary policy. The absence of a secondary market for treasury bills combined with high and rigid interest rates weaken monetary control. The high bank-lending rates (attributed to high nonperforming loans) squeeze private sector credit. State banks continue to provide "soft" loans to nonfinancial state-owned enterprises (SOEs). In the external sector, there is a general slowdown in exports (especially as world trade in textiles and clothing is liberalized), workers' remittances through official channels, FDI, and concessional external financing, which imposes a significant pressure on reserves. The authorities not only lose reserves but resort to additional controls. On the structural front, the lack of central bank independence leads to the prevalence of "soft" budget constraints and a heavy reliance on bank financing of fiscal deficits. Moreover, the SOEs continue to accumulate losses, with little undertaken in the way of privatization.

In the **adjustment scenario** (Table I.2), real GDP growth increases gradually to a sustainable level of 6–7 percent from FY06/07, which is the rate consistent with a significant reduction in poverty within a generation. In particular, the staff estimates that real GDP per capita would need to grow by around 4½ percent per annum (implying real GDP growth of about 6–7 percent) for Bangladesh to achieve the IDA per capita income level ceiling of $885 (in 2000 dollars) within 25 years. Under this scenario, structural reforms, the removal of price distortions, and increased fiscal and monetary discipline as outlined below create a positive environment for private investment leading to efficient resource allocation and utilization. Among the prerequisites for buoyant private investment are improvements in infrastructure and education and training of the labor force.

In particular, with regard to the fiscal sector, with an expansion of the VAT base, reduced tax exemptions and holidays, and wider tax coverage, revenues rise to over 12 percent of GDP in the medium term. The budget deficit initially increases due to greater spending on productive investment in education, health, and poverty reduction, and to fund a bank recapitalization plan and resolution of past SOE debts. The wider fiscal deficits are expected to be financed by increased external financing on concessional terms reflecting a comprehensive poverty reduction plan. With regard to the monetary and external sectors, the reforms in financial markets and the development of the secondary market for treasury bills allows the use of indirect instruments for monetary policy, which enhance monetary management. The reforms in the monetary sector increase control of Bangladesh Bank over state banks and development institutions and lead to an efficient allocation of credit, largely to the private sector. With a reduced reliance on banks for deficit financing and with market-determined lending rates, the availability of credit to the private sector increases. The balance of payments outlook is strengthened as exports are diversified and the export of gas is permitted. More workers' remittances are channeled through the formal financial sector while a favorable business climate leads to higher FDI. International reserves rise gradually to about three months of imports by FY06/07. The inflation rate converges steadily toward international levels in the medium term and the adoption of a more flexible exchange rate regime helps prevent exchange rate misalignments. Finally, the scenario assumes comprehensive structural reforms including restructuring and privatization of SOEs; liberalization of public utility prices; removal of other price and quantitative distortions; comprehensive banking sector reforms; reductions in tariff and nontariff restrictions; improved governance in public administration; and the efficient enforcement of laws in the financial sector.

Table I.1. Bangladesh: Medium-Term Projections, 2000/01-2006/07 Baseline Scenario 1/

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
	Est.			Proj.			
National income and prices (percent change)							
Real GDP 2/	5.2	3.8	4.0	4.0	4.0	4.0	4.0
GDP deflator	1.6	3.1	4.5	6.0	6.0	6.0	6.0
Inflation (annual average) using CPI	1.5	3.0	4.5	6.0	6.0	6.0	6.0
Investment and savings (percent of GDP) 2/							
Gross investment	23.1	21.2	21.0	20.2	20.0	20.0	20.0
Public	6.8	5.5	5.8	5.8	5.8	5.8	5.8
Private	16.3	15.7	15.2	14.4	14.2	14.2	14.2
National savings 3/	21.1	20.5	19.7	19.2	19.5	19.8	20.1
Central government budget (percent of GDP)							
Total revenue	9.0	9.4	9.6	9.8	9.9	10.0	10.1
Tax	7.5	7.8	7.9	8.0	8.1	8.2	8.3
Nontax	1.5	1.6	1.7	1.8	1.8	1.8	1.8
Total expenditure	14.1	15.7	15.8	15.6	15.6	15.5	15.5
Current expenditure	7.8	8.3	8.2	8.1	8.1	8.1	8.1
Of which : Interest payments	1.6	1.7	2.0	2.1	2.1	2.1	2.2
Food account surplus (-)/deficit (+)	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Annual Development Program	6.0	5.5	5.8	5.8	5.8	5.8	5.8
Other capital and net lending 4/	0.0	1.5	1.5	1.4	1.4	1.4	1.3
Overall balance	-5.1	-6.2	-6.1	-5.8	-5.7	-5.6	-5.4
Primary balance	-3.5	-4.5	-4.2	-3.7	-3.5	-3.4	-3.2
Financing (net)	5.1	6.2	6.1	5.8	5.7	5.6	5.4
Domestic	3.1	4.7	4.3	4.1	4.1	4.1	4.1
Of which : Banks	1.5	3.4	3.1	2.8	2.8	2.8	2.8
External	2.0	1.5	1.8	1.7	1.6	1.5	1.3
Total central government debt (percent of GDP)	50.3	54.6	59.0	60.5	61.8	62.9	63.9
Money and credit (end of year; percentage change)							
Domestic credit	18.6	15.7	14.1	12.6	10.3	10.1	10.5
Private sector	16.3	7.4	7.2	7.0	3.7	3.6	4.5
Broad money (M2)	16.6	13.7	13.2	11.4	10.2	10.2	10.2
Balance of payments (US$ millions)							
Exports, f.o.b.	6,477	5,884	6,375	6,758	7,231	7,737	8,278
(Annual percent change)	12.4	-9.2	8.3	6.0	7.0	7.0	7.0
Imports, c.i.f.	9,524	8,846	9,470	9,781	10,210	10,659	11,126
(Annual percent change)	11.2	-7.1	7.1	3.3	4.4	4.4	4.4
Current account	-1,116	-637	-961	-881	-632	-460	-282
(Percent of GDP)	-2.4	-1.4	-1.9	-1.6	-1.1	-0.8	-0.4
Current account, including capital grants	-939	-313	-637	-557	-308	-136	42
(Percent of GDP)	-2.0	-0.7	-1.3	-1.0	-0.5	-0.2	0.1
Capital account	536	354	845	694	671	544	281
Of which:							
Foreign direct and portfolio investments	419	308	308	324	342	360	377
Gross aid disbursements (loans and capital grants)	1,174	1,106	1,193	1,231	1,270	1,309	1,350
Overall balance	-429	-391	-116	-187	39	84	-1
Gross official reserves (US$ millions)	1,302	872	667	448	487	571	589
(In months of imports of goods and nonfactor services)	1.5	1.1	0.8	0.5	0.5	0.6	0.6
Medium- and long-term external debt (US$ millions)	16,227	16,903	17,671	18,467	19,269	20,078	20,892
Total debt (percent of GDP)	35.3	36.9	36.3	35.4	34.8	34.2	33.6
Debt service (percent of current earnings) 5/	7.5	7.7	7.7	7.2	6.7	6.6	6.6
Terms of trade (percent change)	1.5	-2.5	-0.1	-0.1	0.0	0.5	0.5
Memorandum item:							
Incremental capital-output ratio	4.7	5.8	5.5	5.3	5.2	5.2	5.2

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1. Baseline projections assume unchanged policies.

2/ National accounts based on 1995/96 benchmark and prices.

3/ National savings includes official transfers.

4/ Including errors and omissions.

5/ Current earnings are defined as the sum of exports of goods, nonfactor services, and private transfers.

Table I.2. Bangladesh: Medium-Term Projections, 2000/01-2006/07 Adjustment Scenario 1/

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
	Est.			Proj.			
National income and prices (percent change)							
Real GDP 2/	5.2	3.8	4.5	5.0	6.5	7.0	7.5
GDP deflator	1.6	3.1	2.0	2.0	1.8	1.5	1.5
Inflation (annual average) using CPI	1.5	3.0	2.5	2.0	1.8	1.5	1.5
Investment and savings (percent of GDP) 2/							
Gross investment	23.1	21.2	23.2	24.6	25.8	27.3	28.5
Public	6.8	5.5	6.6	7.3	7.6	7.7	7.8
Private	16.3	15.7	16.6	17.3	18.2	19.6	20.7
National savings 3/	21.1	20.5	21.5	22.8	24.5	26.4	28.1
Central government budget (percent of GDP)							
Total revenue	9.0	9.4	10.4	11.1	11.5	12.0	12.4
Tax	7.5	7.8	8.8	9.3	9.7	10.2	10.6
Nontax	1.5	1.6	1.7	1.8	1.8	1.8	1.8
Total expenditure	14.1	15.7	15.7	16.2	16.5	16.6	16.8
Current expenditure 4/	7.8	8.3	7.9	7.8	7.9	8.0	8.1
Of which : Interest payments	1.6	1.7	1.8	1.8	1.8	1.7	1.7
Food account surplus (-)/deficit (+)	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Annual Development Program 5/	6.0	5.5	6.6	7.3	7.6	7.7	7.8
Other capital and net lending 6/	0.0	1.5	0.9	0.8	0.7	0.6	0.5
Overall balance	-5.1	-6.2	-5.2	-5.1	-5.0	-4.6	-4.4
(Excluding additional spending on poverty alleviation)	-5.1	-6.2	-4.0	-3.8	-3.8	-3.6	-3.4
Primary balance	-3.5	-4.5	-3.4	-3.3	-3.2	-2.9	-2.6
Financing (net)	5.1	6.2	5.2	5.1	5.0	4.6	4.4
Domestic	3.1	4.7	2.2	1.8	2.0	2.1	2.2
Of which : Banks	1.5	3.4	1.1	1.0	0.9	1.0	1.0
External	2.0	1.5	3.1	3.3	3.0	2.5	2.1
Central government debt (percent of GDP) 7/	50.3	54.6	59.7	60.3	60.3	60.2	60.0
(Excluding debt to recapitalize banks and SOEs)	50.3	54.6	57.7	57.3	56.3	55.2	54.0
Money and credit (end of year; percent change)							
Domestic credit	18.6	15.7	8.1	7.5	7.3	7.5	7.5
Private sector	16.3	7.4	7.6	7.2	7.2	7.2	7.2
Broad money (M2)	16.6	13.7	11.0	9.8	9.5	9.2	9.1
Balance of payments (US$ millions)							
Exports, f.o.b.	6,477	5,884	6,440	7,084	8,005	9,046	10,222
(Annual percent change)	12.4	-9.2	9.5	10.0	13.0	13.0	13.0
Imports, c.i.f.	9,524	8,846	9,630	10,365	11,355	12,389	13,666
(Annual percent change)	11.2	-7.1	8.9	7.6	9.5	9.1	10.3
Current account	-1,116	-638	-1,133	-1,206	-1,047	-830	-571
(Percent of GDP)	-2.4	-1.4	-2.4	-2.4	-1.9	-1.4	-0.9
Current account, including capital grants	-939	-314	-809	-882	-723	-506	-247
(Percent of GDP)	-2.0	-0.7	-1.7	-1.8	-1.3	-0.9	-0.4
Capital account	536	354	875	925	866	979	905
Of which:							
Foreign direct and portfolio investments	419	308	389	447	514	592	456
Gross aid disbursements (loans and capital grants)	1,174	1,106	1,193	1,231	1,270	1,309	1,350
Overall balance	-429	-391	-257	-281	-181	148	334
External financing gap 8/	0	0	697	798	762	428	321
Gross official reserves (US$ millions)	1,302	872	1,223	1,793	2,493	3,128	3,763
(In months of imports of goods and nonfactor services)	1.5	1.1	1.4	1.8	2.3	2.7	2.9
Medium- and long-term external debt (US$ millions)	16,227	16,903	18,369	19,227	19,980	20,444	21,147
Total external debt (percent of GDP)	35.3	36.9	40.7	39.9	38.1	35.8	33.9
Debt service (percent of current earnings) 9/	7.5	7.7	7.8	7.2	6.5	6.1	5.6
Terms of trade (percent change)	1.5	-2.5	-0.1	-0.1	0.0	0.5	0.5
Memorandum item:							
Incremental capital-output ratio	4.7	5.8	5.4	5.2	4.2	4.2	4.1

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1. Adjustment projections assume implementation of comprehensive reform policies, including a poverty-reducing strategy.

2/ National accounts based on 1995/96 benchmark and prices.

3/ National savings includes official transfers.

4/ Includes interest payments on the assumed recapitalization of banks and SOEs under the adjustment reforms.

5/ Starting FY02/03, includes earmarked spending for poverty alleviation.

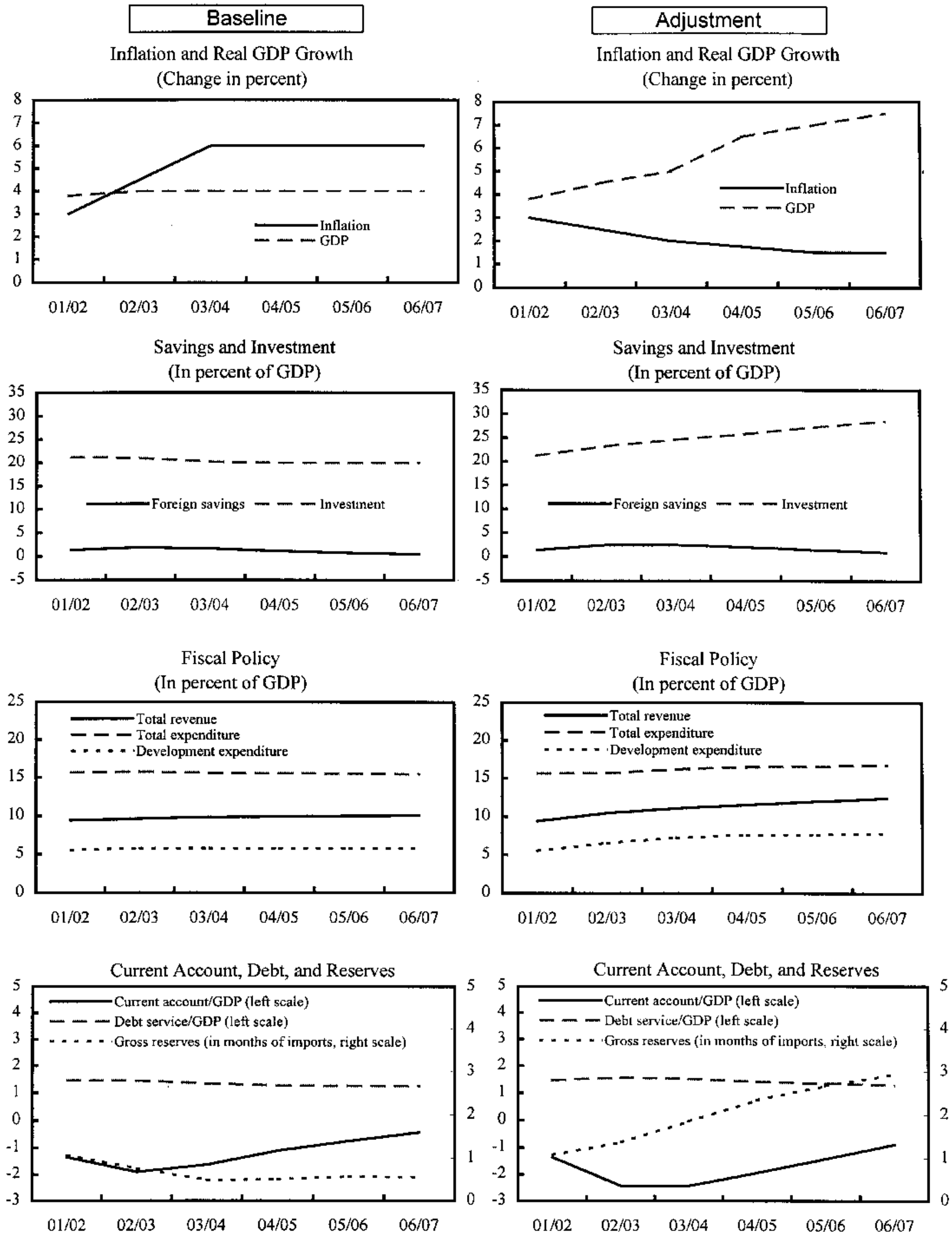
6/ Including errors and omissions.

7/ Debt costs for recapitalization of banks and SOEs are distributed over a five-year period, starting FY02/03.

8/ Including financing needs for a poverty-reducing strategy as reflected in an I-PRSP.

9/ Current earnings are defined as the sum of exports of goods, nonfactor services, and private transfers.

Figure I.1. Bangladesh: Comparison of Selected Economic Indicators in Baseline and Adjustment Scenario, 2001/02-2006/07



Sources: Fund staff estimates and projections.

Bangladesh: Fund Relations
(As of February 28, 2002)

I. **Membership Status**: Joined August 17, 1972; availed itself to the provisions of Article VIII on April 11, 1994

II. **General Resources Account**:	**SDR million**	**Percent Quota**
Quota	533.30	100.00
Fund holdings of currency	618.98	116.07
Reserve position in Fund	0.19	0.03

III. **SDR Department**:	**SDR million**	**Percent Allocation**
Net cumulative allocation	47.12	100.00
Holdings	27.76	58.91

IV. **Outstanding Purchases and Loans**:	**SDR million**	**Percent Quota**
ESAF arrangements	20.13	3.77
Credit tranche	85.86	16.10

V. **Financial Arrangements**:

Type	**Approval date**	**Expiration date**	**Amount approved (SDR million)**	**Amount drawn (SDR million)**
ESAF	8/10/90	9/13/93	345.00	345.00
SAF	2/06/87	2/05/90	201.25	201.25
Stand-by	12/02/85	6/30/87	180.00	180.00

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2002	**2003**	**2004**	**2005**	**2006**
Principal	54.0	51.9	0.0	0.0	0.0
Charges/interest	1.9	1.3	0.4	0.4	0.4
Total	55.9	53.2	0.4	0.4	0.4

VII. **Safeguards Assessment**:

An on-site safeguards assessment of Bangladesh Bank (BB) is tentatively scheduled for June 2002.

VIII. **Exchange Arrangements**:

The taka is pegged to a weighted currency basket of Bangladesh's major trading partners. From March 12 to December 3, 2000, BB maintained a buying-selling rate band for the U.S. dollar against the taka for its transactions with authorized dealer (AD) banks. AD banks set their own buying and selling rates for the U.S. dollar and other currencies within the band, based on cross rates in international markets. The taka was devalued by 5.9 percent on August 13, 2000. Effective December 4, 2000, BB discontinued the practice of selling and buying dollars from the ADs at preannounced rates and moved to setting buying and selling rates for each transaction separately within a band of Tk 53.85–54.15 per U.S. dollar. On May 25, 2001, the taka was devalued by 5.5 percent and the band was widened to Tk 56.5–57.5 per U.S. dollar. On January 5, 2002, the taka was devalued by 1.5 percent.

In December 2000, BB introduced margin requirements on letters of credit for most commercial imports, which constitutes an exchange restriction subject to approval by the Fund. In November 2001, the requirements were increased from 50 percent to 100 percent on 56 categories of imports. In February 2002, BB removed the margin requirement on letters of credit for the imports of inputs to industrial production, and reduced the margin rates for imports of rice and wheat from 100 percent to 25 percent.

On the basis of UN Security Council resolutions, all settlements with Iraq and the Islamic State of Afghanistan are prohibited.

IX. **Article IV Consultation**:

Bangladesh is on the standard 12-month consultation cycle. The last Article IV consultation was held during October 13–26, 1999 and was concluded on January 24, 2000 (SM/99/309). The 2001 Article IV consultation held during February 2001 could not be completed because of successive delays by the authorities. Initially, the officials wished to finalize their fiscal plans before completing the discussions; subsequently, they were reluctant to engage in a policy dialogue ahead of the government's resignation at midyear. Executive Directors were informed of the delays.

X. **Technical Assistance During 2000–02**:

The most recent MAE resident advisor was stationed in Dhaka for four months until September 2000 to assist BB on monetary policy. An MAE/LEG technical assistance mission visited Dhaka during January 2002 to advise on operational steps to facilitate the adoption of a more flexible exchange rate regime. An external legal expert visited Dhaka during February 2002 to advise on amendments to the Bangladesh Bank Order to strengthen the independence of BB.

XI. **Resident Representative**:

The resident representative office was established in 1972. The current Resident Representative, Mr. Marijn Verhoeven, took up the post in August 2001.

Bangladesh: Technical Assistance

I. Fiscal Affairs Department

1. There have been no FAD technical assistance (TA) missions since the previous Article IV consultation in October 1999. Between April 1998 and August 1999, three missions visited Dhaka. The first mission, in April–May 1998, found that significant work was needed to address the weaknesses of the revenue system. It identified the need to reduce the pervasive network of specific tax exemptions and fiscal incentives, as well as to raise the effectiveness and efficiency of the revenue administration. The mission submitted a comprehensive report regarding medium-term structural reform of the revenue system which made several recommendations, including: (a) expansion of the VAT base; (b) phasing-out of tariff, income, and profit tax exemptions; (c) establishment of a large taxpayer unit (LTU) and a uniform taxpayer identification number (TIN) system; and (d) introduction of a mandatory preshipment inspection (PSI) system. The second mission (February 1999) helped to develop a plan for the establishment of the LTU and the TIN, and the third mission (August 1999) assisted the authorities in implementing the plans developed during the second mission.

2. The authorities' implementation of the recommendations has been mixed. The FY99/00 budget strengthened revenue administration with the establishment of an LTU, adoption of a uniform TIN, and the introduction of a mandatory PSI, but the effective implementation of these measures was delayed until September 2000. The subsequent budgets included plans to streamline these measures. Measures to broaden the VAT base have been announced recently, but there are no immediate plans to phase out VAT exemptions and other tax incentives.

3. A fiscal ROSC and TA on budgeting are planned for mid-2002.

II. Monetary and Exchange Affairs Department

4. Several expert visits and long-term advisors were provided by MAE during FY97/98 to FY00/01. The implementation of past TA provided by MAE has been slow, and the last long-term advisor left in September 2000. He produced a report with a wide-ranging analysis of the areas Bangladesh Bank (BB) needed to strengthen in order to take on the role and functions of a modern central bank. With respect to short-term expert visits in 1998–99, the authorities have not moved further on the foreign exchange operations reform that was the subject of two expert visits, and little progress has been made on the more fundamental measures to develop government securities markets that were also the subject of two expert visits in FY97/98 and FY98/99, although some recommendations have been implemented.

5. A joint MAE/LEG mission visited Dhaka during January 2002 to advise on operational steps to facilitate the adoption of a more flexible exchange rate regime. An FSAP is scheduled for May 2002. A peripatetic advisor has been recommended by the staff who could visit Dhaka starting mid-2002 to advise on monetary policy operations and foreign exchange issues.

III. Statistics Department

6. The Statistics Department has provided TA in balance of payments, money and banking, and real sector statistics. As regards balance of payments statistics, there were two missions in February/March 1997 and in February 1998. The February 1998 mission recommended the creation of an interagency committee to promote cooperation between the BB and other data collection agencies. It also stressed that the response rates from surveys must be improved by strengthening the legal basis for collection and vigorous follow-up efforts. No indication of progress in the implementation of the recommendations of the February 1998 mission has been received from the authorities.

7. The most recent mission in money and banking statistics took place in March 1998 which assisted the BB in eliminating deficiencies in monetary statistics and agreed with the authorities on a plan for implementing the recommendations of the mission. The plan covered improvements in the collection, compilation, reporting, and dissemination of monetary and financial statistics, particularly the implementation of: (i) a flash reporting system for reserve money; (ii) separate identification of state enterprises from central government accounts; (iii) monthly revaluation of foreign-currency-denominated accounts at market exchange rates; (iv) a monitoring system for generating timely data on more market-determined interest rates; and (v) a framework for data reporting to BB by other banking institutions that will lead to the compilation of a more complete depository corporations survey. As a result, monthly data on the accounts of the central bank and other depository corporations are now prepared and reported to STA on a regular basis.

8. The most recent real sector statistics mission was in December 1997–January 1998, which found that the earlier Fund recommendations to address weaknesses in the CPI had led to partial improvements. However, lack of financial resources and training continued to impact the quality of data collection and the computerization of price index compilation, and further improvements are necessary to bring the CPI and PPI to international standards. The coverage and estimation methodology of the national accounts have been significantly improved. However, further efforts to enhance the quality of the accounts are still needed as well as further progress made on implementing the 1993 *System of National Accounts*.

9. A multisector/GDDS mission is scheduled for July/August 2002.

IV. Legal Department

10. In addition to the joint MAE/LEG mission to Dhaka in January 2002 (see above), an external legal expert visited Dhaka during February 2002 to advise on amendments to the Bangladesh Bank Order to strengthen the independence of BB.

International Comparison of Selected Social Indicators 1/

	Bangladesh	China	Cambodia	India	Indonesia	Lao PDR	Malaysia	Pakistan	Papua New Guinea	Philippines	Sri Lanka	Thailand	Vietnam
Population													
Total population, midyear (millions)	127.7	1,253.6	11.8	997.5	207.0	5.1	22.7	134.8	4.7	74.3	19.0	60.2	77.5
Growth rate (percent annual average)	1.6	1.0	2.6	1.7	1.6	2.6	2.4	2.4	2.3	2.2	1.2	0.7	1.6
Urban population (percent of population)	24.0	31.6	15.6	28.1	39.8	22.9	56.7	36.5	17.1	57.7	23.3	21.3	19.6
Total fertility rate (births per woman)	3.2	1.9	4.4	3.1	2.6	5.4	3.0	4.8	4.2	3.5	2.1	1.9	2.3
Poverty													
(Percent of population)													
National headcount index	35.6	4.6	36.1	35.0	27.1	46.1	...	...	...	36.8	25.0	...	50.9
Urban headcount index	14.3	<2	21.1	30.5	...	24.0	...	...	...	21.5	15.0	...	25.9
Rural headcount index	39.8	4.6	40.1	36.7	...	53.0	...	...	...	50.7	27.0	...	57.2
Income													
GNI per capita (US$)	370	780	260	440	600	290	3,390	470	810	1,050	820	2,010	370
Consumer price index (1995=100)	126	109	136	138	219	619	115	136	151	135	145	121	...
Food price index (1995=100)	117	...	...	134	119	...	125	134	114	130	152	126	...
Income/consumption distribution													
Gini index	33.6	40.3	40.4	37.8	31.7	37.0	49.2	31.2	50.9	46.2	34.4	41.4	36.1
Lowest quintile (percent of income or consumption)	8.7	5.9	6.9	8.1	9.0	7.6	4.4	9.5	4.5	5.4	8.0	6.4	8.0
Highest quintile (percent of income or consumption)	42.8	46.6	47.6	46.1	41.1	45.0	54.3	41.1	56.5	52.3	42.8	48.4	44.5
Social indicators													
Public expenditure													
Health (percent of GDP)	1.7	2.0	0.6	0.8	0.7	1.2	1.4	0.9	2.5	1.7	1.4	1.9	0.8
Education (percent of GDP)	2.2	2.3	2.9	3.2	1.4	2.1	5.0	2.7	...	3.4	3.4	4.8	3.0
Social security and welfare (percent of GDP)	...	...	...	...	1.1	...	1.4	...	...	...	2.8	0.8	...
Net primary school enrollment rate													
(Percent of age group)													
Total	75	102	100	...	95	72	102	...	...	101	...	...	...
Male	80	101	...	...	96	76	102	...	...	...	...	...	...
Female	70	102	92	...	93	69	102	...	...	...	...	...	...
Access to an improved water source 2/													
(Percent of population)													
Total	97	75	30	88	76	90	89	88	42	87	83	80	56
Urban	99	94	53	92	91	59	100	96	88	92	91	89	81
Rural	97	66	25	86	65	100	94	84	32	80	80	77	50
Immunization rate													
(Percent under 12 months)													
Measles	61	85	63	60	71	71	88	81	57	87	95	94	93
DPT	66	85	64	78	64	56	89	80	56	87	99	97	93
Child malnutrition (percent under 5 years)	56	9	47	45	34	40	20	38	..	30	33	19	37
Life expectancy at birth (years)													
Total	61	70	54	63	66	54	72	63	58	69	73	69	69
Male	60	68	52	62	64	53	70	62	58	67	71	67	66
Female	61	72	55	64	68	56	75	64	59	71	76	71	71
Mortality													
Infant (per 1,000 live births)	61	30	100	71	42	93	8	90	58	31	15	28	37
Under 5 (per 1,000 live births)	89	37	143	90	52	143	10	126	77	41	19	33	42
Adult (15-59)													
Male (per 1,000 population)	276	164	364	218	235	376	183	186	369	193	150	240	205
Female (per 1,000 population)	290	129	315	206	183	317	111	153	330	146	96	147	144
Maternal (per 100,000 live births)	440	55	470	410	450	650	39	...	370	170	60	44	160

Source: The World Bank, *World Development Indicators*, 2001, CD-ROM.

1/ Data refer to most recent (1999) estimates.

2/ Latest year for access to improved water source data is 2000.

Bangladesh: Statistical Issues

National accounts

Bangladesh is a participant in the General Data Dissemination System and its metadata has been posted on the Fund's Dissemination Standards Bulletin website since March 2001.

Bangladesh has a reasonably comprehensive system of national accounts statistics, but it still lacks quarterly estimates of GDP. In April 2000, the Bangladesh Bureau of Statistics published the national accounts for the period 1989/90 onward using a revised 1995/96 benchmark basis and preliminary results are now available for 2000/01. As a result of wider coverage and other methodological improvements, GDP is about 30 percent higher for each year relative to the 1984/85 series, and per capita income is nearly 28 percent higher. The 1999 staff report used the 1984/85 series.

Prices, wages, and employment

Price series include a consumer price index (CPI), a producer price index (PPI), a wholesale price index (WPI), a GDP deflator, and unit value indices for external trade. The CPI and WPI are published with lags of two and three months, while GDP deflator and unit values of exports and imports are available on an annual basis. Data for wages are prepared monthly, but employment and unemployment data are only available at irregular intervals.

Government finance and debt

Fiscal data continue to have major shortcomings. Reporting on budget execution during the fiscal year is incomplete and subject to long delays. The lag in publishing the government's audited accounts has been reduced to one year. The National Board of Revenue produces monthly data on revenues on a cash basis with a lag of two months, and the Comptroller General of Accounts (CGA) produces monthly data on recurrent expenditure with a lag of five weeks. However, the coverage of the above line items are not consistent with financing data. No comprehensive estimates are available on spending for the Annual Development Program. Annual data on the government's external financing for the budget and foreign grants are available with a lag of one year. Domestic financing data are in relatively good shape, provided by Bangladesh Bank (BB) and the National Savings Directorate with a lag of five weeks, although efforts are being made to improve the quality and timeliness of the external financing data.

Bangladesh does not report GFS to STA for either the *Government Finance Statistics Yearbook* or the *International Financial Statistics*.

Monetary accounts

Monthly accounts of BB and deposit money banks are available with a lag of six weeks. In addition, BB also produces a weekly publication (shared with the Fund) which is available with a lag of about five to six weeks.

Balance of payments

Balance of payments data from 1997/98 onward are available on the basis of the fifth edition of the *Balance of Payments Manual*. Apart from export shipments data, most other statistics are recorded on a cash basis, with the banking and exchange control records being the primary source of data. Summary balance of payments data are compiled and disseminated on a monthly basis. Quarterly statistics for all the major accounts are available, while annual data present a detailed classification. The staff believes that official foreign direct investments data continue to be underreported which is in line with the findings of the 1999 Article IV consultation mission. Nontrade activities of companies operating in the export processing zones with the rest of the world are excluded. Data on private sector external borrowing, the transactions of foreign direct investors, and workers' remittances through the informal *hundi* banking system are for the most part not included in the official data. Data on suppliers' credit to the government are available on a monthly basis with a three-month lag, but are not comprehensive.

Recent improvements in monitoring of economic data

Three important ongoing efforts are under way which are aimed at improving the quality and monitoring of data: the Reforms in Budgeting and Expenditure Control (RIBEC) project, the Debt Management and Financial Analysis System (DMFAS), and the Task Force on Monitoring of Economic Data (TMED).

RIBEC, which was supported by the United Kingdom and implemented during 1993–01, has been instrumental in improving the budgeting, financial reporting, and auditing capacity of the government. With the FY98/99 budget, significantly improved budget classification was introduced. The CGA system has been strengthened and computerized and, since the start of FY01/02, produces meaningful monthly accounts disaggregated by economic code, function, and region on a timely basis (with the lag now reduced to less than five weeks). On the basis of these monthly accounts, the Finance Division of the Ministry of Finance produces monthly budget reports for policy purposes. The newly established Financial Management Units (FMUs) in seven line ministries also provide key information for policy formulation. RIBEC will be succeeded in mid-2002 by the Financial Management Reform Program supported by the United Kingdom and the Netherlands.

Implementation of the DMFAS started in November 2001 with donor support. In the course of the current fiscal year, it will capture public debt, guarantees, and contingent liabilities. Information on private debt will also be added.

The government established the TMED in November 2001, with the purpose of creating an interagency system for monitoring macroeconomic data. The emphasis is on data that are relevant in the dialogue with Fund staff. The task force is chaired by the Joint Secretary in charge of the budget, and includes members from the Ministries of Finance and Planning, CGA, BB, and the National Savings Directorate. Its meetings are also attended by the IMF Resident Representative. Building on the RIBEC project, the task force has helped shorten the lag in availability of budget data from over two months in some cases to five weeks; initiated a framework for monitoring SOEs and public arrears; enhanced the quality of existing data, including through more systematic reconciliation of data between sources and across agencies; and increased the exchange of information between organizations

Bangladesh: Survey of Reporting of Main Statistical Indicators
(As of March 3, 2002)

	Exchange rates	International reserves	Reserve/ base money	Central Bank balance sheet	Broad money	Interest Rates 1/	Consumer price index	Exports/ Imports	Current account balance	Overall government balance	GDP/GNP	External debt
Date of latest observation	Mar 2 2002	Mar 2, 2002 Jan 30, 2002 2/	Jan 31, 2002	Dec 30 2001	Dec 30 2001	Feb 20 2002	Dec 30 2001	Dec 2001	Nov 2001	Dec 2001	2000/ 2001 (P)	June 2000
Date received	Mar 3 2002	Mar 3, 2002 Feb 13,2002 2/	Feb 2 2002	Feb 4 2002	Feb 13 2002	Feb 27 2002	Feb 12 2002	Feb 13 2002	Dec 12 2001	Feb 7 2001	Sep 21 2001	Sep 21 2001
Frequency of data 3/	D	D/M 2/	W	W/M	M	W	M	M	M	M	A	A
Frequency of reporting 4/	D	D/M 2/	W	W/M	M	W	M	M	M	M	A	A/O
Source of data 5/	A	A	A	A	A	A	A	N	A	A	A/N	A/N
Mode of reporting 6/	M	M/V	M	M	M/V	M	M	M	M	M	M/V	M/V
Confiden-tiality 7/	C	A	D	D	D	C	C	C	D	B	C/D	C/D
Frequency 3/ of Publication	D	D 2/	M	M	M	W	M	M	M	O	A	A

1/ Interest rates at weekly auctions of Treasury bills.
2/ Data on wage earners accounts are are only available on a monthly basis with a two-week lag, and are not published.
3/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, or O-other.
4/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, V-irregularly in conjunction with staff visits, or O-other irregular basis.
5/ A-direct reporting by central bank, Ministry of Finance, or other official agency, N-official publication or press release, P-commercial publication, C-commercial electronic data provider, E-IMF's Economic Information System (EIS), O-other.
6/ E-electronic data transfer, C-cable or facsimile, T-telephone, M-mail, V-staff visits, O-other.
7/ A-for use by the staff only, B-use by the staff and the Executive Board, C-unrestricted use, D-embargoed for a specified period and thereafter for unrestricted use, E-subject to other use restrictions.
P/ Provisional.

Bangladesh: Trade and Exchange Restrictions

Trade restrictiveness index

Despite significant liberalization in the early 1990s, Bangladesh's trade system remains relatively restrictive compared with Sri Lanka, Nepal, Pakistan, South Korea, Malaysia, and Thailand. As of 2001, the combined average tariff is 25.8 percent and Bangladesh has a rating of 8 on the IMF's overall trade restrictiveness index with a 10 point scale. In comparison, the average tariff of all IMF member-countries is 13.2 percent for 2000–01 while the average for the countries noted above is 13.1 percent. The calculation of the average tariff rates for Bangladesh takes into account not only the tariff level itself but also the following surcharges: (i) a supplementary duty, which is levied at various rates on both domestic and imported goods; (ii) an import license fee set at 2.5 percent; and (iii) an infrastructure development surcharge also set at 2.5 percent, which is levied on most imports. They also include regulatory duties imposed on imports in December 2001 set at levels of 10 percent, 15 percent, 20 percent, and 25 percent for varying products.

Bangladesh: Average MFN Tariff Rates by Product Group, 2001

	Customs Duties	Customs Duties + Surcharges[1]
All products	21.0	25.8
Agricultural sector	24.7	29.5
Live animals and animal products	25.0	29.8
Fruit and vegetable products	20.9	25.6
Animal and vegetable oils	27.3	32.3
Tobacco	30.0	35.0
Alcohol	37.5	42.5
Prepared foodstuffs, beverages, and other products	28.4	33.1
Industrial sector	20.3	25.0
Mineral products	10.4	14.5
Petroleum and fuels	18.4	23.3
Chemicals	16.1	20.8
Leather products	18.1	21.1
Wood products	21.1	25.7
Textiles, clothing, and footwear	30.7	35.6
Other manufactured goods	18.1	22.9
Memorandum items:		
Standard deviation	13.5	13.9
Maximum	37.5	42.5
Minimum	0.0	0.0
Number of lines	6,579	6,579

[1]Includes customs duty, license fee, and infrastructure development surcharge.

Exchange restrictions

Bangladesh's payments and transfers for current international transactions are subject to a number of restrictions that the staff have determined are not in conformity with Bangladesh's Article VIII status, including: (i) margin requirements for letters of credit for imports of several goods; (ii) restrictions on advance payments for imports; (iii) restrictions on the transferability of current proceeds from non-resident accounts; (iv) limits on payments for medical and educational expenses and travel; and (v) payments for other invisibles.

BB has imposed **margin requirements** of up to 100 percent for the opening of letters of credit for imports of several goods in December 2000, which were intensified in November 2001. Since these margin requirements are an additional cost for the making of import payments in connection with normal short-term banking and credit facilities, they constitute restrictions under Article VIII. Margin requirements for rice and wheat were reduced to 25 percent in February 2002, and the margin restrictions on the import of raw materials were left to be negotiated between the commercial banks and their importer-clients. The authorities have stated that they intend to remove the remaining margin requirements by end-June 2002.

Residents in Bangladesh are allowed to enter into contracts to make advance payments for imports, but the availability of the foreign exchange to make such **advance payments** requires BB approval, which is given only for specialized goods or capital goods. To the extent that a resident can legally enter into a current international transaction but is prohibited from making the payment required under the transaction (including advance payments), an exchange restriction arises.

Private nonresident Taka accounts can be credited with proceeds of current international transactions (e.g., dividends and interest income in shares and securities, income from landed property and agricultural rent, house rent, accrued interest, etc.). However, while amounts in these accounts can be used for domestic payments, they are not convertible and cannot be transferred abroad, which constitutes a restriction.

While Bangladesh residents are free to **travel, study, or seek medical treatment** abroad, restrictions exist on the availability of foreign exchange for these purposes. For medical expenses, approval to seek the procedure abroad by the Medical Board is required for the release of foreign exchange by authorized dealers of up to $10,000, and approval by BB is required for foreign exchange in excess of $10,000. Foreign exchange for educational purposes is only available if studies abroad fall into an approved category of courses. Further, not all bona fide requests beyond the ceilings set for travel expenses are freely granted. Since all bona fide requests for foreign exchange related to medical treatment, education abroad, and travel are not freely granted, exchange restrictions arise.

Finally, the 1947 Foreign Exchange Regulation Act prohibits all **payments to nonresidents** unless such payments are generally or specifically authorized, and the Guidelines on Foreign Exchange Transactions only partially regulate and authorize payments for invisibles. A restriction arises because the foreign exchange regulations do not authorize the making of payments and transfers for all invisible current international transactions that have been legally entered into.

Other issues

Export surrender requirements are set at 92.5 percent for proceeds from ready-made garment exports and 60 percent for other exports (including from February 2002 the exports of computer software and support services). Retained amounts are freely convertible for all current international payments, including maintenance of commercial offices abroad, but not for investment outside Bangladesh. Surrendered amounts can be retained with any commercial bank of the exporter's choice, and these amounts are not transferred to Bangladesh Bank. Exporters are free to use foreign exchange in addition to these retained amounts for their imports and for other current transaction needs on the same basis as for other residents.

Under the duty drawback schemes, companies that export are entitled to a reimbursement of duties and taxes paid on importation of raw materials after the product is exported. Most exporters are processed under the flat rate drawback scheme, where the rate is pre-fixed by the government, while others avail of the actual rate drawback scheme, where the actual duties and taxed paid on imports is reimbursed by the government. The authorities indicate that such subsidy claims, which are settled quickly, amounted to about Taka 7 billion (US$130 million) in 2000/01 and about 3 billion (US$53 million) during July to November 2001.

Bangladesh: Relations with the World Bank Group

1. The World Bank has assisted Bangladesh since FY1973. As of February 28, 2002, the World Bank Group has lent $9,713 million for 190 projects to Bangladesh. During FY2001/02, the World Bank had no new commitments, while the disbursements were $184 million and the undisbursed amount was $1121 million.

2. The Board of Executive Directors of the World Bank Group discussed in December 2000, a new Country Assistance Strategy (CAS) for Bangladesh for FY2001–03 (Report No. 21326-BD) which has been adopted. The overarching objective of the joint IDA-IFC CAS is to help Bangladesh attain its goal of reducing poverty substantially within one generation.

3. The Bank is currently supporting 23 ongoing projects in key sectors, including rural development, energy and infrastructure, private sector development, finance, social development, and environment. Five IDA Credits totaling $280 million were approved by the Bank in FY2001: Air Quality Management ($5 million), HIV/AIDS Prevention ($40 million), Micro-Finance II ($151 million), Post-Literacy and Continuing Education ($53 million), and Legal and Judicial Capacity Building ($31 million).

4. The new projects planned to be approved by the Bank in FY2002 (IDA financing in parentheses) are: Second Female Secondary School Assistance ($115 million); Rural Electrification and Renewable Energy Development (IDA $191 million and GEF $8 million); Public Procurement Reform ($4.5 million); and Microcredit for the Poorest ($5 million).

5. The new projects currently envisaged for FY2003 (IDA financing in parentheses) are: Rural Transport Improvement ($200 million); Social Investment Program ($20 million); and Agribusiness Development ($50 million). In FY2003 a structural adjustment credit (Development Support Credit—$250 million) could be provided to support broad-based structural and governance reforms and create the environment for accelerated economic growth and poverty reduction.

6. All sector investment operations emphasize policy and institutional reforms in line with the CAS objectives. The sectoral shares of Bank lending for FY2001–03 (excluding adjustment credit) are: 20 percent each for education and finance; 22 percent each for transportation and power and energy development; 6 percent for agriculture; 5 percent for health and population; 4 percent for public sector management; and 1 percent for environment.

7. The IFC-supported portfolio, amounting to about $141 million, includes projects in the financial, telecommunications, manufacturing, and power sectors. IFC lending is $115 million; equity investment and guarantee each being $13 million which are in the financial sector. IFC is now working on a multi-donor assisted TA facility for the SME sector, which includes Bangladesh, in addition to other countries in the region. IFC's commitment to the facility is $5 million for the duration of the project.

8. The Bank continues to be involved in providing technical and advisory assistance to the government in a number of areas, including banking, privatization, taxation, judicial and legal reform, tariff and trade policy, and poverty monitoring and analysis. Technical assistance and advisory services are to be provided to the government to improve public sector accountability through the strengthening of financial management and procurement system in the next two years.

Bangladesh: Relations with the Asian Development Bank

I. LENDING OPERATIONS

1. The Asian Development Bank (AsDB) has assisted Bangladesh since 1973. The cumulative commitment, disbursement and outstanding credit to Bangladesh stood at $6.46 billion, $4.63 billion and $4.16 billion respectively, on December 31, 2001. The overarching objective of AsDB in Bangladesh is poverty reduction. The medium-term priorities are: (i) to promote faster private sector-led economic growth; (ii) to create better development opportunities for the poor; (iii) to improve human development; and (iv) to improve and protect the environment. A Partnership Agreement on Poverty Reduction (PAPR) was signed on April 3, 2000, under which AsDB supports the government with a substantial aid package subject to resource availability and country performance.

2. The AsDB's lending program for 2002 is about $380 million ($120 million Ordinary Cash Resources (OCR) and $260 million Asian Development Fund (ADF)) for the following projects: Jamuna-Meghna River Erosion Mitigation ($55 million), Rural Infrastructure Improvement ($70 million), Gas Sector Development Project ($120 million), Dhaka Clean Fuel Project ($40 million), Land Administration Reform ($30 million), and Road Network Improvement and Maintenance Project I ($65 million).

II. 2002–04 PROGRAM

3. The lending program of the AsDB for 2002–04 includes 17 loans amounting to $1,205 million ($305 million OCR and $900 million ADF) and covering several sectors: $270 million for energy, $155 million for transportation, $310 million for agriculture and natural resources, $370 million for social infrastructure, and $100 million for finance and industry.

III. TECHNICAL ASSISTANCE

4. As of December 31, 2001, the AsDB had provided 272 technical assistance (TA) grants for project preparatory and advisory services amounting to $145.63 million. The 2002 TA program includes four advisory TAs and five project preparatory TAs, for a total amount of about $5.1 million. The TA program for 2002–04 includes total grants of $20 million.

IV. ECONOMIC AND SECTOR WORK PROGRAM

5. The AsDB has produced a number of studies of Bangladesh's macroeconomic and sectoral policies. The AsDB publishes its Country Economic Review and Asian Development Outlook every year in which it assesses macroeconomic performance. Beginning in 2001, the AsDB has also prepared quarterly economic updates.

6. In addition to regular publications, several studies relating to the implementation of PAPR were undertaken in 2001. A series of operational strategies in key areas (social sector, private sector development, financial sector, governance, and regional cooperation) are under preparation. The AsDB and the World Bank are jointly preparing the Public Expenditure Review and the 2001 Poverty Assessment.

INTERNATIONAL MONETARY FUND

BANGLADESH

Staff Report for the 2001 Article IV Consultation—Supplementary Information

Prepared by the Asia and Pacific, Legal, Monetary and Exchange Affairs, and Policy Development and Review Departments

Approved by François Gianviti, Steven Dunaway, V. Sundararajan, and Shigeo Kashiwagi

April 25, 2002

1. A staff team[1] that visited Bangladesh during April 13–17, 2002 confirmed the findings set out in Annex VI of SM/02/107 (04/08/02) concerning exchange restrictions subject to Article VIII, Section 2(a). The restrictions identified are: (i) margin requirements of up to 100 percent for the opening of letters of credit for the import of certain goods; (ii) limits on the availability of foreign exchange for travel, medical, and educational expenses, as well as for payments for other invisibles that are not expressly authorized in the official guidelines on foreign exchange transactions; (iii) restrictions on advance payments for imports of goods and services; and (iv) restrictions on the convertibility and transferability of proceeds of current international transactions in various types of nonresident taka accounts.

2. The authorities have assured staff of their commitment to ensure that their foreign exchange regulations are consistent with Bangladesh's obligations under Article VIII. To this end, they intend to proceed as follows:

- By July 15, 2002, the authorities will abolish all remaining margin requirements for the opening of letters of credit for the import of goods. They will also by that date issue circulars clarifying that (i) payments and transfers for travel, medical, and educational purposes, as well as for other invisible transactions that have been legally entered into, can be freely made; (ii) any limits for such payments and transfers set out in the foreign exchange regulations are only of an indicative nature; and (iii) foreign exchange in excess of these limits will be made available upon proof of the bona fide nature of the transaction.

[1]The team comprised Messrs. Valdivieso and Orsmond (both APD), and Mr. Steinki (LEG). Mr. Verhoeven, the Fund Resident Representative, assisted the mission. A preliminary assessment of the issues covered in this report was carried out by a joint MAE/LEG mission in January 2002.

- As regards the restrictions on advance payments for imports of goods or services and on the convertibility and transferability of certain proceeds of current international transactions credited to nonresident taka accounts, the authorities intend to eliminate these in the context of a general revision of their foreign exchange regulations with technical assistance from the Fund. This process is expected to be completed before the next Article IV consultation, i.e., within the next 12 months.

3. Since these exchange restrictions are maintained for balance of payments purposes, and do not discriminate amongst Fund members, and considering that the authorities have proposed a reasonable timetable for their elimination, the staff recommends Executive Board approval of the exchange restrictions in line with that timetable.

Statement by the IMF Staff Representative
April 29, 2002

1. **This statement provides information on developments since the issuance of the staff report (SM/02/107).** These developments do not change the thrust of the staff appraisal.

2. **The near-term outlook remains fragile, despite signs that the economic situation is stabilizing.** Industrial production picked up marginally in November (0.3 percent y-o-y), following four months of consecutive declines. External trade has compressed further, but the trade balance has improved, as imports are still declining at a faster pace than exports. Workers' remittances from abroad have rebounded strongly, partly in response to the expansion of official remittance facilities aboard, that has been instrumental in shortening the delay in transmittals and lowering fees. There have also been sizable flows of net foreign financing to the budget in January–February. Gross international reserves reached $1.4 billion by mid April (an import coverage of about 1¾ months), $340 million higher than at its lowest point at end-October 2001. Inflation, however, appears to be rising. Consumer prices increased in January by 3¾ percent (y-o-y), with above average increases for nonfood prices reflecting the upward revision in utility tariffs and the devaluation of the taka in January.

3. **Monetary aggregates have continued to expand rapidly, driven by strong credit growth as interest rates have returned to relatively low levels.** In the 12 months to February, broad money (M2) increased by 14 percent (compared to 14¾ percent in 2001), whereas domestic credit grew by 15¾ percent over the same period (17¾ percent in 2001). The expansion in the banking system credit has been mainly driven by rising lending to the private sector, as the rate of increase in credit to the government has declined somewhat since November 2001. The yield on one-month treasury bills has declined by almost 60 bps to about 4 percent in February. Interbank money market rates have fluctuated around 8-15 percent since mid-February.

4. **The cash budget deficit has been contained so far, but it is likely to increase sharply in the last few months of the fiscal year.** Based on very tentative data for the first eight months of FY01/02, the fiscal deficit is estimated at about Tk 70 billion (roughly 4 percent of GDP on an annualized basis). There has been a broad-based shortfall in revenue collection, but cash expenditures have been restrained, particularly since November. About two thirds of the deficit has been financed by domestic sources. However, since November, the government has consistently reduced its exposure to the banking system, making savings certificates the main source of domestic funding despite their much higher cost relative to treasury bills. The authorities have stated that they expect a sharp seasonal increase in cash outlays in the remaining four months of the year, but have reiterated their intention to keep the budget deficit to their self-imposed target of 5½ percent of GDP.

5. **The government has recently introduced additional trade measures, but has committed to make existing exchange restrictions consistent with Bangladesh's obligations under Article VIII.** In March 2002, the government banned imports of yarn

- over -

through land ports, and imposed a 20 percent regulatory duty on clinker cement. In April, the import tariff on rice was reduced from 43 percent to 33 percent. The government's commitments as regards the elimination of exchange restrictions subject to Fund approval under Article VIII, are detailed in the supplement to the staff report (SM/02/107, Supplement 1, 4/25/02).

6. **Efforts to strengthen monetary and foreign exchange management are under way**. The Bangladesh Bank is currently drafting a new manual for its foreign exchange dealers and laying the groundwork for the introduction of repo operations in line with recommendations of the January 2002 MAE/LEG technical assistance. They have also prepared a revised list of amendments to the Bangladesh Bank Order to enhance its independence and broaden its supervisory and regulatory powers following assistance from LEG in February; these amendments are being reviewed by the Ministry of Finance.

Circulation of a **draft I-PRSP** within government, civil society and the donor community is expected in May, with a view to completing the document by end-June.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 02/54
FOR IMMEDIATE RELEASE
May 15, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation with Bangladesh

On April 29, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bangladesh.[1]

Background

Bangladesh's key economic and social indicators improved steadily in the 1990s, but poverty remained pervasive. Backed by prudent macroeconomic policies and an initial strong drive for structural reforms, Bangladesh recorded robust output and export growth, low single-digit inflation, improved literacy and heath indicators, food self-sufficiency, and lower population growth. Extreme poverty was reduced by 20 percent over the decade, although its level remained relatively high at one-third of the population.

Despite these achievements, the economy became progressively more fragile after the mid-1990s due to a persistent pursuit of expansionary fiscal and monetary policies along with slow progress on needed structural reforms, especially in the banking and state-owned enterprises (SOEs) sectors. Specifically, the central government deficit, which remained in the range of 4-4 percent of GDP in FY95/96–FY97/98, climbed to the range of 5–6 percent in FY99/00–FY00/01. Rising credit demands of the government, the SOEs, and the private sector were readily accommodated by monetary policy; credit from the banking system to the central government grew at annual rates of 30–35 percent in the two years through end-FY00/01.

[1]Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the April 29, 2002 Executive Board discussion based on the staff report.

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Broad money increased at an annual rate of 17–19 percent during this period as the Bangladesh Bank interest rate was kept constant in nominal terms.

These growing domestic imbalances were reflected in pressures in the foreign exchange market and by a marked decline in international reserves. In response, the authorities opted for sporadic step adjustments in the nominal exchange rate and resorted to administrative controls to limit the growth of imports. Despite these controls, gross international reserves by mid-2001 had fallen to less than 1½ months of imports. This policy-induced fragility was exacerbated by the global slowdown that began in late 2000 and, with exports declining sharply, real GDP growth in Bangladesh is estimated to have slowed from 5 percent in FY00/01 to around 3¾ percent in FY01/02. To date the impact on the current account has been contained through the administrative controls on imports as well as ongoing strong worker remittances from abroad.

Against this background, the authorities introduced a number of measures late last year to counter the increased fragility. While some measures have been steps in the right direction—a broadening of tax bases, the reduction in the high interest rates offered on savings certificates—fiscal and monetary policies remained expansionary and there was little reform in the SOEs and banking sectors. To start to offset these imbalances, in February 2002 the Bangladesh Bank rescinded the right of banks to meet their reserve requirements in foreign exchange, lowered and removed some of the exchange restrictions that have been introduced, and the government has announced a cut in some development and recurrent expenditures. The authorities have also redoubled efforts to accelerate the preparation of an interim Poverty Reduction Strategy Paper that could provide a framework for a comprehensive medium-term poverty-reducing growth strategy.

Executive Board Assessment

Directors expressed concern that, following a strong performance until the mid-1990s, the Bangladesh economy has become increasingly fragile as a result of expansionary fiscal and monetary policies and a loss of momentum in structural reforms. As evidence of this growing fragility, Directors cited the projected slowdown in economic growth in fiscal year 2001/02, the compression of trade due to a sharp decline in exports and imports, and the declining level of international reserves. Given the deterioration in the external balance, the authorities now have limited room for maneuver in responding to external shocks.

Against this background, Directors urged the new government to embark decisively on a comprehensive medium-term economic program on the basis of a broad public consensus to address domestic imbalances, accelerate the rate of economic growth, and reduce poverty. They commended the government's efforts to address the immediate economic weaknesses, especially the steps taken to tighten budgetary discipline, improve the finances of SOE, and increase the effectiveness of monetary operations and policies. At the same time, Directors expressed concern about the authorities' resort to administrative measures to cope with underlying weaknesses, noting the intensification of exchange restrictions through margin requirements on letters of credit and increased import duties and surcharges in response to balance of payments pressures. They welcomed the authorities' timetable for eliminating all identified exchange restrictions on current international transactions, and urged them to reduce reliance on administrative controls on economic activity more generally.

Directors stressed that an immediate priority in Bangladesh is to limit the fiscal deficit consistent with the amount of concessional financing available. In this context, they welcomed the government's efforts to contain the deficit in fiscal year 2001/02, to carry out carefully selected expenditure cuts, to ensure only minimal carryover of expenditure into the next fiscal year, and to prevent arrears on government obligations. They agreed that, in the short run, expenditure restraint is the main available means of curtailing the deficit. The key challenge in the medium term will be to place the public finances on a sound footing. This will require determined efforts to strengthen revenue performance and the financial performance of SOEs, reprioritize public expenditure, and cut waste.

Directors welcomed the authorities' commitment to strengthen the effectiveness of monetary policy. They encouraged the authorities to progressively let the market determine yields in the treasury bill auctions, to further develop indirect instruments of monetary management, to remove remaining administered interest rates, and to link the interest rate on national savings certificates to a market-determined treasury bill yield.

Directors were encouraged by the authorities' willingness to move to a more market-oriented exchange rate system in order to help cushion the economy against external shocks and enhance the effectiveness of monetary policy. They recognized the authorities' concerns about a possible overshooting of the exchange rate but considered that the risks involved in the transition would be minimized by the implementation of strong supportive macroeconomic policies and structural reforms. In particular, they stressed the need to improve the fiscal situation, strengthen the financial sector, increase the central bank's independence, and develop more effective monetary policy instruments.

Directors agreed that, in the medium term, the main task will be to lift the rate of economic growth sufficiently to achieve a significant reduction in the prevailing high levels of poverty. In this regard, Directors welcomed progress in preparing an interim poverty reduction strategy paper, noting that this paper could be the first step toward an eventual request for an arrangement with the Fund under the Poverty Reduction and Growth Facility. They urged the authorities to translate the broad strategies into concrete public actions, with clearly identified budgetary costs set in a multi-year macroeconomic framework.

Directors noted that, apart from a stable macroeconomic environment, satisfactory progress on structural reform is required to underpin higher levels of economic growth over the medium term. One priority reform is to strengthen the banking system. To accomplish this, the Bangladesh Bank Order needs to be amended to ensure the central bank's independence and to extend its supervisory powers to cover nationalized commercial banks and development finance institutions. Directors also considered that a more lasting solution should involve addressing the incentives and governance problems of troubled institutions. Directors stressed the importance of reducing the current high level of nonperforming loans and strictly enforcing prudential standards. In this context, they welcomed the Financial Sector Assessment Program exercise scheduled for May 2002. Directors welcomed the recent passage of the Money Laundering Prevention Act.

Noting the financial burden posed by state-owned enterprises, Directors urged the authorities to develop a plan for stemming the losses of the largest enterprises, focusing on revenue-enhancing measures and hard budget constraints. They also urged the authorities to move ahead forcefully to strengthen and implement their plans for privatization and closure or restructuring of nonviable enterprises, and to put in place adequate social safety nets to protect those who will be adversely affected.

Directors noted that further exchange and trade liberalization, including elimination of existing export impediments, will ensure that appropriate price signals are transmitted to the economy and will increase external viability. In view of the authorities' commitment to eliminate all identified exchange restrictions by the time of the next Article IV consultation, Directors agreed to approve these restrictions on a temporary basis.

Directors welcomed the authorities' progress in producing more accurate and timely economic data, especially on the budget, as well as their decision to participate in a fiscal Report on Standards and Codes exercise. Directors noted the importance of technical assistance to fulfill the above agenda, and urged that the technical assistance provided to the authorities be effectively utilized.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Table 1. Bangladesh: Selected Economic and Financial Indicators, 1997/98-2000/01 1/

	1997/98	1998/99	1999/00	2000/01 Est.
National income and prices (percent change)				
Real GDP 2/	5.2	4.9	5.9	5.2
Inflation (annual average) using GDP deflator	5.3	4.7	1.9	1.6
Inflation (annual average) using CPI	7.0	8.9	3.5	1.5
Saving and investment (percent of GDP) 2/				
Gross investment	21.6	22.2	23.0	23.1
National savings 3/	21.7	21.1	22.7	21.1
Central government budget (percent of GDP)				
Total revenue	9.3	8.6	8.6	9.0
Total expenditure	13.3	13.7	14.4	14.1
Of which: Annual Development Program	5.6	5.6	6.4	6.0
Overall balance	-4.1	-5.1	-5.8	-5.1
Primary balance	-2.9	-3.7	-4.2	-3.5
Money and credit (end-year, percent change)				
Domestic credit	13.3	14.0	13.2	18.6
Of which: Private sector	14.7	13.0	10.5	16.3
Broad money (M2)	10.2	12.8	18.6	16.6
M3	...	13.3	19.7	18.3
Interest rates (treasury bill yields, yearly average)	8.6	7.5	6.1	6.1
Balance of payments (US$ millions)				
Exports, f.o.b.	5,172	5,324	5,762	6,477
(Annual percent change)	16.8	2.9	8.2	12.4
Imports, c.i.f.	7,524	8,342	8,566	9,524
(Annual percent change)	5.1	10.9	2.7	11.2
Current account (excluding capital grants)	-253	-846	-416	-1,116
(Percent of GDP)	-0.6	-1.9	-0.9	-2.4
Current account (including capital grants)	51	-499	-133	-939
(Percent of GDP)	0.1	-1.1	-0.3	-2.0
Aid disbursements (loans and capital transfers)	1,052	1,215	1,132	1,174
Overall balance	127	-228	278	-429
External reserves and debt				
Gross official reserves (US$ millions)	1,751	1,522	1,599	1,302
(In months of imports of goods and nonfactor services)	2.6	2.0	2.0	1.5
Medium- and long-term external debt (US$ million)	13,418	14,354	15,727	16,227
Total external debt (percent of GDP)	31.8	32.5	34.4	35.3
Debt service (percent of current earnings) 4/	8.0	7.8	8.4	7.5
Memorandum items:				
Nominal GDP (taka billions)	2,002	2,197	2,371	2,533
Exchange rate (Tk/US$; period average)	45.4	48.1	50.4	53.9
Nominal effective rate (1990=100) 5/	90.9	87.1	83.5	77.7
Real effective rate (1990=100) 5/	101.7	104.1	102.5	101.0
Terms of trade (percent change)	1.7	2.4	2.1	1.5

Sources: Data provided by the Bangladesh authorities; and IMF staff estimates.

1/ Fiscal year begins July 1.

2/ National accounts based on 1995/96 benchmark and prices.

3/ National savings includes official transfers.

4/ Current earnings are defined as the sum of exports of goods, nonfactor services, and private transfers.

5/ IMF, Information Notice System.

Statement by Vijay L. Kelkar, Executive Director for Bangladesh
April 29, 2002

1. I would like to convey the appreciation of my Bangladeshi authorities to staff for their set of documents, which provide an insightful account of the Bangladeshi economy, while highlighting its vulnerabilities and the policy areas which need attention. My authorities agree with staff that following the strong reform led growth in the beginning of the last decade, economic performance unfortunately deteriorated since the mid nineties when expansionary fiscal and monetary policies were pursued with little progress on structural reform. The fragile economy further weakened last year in the wake of the global recession and the events of September 11. About seventy five percent of Bangladesh's total export earnings come from sales of ready-made garments and knitwear to the USA and the European Union. These have been hard hit in the present environment.

Current Environment

2. The new government, recently elected with a strong mandate has reversed the earlier policy deterioration and taken a number of proactive steps to revitalize the economy. While focusing on poverty reduction, it is committed to creating an environment conducive to strong economic growth within a framework of macro-economic stability and participatory local government. Immediately on assuming power, they adopted a 100-day program to address 25 categories of issues embracing all important areas of reforms and governance. This is the first time in the history of Bangladesh that such a unique program was launched. The scope of the program included improving the business climate and enhancing public order, revitalizing educational institutions, enhancing transparency in government procurement, enacting the Money Laundering Prevention Act as well as improvement of the port services. This 100 day program has been implemented satisfactorily.

3. To enable them to regain the momentum of the reform of the early nineties, my authorities are implementing a broad agenda focused on establishing a vibrant market economy in an environment of good governance. My authorities have intensified engagement with the Fund through technical assistance and policy advice to help them in this effort. The bank rate was reduced to stimulate credit including to the agro-processing sector, which was identified as critical to the thrust for generating employment and reducing poverty. A facility for refinancing for distressed export industries was created. Lending rates for exports of ready-made garments (RMG), frozen food and agro-products were reduced. The exchange rate of the taka was adjusted to restore external balance. The new government also demonstrated its commitment to restoring the strength of the economy by taking politically hard decisions like decreasing interest rates on savings certificates, increasing the price of fuel power and gas, freezing of public sector employment and shifting the venue of the Non Aligned Movement (NAM) Summit from Dhaka. While protecting pro poor and social sector expenditure, they are also reducing public expenditure - under both development and revenue heads, by an aggregate of about Taka 35 billion. The broad principles of the budget cuts are reflected in the staff report. Specific cuts in ADP would be approved by NEC (National Economic Council) in the first week of May. Cuts from non-

development budgets including recurrent budget are in the process of finalization through budget discussions with the line ministries and would be reflected in the revised budget.

4. Owing largely to the timely and measured interventions by my authorities, the Bangladesh economy is projected to grow by nearly 5 percent during the current year despite the global downturn. Projections made by other international financial institutions are higher than staff projections. We therefore feel that the staff estimate of growth at 3.75 percent for the year 2002 is overly conservative. While the slump in the export oriented RMG and knitwear sectors will drag down growth, other industries dependent upon the domestic market are expected to grow at a rate of about 8-9 percent, leading to a growth expectation of about 4 percent in the industrial sector. Preliminary information available with the authorities about the performance of the medium and large manufacturing industries sector since January, confirms this growth view.

5. While the level of reserves is a matter of concern, recent trends have been positive. As on 21 April 2002, reserves stood at US $ 1434.10 million, roughly equivalent to about 2 months of import. This increase was primarily due to a 33 percent increase in workers remittances which at $ 1.8 billion in March 2002 represents a 33 percent increase over the same period last year. My authorities are undertaking various policy initiatives to further enhance these flows. While foreign direct and portfolio investments have come down, they are not negative. My authorities therefore do not agree with the staff assessment that 'substantial net private capital outflows are continuing '.

Fiscal Policy

6. Staff has expressed concern about the deteriorating fiscal position and estimate that the deficit for the current year will be 6 percent of GDP. My authorities are committed to the path of fiscal consolidation. They have undertaken a series of expenditure compression measures aimed at bringing down the deficit. As on February 2002, the budget deficit measured from above the line stood at 4.8 percent of GDP and below the line at 5.2 percent. To put this latter figure in perspective, it includes an expenditure of Taka 17 billion (about 0.6 percent of GDP), which is a legacy of the previous government and was carried over from last year. As this figure finds place in last year's accounts against that year's budget, my authorities strongly believe that this should not be a measure of this year's performance; and therefore should not be included in the computation of this years budget deficit. Cost containment measures would save about 35 billion. To ensure fiscal discipline, policy guidelines for limiting recourse to commercial credit have been introduced. These guidelines are aimed at ensuring transparency and procurement efficiency. The 'unclassified expenditures' mentioned in the report are interim expenditures awaiting final classification and will be reconciled by the end of the year. My authorities are also taking firm steps to prevent a recurrence of the carry –over problem faced this year. In line with the position stated above, my authorities believe that the budget deficit for the current year would be around 5.5 percent of GDP.

7. On the revenue side, the administration of VAT and income tax is being streamlined and modernized. Discretionary VAT exemptions will be gradually eliminated. The effort to modernizing income tax laws continues and customs procedures are being simplified. My authorities have decided to set up a Public Expenditure Review Commission to examine public expenditure patterns and trends and to recommend a regime for efficient and effective allocation of public resources and their utilization. Another commission on reforming the public revenue system will be established to review the existing tax and non-tax revenue laws and systems and recommend necessary measures for optimum mobilization of domestic resources. These two commissions will be set up by June this year and it is expected that their recommendations will feed into the budget for 2004.

Monetary Policy

8. The Bangladesh Bank reviewed its Money and Credit Program for FY 2001-2002, to be consistent with the global scenario and revised the broad money growth target downwards to 10 percent. Credit expansion has also been constrained to 10 percent. As on 15 March 2002 domestic credit growth was 8 percent and broad money growth 7.63 percent indicating that these limits have been adhered to.

9. My authorities are committed to maintaining an efficient, effective and transparent financial system overseen by an independent and autonomous central bank. The Bangladesh Bank Order 1972 and the Bank Companies Act 1991 are being amended to give the central bank the required degree of operational autonomy. My authorities have also taken definite steps to improve governance in the banking sector. The boards of the nationalized commercial banks and specialized financial institutions have been revamped and their roles redefined. Professionals have been inducted to provide sound policy advice and enhanced oversight. Incentive schemes for recovery of NPAs have been introduced. Non-profitable branches of NCBs are being eliminated through closures and mergers. A new Money Laundering Prevention Act has been enacted. The further program includes creating a viable bond market in the country and the reform of the capital market.

Exchange Rate Management

10. My authorities agree with staff on the need for a market based exchange rate. They are moving ahead for creating the necessary infrastructure appropriate for such a regime. The Bangladesh Bank Order is being amended to suitable empower the Bangladesh Bank for this purpose. Simultaneously, efforts are being made to upgrade the Bank's technical capabilities in liquidity forecasting and exchange risk exposure monitoring, T-bills auction practices, introduction of repos and secondary trading in T-bills.

Exchange Restrictions

11. In regard to the exchange restrictions pointed out by the staff, my authorities would like to point out that in practice, they pursue a more liberal policy than what would appear from some of these regulations. However, they agree on the need to make changes to the

regulations to ensure their consistency with Article VIII. They propose to do so in a phased manner. This intention has been communicated to the staff, who have issued a supplement to the staff report incorporating the commitments made by my authorities.

Governance, Transparency and Accountability

12. My authorities recognize that improvement in the areas of governance, transparency and accountability is critical to successfully manage the reform effort and progress in these areas has to proceed simultaneously with the other initiatives. They are taking immediate steps to set up a National Human Rights Commission. The Ombudsman Act has recently been made effective and the office of the Ombudsman will become operational soon. Measures have been taken to establish an independent Anti-Corruption Commission. A high-powered inter-ministerial task force has been formed to devise an effective strategy to prevent corruption. My authorities are committed to maintaining a strong and independent judicial system and to this end will establish a separate judicial service commission and a judicial pay commission. The presence of an independent and vibrant press in the country provides another strong incentive for good governance.

13. In respect of transparency, the new government has, agreed for publication of the Staff Report for the Article IV consultation. This will be the first time a government in Bangladesh has done so and is a clear indication of their commitment to transparency. My authorities have also agreed to participate in the Data ROSC and the FSAP- emphasizing their steadfastness to improve fiscal governance and accountability as well as the financial framework.

Trade Measures

14. The policy of the Bangladesh Government is to implement trade measures consistent with their WTO commitments. They have already communicated to the WTO their intention to undertake a phased program to eliminate the restrictions on sugar, salt, woven and knitted fabrics.

Other Structural Issues

15. My authorities are concerned that the poor performance of the State Owned Enterprises (SOEs) is acting as a drag on the development of the economy. They are committed to privatizing all SOEs irrespective of whether they are profit-making or losing concerns. The Privatization Commission has been revamped to energize the privatization program. The privatization policy has been amended to make it more broad based. They have identified 51 (fifty one) enterprises which will be divested as soon as possible.

16. Reforms have also been initiated in the areas of energy, telecommunication, the administration of justice, resource mobilization, expenditure rationalization, human development and local government. My authorities plan to focus on the development of infrastructure for economic growth as well as for poverty reduction. They have undertaken a

series of reforms in the energy and power sector to create an appropriate enabling environment. The Private Sector Power Generation Policy has been formulated. A power sector area restructuring program has recently been approved by the Cabinet. The draft Bangladesh Electricity Reforms Act 2002 has been approved by the Cabinet Committee and an Energy Regulatory Commission will be established. The Bangladesh Gas Act aimed at expediting long-term development of the gas sector will be enacted shortly. In order to promote efficient energy use, my authorities have decided that as a medium term objective the price of energy should be market related. With regards to arrears to international oil companies, the issue has been resolved with the international oil companies through a meeting that took place in January this year. Arrear payments have been rescheduled and all payments are being made regularly.

17. In view of the positive impact of telecommunication and the new information and communication technology on poverty alleviation and growth, my authorities have been giving priority to undertaking reforms in the telecommunication sector. Passage of the Bangladesh Telecommunication Act enabled the creation of the Bangladesh Telecommunication Regulatory Commission, which has now become operational. This Commission will facilitate the growth and development of telecommunication activities in a multi-operator competitive environment with the private sector playing a key role. Tariffs in the Telecommunication Sector have been recently rationalized to generate fair competition.

Poverty Reduction and I-PRSP

18. My authorities place strong emphasis on poverty reduction. A number of innovative poverty reducing programs have been launched by the Government and Non-government Organizations (NGOs) with remarkable success. As a result, the incidence of poverty has declined significantly by nearly twenty percentage points during the last three decades. However, poverty has remained a pervasive feature of the country, as about sixty five million people still live below the poverty line. Currently, my authorities are preparing the Interim Poverty Reduction Strategy Paper (I-PRSP). This paper, based upon poverty trends, will forge sustainable strategies within a growth oriented medium term macroeconomic framework. The I-PRSP paper is being formulated on the basis of broad-based consultations making it a homegrown and country owned document. My authorities remain firmly committed to this concept for poverty reduction and economic growth. They attach top most priority to finalization of I-PRSP as well as integrating the next budget into this framework. They look forward to Fund support in the implementation of this strategy through a PRGF arrangement.

19. The proposed anti-poverty policy strategy, which includes development of institutions, will follow four broad action paths. The first set of policies will expand the scope for pro-poor economic growth by increasing income and employment of the poor. The second set of policies will foster human development of the poor. The third policy set will aim to provide a social safety net to the poor against various anticipated and unanticipated income and consumption shocks. The fourth set of policies will aim at enhancing the voice of the poor by strengthening women's empowerment and creating pro-poor institutions.

Concluding Remarks

20. My authorities would like to thank Fund staff for their untiring efforts and very valuable contribution. They have benefited from the insightful advice provided by staff on key policy issues as well as from their sympathetic attitude towards their technical assistance requirements. My authorities would like to continue this policy dialogue with the Fund through the medium of focused Technical Assistance as well as general staff visits. They also look forward in the future to program support from the Fund.