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AGENDA

EBS/83/121
Correction 1

CONFIDENTIAL

July 7, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Bangladesh - Staff Report for the 1983 Article IV Consultation
and Review of Stand-By Arrangement

The following correction has been made in EBS/83/121 (6/10/83):

Page 14, footnote 1, lines 2 and 3: for "net value added of their foreign
exchange earnings,"
read "f.o.b. value of their exports,"

A corrected page is attached.

Att: (1)

Although the deficit in the services account is estimated to double due to increased interest payments and higher international operating costs for the national airline, the current account deficit is now expected to narrow from US\$1.58 billion (14.8 per cent of GDP) in 1981/82 to US\$1.16 billion (11.5 per cent) in 1982/83, compared with a deficit of US\$1.26 billion (12.3 per cent) envisaged earlier. Aid disbursements will be somewhat less than anticipated under the program, because implementation of the full ADP had not been authorized until the second half of the year and there have been delays in processing commodity aid requests. While the Government increased its external borrowings to finance the additional food imports, some deferred food import payments that fell due were postponed.

Reflecting the above developments, the overall balance of payments is projected to show a surplus of US\$112 million in 1982/83, compared with a deficit of US\$245 million recorded in the previous year and a deficit of US\$70 million foreseen under the program. Such a surplus has permitted a much-needed buildup of reserves, which is projected to reach a level equivalent to about five weeks of imports at the end of 1982/83, compared with less than three weeks of imports a year earlier. Even though the program foresaw no change in the stock of outstanding short-term external debt, the better balance of payments performance has allowed a reduction in such debt, which is now estimated to decline by close to US\$40 million. As to external borrowings with maturities of more than one year, the contracting of new loans has remained comfortably below the program limits.

6. Exchange and trade policies

Since October 1980, the authorities have adopted a flexible exchange rate policy aimed at encouraging a gradual shift of resources toward the external sector (Chart 6). Since then through December 1982, the nominal effective exchange rate for the taka in the official market depreciated by 37 per cent, and the real rate, by about 17 per cent. The objective of the program was to avoid an appreciation in the real effective exchange rate for the taka. This policy was to ensure an average depreciation of the official rate of about 7 per cent in real terms during 1982/83. As of end-March 1983, the level of the real effective exchange rate was approximately the same as in December 1982.

With a view to providing incentives for workers' remittances and nontraditional exports,^{1/} a secondary exchange market has been maintained in which proceeds from these transactions are auctioned off.^{2/} Until December 1981, there was an important premium (fluctuating between 15 to

^{1/} Through the Wage Earners' Scheme (WES) and the Export Performance Licensing Scheme (XPL), respectively. See the associated Recent Economic Developments report to be issued shortly.

^{2/} During the past two years, an average of about 20 per cent of total imports and 50 per cent of nonaid imports have transited through the secondary market.

30 per cent during the preceding two years) in this market vis-a-vis the official exchange rate. However, in the course of 1982, the premium virtually disappeared due to a combination of several factors, including the restrictive credit policy for financing imports in the secondary market and the depreciation of the official exchange rate. Partly to maintain a minimum premium in the secondary market and partly to prevent a manipulation of the market by brokers at a time when demand for foreign exchange has been weak, the Bangladesh Bank has, since November 1982, set a floor price in the auction market at which price it purchases all foreign exchange not sold through the auction. The floor price has been set at about 1 per cent above the official exchange rate and has been adjusted whenever the official rate has been changed. This policy, coupled with the continued depreciation of the official rate, ensured a depreciation of the exchange rate in the secondary market, reversing the appreciation which took place in this market between September 1981 and March 1982.

The flexible exchange rate policy has had a beneficial impact on the economy in several ways. Although the development of major exports, such as jute, jute goods, and leather, has been constrained by weak world demand, the depreciation has, in the face of declining world prices, made it possible for producers to receive a higher price in domestic currency than would have been possible otherwise, thereby attenuating the adverse impact of the decline in world prices on producer incentives. In addition, the depreciation has helped the Jute Mills Corporation to substantially improve its financial position. The continued good performance of such exports as ready-made garments, tobacco, handicrafts, and fresh fruits and vegetables is an indication that the flexible exchange rate policy, together with the promotion efforts undertaken over the past two years, has had a favorable impact on the development of nontraditional exports. The depreciation is also likely to have contributed to the increase in workers' remittances by reducing the incentives for workers to remit their foreign savings in the form of unrecorded imports from neighboring countries; it may have also reduced the incentives for them to hold back their savings in the expectation of a more favorable rate. Furthermore, through the real balance effects, the depreciation has reduced demand and has helped contain imports without resorting to quantitative restrictions. Finally, the flexible exchange rate policy has had a strong secondary benefit in the form of increasing import duty receipts and commodity aid counterpart funds.

In addition to the flexible exchange rate policy, several other exchange measures were introduced to encourage exports and expand the secondary market. In July 1982, the export duties on raw jute and tea were abolished, and the XPL 1/ was modified by the addition of an 80 per

1/ Under the scheme, exporters obtain import entitlement certificates up to the indicated percentage of the f.o.b. value of their exports, which can be sold or utilized for the import of any commodity eligible for import in the secondary market. All exports other than raw jute, jute goods, and tea are eligible for import entitlements under the scheme.