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EBS/87/227
Correction 2

CONFIDENTIAL

December 1, 1987

To: Members of the Executive Board
From: The Secretary
Subject: Bangladesh - Request for Second Annual Arrangement Under the
Structural Adjustment Facility

The following correction has been made in EBS/87/227 (10/28/87):

Page 1, footnote 1, line 5: for "A. G. Choudhury," read "S. B. Chaudhuri."

A corrected page is attached.

Att: (1)

I. Introduction

In the attached letter dated October 28, 1987, the Government of Bangladesh requests the second annual arrangement under the structural adjustment facility (SAF) in an amount equivalent to SDR 86.25 million, or 30 percent of quota, in support of a medium-term adjustment program for the three-year period ending June 1989. 1/ The Memorandum of Economic and Financial Policies, which describes the program that the Government intends to implement, is annexed to the letter. A detailed description of the economic policies and objectives of the Government's medium-term program for the period 1987/88-1989/90 is set forth in the updated policy framework paper (PFP), which has been prepared in collaboration with the staffs of the Fund and the World Bank (EBD/87/276; 10/27/87). It is expected that the updated PFP will be considered by the Bank's Executive Directors, at a meeting of the Committee of the Whole, on November 17, 1987. This PFP updates and extends the original PFP (contained in EBS/87/7; 1/15/87), which covered the period 1986/87-1988/89.

On February 6, 1987, the Executive Board approved Bangladesh's request for a three-year arrangement under the SAF and for the first annual arrangement thereunder (EBS/87/7, 1/15/87). The loan under the first annual arrangement, in an amount equivalent to SDR 57.5 million (20 percent of quota) was disbursed shortly thereafter. 2/ The first annual SAF program, covering the period July 1986-June 1987, overlapped with the final 12 months of a 19-month stand-by arrangement, in an amount equivalent to SDR 180 million or 62.6 percent of quota, approved by the Executive Board on December 2, 1985 (EBS/85/251, 11/12/85). Bangladesh observed all performance criteria established under the

1/ Negotiations were held in Dhaka during May 11-25 and August 26-September 9, 1987 and were concluded in Washington during the Annual Meetings. The staff representatives met with Mr. M. Syeduzzaman, Minister of Finance; Mr. G. Kibria, Finance Secretary; Mr. S.B. Chaudhuri, Governor, Bangladesh Bank; and other senior government officials. The staff representatives were Mr. Al-Eyd (Head), Ms. Milne, Messrs. Banerjee, Miranda (all ASD), Shome (FAD), Felman (ETR), and Mrs. Atienza (TRE) and Ms. Job (ASD). Mr. Westin of the World Bank participated in one of the missions. The staff team was assisted by Mr. Ghesquiere, the Fund's Resident Representative in Bangladesh and Mr. Hughart of the World Bank Resident Mission in Dhaka. Both visits to Dhaka overlapped with a Bank-Fund financial sector mission, in which Mr. Lindgren (CBD) participated.

2/ At that time, the Board also approved Bangladesh's request for a purchase under the compensatory financing facility in an amount equivalent to SDR 88.9 million in respect of an export shortfall during the year ended September 30, 1986 (EBS/87/8, 1/16/87).

stand-by arrangement (Table 1) and the full amount was purchased (Table 2). 1/

The second arrangement is being requested prior to the termination of the first arrangement. The lengthy review of the original PFP by the Bangladesh authorities resulted in a seven month divergence between the program year--which corresponds to the fiscal year--and the coverage of the first annual arrangement. By advancing the second arrangement, this divergence will be narrowed to about four months. The staff recommends the early approval of the second annual arrangement so that there is a better coincidence between the SAF arrangement and the policymaking cycle in Bangladesh.

The second annual arrangement under the SAF is included in Attachment I, and the letter of transmittal from Bangladesh's Minister of Finance and the Memorandum of Economic and Financial Policies of the Government of Bangladesh are included in Attachment II. Bangladesh's relations with the Fund and the World Bank are described in Attachments III and IV, respectively, and social and demographic indicators are contained in Attachment V.

II. Background

In an effort to deal with mounting macroeconomic imbalances, the Bangladesh authorities adopted a stabilization program covering the two-year period 1985/86-1986/87, which was supported by a stand-by arrangement from the Fund. During the first year of the program, economic performance improved significantly. Real GDP growth reached 4.4 percent, inflation moderated, and the external current account deficit narrowed, despite a sharp fall in the terms of trade. The overall balance of payments swung into surplus, and by the end of the year, gross reserves increased to the equivalent of 2.4 months of merchandise imports, compared with only 1.8 months at end-1984/85. This progress reflected the implementation of strong adjustment measures, including a sharp reduction in the rate of broad money expansion and the adoption of a flexible exchange rate policy. The latter was crucial in stimulating rapid growth in nontraditional exports and workers' remittances.

1/ At end-September 1986, Bangladesh Bank transferred to the central government all of its estimated profits of Tk 350 million for the first quarter of 1986/87; in the past, profits were calculated at the end of the fiscal year and transferred in the first quarter of the following year. In the absence of the transfer, the September 30 ceiling on net credit to Government, which was a performance criterion under the stand-by arrangement then in effect, would have been exceeded by a small margin (0.8 percent). After reviewing the matter, Management has found that the transfer of estimated profits did not constitute a form of "net bank credit to the Government" for purposes of the performance criterion under the stand-by arrangement.