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The Acting Chair's Summing Up
Bangladesh—Second Review Under the Poverty Reduction and Growth Facility (PRGF) and Waiver of Performance Criteria, Activation of the Trade Integration Mechanism (TIM), and Augmentation of the Access Under the PRGF in Accordance with the TIM; Poverty Reduction Strategy Paper Status Report, and Joint Staff Assessment
Executive Board Meeting 04/74
July 28, 2004

Executive Directors commended the Bangladeshi authorities for the strengthened economic performance under the first year of the PRGF-supported program. They observed that the economic recovery has continued, inflation has been kept in check, and the external sector has strengthened. Macroeconomic management has remained on course and all quantitative targets and performance criteria have been observed. On the structural front, while expressing some concern about initial policy slippages, Directors commended the authorities for continuing with their reform agenda, despite a difficult political environment.

Directors underscored that faster and lasting growth needed for poverty reduction will require determined policy implementation and deeper structural reforms to tackle governance issues and improve the investment climate, and to meet the challenge posed by the phase-out of quotas under the Multifiber Agreement at end-2004. Directors agreed that the macroeconomic stance should continue to be supportive of growth. On the structural front, Directors welcomed policy actions that have already been implemented, but stressed that stepped up reform efforts are needed, particularly with respect to tax administration, the nationalized commercial banks (NCBs), and improved governance. Enhancing investor confidence will require concerted actions to improve law and order, and develop and implement an anti-corruption strategy, including the early and effective functioning of the Independent Anti-Corruption Commission (IACC). Against this background, it will be important to strengthen the political consensus on reform and address capacity constraints, including through the introduction of appropriate social safety nets.

Directors endorsed the targeted increase in the FY05 budget for infrastructure and pro-poor social spending to better support growth and the attainment of the MDGs. They stressed, however, that stepped-up spending in the context of the Annual Development Program would require improved project selection and execution, better public expenditure management with improved fiscal transparency and accountability, and timely decisions on policy conditions for project financing.

On the revenue side, Directors stressed the need for strengthened tax administration and for ensuring the continued effectiveness of measures already in place. They noted that decisive and timely steps are needed to expand the Large Taxpayers Unit, which should cover also the value-added and withholding taxes. Given the need to strengthen the

implementation capacity of the National Board of Revenue, Directors encouraged the authorities to take advantage of further technical assistance.

Directors agreed that monetary policy should continue to balance the support for economic growth while containing inflation. They welcomed the introduction of market-based monetary operations through the development of the interbank and treasury securities markets, and encouraged timely action to establish a treasury bill market to meet the nonbank financing needs of the budget. They also supported the authorities' request for technical assistance in this area. Directors welcomed the interest rate adjustments on the National Savings Certificates (NSCs), but most Directors expressed concern about the special window for limited access by pensioners to NSCs at above market interest rates. Given the potential for abuse of such a system, they encouraged the authorities to consider alternative forms of social safety nets.

Directors noted that the floating exchange rate regime has worked well for Bangladesh. They encouraged the authorities to continue to confine their interventions in the exchange market to countering disorderly conditions and building international reserves to a more comfortable level. Moreover, they supported using the floating exchange rate as a first line of defense against the potential impact from the lifting of the MFA quotas, noting that a market-based depreciation of the taka will be consistent with the need to maintain external competitiveness.

Directors supported the reform agenda for the NCBs, and stressed that its implementation will require strong political will and technical assistance. They noted that the poor financial condition of the NCBs as evidenced in the special audits underscores the urgency for decisive actions, particularly with regard to Sonali Bank. They called for close monitoring to ensure adherence to the strengthened memoranda of understanding between the NCBs and the central bank. The authorities were also encouraged to build on the first steps recently implemented in strengthening bank management and persevere with the implementation of the bank-by-bank resolution strategies that have been adopted.

Directors welcomed the concerted trade reform efforts identified in the budget, particularly given the background of the MFA quota phase-out at end-2004. They were encouraged by the prospects for enhanced competitiveness and reduced anti-export bias through such trade reform. While the tariff reforms are estimated to be revenue neutral, Directors urged the authorities to protect revenue through the rigorous implementation of the additional revenue measures in the FY05 budget. In addition, the authorities should move quickly in further defining and implementing their post-MFA action program, together with decisive efforts to improve the business climate.

Directors noted that stepping up the reform of the energy sector will be important to address infrastructure bottlenecks to growth and improve the financial performance in this sector. They encouraged the authorities to work closely with the World Bank and the ADB to define a framework for turning around the financial and operational performance of the energy sector SOEs, particularly the Dhaka Electricity Supply Authorities (DESA). In this

connection, they welcomed the recent decision of the government to adopt an operational restructuring plan for DESA supported by the ADB. They urged the authorities to keep domestic energy prices under close review and to make any needed adjustments in a timely manner. Directors stressed the need to regain the momentum for reform of state-owned manufacturing enterprises as soon as practicable.

Directors welcomed the progress that has been made toward finalization of the full PRSP by end-2004, but they noted that much work is still ahead. They endorsed the staff assessment in the joint staff assessment of the PRSP preparation status report, particularly the need for a more comprehensive approach to tackle governance issues, including law and order, and for a strengthened effort in public expenditure management.

Directors noted that risks to program implementation have heightened in a difficult political environment, but were reassured by the continued strong commitment of the government to the overall reform process. In particular, they pointed out that risks remain considerable, especially in the structural areas deriving from resistance of vested interests and weak administrative capacity, in addition to the external risk from the phasing out of the MFA quotas. To mitigate these risks, Directors encouraged the authorities to be vigilant on policies, while noting the importance for close monitoring and continued technical assistance.

To assist Bangladesh to better cope with the MFA quota phase-out, and encouraged by the authorities' commitment to strengthening the reforms under the PRGF arrangement, Directors agreed an augmentation of access under the PRGF arrangement, in accordance with the Trade Integration Mechanism.