BUFF/ED/07/104

June 20, 2007

Statement by Mr. Kishore and Mr. Bannerji on Bangladesh
Executive Board Meeting
June 22, 2007

1. Introduction:

1.1 The Bangladesh Authorities take this opportunity to place on record their thanks and appreciation to IMF staff for the Article IV Consultation and the Sixth PRGF Review mission conducted in April 2007. The Authorities are in broad agreement with the observations, recommendations and the policy advice on macro-economic and structural reforms covered in the Staff Report.

1.2 Since November 2006, the already vitiated political situation in Bangladesh began to worsen, and by January 2007, assumed dangerous proportions. The street riots, violent *hartals* and blockades brought economic and social life to a virtual standstill. To put an end to the destabilizing political situation, the President declared Emergency on January 11, 2007 and formed a new Caretaker Government (CTG), the major responsibility of which, *inter alia*, is to create a congenial environment to conduct a free and fair election expeditiously and in a transparent manner. The new CTG has come down heavily against corruption. A number of studies in recent years have determined that corruption in Bangladesh consumes 1-2 percent of GDP. In order to pursue cases against corrupt individuals, the Judiciary and Anti-Corruption Commission have been strengthened and more court houses are being set up to enable quick disposal of the growing number of cases.

1.3 In spite of the difficult political situation, Bangladesh economy has made remarkable progress buttressed by wide-ranging reforms supported by the World Bank Development Support Credit (DSC), Poverty Reduction Growth Facility (PRGF) of IMF and DFID-supported Financial Management Reform Programme. Strong growth and well-designed policies to attack poverty during the last decade seemed to have paid dividends as revealed in the recent Household Income and Expenditure Survey (HIES). The proportion of people living in poverty fell from 49 percent in 2000 to 40 percent, with the hardcore poverty falling from 34 percent to 25 percent. In FY 2005-06, economic growth posted a historic high rate of 6.7 percent, thanks to the robust growth of both agriculture and industry. Bangladesh continues to post current account surpluses reflecting strong growth of export and remittance inflows. Gross reserves, at over $ 4 billion are comfortable.

1.4 The Government of Bangladesh remains fully committed to the earnest pursuit of reforms despite some difficult domestic and external circumstances. Some of the reform measures implemented in recent times include adjustment of oil prices, rationalization of electricity tariff, corporatization of national commercial banks, reconstitution of Election

Commission, Anti-Corruption Commission. These reforms are the building blocks for faster growth to reduce poverty, and thereby improve the welfare of the people. Bangladesh's development and poverty reduction strategy is enshrined in the document named "Unlocking the Potential: National Strategy for Accelerated Poverty Reduction (NSAPR)". The budgets are formulated in consonance with the overarching framework of NSAPR, and their effective implementation is aided by Medium-term Budget Framework (MTBF), that has now been extended to14 important ministries that spend 60 percent of the total budget.

2. Budget Highlights

2.1 The recently announced national budget has set out the major policy directions of the new CTG. The FY 2007-08 budget includes: emphasis on maintaining a favorable macro economic environment; rationalization of the trade regime; decisive steps to assume SOE liabilities, principally of Bangladesh Petroleum Corporation and Power Development Board; significantly higher allocation in strategic sectors of power and agriculture, including a provision for diesel subsidy to poor farmers facing higher irrigation cost. Safety net programmes have been deepened and widened and new programs added with more focused targeting. The Authorities have reconstituted the hitherto ineffective Anti-Corruption Commission and further demonstrated their commitment to elimination of corruption by signing UN Convention against Corruption. The judiciary has been separated from the executive organ. Human resource development constitutes 25 percent of the total budget allocation with education and health receiving 15.2 percent and 7 percent respectively. A Universal Self-Assessment Procedure of tax return has been introduced. The tariff structure has been simplified and the tariff distortion brought to a minimum. The trade regime has been further liberalized. Both the VAT net and Income-tax net have been widened. Government borrowings from ad hoc treasury bills have been replaced by transparent auction based system.

2.2 In the absence of a working parliament in the country, the Government has ensured an extensive consultative process involving former finance ministers, finance secretaries, intelligentsia, civil society, non-government organizations, journalists, and people at large both before and after the announcement of the budget. Following the declaration of the budget, the government allowed 10 days for receiving suggestions, ideas and comments from individuals, groups and institutions. All such inputs are currently being processed and the ones determined as having merit would be considered before final approval.

2.3 In the coming fiscal year, the Government has attached the highest importance to the implementation of the budget. To this end the Finance Ministry is mobilizing its manpower and resources for monitoring the implementation of budget. The Authorities put special allocation of resources to in major ministries that cover the key sectors to conduct special/performance audit, with the work to be outsourced to private sector audit firms of good standing. The Finance Division has introduced an Internal Control Manual to be uniformly applied in relation to public expenditure to all ministries / divisions and departments under them.

3. Macro-economic Stability

3.1 Propelled by higher growth in industrial and service sectors, the overall economic growth in FY 2006-07 is likely to be around 6.5 percent despite the political turmoil and *hartals* and poor weather for key rice crops. Export and remittance have been the bulwark of growth recording 19 percent and 27 percent respectively in the three quarters of this fiscal year. Credit to the private sector grew at an annualized rate of 19 percent during the same period. The domestic investment looked robust with 21 percent growth in LC settlement for capital machinery.

3.2 Inflation, however, appears in the horizon as a major concern averaging 7 percent. The Bangladesh Bank is closely watching the situation and will exercise appropriate monetary policy option to contain inflation. The Authorities are aware that inflation hurts people, particularly the poor. It undermines economic stability and discourages investment; it deters growth and widens income inequality. To rein in inflation, the Government withdrew import duty on a number of items including rice and wheat. Bangladesh Bank has instructed commercial banks to encourage larger number of new importers of food to bring about greater competition. National Task Force and Task Forces in district and sub-district level regularly monitor the prices of essential commodities including a group devoted to the analysis of the prices. Government is to double its import of rice and wheat.

3.3 Cautious monetary policy has been matched by prudent fiscal policy. The overall fiscal deficit in FY 06 was kept below the target despite revenue shortfall. Our revenue to GDP ratio remains phenomenally low with 10.5 percent. The Annual Development Programme fell short in terms of implementation by about 20 percent due to resource inadequacy and implementation capacity constraints. For maintaining macro-economic stability, keeping public debt at a sustainable level and avoiding any crowding out impact on the private sector, the Government has limited domestic borrowing to 2 percent of the GDP in line with staff suggestions and prudential borrowing practice.

3.4 Of late, there has been growing interest from overseas investors for large scale foreign direct investment (FDI) in Bangladesh. The growth of FDI in Bangladesh averaged 16 percent from 2002 to 2007. Very recently, the Mittal Group, the steel conglomerate, signed a Memorandum of Understanding with Board of Investment for investing US$ 2.8 billion in coal, steel and power industries.

4. Structural and Institutional Reforms:

4.1 The commitment of the CTG to structural and institutional reforms has been demonstrated through several bold measures during the last 5 months. The reforms cover the financial sector, state-owned enterprises, the power and energy sector, telecommunications, fiscal policy and broad governance issues.

4.2 Three Nationalized Commercial Banks (NCBs) are about to be converted into public limited companies to enable them to operate like private banks. From January 2007, Authorities made it mandatory to have all commercial banks credit rated, and updated annually by a Credit Rating Company of good reputation to safeguard interest of the depositors and prospective investors. Reforms in insurance laws relating to protection of policy holders and supervision of insurance business are in process. To ensure international accounting, auditing and reporting standards, a Financial Reporting Act has been approved by the Council of Advisors. Money Laundering Prevention Act has been made more effective to prevent illegal transfer of funds.

4.3 In next fiscal year, more shares of SOEs and Government's share in commercial banks will be off-loaded in the Stock exchange. The listing of the new SOEs and the sale of bank shares is expected to bring about further vibrancy in the capital market which has grown significantly over the last three years. The Government is encouraging the private conglomerates and the mobile phone companies to raise capital from the market. The implementation of these steps will widen and deepen the capital market.

4.4 Despite the Government’s flexibility in the divestment of Rupali Bank, the process has got stalled owing to frequent shifts in stance by the highest bidder. The Bangladesh Government has, time and again, acceded to the request of the bidder, and the present delaying tactics by the bidder has placed the Authorities in an embarrassing situation.

4.5 The revised FY 07 budget, the Government has allocated Taka 15 billion to make the quasi-fiscal costs of the Government more transparent. In FY 2007-08, the Government will assume the total liabilities of Bangladesh Petroleum Corporation (BPC), in the amount of Taka 75 billion arising out of administered fuel price over the past few years. BPC is being geared up to run on a commercial basis and will be allowed to adjust petroleum prices on a previously agreed automatic price adjustment formula.

4.6 One of the biggest challenges facing the CTG is tackling the power crisis, a legacy that will continue to affect the economy for at least 3 more years. We have made highest allocation increase of 51 percent in power sector and the Government is building quite a few more power plants. Private sector power producers are also encouraged. Power has been identified as a thrust sector and Bangladesh would appeal for larger soft-term loan for investment in this sector from development partners. In the other strategic transportation sector, reforms in the seaports of Chittagong and Mongla led to a reduction of ship turnaround time from 9 days to 4 days with handling costs cut down by 20 percent. Low revenue collection remains a fundamental problem in fiscal management for the Government. Revenue as a share of GDP continues to be stagnant coasting around 10.5 percent. The Authorities have identified this low revenue growth as the main challenge in the fiscal front. The Government has expressed their broad agreement with the April 2007 IMF Staff Report suggesting overhaul of tax legislation and separation of revenue collection from policy-making.

5. PRGF Programme

5.1 At the conclusion of this statement on behalf of my Authorities I wish to state that the PRGF engagement with the IMF during the past 4 years, along with budgetary support from the World Bank through DSCs, has been largely successful. A flexible exchange rate regime was introduced in 2003, discreetly timed and executed, without creating any turbulence in the market. GDP growth has been impressive sustained over the programme years, there has been sustained reduction of poverty and progress in several MDG targets. Several key structural reforms have been implemented. Price adjustments in fuel, gas and power have significantly reduced hidden quasi-fiscal costs of the Government. The corporatization of the NCBs, the issuance of unique taxpayer identification numbers to large tax payers, and the establishment of Large Taxpayers' Units, are examples of some significant reforms in the financial / fiscal sectors. However, the tax to GDP ratio remains stagnant. You will appreciate that this has been largely due to revenue loss owing to liberalization of international trade regime. The Programme target of an increment of 1.5 percent in revenue to GDP ratio during the period could not be met.

5.2 **Post PRGF :**

Our Authorities concur with the broad gist of the Staff report and are prepared to go forward in: (a) initiating a detailed overview of the current tax legislation through a possible Technical Assistance package from the Fund. This would be with a view to streamlining existing legislation and plugging loopholes existing at present; (b) combining the two Large Tax Payers' Units (LTUs) and issuing Unique Tax Identification Numbers (UTINs) to all large taxpayers; (c) separating aspects of Tax policy and planning away from administration of tax collection. Our Authorities feel that these steps are indeed necessary for tax buoyancies to improve in the long run.

5.3 The CTG is committed to change. The CTG has in the last 5 months brought in more fundamental and institutional reforms than what was witnessed in the past several years. An Independent Election Commission for holding a free and fair election by end 2008, anti-corruption drive through Anti-Corruption Commission, banking and financial sector reforms are some of the major icons.

5.4. Many more important reforms will be forthcoming in the coming months. My Authorities' goal is to establish the conditions for sustainable and long-lasting reforms that are oriented to the welfare of the people, enhance efficiency and improve growth performance. The Government has weighed the three options provided in Staff Report for future engagement with the Fund and have resolved to pursue negotiation for a new PRGF.