FOR AGENDA

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November 11, 1993

To: Members of the Executive Board

From: The Secretary

Subject: Bangladesh - Staff Report for the 1993 Article IV Consultation and Request for Monitoring Under the Procedures for Enhanced Surveillance

Attached for consideration by the Executive Directors is the staff report for the 1993 Article IV consultation with Bangladesh, and its request for monitoring under the procedures for enhanced surveillance, which is tentatively scheduled for Board discussion on Wednesday, December 1, 1993. A draft decision appears on page 18.

Mr. Hicklin (ext. 37137) or Mr. D. J. Robinson (ext. 37489) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Asian Development Bank (AsDB) and the GATT Secretariat, following its consideration by the Executive Board.

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BANGLADESH

Staff Report for the 1993 Article IV Consultation and Request for Monitoring Under the Procedures for Enhanced Surveillance

Prepared by the Staff Representatives for the 1993 Article IV Consultation with Bangladesh

Approved by Bruce J. Smith and A. Basu

November 10, 1993

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I. Introduction

The 1993 Article IV consultation discussions with Bangladesh were held in Dhaka during May 15-29, 1993 and August 28-September 9, 1993 and further discussions were held at the Fund's headquarters during September 27-October 1, 1993. The Bangladesh representatives included Mr. M. Saifur Rahman, Minister of Finance; Mr. Nasimuddin Ahmed, Finance Secretary; Mr. Korshed Alam, Governor, Bangladesh Bank; and other senior officials. 1/ Following the expiration in September 1993 of the third annual arrangement under the enhanced structural adjustment facility (ESAF), in a letter to the Managing Director dated November 8, 1993, the Government of Bangladesh has requested the Fund to monitor Bangladesh's economic and financial program for 1993/94 under the enhanced surveillance procedure (Appendix I). 2/ Bangladesh's relations with the Fund, the World Bank Group, and the Asian Development Bank (AsDB) are set out in Appendices II, III, and IV, selected social indicators are contained in Appendix V, and statistical issues in Appendix VI.

Bangladesh continues to avail itself of the transitional arrangements under Article XIV and is on the standard 12-month consultation cycle. In concluding the last Article IV consultation in September 1992, as well as in the discussion of the midterm review under the third annual ESAF arrangement in March 1993, Executive Directors welcomed the progress that Bangladesh had made toward financial stability and external viability during the ESAF arrangements, which had resulted in a significant reduction in inflation and a marked improvement in the balance of payments. GDP growth, however, had continued to lag, underlining the need to accelerate the pace of structural reform.

The Bangladesh Nationalist Party Government of Prime Minister Khaleda Zia was elected in early 1991. Parliamentary elections are to be held by 1996.

II. Report on the Discussions

The discussions focused on the outcome in 1992/93 under the third-year ESAF arrangement, the program for 1993/94 which is to be monitored under the

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1/ The staff team was headed by Mr. Al-Eyd (in May), Mr. Smith (in August-September) and also comprised, in one or both missions, Messrs. Hicklin, Robinson, Cangiano, and Buyantogtokh (all SEA), Mr. Clements (FAD), Mr. Watanabe (PDR), Miss Cullati and Mrs. Horton (Administrative Assistant and Staff Assistant, respectively, both SEA). The Fund's Resident Representative, Mr. Khenissi, took part in the discussions in Dhaka, as did Mr. Ghanem, from the World Bank's resident office, and Ms. Akhtar (AsDB).

2/ The fiscal year runs from July 1 through June 30.

enhanced surveillance procedure, and policies that would be consistent with achieving a significantly higher growth rate over the medium term.

1. Economic developments and policies under the third-year ESAF-supported program, 1992/93

The program for 1992/93, supported by the third annual arrangement under the ESAF, aimed to support GDP growth of 5 percent, keep inflation to 5 1/2 percent, and consolidate progress toward external viability. These objectives were to be achieved through increasing investment and saving in both the public and private sectors, supported by structural reform to improve economic efficiency, particularly in the areas of investment policy, the tariff and trade system, the financial sector, and the public enterprises.

Under the program, significant further progress was made in macroeconomic stabilization, inflation was lower than programmed, and the balance of payments position strengthened (Charts 1 and 2, and Table 1). However, the growth and investment targets were not achieved, repeating the pattern of previous years. While the quantitative performance criteria and benchmarks were met, the mixed record on the structural benchmarks reflected delays in implementing structural reform (Tables 2 and 3).

a. Output and prices

Real GDP growth was estimated at 4.3 percent in 1992/93, compared with a program target of 5 percent. Though agricultural output was boosted by favorable weather and a record rice harvest, the rise in industrial production was limited to 7 percent, sharply lower than anticipated. This reflected the slower-than-expected implementation of public sector projects in the Annual Development Program (ADP) and sluggish private sector activity, which the authorities attribute to uncertainties associated with the transition to a more liberal environment and high interest rates on bank lending. There were signs of a pickup in activity toward the end of the year, helped by some easing of interest rates. Investment is estimated to have increased slightly but, at almost 13 percent of GDP, was lower than programmed. 1/ An increase in private savings helped raise national savings to 11 percent of GDP. As a result, the external current account deficit narrowed.

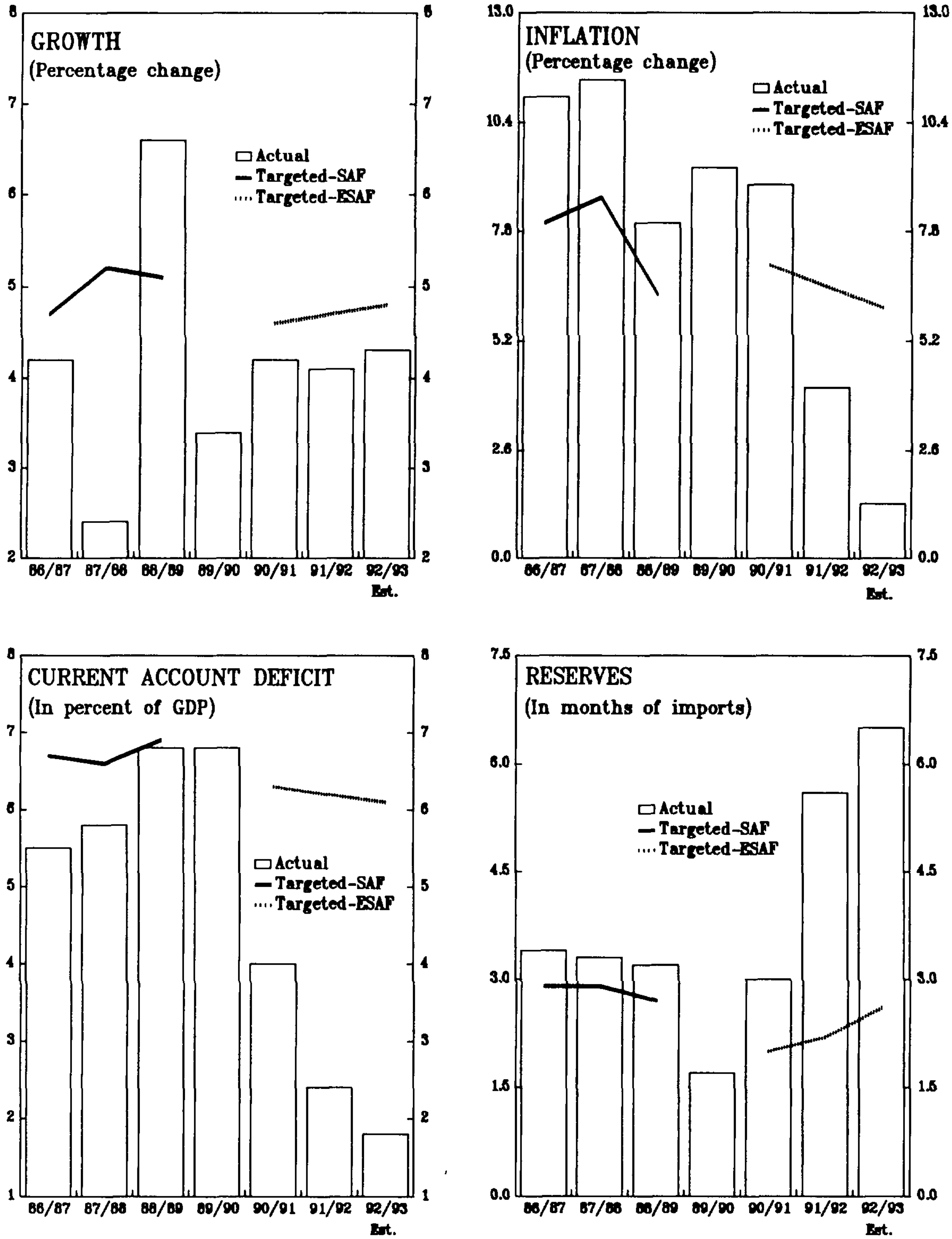
Average annual inflation (as measured by the CPI) continued to decline from some 10 percent in the late 1980s to 1.3 percent in 1992/93. The inflation performance in 1992/93 can be attributed mainly to a sharp fall in food prices, increasing real incomes for many of the poor; in particular, rice prices fell by 16 percent during the year, reflecting abundant supply. Nonfood price inflation also weakened through the year, as a result of sluggish demand.

1/ Exact comparisons are complicated by revisions to the data.

CHART 1

BANGLADESH

ECONOMIC PERFORMANCE UNDER THE SAF AND ESAF ARRANGEMENTS, 1986/87-1992/93 1/

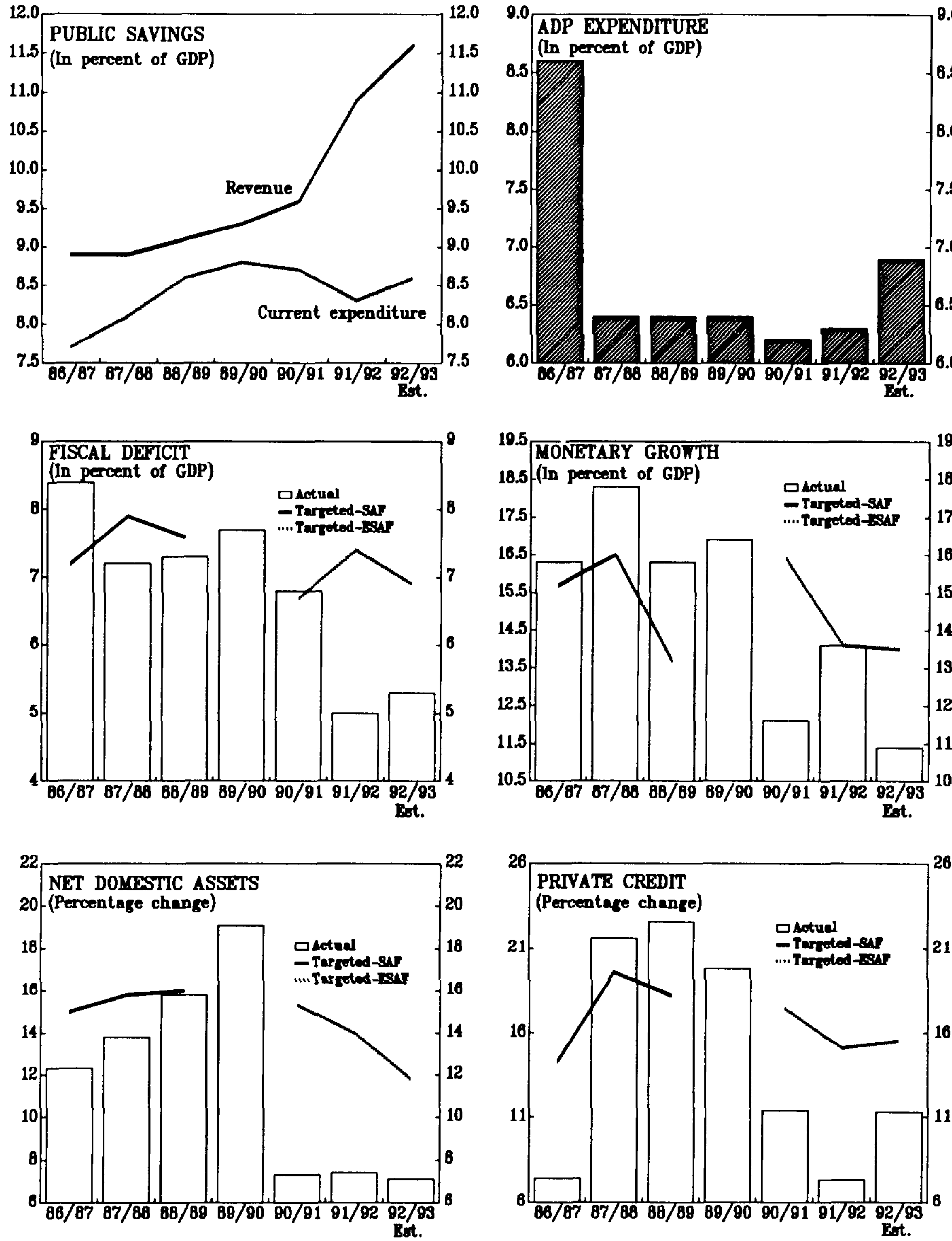


Sources: Data provided by the Bangladesh authorities; and staff estimates.
1/ Targets are in some cases not precisely comparable with outturns, owing to revisions to the national income accounts over the period.

CHART 2

BANGLADESH

FINANCIAL POLICIES UNDER THE SAF AND ESAF ARRANGEMENTS, 1986/87-1992/93



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

Industrial policy was further streamlined during 1992/93. Measures included: (i) allowing private investment in electricity generation and transmission, and telecommunications (leaving only five activities reserved for the public sector) and (ii) eliminating the prior approval requirement of the Board of Investment (BOI) on setting up new industries with financing by public banks. These new policies are applied equally to domestic and foreign investors. With respect to agricultural policy, the role of the private sector in input distribution and marketing was progressively expanded. All subsidies and administered prices on fertilizers were eliminated. Existing tubewells and minor irrigation equipment held by the Bangladesh Agricultural Development Corporation (BADC) continued to be sold through auction.

b. Fiscal policies and reforms

The central government deficit, excluding grants, is estimated to have increased only slightly from 5.0 percent of GDP in 1991/92 to 5.3 percent of GDP in 1992/93, 0.7 percent below the program target (Table 4). While revenue exceeded the target, and current expenditures were contained, there was, as in the previous year, a major shortfall in implementing the ADP (most of which involves central government expenditure). Despite lower-than-expected foreign aid inflows, high domestic nonbank financing of the central government allowed a substantial retirement of bank credit.

Total revenue is estimated to have reached 11.6 percent of GDP in 1992/93, exceeding the program target by 0.1 percent of GDP. This built on the progress in revenue mobilization made in the previous two years to raise the revenue/GDP ratio from just over 9 percent. Income tax, value-added tax (VAT), and excise tax receipts grew sharply, exceeding their target: positive factors included several administrative improvements that more than offset the less buoyant performance of customs receipts which, in part, reflected a drop in average tariff rates. The revenue effort was enhanced by the widening of the VAT base through the elimination of exemptions, improved administration of the VAT on services and construction, and collection of arrears. Nontax revenue also exceeded expectations, mainly because of larger profits by Bangladesh Bank as foreign exchange reserves increased.

Current expenditure (including the food account deficit) is estimated at 9.1 percent of GDP, 0.2 percent of GDP below program. Although expenditures for wages, pensions, and grants-in-aid exceeded initial budgetary allocations, these overruns were more than covered by "unallocated expenditure." The food account deficit fell by 0.1 percent of GDP, as the decline in food subsidies offset the rise in foodstock expenditures associated with the good harvest. Other subsidies were also kept under control, while operations and maintenance outlays rose sharply.

Total ADP expenditures (including those self-financed by state enterprises) rose by 5 percent to Tk 70 billion (7.2 percent of GDP). ADP spending was significantly less than the operational ADP target of

Tk 80 billion (which was itself much lower than the Government's initial budget allocation). The shortfall in ADP spending, which was more marked in the second half of the year, is of particular concern to the authorities. It occurred despite attempts to strengthen project implementation, including revised procurement guidelines, greater decentralization of project approval, and frequent progress reviews. Capital expenditure (other than ADP) rose faster than programmed, with higher expenditures on retrenchment programs.

The performance of the public enterprise sector, with some exceptions, remained weak in 1992/93, as reflected by low return on assets, excess staffing, and noncommercial access to credit, including from the banking system. On the positive side, progress was made in the much delayed programs in the jute, power, and railways sectors. However, the privatization program faltered. Plans to privatize 42 public enterprises first targeted in late 1991 have been delayed by a lack of clarity in the aims of the program, insufficient incentives for the ministries to divest, and lack of support given to the interministerial committee charged with overseeing the program. Though a new Privatization Board has been established, and there was some relaxation in the requirements for investors to assume all liabilities and employees of the firms for sale, the implementation of the program remains modest.

c. Monetary policy and financial sector reforms

Growth in money and credit remained well within the program targets in 1992/93 (Table 5). Broad money growth slowed to 11 1/2 percent, some 2 1/2 percent lower than the program target. The fiscal outturn, combined with weak private sector credit demand, helped limit net domestic credit growth to only 4 percent during the program period and net foreign assets rose by more than targeted. In response to the weakness of economic activity in the first part of the financial year, monetary policy was eased in the first half of 1993 through reductions of 2 1/2 percent in the bank rate (to 6 percent) and of 1-2 percent in floor interest rates on deposits. However, both banks and borrowers remained cautious in response to recent measures to improve financial discipline, although there were tentative signs of a pickup in private sector credit growth by year end.

Excess liquidity in the banking system declined somewhat during the year but remained at a relatively high level, complicating monetary management. In addition, the intermediation costs of the banks have risen, as the declining stock of government paper forced them to hold substantial unremunerated deposits at Bangladesh Bank to meet the statutory liquidity ratio (SLR).

The measures taken by the authorities, as well as the impact of continued excess liquidity, led to a decline in interest rates on deposits, though this was more marked in the nationalized commercial banks (NCBs) than in the private banks, apparently reflecting depositors' concerns over the riskiness of holding deposits in the private banks. The authorities were particularly concerned that lending rates had remained high and would discourage credit demand. Although most interest rates have been liberalized in recent years, official lending bands for agriculture, exports, and small and cottage industries were maintained, and these were unchanged during 1992/93.

The financial health of the banking system has deteriorated significantly in recent years and the authorities have responded by taking steps to improve the regulation and supervision of banks. However, the full extent of nonperforming loans is unknown, since the present loan provisioning and classification regulations remain weak by international standards. The high level of nonperforming loans has led to low bank profitability and difficulties in meeting the capital adequacy requirement and has contributed to the present high lending rates. In April 1993, an amendment to the Banking Companies Act strengthened capital adequacy standards. As the extent of undercapitalization and underprovisioning becomes clearer, the consequences of past lending practices are being faced through recapitalization exercises. Following one round in 1991/92 to recapitalize the NCBs to the standards required as of end-1990, a further exercise in June 1993 partly compensated NCBs for a compulsory write-off of agricultural loans in 1991/92, and for shortfalls in capital and provisioning as of end-1992.

d. External policies and reforms

The external payments position was considerably stronger than programmed in 1992/93, with the current account deficit narrowing to $0.4 billion (1.8 percent of GDP), compared with the program target of $1.1 billion (4.5 percent of GDP) (Table 6). Exports rose by 20 percent in dollar terms and surpassed expectations on account of strong exports in garments (and, to a much lesser extent, other items, including leather products, frozen food, tea, and chemical products). Workers' remittances also increased sharply. While import demand picked up somewhat in the second half of 1992/93, it was lower than projected, mainly owing to lower-than-expected public and private investment. Total aid flows were about $1.6 billion, $0.3 billion below the projected level. In particular, food aid fell well short of the program target, owing partly to the increase in domestic rice production. Project aid was also below expectations, owing to the slow implementation of the ADP. Reflecting these developments, an overall surplus of $0.5 billion was recorded and gross official reserves rose to $2.1 billion (6.5 months of imports) by end-June 1993. The debt service ratio declined further. The real effective exchange rate remained broadly unchanged during most of the year, before depreciating somewhat during the last quarter, owing both to the decline in inflation and some nominal effective depreciation (Chart 3).

The Government took further steps in import liberalization. In February 1993, the Import Policy Order was revised and the number of items subject to quantitative restrictions in the Import Control List (including both trade- and nontrade-related items) was reduced from 193 to 93.

Passbook requirements, which had previously been used for specifying the annual import entitlement for each industrial importer, were abolished, except for the remaining restricted items. Significant tariff rationalization was also undertaken, comprising reduction of maximum rates, compression of the duty schedule, and elimination of some user concessions.

The Government continued to liberalize the exchange system. In April 1993, the maximum limit on travel allowances was raised from $2,000 to $2,500 for visits to most countries. For air travel to Bhutan, India, Maldives, Myanmar, Nepal, Pakistan, and Sri Lanka the limit was raised from $400 to $500. The requirement for prior approval from Bangladesh Bank was eliminated for a broad range of current international transactions. Bilateral payments agreements with China, Poland, Romania, and the Slovak Republic were terminated during 1992/93.

2. Economic and financial policies for 1993/94

The program for 1993/94 aims to support GDP growth of about 5 percent, keep inflation to 4 percent, and maintain progress in strengthening the balance of payments. These objectives are to be achieved through sharply higher investment expenditure and a further rise in savings. The program for 1993/94 is consistent with the progress envisaged in the medium term to achieve a substantial increase in the growth rate while consolidating the improvement in macroeconomic performance already achieved. The authorities intend to continue to pursue a vigorous program of structural reforms. During 1993/94, such reforms would be focused on the financial sector (including supervision) and the exchange and trade system, as well as the continued restructuring of the public enterprises. The program for 1993/94, to be monitored under the enhanced surveillance procedure, is summarized in Table 7 and described in the Memorandum on the Economic and Financial Policies (Appendix I).

a. Output, prices, and real sector policies

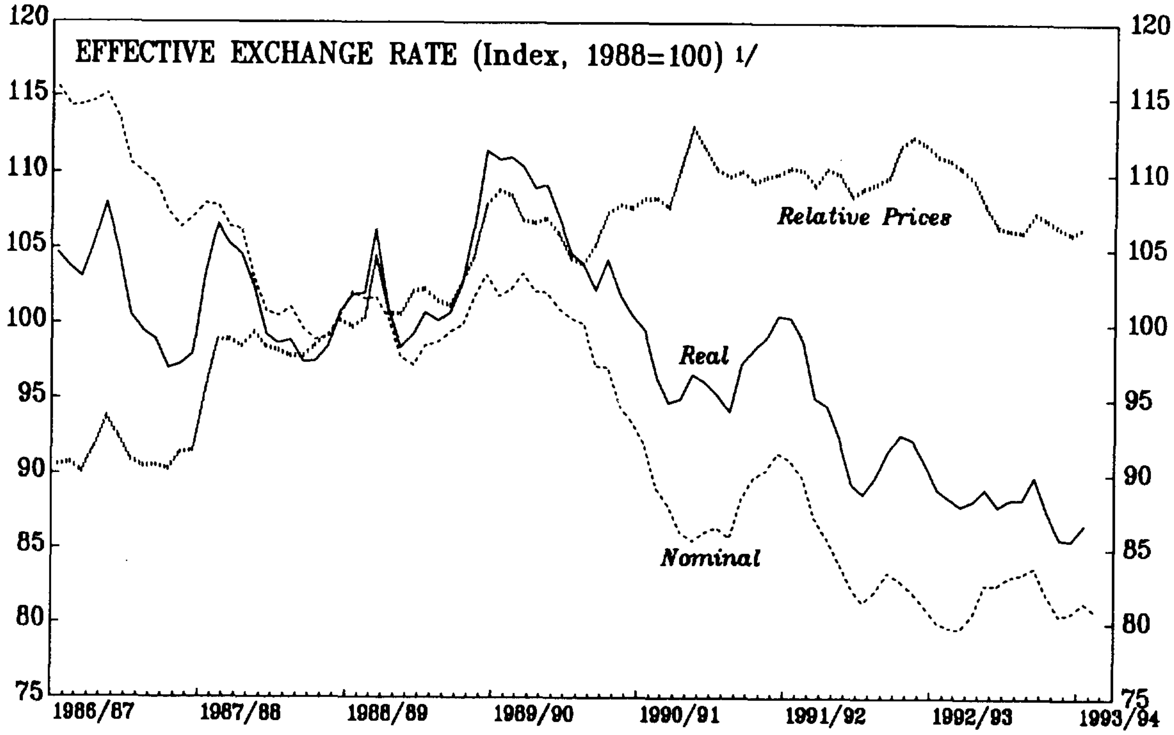
Real GDP is projected to grow by about 5 percent in 1993/94, predicated on relatively favorable weather (despite recent floods), which would allow agricultural output to rise by some 2 percent and on an increase in private sector activity and public investment, which would permit industrial output to grow by 9 percent. The authorities expect that both agriculture and private sector industry would begin to respond to the economic reforms made in the recent past, including by increasing investment. Inflation is projected to be contained to 4 percent during 1993/94, after allowing for some rebound in food prices.

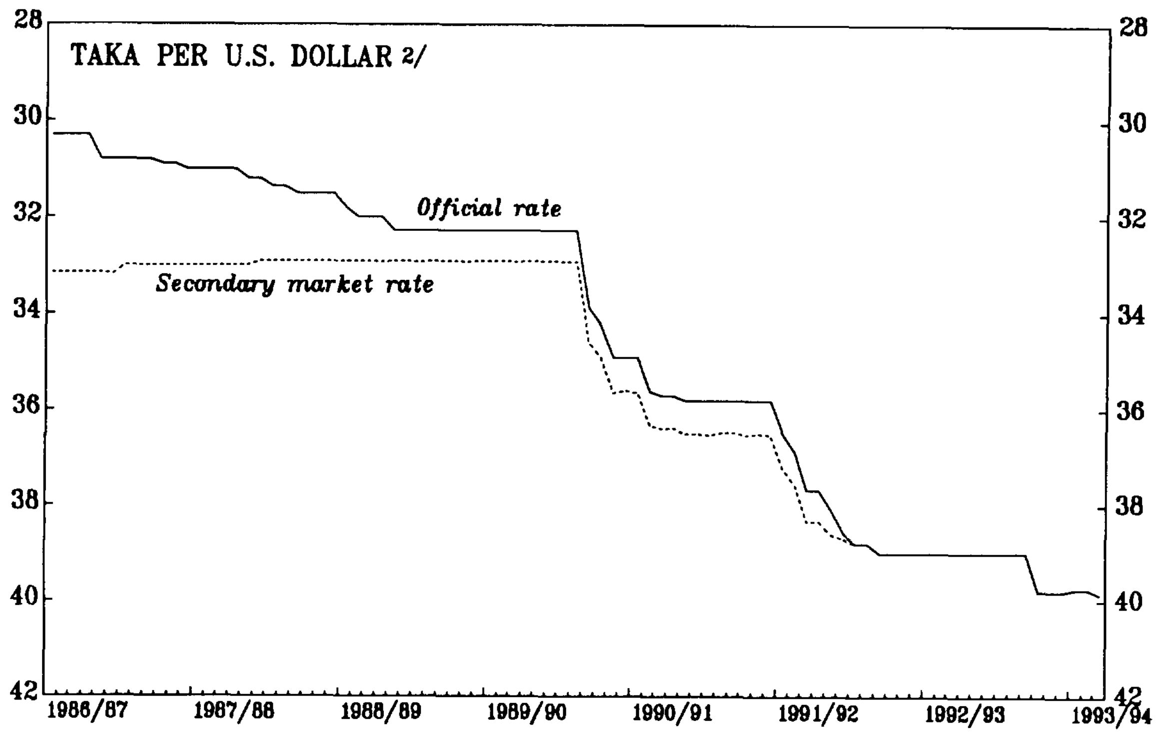
Agricultural policy will be based on allowing greater private sector participation and market-based prices to achieve higher foodgrain production and diversify output. As part of a program agreed with the AsDB, the authorities intend to continue the reforms of the BADC, thereby allowing greater scope for private sector distribution and marketing of both inputs and outputs. In other areas, the steps envisaged by the authorities include

CHART 3

BANGLADESH

EXCHANGE RATE DEVELOPMENTS, 1986/87-1993/94





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

1/ Index based on currencies of ten major trading partner countries. Downward movement indicates depreciation.
2/ Dual exchange markets were unified effective January 1, 1992.

the approval by the Cabinet of the draft legislation prepared in late 1992 for the Board of Investment Act, as well as the implementation of the required changes to the Board's organization and methods of operation.

b. Fiscal policies and reforms

The overall central government deficit is programmed at 6.3 percent of GDP, consistent with a continuation of the fiscal objectives under the ESAF arrangements: a further increase in the ratio of revenue to GDP, containment of current expenditure, and a sharp rise in ADP expenditure.

Following the increases in the last two years, the operational revenue target for 1993/94 is set at 12.1 percent of GDP, an increase of 0.5 percent of GDP. Although there are pressures not to increase revenues in the present circumstances in which expenditure has fallen well short of target and private sector demand is sluggish, the authorities recognize the importance, in a medium-term context, of steadily increasing the revenue ratio, given the projected path of expenditures and financing and the low level of the ratio by international norms. Much of the increase is expected from administrative improvements, especially with respect to the VAT. Several tax rates were reduced in the 1993/94 budget, including corporate tax rates and tariffs, in line with the trade reform program agreed with the World Bank. A wide range of structural measures to expand the tax base and improve tax compliance, as well as to strengthen tax administration, are being taken. These measures include the full implementation of a withholding scheme for VAT payments for government contracts in the construction sector; the allocation of more staff to collect the VAT, and efforts to enforce better compliance in services; inspection of bulk consignments at customs; an increase in staffing in the income tax department; and the creation of taxpayer identification numbers. Performance toward meeting the operational revenue target, including the benchmark on the four major taxes, and any possible need for additional measures, will be assessed at the time of the midterm review under the enhanced surveillance procedure.

Current expenditures (including the food account deficit) are programmed to be contained to 9.3 percent of GDP in 1993/94. This figure incorporates the impact of the structural reforms that are being implemented, including interest costs on bank recapitalization bonds and temporary support to the jute industry (estimates for which are provisional and remain under discussion in the context of the World Bank supported jute sector adjustment program). Other shifts in emphasis include an increased share of expenditures on operations and maintenance, a decline in the food account deficit (reflecting lower subsidies and smaller outlays on stockbuilding), and an increase in food distribution, targeted to the neediest.

The operational ADP target for expenditures in 1993/94 (Tk 85 billion, 8.1 percent of GDP, including central government and public enterprise expenditures), though less than the initial budget allocation, represents a substantial increase over that in 1992/93. The authorities are committed to achieve the target, in part by ensuring that procedural changes to speed implementation are fully operational and by holding high-level review meetings to resolve implementation problems facing line agencies. Supported by the World Bank, the authorities are continuing efforts to improve the quality of the investment program, concluding sectoral strategy investment reviews, and shifting the priorities in the direction of greater expenditure on education and health (see Appendix I for details).

The public enterprise reform program is continuing, despite the announcement of wage increases for some public enterprise workers averaging 17 percent. This is projected to increase the wage bill in six major public enterprises by Tk 2.9 billion, of which Tk 1.6 billion is due to retroactive payments for previous years. The authorities believed that this increase was necessary to reflect developments, since the last basic wage increase was awarded in 1986, and to ensure pay comparability within the enterprises. The increase will have a significant adverse effect on the financial position of the public enterprises and make more difficult the task of achieving commercial viability, including in the restructuring of the jute sector. Additional measures are to be taken to ensure that the needed adjustment in the public enterprises will be achieved, including cost-cutting and other efficiency measures, an acceleration of the privatization program and sales of assets, and further staffing reductions. In this context, the public sector employee retrenchment program has taken on increasing importance. It accelerated in 1992 (with a reduction of some 20,000 public employees by end-June 1993) and will be extended to cover at least another 25,000 officers and workers in 1993/94. A revised set of guidelines and regulations to enhance public manufacturing enterprise autonomy will be introduced--together with measures to strengthen financial accountability and management information systems--as soon as possible (in line with a program supported by the AsDB).

c. Monetary policy and financial sector reforms

The growth of broad money is projected at 13 percent in 1993/94, based on the targeted growth and inflation rates and an expected decline in velocity. Net domestic assets are programmed to grow by 11 percent. With almost no recourse to bank finance by the central government and a 9 percent growth in borrowing by the public enterprises, credit to the private sector is programmed to expand by 14 percent, which would allow for the targeted increase in private investment and economic activity. The authorities agreed that, in conjunction with moves to introduce indirect monetary management, measures should be taken to promote the development of the domestic money market. Technical assistance from MAE will be provided and a shadow reserve money program is being monitored in 1993/94.

The authorities have made much progress in recent years in eliminating many of the direct ceilings on credit and on interest rates. The staff argued that the remaining interest rate bands on some lending and floors on deposits should be removed as soon as possible and that a move to impose new caps, which was being discussed, would be ill-advised. The latter would discourage lending to the sectors concerned--thereby defeating the essential purpose--and would send the wrong signal about the authorities' attitude toward their own role and the responsibility of banks. The tax breaks and high interest rates on government borrowing from the nonbank sector should also be reviewed, as these were costly to the budget and encouraged disintermediation from the banking system. The authorities argued that some direct pressure needed to be imposed on banks to lower lending rates, since high real interest rates had a negative impact on investment. However, the question of imposing formal caps and the present rates on nonbank sector finance would be reviewed (some rates were reduced in September 1993).

The condition of the banking system was a major concern. Symptoms include large spreads between lending and deposit rates; a large proportion of nonperforming loans; excess reserves held with the central bank; inadequate provisioning and capitalization; and continuing losses that end up as charges on the budget. The authorities recognized that the provisioning and classification regulations needed to be strengthened further. A benchmark for 1993/94, therefore, involves assessing the impact of strengthened provisioning and classification regulations by end-December 1993. A timetable would then be established to bring regulations in line with international practices within two years. The staff indicated that this was an essential first stage in determining a medium-term financial sector reform program. The authorities were also preparing, with World Bank assistance, to privatize one of the four nationalized banks and restructure the development finance institutions.

d. External policies and reforms

In 1993/94, the external current account deficit is projected to widen to $0.7 billion (2.6 percent of GDP), reflecting mainly a 15 percent increase in imports associated with the expected pickup in public and private investment and further trade liberalization. The increase in imports is expected to be partly offset by a 14 percent growth in exports and a steady increase in workers' remittances. Aid disbursements are projected to increase somewhat, reflecting some rebound of food aid disbursements and slightly higher program loan disbursements from IDA and the AsDB. Taking account of these developments and scheduled amortization and Fund repurchases, the gross reserves of Bangladesh Bank would increase modestly to about $2.4 billion, with import coverage declining to 6.1 months.

Important steps to improve the exchange system have been initiated recently. In particular, following technical assistance from MAE, steps were implemented in August 1993 to develop the interbank foreign exchange market, including a wider margin between Bangladesh Bank's buying and selling rates, an increase in the minimum amount of foreign exchange transacted between the commercial banks and Bangladesh Bank, and operational improvements in the commercial banks. The market appeared to be growing. The taka is pegged, within margins, to a basket of currencies, with changes in parity achieved through periodic adjustments in Bangladesh Bank's buying and selling rates for the taka against the U.S. dollar. The taka has, in practice, remained little changed against the U.S. dollar since January 1992.

The authorities confirm their commitment to an exchange rate policy that is consistent with the maintenance of external viability and competitiveness. The staff concurs with the authorities' view that the existing level of the exchange rate is broadly appropriate. Exchange rate policy will continue to be reviewed as structural reforms are implemented, taking account of, inter alia, the effects of trade liberalization; the import requirements of the targeted increase in public and private investment; the future of the Multifiber Arrangement and its implications for garment exports; and developments in the level and structure of aid flows. Nonetheless, the authorities' intention is to sustain competitiveness in the first instance through cost reduction. In this context, the authorities are mindful of the impact that reform in other countries could have on the competition for export markets and foreign direct investment.

Important steps have been taken to reduce exchange restrictions on current international transactions during the first few months of 1993/94. The remaining ceilings on personal travel allowances have been declared to be indicative, with foreign exchange beyond the limits to be made available on verification of bona fide character of the transaction. The official forward cover scheme, to which commercial banks formerly had access from Bangladesh Bank with a fixed premium, which gave rise to a multiple currency practice, was terminated, except for the currencies of Asian Clearing Union (ACU) member countries (India, the Islamic Republic of Iran, Myanmar, Nepal, Pakistan, and Sri Lanka). 1/ Bangladesh Bank now trades only in U.S. dollars and ACU currencies and has eliminated broken cross rates. The exchange rate guarantee scheme on the interest component of Nonresident Foreign Currency Deposits (NFCDs) has been abolished. Contracts entered into under old forward cover and NFCD schemes that are still in effect continue to give rise to a multiple currency practice until they expire.

Following these measures, the exchange system has been substantially liberalized with only a few restrictions remaining. These are: (i) limits on business travel allowances, remittances for family-living expenses abroad by Bangladesh nationals, and allowances for certain types of educational programs; (ii) bilateral payments arrangements with three Fund members (Bulgaria, the Czech Republic, and Hungary) and with companies in Egypt and Germany; and (iii) the multiple currency practices that arise from contracts under the old forward cover and NFCD schemes. Among these, the bilateral payments arrangements with the companies in Egypt and Germany, as well as the multiple currency practices, are subject to the approval of the Fund

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1/ The staff is reviewing jurisdictional implications of the forward cover scheme for the ACU currencies.

under Article VIII, Sections 2(a) and 3. Other measures are maintained under the transitional arrangements under Article XIV. The authorities intend to eliminate all remaining restrictions by no later than end-June 1994, before accepting the obligations of Article VIII.

Further trade liberalization is being pursued in 1993/94 to promote a rapid expansion in industry and improve efficiency and resource allocation in the economy. As of October 1993, the Government had reduced the total number of trade-related quantitative restrictions (including those previously restricted outside the Control List) to 39. The Government will undertake a study by June 1994 on any offsetting measures that may be required to be able to eliminate the remaining trade-related restrictions as soon as possible. With regard to tariff reforms, the maximum tariff rate was reduced to 100 percent, except for two product groups: alcoholic beverages and cigarette paper. Following the tariff measures announced in the 1993/94 budget, the coverage of items subject to the tariff rate above 45 percent was reduced considerably. A minimum tariff of 7.5 percent was imposed on many of the previously zero-rated items. 1/ Regarding export policy, the bans or restrictions on exports of rice and re-exports of unprocessed goods were eliminated. The authorities are committed to reviewing export policy, with a view to further reducing restrictions, including bans on exports and the export price check for raw jute exports.

e. Quantitative and structural benchmarks

To facilitate the monitoring of the progress in policy implementation, a number of quarterly quantitative and structural benchmarks have been established, as specified in Table 1 attached to Appendix I. A midterm review of the program will be undertaken and completed not later than end-March 1994.

3. Medium-term policy framework

The key challenge for the authorities is to design and implement a policy package sufficiently strong to put Bangladesh firmly on a significantly higher growth path. This is required in order to bring about a more decisive break from the past and make faster progress in reducing oppressive poverty. Past experience confirms that this cannot be achieved by reliance on foreign aid inflows and prudent macroeconomic policies alone. Although these will continue to be necessary ingredients for success, the key lies in greater efforts on Bangladesh's own part to restructure and strengthen its economy. In this, reducing the role of the public sector and improving the environment for private sector activity and foreign investment through a comprehensive program of structural reform will be crucial. Failure to implement such a medium-term program--described below as the

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1/ According to preliminary calculations by World Bank staff, the average nominal protection rate (unweighted) fell from 55 percent in 1991/92 to 48 percent in 1992/93 and further to 42 percent in 1993/94.

high-growth "base" scenario--would have very serious implications. Continued growth at present rates--the low-growth "alternative" scenario--would be insufficient even to absorb the projected increase in the labor force, and the absolute number of the poor would be expected to increase. The program for 1993/94 is seen as serving as a bridge to the medium-term program of accelerated reforms required to lift constraints on sustained higher growth. Discussions focused on the medium-term macroeconomic framework and on a few key elements of the required structural reforms.

a. Macroeconomic framework

(i) High-growth "base" scenario

The main macroeconomic objectives over the medium term are to achieve a progressive acceleration in GDP growth to 7-7 1/2 percent, in line with the authorities' publicly announced aim, which would allow a sustained absolute reduction in underemployment and poverty; to hold inflation to no more than 4 percent, broadly in line with inflation in trading partner countries; and to maintain gross international reserves at about five months of imports (Chart 4, and Tables 8 and 9). 1/ A significant shift would be required in the structure of the economy, including an expansion of outward-oriented labor-intensive industry in line with Bangladesh's comparative advantage. This would involve an acceleration of industrial sector growth to over 10 percent per annum, while agricultural output would grow at 2 1/2-3 percent per annum.

Given the history of inward-looking policies and the limited modern business tradition in Bangladesh, the growth rate is likely to increase relatively slowly at first, averaging about 5 percent over 1993/94-1995/96. Thereafter, as the reforms begin to bear fruit, activity would pick up more rapidly in the middle of the decade. An increase in investment to 18 percent of GDP over the medium term (still well below the average for low-income countries in general), together with broad efficiency gains, would be required to achieve the GDP growth target. A central element of the strategy will be a significant improvement in the environment for private sector activity through the program of structural reform, which is expected to lead to an increase in both the efficiency and the level of private investment.

Through 1995/96, a sizable part of the projected increase in investment is expected to come from the public sector, facilitated by improvements in project implementation; private investment is expected to increase steadily to over 10 percent of GDP. To avoid undue pressure on the external accounts, this would need to be accompanied by a significant increase in national savings. Although higher public savings would

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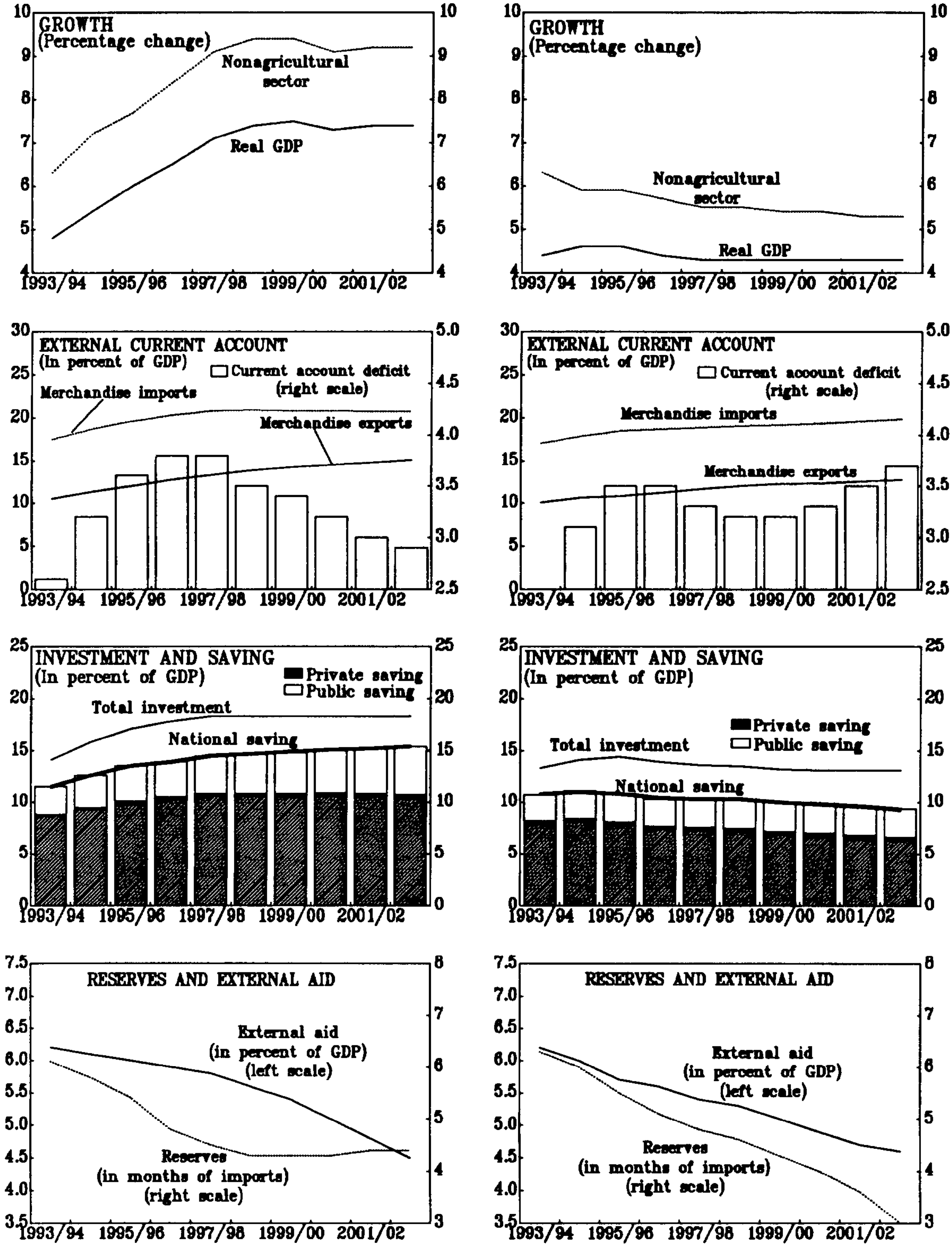
1/ Except in maintaining this level of reserves, the illustrative nature of the projections in this section makes no allowance for the vulnerability of Bangladesh to severe shocks and natural disasters.

CHART 4

BANGLADESH

MEDIUM-TERM SCENARIOS, 1993/94-2002/2003

HIGH-GROWTH SCENARIO | LOW-GROWTH SCENARIO



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

contribute, private sector savings are projected to increase significantly, in response to the increased return on investment generated by structural reform, the acceleration in GDP growth, and the effects of financial reform.

The increase in public sector savings will be achieved primarily through higher revenues, with tax revenues projected to increase by a further 1 1/2 percent of GDP over the medium term. Current expenditures (including the food account deficit) are projected to stabilize as a share of GDP, aided by tight control of the wage bill and defense expenditures and by a reduction in subsidies. Capital and net lending will increase sharply in the short term, owing both to the increase in ADP expenditures and to transitory expenditures related to public enterprise restructuring over the period 1993/94-1996/97. The overall fiscal deficit is projected to decline in tandem with the expected reduction in net foreign financing, so that public sector recourse to net domestic financing remains broadly constant as a percentage of GDP. This, in turn, will greatly facilitate the conduct of monetary policy and allow sufficient room for the expansion of credit to the private sector necessary to finance higher business investment over the longer term.

On the external side, the current account deficit is projected to increase from less than 2 percent of GDP in 1992/93 to close to 4 percent of GDP in the middle of the decade, primarily reflecting rapid import growth in response to the pickup in investment and output growth and the impact of trade liberalization. Aid inflows are assumed to increase by about 5 1/2 percent annually in U.S. dollar terms, slower than the rate of growth of nominal GDP. Thus, notwithstanding a significant increase in foreign direct investment, the capital account surplus is expected to decline steadily as a percentage of GDP and the balance of payments surplus would fall, with gross international reserves declining to about five months of imports. Debt and debt-service indicators will improve steadily over the period.

(ii) Low-growth "alternative" scenario

The staff has also produced an alternative scenario in which it is assumed that the stance of macroeconomic policies would remain prudent, but only limited progress would be achieved in structural reform (Table 8). Delays in implementing the structural reform program would hold back business confidence, while little improvement would be achieved in project implementation. The investment-to-GDP ratio would remain at about 14 percent and aid inflows would decline, as delays in the structural reforms would force multilateral and bilateral donors to reduce disbursements. In such a scenario, GDP growth would remain at 4-4 1/2 percent, broadly in line with the historical trend. While the fiscal deficit would be slightly lower than in the high-growth scenario, the quality of fiscal adjustment would deteriorate. Limited improvement in the revenue effort would imply lower public savings than under the high-growth scenario and ADP expenditures would be significantly lower. The external current account deficit would also initially be lower than in the high-growth scenario, reflecting weaker activity and lower levels of investment. This would, however, be more than offset by the weakening of the capital account; as a result, the balance of payments would gradually deteriorate, so that reserves would decline to below four months of imports by the end of the decade.

b. Key structural policies

Key elements of a comprehensive program that could achieve the desired improvement in investment, savings, and growth are reforms in the areas of: (i) the financial sector; (ii) public enterprises; (iii) fiscal structure; and (iv) trade policy. Labor market and legal reforms are also required.

Attempts at financial sector reform have been made for several years. Nonetheless, evidence is manifest of serious difficulties in the banking system that are proving a major impediment to the growth of the private sector. A comprehensive reform program will involve enhanced regulation and supervision by Bangladesh Bank; commercialization and privatization of state banks; competition by allowing new entrants, including foreign banks; and government restraint in imposing quasi-fiscal burdens on the commercial banks. The upgrading of loan classification standards, provisioning requirements, and capital adequacy ratios in line with international standards, together with improved bank supervision and methods to deal with problem banks, are essential steps. Recapitalization operations--which should avoid the gradualist approach of recent years--will have important implications for monetary policy, which will need to be taken fully into account in deciding the form in which the recapitalization is undertaken. The specification and sequencing of the immediate and medium-term financial sector reforms need to be determined urgently in light of the World Bank's work in this area.

In the staff's view, a comprehensive reform of the public enterprise sector should--in light of the administrative constraints--focus initially on hastening the completion of adjustment programs for the three sectors with the most severe problems: jute, the railways, and power. At the same time, however, preparatory work should begin on restructuring programs for other sectors, including textiles, utilities, and telecommunications. Common elements of restructuring programs for the public enterprises would include the introduction of appropriate wage and price policies; retrenchment of excess workers; closure of enterprises that cannot be made viable within a short transitional period; debt restructuring; and privatization. The privatization program for all sectors should also be accelerated. Since many public enterprises have significant nonperforming debt to the banking system, public enterprise restructuring and the recapitalization of the banking system are inevitably closely linked.

Fiscal reform would involve more rapid implementation of ADP expenditure, prioritization of expenditures, and improvements in the revenue structure. To this end, planned technical assistance by FAD in 1993/94 on direct tax policy and tax administration will provide guidance on steps to be taken in 1994/95 and beyond to achieve the medium-term revenue/GDP target, while reducing the share of trade taxes.

The authorities are committed to implementing further trade liberalization under the Industrial Sector Adjustment Credit (ISAC II) agreed with the World Bank. Priority should be given to removing all remaining trade-related quantitative restrictions and to reducing tariffs to the low levels prevailing in internationally competitive developing countries within the next two or three years. This would entail a significant reduction in the maximum and average tariff rates, as well as in the number of bands. An early public statement of such a program would be helpful to the industries concerned by providing a clear timetable for needed adjustment. Such a tariff reduction program would be an essential element in developing a stronger and more self-reliant economy.

The authorities agree that continuing data deficiencies, particularly in the areas of government finance and national income statistics, hamper economic analysis and need to be addressed. Technical assistance by STA is being planned to establish a medium-term program.

III. Staff Appraisal

Bangladesh has made substantial progress in recent years. In particular, under the ESAF arrangements, macroeconomic stability has been achieved in the face of difficult circumstances. But as the authorities themselves recognize, success in the macroeconomic area has not been fully matched in the structural sphere. While some important measures have been taken, progress has been much slower than planned, especially in the financial sector and the public enterprises, as well as in trade policy. The necessary conditions for a sustained upturn in private business investment and activity are not yet fully established. Largely as a consequence, growth has continued below expectations and potential, and little dent has been made in the pervasive incidence of poverty. The challenge now is to build on what has been accomplished in order to achieve the Government's ambitious medium-term objectives.

Against this background, economic performance during 1992/93, the last annual ESAF arrangement, yielded further progress but no breakthrough to sustainable higher growth. Growth remained at about 4 1/4 percent--which was below target despite a bumper harvest. Public investment fell well short of the budget estimate, owing to shortfalls in the implementation of the ADP, and private investment, both domestic and foreign, has been low. While some important structural measures were implemented in the areas of investment, the trade and exchange system, and public enterprises, little progress was achieved in financial reform and privatization. In contrast, there were notable achievements in other areas. The macroeconomic position strengthened significantly, as inflation fell to the lowest level in two decades and foreign exchange reserves increased to record levels. This result owed much to prudent monetary and fiscal policies--including a significant increase in domestic resource mobilization and control of current expenditure. Exports rose strongly, despite weakness in the world economy, and the overall external position remained strong.

Under the 1993/94 program, GDP growth is expected to increase, aided by a substantial pickup in public and private investment. Inflation is projected to remain low and the current account deficit to widen, although the balance of payments would remain in sizable surplus. These favorable prospects result from a continuation of firm policies. With sharply higher expenditures on ADP and additional retrenchment, and a further strengthening of revenue performance, the fiscal position would remain sound. The monetary program provides for significant private sector credit growth, sufficient to accommodate the targeted increase in private investment. Progress is also expected in the structural area, where tariffs and trade restrictions are being reduced and the exchange system liberalized, while public enterprise reform and privatization are to be pursued.

If this program is implemented as planned, prospects are good for a consolidation of the gains made in macroeconomic performance in recent years and for progress on a range of structural issues. The question remains, however, whether the reforms already in place and those planned for this year will be sufficient to attain the higher medium-term growth path that the authorities have as their aim. The staff's view is that, without a significant acceleration of reforms in key areas, constraints on sustained higher growth are likely to remain.

Such a prospect would have very serious implications. Continuation of growth at about the present rate would be insufficient even to absorb the projected increase in the labor force, and the absolute number of the poor would be expected to rise. The frustration of expectations could also undermine domestic support for the reform process, as well as the confidence of the donor community. Bangladesh, in any case, needs to keep in step with other countries as the pace of reforms quickens throughout the region. Moreover, delays in undertaking reform could make the present stronger macroeconomic position difficult to maintain.

Against the background of the progress made under the SAF and ESAF arrangements, the authorities should now meet the challenge of designing and implementing a sufficiently strong and decisive medium-term policy program to put Bangladesh firmly on a higher growth path. Circumstances are now propitious for this task--with low inflation, a high level of reserves, and the increasing confidence born of recent success. Since no single action can engineer a sustained jump in output, a comprehensive, medium-term program of reforms will be essential. The immediate priorities should be reform of the financial system, the public enterprises and the trade and exchange system, and improvements in the fiscal structure. When combined with other measures to encourage the private sector, including much-needed labor and legal reforms, the critical mass of reforms to allow faster growth would be within reach. In contrast, the failure to undertake these reforms would carry high risks. The recent public enterprise wage award, with significant adverse impact on the profitability and ultimate viability of many enterprises, is a reminder of the potential threat to the economy that can arise from delays in implementing structural reforms. In addition, the lack of a healthy and properly functioning banking system not only stymies the development of the private sector, but also threatens fiscal stability. A comprehensive financial sector reform, closely tied to the restructuring of public enterprises, is therefore urgent, with particular importance attached in the first instance to much improved regulation and supervision, and greater competition. Intervention in commercial decisions by banks, including in setting interest rates, should be avoided.

Substantial preparation will be required over the coming months to lay the technical groundwork, program the sequencing of reforms, coordinate donor support, and develop a consensus for far-reaching action that, in a situation of balance of payments need, could be supported by further access to Fund resources. In the staff's view, such an effort on the part of the authorities warrants the Fund's support, including through providing technical assistance in close collaboration with the World Bank, the AsDB, and bilateral donors. In light of the good track record under Fund arrangements and the desirability of continued close Fund involvement with Bangladesh, and to provide confidence to donors that sound policies are being pursued, the staff supports the authorities' request that their program for 1993/94 be monitored under the enhanced surveillance procedure.

Recent exchange rate policy has served Bangladesh well: in particular, as inflation has been reduced to the level prevailing in partner countries over the past year, the authorities have been able to reap the benefits of nominal exchange rate stability without adverse effects on competitiveness. The staff agrees with the authorities' view that the present level of the exchange rate is broadly appropriate. Bangladesh has taken several steps to liberalize its exchange system in the past year. The development of the interbank foreign exchange market is timely and has yielded encouraging initial results. A few restrictions remain on payments and transfers for current international transactions, including exchange restrictions arising from bilateral payments agreements and multiple currency practices which are subject to approval under Article VIII. In the absence of full information on the expiration of the contracts under the old forward cover and NFCD schemes, and because of the discriminatory nature of the payments agreements, the staff does not recommend the approval of these restrictions. The staff would also encourage the elimination of remaining restrictions maintained under Article XIV, including the restrictive aspects of the bilateral payments agreements and the restrictions related to payments for business travel, education abroad, and remittances. When these restrictions are removed, the staff would encourage the authorities to accept the obligations of Article VIII.

It is expected the next Article IV consultation with Bangladesh will be held within 12 months of completion of the present consultation.

IV. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Bangladesh's exchange measures subject to Article VIII, Sections 2(a) and 3 and in concluding the 1993 Article XIV consultation with Bangladesh, in the light of the 1993 Article IV consultation with Bangladesh conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Bangladesh's restrictions on payments and transfers for current international transactions are maintained in accordance with Article XIV as described in EBS/93/174, except that the restrictions arising from the two bilateral payments agreements are subject to the approval of the Fund under Article VIII, Section 2(a), and the multiple currency practices that arise from existing contracts entered into under the old forward cover scheme and the old nonresident foreign currency scheme are subject to approval under Article VIII, Section 3. The Fund urges Bangladesh to eliminate the remaining restrictions as soon as possible.

Table 1. Bangladesh: Selected Economic and Financial Indicators, 1989/90-1993/94

	1989/90	1990/91	1991/92	1992/93 Program	1992/93 Estimate	1993/94 Projection
	(Annual percentage change; unless otherwise specified)					
National income and prices						
GDP at constant market prices	6.6	3.4	4.2	5.0	4.3	4.8
Implicit GDP deflator	4.9	9.4	4.2	5.5	2.6	3.7
Consumer prices	9.3	8.9	5.1	5.5	1.3	4.0
External sector (in terms of U.S. dollars)						
Exports	18.5	12.7	16.1	11.1	19.5	16.7
Imports	12.0	-7.0	-0.1	18.4	11.8	18.0
Export volume	14.4	5.6	16.9	9.2	19.8	14.4
Import volume	5.9	-12.6	1.0	16.8	11.1	15.4
Nonfoodgrain import volume	8.8	-12.6	0.2	16.6	12.8	18.0
Terms of trade	-2.0	0.8	0.4	0.4	-0.8	-0.2
Government budget						
Revenue	14.8	16.1	23.6	15.4	13.5	13.2
Expenditure 1/	16.6	8.8	5.0	24.7	14.1	17.9
Money and credit 2/						
Net domestic assets	19.1	7.3	7.4	11.8	5.2	11.1
Domestic credit	18.9	10.1	5.3 3/	12.1	7.1 4/	11.1
Government (net)	46.9	8.5	-13.3 3/	2.7	-33.2 4/	0.3
Other public sector	8.2	6.9	6.3 3/	7.1	6.9 4/	8.7
Private sector	19.8	11.4	7.3 3/	15.5	11.3 4/	14.0
Broad money	16.9	12.1	14.1	14.0	11.4	12.8
	(In percent of GDP; unless otherwise specified)					
Gross fixed investment	12.8	12.1	12.4	... 5/	12.7	14.1
Public	6.4	5.7	5.8	... 5/	5.8	6.6
Private	6.4	6.4	6.6	... 5/	7.0	7.5
National saving	5.8	8.0	10.0	... 5/	11.0	11.5
Public	-0.6	--	1.9	... 5/	2.5	2.7
Private	6.5	7.9	8.1	... 5/	8.5	8.8
Domestic saving	2.8	4.8	5.9	... 5/	7.1	7.7
External sector						
Current account balance	-6.9	-4.2	-2.4	-4.5	-1.8	-2.6
External public debt (end of period)	45.9	49.3	51.2	50.3	51.4	50.4
Debt service (percent of exports of goods, services, and private transfers)	19.9	20.4	15.0	13.6	11.8	11.2
Government budget						
Revenue	9.3	9.6	10.9	11.5	11.6	12.1
Current expenditure 1/	10.0	9.6	8.9	9.3	9.1	9.3
Annual Development Program	6.4	6.2	6.3	7.4	6.9	7.6
Overall balance	-7.7	-6.8	-5.0	-6.0	-5.3	-6.3
Domestic financing (net)	1.1	0.6	0.1	-0.4	-0.2	1.2
Foreign financing (net)	6.6	6.2	4.9	6.4	5.6	5.2
	(In millions of U.S. dollars; unless otherwise specified)					
Overall balance of payments	-125	355	585	335	465	318
Gross official reserves (end of period) 6/	520	880	1,608	1,895	2,121	2,368
In months of imports	1.7	3.0	5.5	5.4	6.5	6.1
	(In billions of taka)					
Memorandum item:						
GDP	738	834	907	968	970	1,054

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

1/ Including the food account deficit.
2/ Data are at the end-June 1989 exchange rate (Tk 32.27 per U.S. dollar) through 1992/93 and at the end-June 1993 rate (Tk 39.80 per U.S. dollar) in 1993/94.
3/ Excludes the impact of the write-off of industrial loans and recapitalization of the banks.
4/ Excluding Tk 15 billion of bonds issued to recapitalize banks and compensate for the agricultural loan write-off.
5/ Program data not comparable with actuals, owing to revision of national accounts.
6/ Excluding nonresident foreign currency deposit accounts.

Table 2. Bangladesh: Performance Criteria and Benchmarks
Under the Third-Year ESAF Arrangement, 1992/93 1/

	1991/92	1992/93			
	June	September Benchmark	December Performance Criteria	March Benchmark	June Benchmark
		(In billions of taka; end of period)			
1. Quantitative performance criteria					
Net domestic assets 2/	251.1	252.8 (244.2)	271.6 (259.0)	272.0 (258.6)	280.9 (268.9)
Credit to the public sector 2/	92.7	93.3 (82.6)	96.9 (87.4)	95.4 (83.1)	97.7 (84.6) 3/
		(In millions of U.S. dollars; end of period)			
Cumulative contracting or guaranteeing by the public sector of new nonconcessional external debt of over 1 year and not more than 12 years' maturity	--	40 (--)	40 (--)	40 (--)	40 (--)
Of which: Over 1 year and not more than 5 years' maturity	--	20 (--)	20 (--)	20 (--)	20 (--)
Outstanding stock of external public debt of 1 year or less maturity 4/	--	15 (--)	15 (--)	15 (--)	15 (--)
Outstanding stock of external liabilities of Bangladesh Bank of 1 year or less maturity	--	10 (--)	10 (--)	10 (--)	10 (--)
Minimum level of Bangladesh Bank's net international reserves 5/	781	871 (931)	934 (1,085)	1,043 (1,399)	1,116 (1,298)
Minimum level of Bangladesh Bank's gross international reserves 5/	1,608	1,681 (1,719)	1,754 (1,845)	1,826 (2,151)	1,895 (2,121)

2. Structural performance criterion

Revenue collection. Collect Tk 35 billion from the four main National Board of Revenue (NBR) taxes (income, excise, VAT, and customs duties) during July-December 1992. Tk 38.1 billion was collected.

3. Structural benchmarks

a. Revenue collection. Collect Tk 17.7 billion from the four main NBR taxes (income, excise, VAT, and customs duties) during July-September 1992. Tk 17.9 billion was collected.

b. Public investment. Achieve at least a 33 percent increase in the Annual Development Program (ADP) spending over the 1991/92 outcome, with 35 percent of this achieved during July-December 1992. Central government ADP expenditures are estimated at Tk 23 billion during the first six months, and at Tk 67 billion (a 17 percent increase) for 1992/93 as a whole, both below the levels required under the benchmarks.

c. Public enterprise privatization. Complete disinvestment of 11 nonfinancial public enterprises through tender and negotiated sales by end-December 1992. By September 1993, the authorities had sold three enterprises and contracted to sell one other below the level required under the benchmark. 6/

d. Public enterprise reform. Adopt the jute restructuring program as specified in the World Bank studies entitled Bangladesh: Restructuring Options for the Jute Manufacturing Study (February 1992) and Jute Manufacturing Study (May 1992), by end-December 1992. The main elements of a restructuring program were agreed upon, although measures to offset the recent wage increase are still being discussed.

e. Industrial policy. Amend the Board of Investment Act with a view to restructuring the Board along the lines envisioned in the 1991 Industrial Policy, including the elimination of its regulatory functions. The restructuring of the Board was completed; the Board of Investment Act is expected to be approved by Cabinet by end-December.

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

1/ Figures in parentheses are actual.
2/ At constant June 30, 1989 exchange rate (Tk 32.27 per U.S. dollar).
3/ Excluding Tk 15 billion of bonds issued to the nationalized commercial banks in relation to the agricultural loan write-off, and recapitalization and provisioning requirements.
4/ Excluding normal short-term, import-related credits.
5/ Excluding nonresident foreign currency deposit accounts.
6/ In addition, six enterprises had been sold earlier to Sadharan Bima Corporation.

Table 3. Bangladesh: Objectives and Achievements of the Third-Year ESAF Arrangement, 1992/93

Objectives and Measures	Progress in Implementation
Tax revenue	
Introduce tax measures to raise tax/GDP ratio by 0.5 percent of GDP.	Revenue/GDP ratio raised by 0.7 percent of GDP.
Tax reform	
Enhance efforts to improve tax administration and reduce tax arrears.	Measures were introduced to improve administration of income, value-added, and customs taxes; Tk 0.4 billion and Tk 1.3 billion of arrears were collected for income taxes and customs, respectively.
Subsidies	
Eliminate jute subsidies; reduce subsidies on food and interest rates.	Subsidies to jute sector and interest subsidies for exports were eliminated. Food subsidies were reduced over 40 percent through increases in ration prices, and lower procurement and procurement prices.
Current expenditure	
Current expenditure to grow more slowly than nominal GDP; increases for operation and maintenance and education and health to be provided.	Current expenditure held within budgetary target but rose as a share of GDP due to the fact that actual 1991/92 expenditures were lower than initially estimated. Operations and maintenance, education, and health spending rose by 28 percent, 15 percent, and 26 percent, respectively.
Annual Development Program (ADP)	
Increase ADP expenditures by 33 percent, with new projects restricted to those in the rolling plan. Locally funded projects and block grants budgeted not to exceed 25 percent of local funds available for ADP. ADP/GDP ratio to increase by more than 1 percent.	ADP expenditures (including self-financed projects) are estimated at Tk 69.75 billion in 1992/93, below the level implied by the structural benchmark.
Public enterprise reform	
Formulate action plans for accelerated reform of public enterprises. Privatize 17 identified enterprises.	Agreement was reached with the IBRD on the main elements of a jute restructuring program (although measures to offset the recent wage increase are still under discussion) and with the AsDB on a Railway Recovery Program; retrenchments were begun in both sectors. Conditions were met for resuming disbursements in the power sector. Only 8 out of 17 identified enterprises had been divested in 1992/93. One additional enterprise not on the list of 17 was sold.
Monetary program	
Limit growth of domestic credit to 12 percent, almost all of which to be directed to the private sector.	Credit growth was 4 percent, well within the program target. Credit to the public sector declined by Tk 6 billion; 1/ private credit growth was sluggish during the first semester but picked up somewhat in the second half of the year.
Financial sector reform	
Further liberalization of interest rates; measures to strengthen the banking system.	Measures to improve loan recovery and banking supervision were introduced. Tk 15 billion of bonds was issued to compensate the banks for the earlier agricultural loan write-off and for shortfalls in capital and provisioning.
Industrial and trade policy	
Expeditious implementation of new Industrial Policy. Remove import restrictions on 80 categories and reduce maximum tariffs.	The Board of Investment was transformed from a regulatory to a promotional organization and the telecommunications and power sectors were opened to private investors. Import restrictions on 100 categories were eliminated and the first stage of tariff rationalization was implemented as scheduled.
Exchange rate policy	
Manage exchange rate flexibly to ensure competitiveness.	The real effective exchange rate depreciated slightly during the year, mainly owing to lower inflation than in partner countries.
Human resources and poverty alleviation	
Increase funding for human resource development. Improve targeting for food aid.	Implemented in budget.

Source: International Monetary Fund.

1/ Excluding the issuance of Tk 15 billion of bonds to compensate the banks for the agricultural loan write-off and shortfalls in capital and provisioning.

Table 4. Bangladesh: Central Government Operations, 1989/90-1993/94

	1989/90	1990/91 1/	1991/92	1992/93 Program	1992/93 Estimates	1993/94 Projections
			(In billions of taka)			
Total revenue	68.9	80.0	98.9	111.1	112.3	127.1
Tax	57.3	65.2	79.5	90.1	90.5	102.3
Nontax	11.6	14.8	19.4	21.0	21.8	24.7
Total expenditure	125.9	137.0	143.8	169.5	164.1	193.4
Current expenditure	64.7	72.3	75.6	84.1	83.5	96.2
Food account deficit	8.8	7.4	5.8	5.8	4.6	1.6
Annual Development Program (ADP)	47.2	52.0	57.0 2/	72.0	66.9 2/	80.4
Other capital expenditure and net lending	5.2	5.3	5.4	7.6	9.0	15.2
Overall budget deficit	57.0	57.0	44.9	58.4	51.7	66.4
Net foreign financing 3/	48.6	51.8	44.1	61.9	53.9	54.2
Food aid	6.2	9.7	8.8	9.7	4.7	7.0
Commodity aid	13.5	16.3	6.4	17.6	17.2	15.1
Project aid	35.5	35.2	36.4	43.1	40.6	41.8
Commercial food borrowing	-0.8	-0.5	-0.8	-0.8	-0.7	-0.5
Debt amortization	-5.8	-8.8	-6.7	-7.7	-7.8	-9.1
Net domestic financing	8.4	5.2	0.8	-3.5	-2.1	12.1
Banking system (net)	6.5	1.7	-2.9	1.0	-12.0	0.1
Other (net)	1.9	3.5	3.7 4/	-4.5	9.9	12.0
			(In percent of GDP)			
Total revenue	9.3	9.6	10.9	11.5	11.6	12.1
Tax	7.8	7.8	8.8	9.3	9.3	9.7
Nontax	1.6	1.8	2.1	2.2	2.3	2.4
Total expenditure	17.1	16.4	15.9	17.5	16.9	18.4
Current expenditure	8.8	8.7	8.3	8.7	8.6	9.1
Food account deficit	1.2	0.9	0.6	0.6	0.5	0.2
Annual Development Program (ADP)	6.4	6.2	6.3	7.4	6.9	7.6
Other capital expenditure and net lending	0.7	0.6	0.6	0.8	0.9	1.4
Overall budget balance	-7.7	-6.8	-5.0	-6.0	-5.3	-6.3
Net foreign financing	6.6	6.2	4.9	6.4	5.6	5.2
Net domestic financing	1.1	0.6	0.1	-0.4	-0.2	1.2
Banking system (net)	0.9	0.2	-0.3	0.1	-1.2	--
Other (net)	0.3	0.4	0.4	-0.5	1.0	1.1

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

1/ Excluding Tk 17 billion in 15-year nonnegotiable bonds issued to recapitalize the nationalized commercial banks.

2/ Tk 3.1 billion of ADP expenditure has been reallocated from 1992/93 to 1991/92 relative to the authorities' estimates.

3/ Includes foreign grants.

4/ Includes Tk 9.2 billion of financing through National Savings schemes, prize and wage bonds, and the surplus of the government employee pension fund (the Provident Fund). The remaining residual (minus Tk 5.5 billion) may reflect errors in recorded revenue and expenditure, as well as the misclassification of some project aid accounts ("government lending funds"). These issues are currently under investigation by the staff.

Table 5. Bangladesh: Monetary Survey, 1989/90-1993/94

End-June	1989/90	1990/91 Actual	1991/92 Actual (Program Definition) 1/	1991/92 Actual	1992/93 Program	1992/93 Actual (Program Definition) 2/	1992/93 Actual	1992/93	1993/94 Program
	(In billions of taka; at end-June 1989 constant exchange rate) 3/							(In billions of taka; at end-June 1993 constant exchange rate)	
Net foreign assets	5.00	16.18	34.15	34.15	44.35	48.87	48.87	59.61	71.68
Net foreign reserves	7.20	18.03	37.34	37.34	48.15	52.17	52.17	63.73	76.40
Other foreign accounts	-2.20	-1.85	-3.19	-3.19	-3.80	-3.30	-3.30	-4.12	-4.71
Net domestic assets	218.01	233.87	251.11	251.11	280.85	268.88	266.49	255.75	284.04
Domestic credit	230.33	253.68	267.11	272.08	304.90	284.15	292.74	292.74	325.13
Public sector	70.29	75.46	75.95	92.69	97.70	84.56	99.56	99.56	104.92
Government (net)	20.17	21.88	18.98	36.26	37.25	24.22	39.22	39.22	39.32
Other	50.12	53.58	56.97	56.43	60.45	60.34	60.34	60.34	65.60
Private sector	160.05	178.23	191.16 4/	179.39 4/	207.20	199.59	193.17	193.17	220.21
Other items (net)	-12.32	-19.82	-16.00	-20.97	-24.05	-15.27	-26.25	-36.99	-41.09
Broad money	222.98	250.04	285.26	285.26	325.20	317.75	315.36	315.36	355.72
	(Annual percentage change)								
Net foreign assets 5/	-1.4	5.0	7.2	7.2	3.6	5.2	...	...	3.8
Net domestic assets	19.1	7.3	7.4	7.4	11.8	7.1	...	...	11.1
Domestic credit	18.9	10.1	5.3	7.3	12.1	4.4	...	...	11.1
Public sector	17.0	7.4	0.7	22.8	5.4	-8.8	...	...	5.4
Government (net)	46.9	8.5	-13.3	65.7	2.7	-33.2	...	...	0.3
Other	8.2	6.9	6.3	5.3	7.1	6.9	...	...	8.7
Private sector	19.8	11.4	7.3 4/	0.7 4/	15.5	11.3	...	...	14.0
Other items (net) 5/	-0.9	-3.4	1.5	-0.5	-1.1	2.0	...	...	-1.3
Broad money	16.9	12.1	14.1	14.1	14.0	11.4	...	...	12.8

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

1/ Data are adjusted to exclude the write-down of industrial loans and recapitalization of state banks, which involved the issuance of Tk 17.3 billion of long-term governnment paper to meet shortfalls in bad debt provision and capital requirements.

2/ Adjusted to exclude Tk 15 billion of bonds issued to capitalize the banks in connection with the agricultural loan write-off and shortfalls in capital and provisions, which was excluded from the program, and for misreporting by two banks in June 1992, which was included in the base for the program.

3/ The end-June 1989 exchange rate was Tk 32.27 per U.S. dollar.

4/ Agricultural loan write-offs during the year resulted in a reduction in private sector credit, matched by an increase in other items (net). Underlying private credit growth is therefore somewhat higher than implied by the data shown in the table.

5/ Contribution to broad money growth.

Table 6. Bangladesh: Balance of Payments, 1989/90-1993/94

	1989/90	1990/91	1991/92	1992/93 Program	1992/93 Estimates	1993/94 Projections
			(In millions of U.S. dollars)			
Trade balance	-2,258	-1,800	-1,521	-2,025	-1,546	-1,857
Exports	1,524	1,718	1,993	2,177	2,383	2,780
Imports	-3,782	-3,518	-3,514	-4,202	-3,928	-4,637
Foodgrain	-343	-268	-265	-302	-200	-204
Petroleum	-312	-420	-320	-344	-355	-366
Other	-3,127	-2,830	-2,928	-3,557	-3,373	-4,067
Net services	-108	-26	-19	-27	-32	53
Private transfers	802	846	975	926	1070	1,126
Of which:						
Workers' remittances	(761)	(764)	(847)	(843)	(946)	(997)
Current account balance 1/	-1,564	-980	-565	-1,126	-443	-678
Capital account, net	1,529	1,457	1,330	1,541	1,071	1,117
Aid disbursements 2/	1,810	1,732	1,691	1,869	1,587	1,644
Food aid	(188)	(258)	(241)	(244)	(121)	(174)
Commodity aid	(457)	(408)	(386)	(425)	(372)	(399)
Project aid	(1,165)	(1,056)	(1,064)	(1,200)	(1,094)	(1,071)
Amortization payments	-186	-197	-210	-233	-239	-275
Short- and medium-term loans (net) 3/	-99	-81	-161	-105	-294	-282
Foreign direct investment	3	2	10	10	17	30
Net errors and omissions	-89	-121	-179	-80	-163	-120
Overall balance	-125	355	585	335	465	318
Financing items	125	-355	-585	-335	-465	-318
Bangladesh Bank	236	-383	-546	-335	-524	-318
Assets (- increase) 4/	(377)	(-360)	(-728)	(-287)	(-513)	(-247)
Liabilities	(-141)	(-23)	(182)	(-48)	(-11)	(-72)
Of which:						
ESAF disbursements	--	196	198	82	81	--
Fund repurchases	-151	-190	-112	-80	-79	-72
Other (net)	10	-29	96	-50	-13	--
Commercial banks	-111	28	-39	--	59	--
			(In percent of GDP) 3/			
Current account balance	-6.9	-4.2	-2.4	-4.5	-1.8	-2.6
Gross reserves ($mn.) 4/	520	880	1,608	1,895	2,121	2,368
(In months of imports)	(1.7)	(3.0)	(5.5)	(5.4)	(6.5)	(6.1)
External public debt	45.9	49.3	51.2	50.3	51.4	50.3
Outstanding Fund credit	(2.7)	(2.7)	(3.3)	(2.9)	(3.1)	(2.6)
Debt service ratio 4/	19.9	20.4	15.0	13.6	11.8	11.2
Debt service to the Fund 5/	(7.2)	(7.4)	(3.7)	(2.3)	(2.2)	(1.7)

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

1/ Excluding offical grants.
2/ Including official grants.
3/ Includes IMF Trust Fund, aircraft loans, food loans, trade credits, and short-term petroleum loans (net).
4/ Gross foreign reserves of Bangladesh Bank, excluding nonresident foreign currency deposit and other special accounts.
5/ In percent of current receipts.

Table 7. Bangladesh: Summary of Program for 1993/94

1. Macroeconomic objectives

Achieve macroeconomic targets of a real GDP growth rate of about 5 percent, an inflation rate of 4 percent, a current account deficit of about 2 1/2 percent of GDP, and an overall balance of payments surplus of about $320 million. Gross reserves are expected to be $2.4 billion (6.1 months of imports).

2. Fiscal policy

Contain the overall budget deficit to 6.3 percent of GDP and keep net domestic financing to 1.2 percent of GDP. Raise the revenue/GDP ratio by 0.5 percent of GDP to 12.1 percent of GDP, involving additional measures, *and maintain the ratio of current expenditure (including the food account)* to GDP approximately constant. Achieve a substantial increase in ADP expenditures (at least Tk 85 billion). Strengthen tax administration.

Accelerate public enterprise restructuring in the jute, railways, and power sectors. Privatization Board to identify and initiate bidding sale process for a specified number of firms.

3. Monetary and credit policy

Hold domestic credit growth to about 11 percent, consistent with present projections for broad money (about 13 percent increase) and the external position. Lay groundwork for rapid movement to reliance on indirect instruments of monetary control through technical assistance and monitoring of shadow reserve money program. Strengthen banking system through recapitalization of nationalized commercial banks (NCBs); tightening of provisioning and classification regulations and capital adequacy requirements; *issuing invitation to bid for privatization of one NCB* (Rupali Bank); begin restructuring DFIs; and encouraging entry of private banks.

4. Trade and exchange system

Reduce the number of trade-related quantitative restrictions to at most 39, as required under the first tranche of the World Bank's Second Industrial Sector Adjustment Credit (ISACII) and prepare a study on any offsetting measures to be able to eliminate the remainder as soon as possible. Implement tariff reforms as introduced in the 1993/94 budget and develop an accelerated program of trade reform.

Eliminate all remaining exchange restrictions on the payments and transfers of current international transactions. Implement measures recommended by the recent MAE technical assistance mission to develop foreign exchange market.

5. Quantified macroeconomic targets and benchmarks subject to quarterly monitoring

a. Ceilings on net domestic assets of the banking system.

b. Ceilings on credit extended to the public sector (central government, local governments, and public enterprises), adjusted (for June 1994) to take account of any excess of net domestic nonbank financing of the central government from initial projection.

c. Ceilings on cumulative contracting or guaranteeing by the public sector of new nonconcessional external debt of over one year and not more than 12 years' maturity (with a subceiling of one-five years' maturity).

d. Ceilings on the outstanding stock of external public debt, including central bank liabilities, of one year or less maturity.

6. Structural benchmarks

a. Collect agreed amounts from the four main NBR taxes for the period July-December 1993, July 1993-March 1994, and for the year as a whole (Tk 94.9 billion).

b. Achieve the specified expenditure on ADP and retrenchment of Tk 91 billion, with subceiling for retrenchment of Tk 6 billion (a benchmark is also set for ADP spending between July-December 1993).

c. Reduce the number of trade-related quantitative restrictions to 39 by October 1993 and prepare a proposal by June 1994 on any offsetting measures required to be able to eliminate the remaining restrictions as soon as possible.

d. Complete exercise to assess the impact of strengthened provisioning and classification by end-December 1993 and establish timetable by February 1994 to bring regulations in line with international practices within two years.

e. Make legislative changes necessary to allow extension of the VAT to distribution sector, with a view to allowing voluntary registration of wholesalers in preparation for the extension of the VAT to the wholesale level in 1994/95.

f. Prepare proposal to reform structure of direct taxes for implementation in 1994/95.

g. Eliminate all remaining restrictions on payments and transfer current international transactions by June 30, 1994.

Table 8. Bangladesh: Medium-Term Scenarios, 1992/93-2002/2003

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1988/89-1992/93 Average	1993/94-1997/98 Average	1998/99-2002/2003 Average
				(In percent of GDP; unless otherwise specified)					
a. High-growth scenario									
Real sector									
Real GDP (annual change, %)	4.3	4.8	5.4	6.0	6.5	7.1	4.2	6.0	7.4
CPI (annual change, %)	1.3	4.0	4.0	4.0	4.0	4.0	6.5	4.0	4.2
Gross investment	12.7	14.1	15.8	17.1	17.8	18.3	12.6	16.6	18.3
Private	7.0	7.5	8.5	9.4	10.1	10.6	6.6	9.2	10.6
Public	5.8	6.6	7.3	7.7	7.7	7.7	6.0	7.4	7.7
National saving	11.0	11.5	12.6	13.5	13.9	14.5	8.2	13.2	15.1
Private	8.5	8.8	9.5	10.1	10.5	10.8	7.4	9.9	10.8
Public	2.5	2.7	3.1	3.4	3.4	3.7	0.7	3.3	4.2
Central government budget									
Total revenue	11.6	12.1	12.6	12.7	12.8	13.0	10.1	12.6	13.5
Current expenditure	9.1	9.3	9.3	9.1	9.1	9.1	9.3	9.2	9.1
Capital expenditure	7.8	9.0	9.6	9.9	9.9	9.9	7.2	9.7	9.9
Overall deficit	5.3	6.3	6.2	6.3	6.3	6.0	6.4	6.2	5.5
External sector									
Current account	-1.8	-2.6	-3.2	-3.6	-3.8	-3.8	-4.3	-3.4	-3.2
Reserves (months of imports)	6.5	6.1	5.8	5.4	4.8	4.5	4.1	5.3	4.3
					(In U.S. dollars)				
Per capita GDP (1992/93 prices)	217.4	223.3	230.9	240.1	251.1	264.1	203.3	241.9	311.6
b. Low-growth scenario									
Real sector									
Real GDP (annual change, %)	4.3	4.4	4.6	4.6	4.4	4.3	4.2	4.4	4.3
CPI (annual change, %)	1.3	4.0	4.0	4.0	4.0	4.0	6.5	4.0	4.2
Gross investment	12.7	13.3	14.1	14.4	13.9	13.6	12.6	13.9	13.2
Private	7.0	7.0	7.5	7.5	7.0	7.0	6.6	7.2	7.0
Public	5.8	6.3	6.6	6.9	6.9	6.6	6.0	6.7	6.2
National saving	10.9	10.8	11.0	10.8	10.4	10.3	8.2	10.7	9.8
Private	8.5	8.2	8.4	8.1	7.7	7.6	7.4	8.0	7.0
Public	2.5	2.5	2.7	2.7	2.6	2.7	0.7	2.7	2.8
Central government budget									
Total revenue	11.6	11.8	11.9	12.0	12.1	12.1	10.1	12.0	12.4
Current expenditure	9.1	9.3	9.4	9.4	9.5	9.6	9.3	9.4	9.9
Capital expenditure	7.8	8.3	8.6	8.9	8.8	8.5	7.2	8.6	7.9
Overall deficit	5.3	5.8	6.0	6.2	6.3	6.0	6.4	6.1	5.4
External sector									
Current account	-1.8	-2.5	-3.1	-3.5	-3.5	-3.3	-4.3	-3.2	-3.4
Reserves (months of imports)	6.5	6.3	6.0	5.5	5.1	4.8	4.1	5.5	3.9
					(In U.S. dollars)				
Per capita GDP (1992/93 prices)	217.4	222.5	228.2	234.1	239.9	245.7	203.3	234.1	264.6

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

Table 9. Bangladesh: Medium-Term External Outlook, 1993/94-2002/2003

(In millions of U.S. dollars)

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/2001	2001/2002	2002/2003
Trade balance	-1,857	-2,122	-2,362	-2,563	-2,713	-2,801	-2,908	-3,004	-3,118	-3,233
Exports (f.o.b.)	2,780	3,236	3,711	4,247	4,831	5,481	6,178	6,966	7,826	8,774
Imports (c.i.f.)	-4,637	-5,357	-6,073	-6,810	-7,545	-8,282	-9,086	-9,970	-10,943	-12,008
Current account balance	-678	-910	-1,120	-1,286	-1,378	-1,403	-1,481	-1,533	-1,605	-1,672
Capital account (net)	1,117	1,307	1,428	1,542	1,665	1,799	1,956	2,103	2,165	2,229
Of which:										
Aid disbursements	1,644	1,756	1,875	1,979	2,091	2,211	2,340	2,443	2,514	2,587
Food aid	174	166	155	143	129	115	99	82	64	44
Commodity aid	399	411	423	436	449	463	477	491	506	521
Project aid	1,071	1,179	1,296	1,400	1,512	1,633	1,764	1,870	1,944	2,022
Overall balance	318	277	187	135	166	275	354	449	439	437
Outstanding total debt										
(In percent of GDP)	50.3	48.9	47.4	46.1	44.6	43.1	41.2	39.5	37.9	36.3
Outstanding Fund credit										
(In percent of GDP)	2.6	2.2	1.8	1.4	1.0	0.6	0.4	0.2	0.1	0.0
(In percent of quota)	171.7	157.7	142.2	115.7	88.8	63.2	40.2	18.8	9.0	6.0
Debt service on total debt										
(In percent of current receipts)	11.2	10.4	10.0	10.5	10.0	9.5	9.3	8.9	8.2	7.7
(In percent of reserves)	21.7	20.7	21.2	24.5	25.5	25.4	25.1	23.9	22.0	20.6
Debt service to the fund										
(In percent of current receipts)	1.7	1.2	1.1	1.7	1.5	1.3	1.1	0.9	0.4	0.1
(In percent of total debt service)	14.9	11.3	11.5	16.3	15.4	13.8	11.5	10.1	4.9	1.4
Memorandum items:										
Exports/GDP	10.5	11.3	12.0	12.7	13.3	13.8	14.2	14.5	14.8	15.1
Imports/GDP	17.5	18.7	19.6	20.3	20.8	20.9	20.8	20.8	20.7	20.7
Current account/GDP	-2.6	-3.2	-3.6	-3.8	-3.8	-3.5	-3.4	-3.2	-3.0	-2.9
Aid disbursements/GDP	6.2	6.1	6.0	5.9	5.8	5.6	5.4	5.1	4.8	4.5
Official reserves										
(In months of imports)	6.1	5.8	5.4	4.8	4.5	4.3	4.3	4.3	4.4	4.4

Sources: Data provided by the Bangladesh authorities; and staff estimates and projections. Consistent with high-growth scenario.

November 8, 1993

Dear Mr. Camdessus:

1. The attached Memorandum on the Economic and Financial Policies of Bangladesh sets out the objectives and policies that the Government intends to pursue during 1993/94. In order to continue to benefit from a close dialogue with the Fund following the expiration of the program supported by the third annual arrangement under the enhanced structural adjustment facility (ESAF), the Government of Bangladesh requests that the Fund monitor the above-mentioned program under the enhanced surveillance procedure for 1993/94.

2. The Government of Bangladesh will provide the Fund with such information as the Fund requests in connection with the progress made in implementing the economic and financial policies and achieving the objectives for 1993/94.

3. The Government of Bangladesh believes that the policies and measures set forth in the attached memorandum are adequate to achieve the objectives of its economic and financial program, but it will take any further measures that may become appropriate for this purpose. During 1993/94, the Government will consult with the Managing Director on the adoption of any measures that may be appropriate, at the initiative of the Government or whenever the Managing Director requests such a consultation. In any event, the Government of Bangladesh will conduct with the Fund a midyear review of its program for 1993/94, to be completed not later than March 31, 1994.

Sincerely yours,

Md. Saifur Rahman
Minister of Finance

Attachment

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Memorandum on the Economic and Financial Policies of Bangladesh

1. During the past three years, supported by an arrangement under the Enhanced Structural Adjustment Facility, Bangladesh's macroeconomic position has significantly improved. Fiscal and monetary policies have remained prudent; inflation has declined to below 2 percent, the lowest level in two decades; and significant progress has been made toward external viability, reflected, inter alia, in the substantial improvement in international reserves. At the same time, however, GDP growth--averaging 4 percent--has persistently fallen below expectations and has proved insufficient to yield significant gains in reducing poverty.

2. For 1993/94 and beyond, the Government is determined to press forward with a growth-oriented economic strategy designed to bring about a substantial absolute reduction in poverty over the medium term. To this end, the Government is presently developing--in collaboration with the Bank and the Fund staffs--a detailed program to accelerate structural reforms, focusing on the financial sector, trade policy, and the public enterprises. Continued prudent macroeconomic policies and substantial foreign aid inflows will remain essential elements for this strategy. However, the key to success will be a marked acceleration of structural reforms designed to reduce the role of the public sector in the economy and improve the environment for private sector activity. Crucial elements of these reforms will include a restructuring of the financial sector (including a strengthening of prudential and supervision functions); trade, exchange, and public enterprise reforms; improved project implementation; and targeted poverty alleviation measures.

Outcome of the third year of the ESAF arrangement, 1992/93

3. Consistent with the three-year ESAF-supported program, the macroeconomic objectives of the third-year program were to raise real GDP growth to 5 percent; reduce the inflation rate to 5 1/2 percent; contain the budget deficit to about 6 percent of GDP (excluding the projected write-off of agricultural loans of 0.8 percent of GDP); and hold the external current account deficit (excluding official transfers) to $1.1 billion (4 1/2 percent of GDP). Given the projected increase in aid disbursements, an overall balance of payments surplus of $335 million was envisaged, with gross official reserves remaining at about 5 1/2 months of imports. The monetary program aimed at limiting the growth in total domestic credit to 12 percent; with public sector credit strictly restrained, this permitted private sector credit growth of 15 1/2 percent. Structural reforms were aimed at reducing obstacles to private sector activity, improving public resource management, rationalizing public enterprises, strengthening the effectiveness of the financial system, and liberalizing the exchange and trade regime.

4. While progress was made in meeting these objectives and improving financial stability, economic activity did not pick up as expected. GDP growth is estimated at 4.3 percent in 1992/93, broadly the same as in

1991/92. Agricultural output grew by 2.1 percent, reflecting a record aman harvest. Industry and services grew faster, but less than had been projected. Domestic demand remained somewhat sluggish, owing to delays in implementing the public investment program and transitional uncertainties as investors became acclimatized to the ongoing financial, trade, and industrial reforms, although there were some signs of a pickup in the second half of the year. Correspondingly, gross investment was below target, owing to shortfalls in both private and public investment. The sharp fall in the inflation rate was due largely to a substantial decline in food prices, particularly rice, in a situation of abundant supply.

5. The overall fiscal deficit (excluding grants) is estimated at 5.3 percent of GDP, 0.7 percent of GDP lower than targeted. Revenues were 0.1 percent of GDP higher than programmed and current expenditures were below budget. Notwithstanding efforts to accelerate project implementation, the Annual Development Program (ADP) expenditure (including self-financed projects) was less than expected and is estimated at Tk 73 billion, some 10 percent short of the revised ADP target of Tk 81.2 billion. The shortfall in government expenditure on the ADP (0.5 percent of GDP) was less pronounced, since self-financed projects were markedly below target. Despite lower-than-expected foreign aid inflows, high domestic nonbank financing of the central government allowed net bank financing to decline sharply during the year.

6. Broad money grew by 11 1/2 percent, about 2 1/2 percent lower than the program target. Net domestic credit growth fell sharply to 4 percent, owing to the failure to fully implement the ADP, to the strength of revenue performance, and to sluggish private credit demand. In response to the latter, monetary policy was eased in early 1993 through reductions in the Bank rate and in floors on deposit rates, and some signs of a pickup in private credit growth emerged in the second half of the year. Net foreign assets grew significantly faster than projected, with the weak credit demand contributing to the strength of the external position. Excess liquidity in the banking system declined somewhat over the year, but remained high (Tk 7 billion at end-June 1993). The growing shortage of government bonds forced the banks to hold increasing amounts of cash to meet the statutory liquidity ratio (SLR).

7. The external position was significantly stronger than programmed, with the current account deficit estimated to have narrowed to $0.4 billion (1.8 percent of GDP), nearly 3 percent of GDP below the program target. Export volume increased by 20 percent, owing to buoyant exports of ready-made garments (and, to a much lesser extent, other export items including leather products, frozen food, tea, and chemical products). While import demand picked up somewhat in the second half of 1992/93, it was lower than projected mainly owing to the slower implementation of the ADP and lower-than-expected private sector activity. Total aid flows were about $1.6 billion, $0.3 billion below the projected level. In particular, food aid and project aid disbursement fell well short of the program target. The overall balance of payments recorded a surplus of $465 million and gross reserves increased to $2.1 billion by end-June 1993, equivalent to

6.5 months of imports. The real effective exchange rate remained broadly constant during most of the year, depreciating somewhat during the last quarter, owing both to the decline in inflation and some nominal effective depreciation.

8. The pace of structural reform accelerated during 1992/93, although progress was slower than expected in a number of areas. It is recognized that a faster pace in implementing structural reforms is necessary to lay the basis for the desired pickup in economic growth. In the fiscal area, tax administration was strengthened through measures to collect arrears, increase income tax registration, and register construction firms for the value-added tax (VAT). Measures were introduced to improve project implementation, including the revision of procurement guidelines; elimination of the backlog of projects waiting for approval; and strengthening of project monitoring. Some progress was also made in public enterprise reform, particularly in the implementation of the Railway Recovery Program and in formulating a program to restructure the jute industry. Progress in privatization, however, was disappointing, owing to procedural and institutional problems and the need for technical assistance, and only 3 of the 11 enterprises specified in the structural benchmark were privatized. On the financial side, loan recovery efforts were strengthened further. The Government issued Tk 15 billion of bonds (one-year maturity, zero interest) to recapitalize the nationalized commercial banks (NCBs) on account of the agricultural loan write-off and shortfalls in capital and provisioning in December 1991 and December 1992. Some initial steps were taken to improve bank supervision, including the establishment of a Credit Information Bureau at Bangladesh Bank.

9. In the area of trade reform, the number of items in the Import Control List was reduced from 193 to 93. Significant tariff rationalization was also undertaken, comprising reduction of maximum rates, compression of the duty schedule, and elimination of some user concessions. Facilities for relieving duty for export production were improved and exchange control procedures were streamlined, including through an increase in the maximum limits on travel allowance, and the elimination of the requirement of prior approval from Bangladesh Bank for a wide range of current and capital transactions. In the area of investment policy, some of the sectors still reserved for the public sector only were opened to private entrepreneurs, leaving only five activities reserved for public enterprises. The Tk 300 million limit on setting up new industries with financing by public banks without prior permission of the Board of Investment (BOI) was abolished. The number of sponsoring agencies was reduced from six to three and steps were taken for the BOI to be transformed from a regulatory to a promotional organization.

10. The quantitative performance criteria and benchmarks under the third annual ESAF arrangement were met (while net credit to the public sector slightly exceeded the June benchmark owing to the issue of Tk 15 billion of bonds to recapitalize the banks, excluding the latter, the target was undershot by a large margin). The structural benchmarks for revenue and public enterprise reform were met; those relating to privatization and ADP

expenditure were not achieved. Measures were taken to transform the Board of Investment from a regulatory to a promotional organization, as envisaged under the structural benchmark, although the Board of Investment Act has not yet been formally amended.

Program for 1993/94

11. With the marked improvement in macroeconomic performance over the past three years, the Government is committed to implement measures to put Bangladesh firmly on a significantly higher growth path, while maintaining a satisfactory performance on inflation and the balance of payments. In view of the implementation shortfalls in recent years, and their importance for a sustained improvement in growth performance, the Government intends to accelerate implementation of its program of structural reforms. During 1993/94, such reforms will be focused on the financial sector (particularly supervision) and exchange and trade system, as well as on continued reforms of the public enterprises. These efforts, which are aimed at promoting growth based on the private sector, should increase demand in the short run and by improving efficiency strengthen the economy's long-run growth potential. Consistent with this, real GDP growth is targeted at about 5 percent, with gross fixed investment raised to about 14 percent of GDP from 13 percent in 1992/93. National savings are targeted to increase to 12 percent of GDP from 11 percent of GDP in 1992/93. Assuming some rebound in food prices, inflation will be contained to 4 percent. The overall fiscal deficit is projected at Tk 66.4 billion (6.3 percent of GDP), 1 percent of GDP higher than in 1992/93, owing mainly to higher ADP expenditures. The external current account deficit is projected to widen to $0.7 billion (2.6 percent of GDP), primarily reflecting an expansion of imports to support the projected acceleration in investment and economic growth. With aid flows likely to increase, and export performance forecast to strengthen further, the balance of payments is expected to continue in surplus. Gross official reserves are projected to rise by about $250 million to $2.4 billion by end-1993/94, the equivalent of six months of imports.

Real sector policies

12. The attainment of the economic growth projected in 1993/94 is predicated on a continued expansion in agricultural production (on the order of 2 percent) and an acceleration of industrial output growth (to some 9 percent). Agricultural policy is aimed at raising foodgrain production to achieve self-sufficiency and at diversifying agricultural production. In 1993/94, specific measures will include disposal of the BADC's remaining inventories of deep tubewells and minor irrigation equipment; the formulation of plans to restructure and downsize the BADC, including an acceleration of retrenchment; and a phaseout of seed subsidies and encouragement of private seed distribution. The Government also intends to accelerate much desired reforms in the Water Development Board.

13. To promote a substantial expansion of nonagricultural output and to improve the efficiency of the sector, the Government will strengthen its

efforts to promulgate and implement the reforms already in train. Further steps are being taken to implement the change in the role of the BOI from a regulatory to a promotional organization. The new role of the BOI was defined in late 1992 and new draft legislation prepared. The BOI Act will be formally approved by Cabinet by end-December 1993, and reforms are being implemented in the organization and methods of operation. The Government has been reducing the number of sectors reserved for the public sector. In 1992/93, private investment was allowed in power and telecommunications and limited participation allowed in domestic air transport. During 1993/94, the possibility of opening some of the other reserved sectors will remain under active consideration. Improvements in business legislation and the efficiency of the judicial system are being implemented to overcome the disincentive effect that the present arrangements have on private sector activity, including measures to improve enforcement of contracts pertaining to commercial and other transactions. In particular, the Companies Act will be substantially revised; amendments to the Bankruptcy Act will be placed before the Parliament; and the Nonbank Financial Institutions Act has already come into effect. A Reform Commission with broad terms of reference, incorporating both civil and criminal laws, will be established by end-December 1993. The Government has before it: (i) the public administration efficiency study; (ii) the UNDP report on public administration; and (iii) the report of the Secretary Team "Towards Better Government." Based on the above and other relevant materials, reforms of structure and size of government and its attached departments are under active examination.

Public finances

14. Fiscal policy remains a central element of the adjustment policies to be pursued in 1993/94. Despite significant improvements in recent years, the revenue/GDP ratio remains below that appropriate for the structure of public finances over the medium term. The 1993/94 budget envisaged an increase in revenues from Tk 112 billion in 1992/93 to Tk 124 billion. Income tax rates for individuals were further lowered, and the exemption limit increased; the corporate tax rate was reduced from 55 percent to 50 percent for banks, financial institutions, and public enterprises; to 45 percent for companies that are not publicly traded; and to 40 percent for all publicly traded companies; and further tariff reform measures were introduced. The revenue loss from these measures is expected to be more than offset by improvements in tax administration, including the introduction of taxpayer identification numbers and expansion of presumptive income taxation; further computerization of customs records, the inspection of bulk consignments, and better tracking of the revenue performance of tax officers. VAT administration will also be strengthened by the creation of two new collectorates. Subsequent to the budget presentation, the Government has decided to implement a number of improvements to the revenue system, including requiring all importers to file VAT returns by January 1994, and taking further steps to improve VAT administration by ensuring VAT submission rates of 80 percent and better compliance in services. In light of these measures, and of revised economic projections for 1993/94, revenues are expected to be somewhat higher than previously

estimated, and an operational revenue target of Tk 127 billion has been adopted for 1993/94. Performance toward meeting the operational revenue target, and any possible need for additional measures, will be assessed at the time of the midterm review.

15. Developments in revenue, especially the four major NBR taxes, will be closely monitored during the course of the year against monthly targets for each tax and benchmarks for revenues from the four major NBR taxes (Tk 41.6 billion by end-December 1993, Tk 64.8 billion by end-March 1994, and Tk 94.9 billion by end-June 1994).

16. The momentum for introducing structural improvements in the tax system will be continued. To the extent necessary, the VAT law will be changed so as to allow extension of the VAT from the manufacturing sector to include the distribution sector. Following this, the Government intends to allow voluntary registration of wholesalers in preparation for the extension of VAT to this sector on a voluntary basis in 1994/95. In addition, the structure of direct taxes, particularly of the corporate income tax (where we aim to eliminate tax holidays and streamline other concessions) will be studied. We have requested assistance from the Fund in this matter, with a view to introducing reforms in 1994/95. A study on measures to restructure the land tax will also be undertaken.

17. Following the better-than-programmed performance in 1992/93, current expenditures (including the food deficit) are budgeted to increase from Tk 88.2 billion in 1992/93 (9.1 percent of GDP) to Tk 98.3 billion (9.3 percent of GDP) in 1993/94, including interest costs on recapitalization bonds and temporary support to the jute industry. Pay and allowances are programmed to rise by just 6.4 percent relative to revised 1992/93 estimates, while subsidies, other than the temporary support to the jute industry, will decline, aided by the improved financial performance of the railways. Outlays on operations and maintenance, which are crucial to ensure the effectiveness of the investment program, are budgeted to rise by 32 percent. The food account deficit is projected to decline sharply, reflecting a reduction in food subsidies and to much smaller outlays for the accumulation of food stocks. Targeted food distribution under the Vulnerable Group Development Program (VGD) and the Food for Work Program (FFW) will expand by Tk 1.0 billion relative to original budget projections.

18. Actual ADP expenditures (including self-financed projects) are not expected to be less than Tk 85 billion in 1993/94 (a 22 percent increase over 1992/93), as against the budget allocation of Tk 97.5 billion. Of this, actual government ADP expenditure (excluding self-financing) is projected to reach Tk 80.4 billion, of which a significantly higher share will be financed by taka resources. Though this outturn will require a considerable improvement in implementation, compared with that achieved in recent years, the Government is determined that at least this figure will be attained. To this end, the Government has revised guidelines for the procurement of goods and services, improved procedures for project approval and funding for land acquisition, and strengthened personnel policies affecting project management. The focus during 1993/94 will be to ensure

that all these procedural changes are fully operational. The Government will continue holding high-level ADP review meetings to resolve implementation problems facing line agencies. The Government has made considerable progress in setting investment priorities, within the context of the three-year rolling investment program, to match previously announced social sector priorities and potentially available resources. Thus, while the bulk of ADP spending will continue to be on agriculture and flood control (21 percent), and infrastructure and energy (37 percent), the share of industry is projected to fall from 7 percent in 1989/90 to 2 percent in 1993/94, while that of education will rise from 4 percent to 9 percent and that of health and family planning from 6 percent to 8 percent. The Government will continue its efforts aimed at improving the quality of its investment program, including through annual project pruning exercises. In addition, three sectoral strategic investment reviews were completed in 1992/93, and the Government intends to continue this exercise to cover three more sectors during 1993/94.

Public enterprise reform and privatization

19. The Government is committed to continue its major programs to restructure the public sector enterprises, especially in the jute, power, and railway sectors (with assistance from IDA and the AsDB). In September 1993, the Government announced wage increases for public sector workers, averaging 17 percent. This is projected to increase the wage bill in six major public enterprises by Tk 2.9 billion, of which Tk 1.6 billion is due to retroactive payments for previous years. The Government believes that this increase was necessary to reflect developments since the last basic wage increase was awarded in 1986, and to ensure pay comparability within the enterprises. It is conscious, however, that the increase will have a significant adverse effect on the financial position of the public enterprises and make more difficult the task of achieving commercial viability. To this end, it intends to take additional measures to ensure that the needed adjustment in the public enterprises will be achieved, including cost-cutting and other efficiency measures, an acceleration of the privatization program and sales of assets, and further manpower reductions. However, the net increase in credit to the public sector overall will be constrained to ensure that the availability of credit to the private sector is not reduced.

20. The public sector employee retrenchment program, which started in 1992 and had led to a reduction of 20,000 public employees by end-June 1993, will be extended to cover at least another 25,000 officers and workers in 1993/94. To this end, Tk 6 billion, including an additional Tk 3 billion more than originally budgeted, should this be needed and justified, has been provided to finance worker retrenchment programs in enterprises and government departments in 1993/94. This will focus on the jute sector; the railways; the Ministry of Food; BADC; BRTC; BTMC; and TCB. Retrenchment plans for BSFIC, BSEC, and BCIC will be finalized by December 1993, with a view to initiating retrenchment shortly thereafter. It will be important to ensure that the retrenchment programs are designed to enhance the operating efficiency of the enterprises. To avoid potential abuse, close monitoring

of the retrenchment program will be necessary, and retrenchments will be fully matched by reductions in sanctioned positions.

21. More generally, the Government is committed to improve the financial performance of the public enterprises. In this context, the Government has prepared a revised set of guidelines and regulations to enhance public manufacturing enterprise autonomy, and plans to introduce these--together with measures to strengthen financial accountability and management information systems--as soon as possible.

22. Privatization of the public enterprises remains an important objective to reduce the burden on the public exchequer; enhance productive efficiency and improve management; and restructure their labor force and debt. The new Privatization Board has been provided with adequate autonomy to pursue the privatization program reaffirmed at the Paris Aid Group meeting in April 1993. The Government intends to strengthen the Board's administrative, financial, and technical capabilities so that it can implement the privatization program effectively and rapidly. A number of measures have been taken to improve the attractiveness of enterprises offered for sale, including the elimination of the requirement that the entire work force be kept on by the buyer for at least one year. In the context of the targets set, the Government has so far sold 3 companies, contracted to sell 1 other, and tendered 13 industrial companies from the initial list of 42, as well as 7 textile mills. By end-March 1994, at least a further 4 industrial companies, as well as 3 textile mills, will be offered for sale, with a view to completing the sales by end-June 1994. The authorities also intend to privatize 9 jute mills by end-December 1994.

Monetary policies and financial sector reform

23. Monetary growth is targeted at 12.8 percent, based on projected growth and inflation rates, and allowing for the expected decline in velocity. Domestic credit is projected to expand by 11 percent. The increase in credit to the public sector would be limited to Tk 5.3 billion. Private sector credit would increase by 14 percent, consistent with the targeted increase in private investment and economic activity. To facilitate future progress in moving toward indirect monetary management, the Government has prepared a shadow reserve money program, consistent with the broad money program and a declining level of excess liquidity, which will be closely monitored in 1993/94. In preparing a detailed program for the development of monetary policy instruments and monetary management for 1994/95 and beyond, we have requested technical assistance from the Fund.

24. The high level of lending rates continues to be a concern. While this largely reflects the financial difficulties faced by the banking sector, interest rate policy, including the level of deposit rate floors, will continue to be managed flexibly and no new bands will be imposed. The Government recently reduced the Bank rate from 6.5 percent to 6 percent, and the interest floor on time deposits from 6.0 percent to 5.5 percent. The Government will continue to keep the bands on lending for exporters, agriculture, and small and cottage industries under review, with a view to

their eventual elimination. The interest rates on national savings certificates and other government savings instruments, which are risk free and were very high in comparison with other financial instruments, were reduced significantly in September 1993.

25. Measures to strengthen the financial position of the banking system are crucial to support growth over the medium term. To this end, the Government intends to formulate a statement of public policy toward the banking sector and promulgate it as soon as possible. A key element of such a strategy will be the development of a comprehensive program to restructure problem banks. The Government is conscious that the interest rate on bonds issued to recapitalize the banks needs to be set taking into account the impact on bank profitability. In this context, it has decided to refinance the Tk 15 billion of noninterest-bearing bonds issued at end-June 1993, mostly with treasury bills bearing an interest rate of 4.25 percent. The Government is determined that bank lending will be made purely on the basis of the banks' own commercial and financial interests. To underpin this commitment, as well as to improve efficiency and competitiveness more generally, it intends to prepare a detailed proposal for privatization of Rupali Bank and issue an invitation to bid for potential buyers by June 1994. The Government will also encourage new entry of private banks and issue licenses to bona fide applicants. The Government recognizes that a strengthening of banking supervision and prudential regulations is essential to promote the health of the banking system, and recommendations in these areas have been provided by a recent World Bank mission. Bangladesh Bank will complete the exercise to assess the impact of a strengthening of provisioning and classification regulations by December 1993 and announce by February 1994 a timetable to considerably strengthen these regulations in line with international practices within two years, consistent with the results of the study. It will also consider the introduction of new measures of capital adequacy, with the aim of moving to BIS standards over the medium term. The quality of banking supervision, both on- and off-site, will be improved with help from USAID and the World Bank. Particular attention will be given to the supervision of the private banks; to legal reforms to improve debt recovery; and to improving the operational management of banks through efforts to improve training, rationalize incentives, and recruit qualified staff. The Government intends to restructure the DFIs. To this end, it is considering merging BSB and BSRS. The Government envisages the need to create a private sector development bank, possibly with foreign equity participation, to promote quality investment especially in the industrial sector.

26. The Government recognizes that the success of monetary and financial sector reforms will depend, in large part, on a strengthening of the institutional capacity of Bangladesh Bank. A comprehensive program to achieve this will be designed during 1993/94, with assistance from the World Bank. In this context, the Government will request technical assistance from the Fund through the posting of long-term advisors in Bangladesh Bank, to provide general policy advice to the Governor (including monetary management and forecasting) and to advise on banking supervision.

27. Further development of the capital market will remain a priority, supported by a Capital Market Development Program. The Program aims to improve incentives for securities and to develop a government bonds and securities market; to develop an auctioning system for treasury bills; to induce more autonomy and competition among the capital market institutions, including the Investment Corporation of Bangladesh (ICB), the Dhaka Stock Exchange, and other institutional investors; and to develop the regulatory mechanisms for the securities market. The Debt Management Committee was formed in October 1992 to formulate the Government's debt management strategy, examine the system of issuance and auctioning of treasury bills and other securities and develop a program for the development of the bond market; measures to promote the development of the domestic money market will also be pursued. In order to develop the securities market and to improve the efficiency of regulatory systems, the Securities and Exchange Commission (SEC) was established in June 1993, which will be made operational with technical assistance from the AsDB.

Trade and exchange policies

28. Further trade liberalization will be pursued in 1993/94 to promote a rapid expansion in industry and improve efficiency and resource allocation in the economy. As of October 1, 1993, the Government has reduced the total number of trade-related quantitative restrictions (covering those specified in the Import Policy Order (IPO) control list, the IPO text, and those included neither in the list nor in the text) to 39 (in terms of the four-digit HS code), in line with the agreements under the Second Industrial Sector Adjustment Credit. The Government will undertake a study by June 1994 on any offsetting measures that may be required to be able to eliminate the remaining trade-related restrictions as soon as possible. With regard to tariff reform, the Government has reduced the maximum tariff rate to 100 percent except for two product groups: alcoholic beverages and cigarette paper. Following the tariff measures announced in the 1993/94 budget, 7.5 percent of import value is subject to tariffs of above 45 percent (compared with 13.5 percent in 1991/92); and rates above 75 percent apply to only about 0.5 percent of import values (4 percent in 1991/92). Within the 7.5-75 percent range, some categories of discrimination by user have been removed. The items subject to zero tariff were reduced to about 3.5 percent of import values (17 percent in 1991/92). The Government is determined to undertake further trade reform in the years to come. To underpin this commitment, it will publicly announce its objective of reducing effective protection to low levels prevailing in internationally competitive developing countries. To this end, the Government intends to develop an accelerated program of trade reform, in consultation with the Bank and the Fund staffs, for implementation within the next two-three years. With respect to export policy, the Government has eliminated bans or restrictions on exports of rice and re-exports of unprocessed goods. It will continue to review export policy with a view to further reducing restrictions, including remaining bans on exports and the export price check for raw jute exports.

29. Economic reforms being introduced across the region will have important effects on Bangladesh, as countries--with similar comparative advantages to Bangladesh--increasingly compete for export markets and foreign direct investment. The Government is committed to pursuing an exchange rate policy that is consistent with the maintenance of external viability and competitiveness. Against this background, the Government considers that the present level of the exchange rate is broadly appropriate. However, exchange rate policy will be reassessed periodically, taking account of, inter alia, the effects of trade liberalization; the import requirements of the targeted increase in public and private investment; the future of the Multifiber Arrangement and its implications for garment exports; and developments in the level and structure of aid flows.

30. The Government has recently implemented a series of measures to eliminate exchange restrictions on international current account transactions. In July 1993, existing limits on travel allowance were declared to be only indicative, with foreign exchange beyond the limits being granted on verification of bona fide character; the official forward cover scheme was abolished, except for Asian Clearing Union (ACU) currencies; by trading only in U.S. dollars and ACU currencies at current rates, Bangladesh Bank eliminated the broken cross rates; and the exchange guarantee scheme on the interest component of NFCDs has been abolished. The Government has eliminated almost all the remaining exchange restrictions on current international transactions. It intends to eliminate remaining restrictions by end-June 1994, before accepting the obligations of Article VIII of the IMF's Articles of Agreement at an appropriate time. The Government has moved swiftly to establish an interbank foreign exchange market, based on the recommendations of the recent Fund technical assistance mission. To this end, the spread between Bangladesh Bank's selling and buying rates has been doubled to Tk 0.20 per U.S. dollar; authorized dealers are now permitted to set retail exchange rates freely; and, as noted above, the official forward cover scheme has been abolished. During 1993/94, Bangladesh Bank will further improve the institutional and regulatory environment to promote active foreign exchange transactions. Particular attention will be paid to designing and setting limits on banks' gross and net foreign exchange position based on the size of their capital. Guidelines on a code of conduct for the foreign exchange dealers will be published shortly. The Government will continue to review the spread between the Bangladesh Bank selling and buying rates, in light of market developments and the recommendations of the recent MAE report.

31. To facilitate the monitoring of progress in policy implementation, a number of financial and structural benchmarks have been prepared in consultation with the staff of the Fund which are summarized in the attached table.

Attachment

Table. Bangladesh: Benchmarks for 1993/94

	1992/93 June	1993/94 Sept.	Dec.	March	June
	(In billions of taka; end of period)				
1. Quantitative benchmarks					
Net domestic assets 1/	255.7	258.5	272.0	271.3	284.0
Credit to the public sector 2/, 3/	99.6	98.9	102.6	103.8	104.9
	(In millions of U.S. dollars; end of period)				
Cumulative contracting or guaranteeing by the public sector of new nonconcessional external debt of over 1 year and not more than 12 years' maturity	--	40	40	40	40
Of which:					
Over 1 year and not more than 5 years' maturity	--	20	20	20	20
Outstanding stock of external public debt, including Bangladesh Bank liabilities, of one year or less maturity 4/	--	15	15	15	15

2. Structural benchmarks

a. Revenue collection	Collect the following amounts from the four main NBR taxes (income, value-added, excise, and customs): July-December, Tk 41.6 billion; July-March, Tk 64.8 billion; July-June, Tk 94.9 billion.
b. Public investment and retrenchment	Achieve a combined expenditure on the ADP and retrenchment of Tk 91 billion, of which at least Tk 6 billion should comprise retrenchment expenditures. Achieve ADP expenditure of Tk 29.8 billion (including self-financed projects), as measured by the External Relations Division of the Ministry of Planning, by December 1993.
c. Trade policy	Reduce the number of trade-related quantitative restrictions to 39 (in the Control List, Import Policy Order text, and elsewhere) by October 1, 1993 and prepare a proposal by June 1994 on any offsetting measures required to be able

	to eliminate the remaining restrictions as soon as possible.
d. Bank supervision	Complete exercise to assess the impact of a strengthening of provisioning and classification regulations by end-December 1993. Consistent with the results of this exercise, establish timetable by February 1994 to bring provisioning and classification regulations in line with international practices within two years.
e. VAT	Make legislative changes necessary to allow extension of the VAT to the distribution sector, with a view to allowing voluntary registration of wholesalers in preparation for the extension of the VAT to wholesalers in 1994/95.
f. Direct taxes	Prepare proposal to reform the structure of direct taxes, particularly corporate income tax, for implementation in 1994/95, following Fund technical assistance.
g. Exchange restrictions	Eliminate all remaining restrictions on current account transactions by June 30, 1994.

1/ At constant June 30, 1993 exchange rate (Tk 39.8 per U.S. dollar).

2/ This benchmark will be adjusted upward to take account of the remaining bond issues related to the agricultural loan write-off and shortfalls in NCB capital and provisioning as of 12/31/92 (estimated at Tk 2.13 billion); and adjusted downward to take account of write-offs of public jute sector debt which are to be absorbed by the banks. The composition of credit to the public sector (but not the overall total) will also be affected by bond issues related to the write-offs of jute sector debt in BJC (up to Tk 10.37 billion), and closed and privatized mills in BJMC (Tk 2.68 billion), and for operational losses of jute mills up to June 1993.

3/ The end-June 1994 ceiling on net credit to the public sector will be adjusted downward to the extent that net nonbank financing of central government exceeds Tk 12.01 billion. Net nonbank domestic financing is defined here as financing provided through Accounts 74 and 191, permanent domestic debt (including treasury bonds, Prize and Wage-Earner Development bonds, and bonds to Bangladesh shareholders on account of nationalized industries); and nonbanking net credit in the Public Account of the Republic through the Provident Fund and National Savings schemes.

4/ Excluding normal short-term import-related credits and balances of the Asian Clearing Union.

Bangladesh: Relations with the Fund
(As of September 30, 1993)

I. Membership Status: Joined 8/17/72; Article XIV

II. General Resources Account

General Resources Account	SDR Million	Percent Quota
Quota	392.50	100.0
Fund holdings of currency	401.45	102.3
Reserve position in Fund	.06	.0

III. SDR Department

SDR Department	SDR Million	Percent Allocation
Net cumulative allocation	47.12	100.0
Holdings	15.77	33.5

IV. Outstanding Purchases and Loans

Outstanding Purchases and Loans	SDR Million	Percent Quota
Other credit tranche	8.98	2.3
SAF arrangements	175.38	44.7
ESAF arrangements	345.00	87.9

V. Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved	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 the Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	9/30/93	1993	1994	1995	1996	1997
Principal		17.6	38.4	40.3	58.9	83.3
Charges/interest		1.5	3.7	3.5	3.3	3.0
Total		19.1	42.1	43.8	62.2	86.3

VII. Exchange Rate Arrangement

Since August 13, 1979, the taka has been pegged, within margins, to a currency-weighted basket. Until January 1, 1992, when the official and secondary exchange markets were unified, the authorities maintained a secondary exchange market in which proceeds from workers' remittances and most services and exports were sold. Since then, the taka has, in practice, remained little changed against the U.S. dollar (Tk 39.85 per U.S. dollar at end-September 1993). The taka has depreciated by 0.5 percent in nominal effective terms, and by 5.8 percent in real effective terms, in the year ending June 1993.

VIII. Last Article IV Consultation

The 1992 Article IV consultation report (EBS/92/133) was discussed by the Executive Board on September 14, 1992 (EBM/92/117). The following decision was adopted:

1. The Fund takes this decision relating to Bangladesh's exchange measures subject to Article VIII, Section 2(a) and in concluding the 1992 Article XIV consultation with Bangladesh, in the light of the 1992 Article IV consultation with Bangladesh conducted under Decision No. 5392-(77/63) adopted April 29, 1977 as amended (Surveillance over Exchange Rate Policies).

2. Bangladesh's restrictions on payments and transfers for current international transactions are maintained in accordance with Article XIV as described in EBS/92/133, except that the restriction arising from the bilateral payments arrangement with a Fund member is subject to the approval of the Fund under Article VIII, Section 2(a). The Fund urges Bangladesh to eliminate the restrictive features of this bilateral payments arrangement. The Fund also encourages Bangladesh to administer the restrictions maintained under Article XIV in a liberal manner.

IX. Consultation Cycle

A consultation cycle of 12 months was specified in the summing up of the 1992 Article IV consultation.

X. Technical Assistance

a. Recent missions

FAD: Mr. Shome and two consultants assisted with administrative arrangements for the VAT in June 1990; a follow-up visit was made by consultants in October 1990.

MAE: Mr. Schiffman visited Dhaka in the summer of 1991 to assess measures for strengthening bank supervision. Mr. Huh visited Dhaka in November 1992 to assist with the development of the forward exchange market.

Messrs. Enoch and Hardy and a consultant visited Dhaka in July 1993 to assist in the development of an interbank foreign exchange market and on measures required to reach current account convertibility of the taka.

STA: Messrs. Patel and Gutiérrez examined national accounts methodology in October 1989.

b. Tentative plans

FAD: Two missions are planned for early 1994 on direct tax policy and on tax administration respectively. A long-term advisor on VAT administration is envisaged from April 1994.

MAE: A mission is planned for early 1994 on indirect monetary instruments. Two long-term advisors to the Governor of Bangladesh Bank are envisaged from late FY 1994, on general policy advice and on bank supervision.

STA: A mission is planned for January 1994 on government finance statistics, and a multitopic assessment mission is planned for early FY 1995.

XI. Resident Representative

The resident representative office was established in 1972. Mr. Slaheddine Khenissi took up the post in March 1993.

Bangladesh: Relations with the World Bank Group 1/

IDA is currently the largest among Bangladesh's donors. Cumulative IDA commitments totaled $5.8 billion (net of cancellations) and IFC assistance was $22 million as of June 30, 1993.

More than one third of IDA lending has been directed to the agricultural and energy sectors. Agricultural lending has aimed at increasing food production by the use of modern inputs, flood control, and input and output pricing policies that provide adequate incentives to farmers. Energy projects have concentrated on the development of natural gas resources and the expansion of power-generating and transmission facilities, including rural electrification.

Industrial lending has sought to improve the efficiency of public sector enterprises and promote exports and efficient import-substituting industries. Transportation credits have focused on road maintenance and rehabilitation and inland water transport. Lending to the social sectors has emphasized primary education and skills development, and primary health care and family planning.

IDA has also provided sector adjustment credits, including two industrial sector credits in 1986/87 and 1992/93, a 1988/89 energy sector credit, a 1989/90 financial sector credit, and a 1991/92 public resource management credit to achieve policy and institutional reforms.

Future operations will continue to support policy-based lending. A jute sector adjustment credit is being negotiated. Lending to agriculture and energy will also continue to be important, accounting for an estimated 40 percent of disbursements. IDA also plans to emphasize operations that will directly benefit the poor, including projects in the social sectors, water supply and sanitation, and general education.

IDA chairs the annual Bangladesh Aid Group meeting and IDA's Resident Representative chairs regularly scheduled donor meetings in Dhaka. The most recent Aid Group meeting was held in Paris on April 27-28, 1993 and the next one is planned for April 19-20, 1994 in Paris.

1/ Prepared by World Bank staff.

Table 1. Bangladesh: IBRD and IDA Lending Operations

(In millions of U.S. dollars; as of June 30, 1993)

	Disbursed	Undisbursed
Completed projects and import program credits	3,517.6	--
IBRD	54.9	--
IDA	3,462.7	--
Projects in execution	1,014.8	1,522.6
IDA	1,014.8	1,522.6
Total	4,532.4	1,522.6
Repayments	123.2	
Total outstanding (including undisbursed)	5,931.8	

Source: Data provided by the World Bank.

Table 2. Bangladesh: IBRD and IDA Lending by Sector, 1972/73-1991/92

(In millions of U.S. dollars; as of June 30, 1993)

	Original Amount	Percent	Number of Projects
Agriculture	1,215.34	20	40
Power and energy	1,033.00	17	14
Urban and water supply	141.73	2	6
Transport and telecommunications	419.48	7	13
Industry	936.35	15	21
Education	468.78	8	11
Technical assistance	87.50	1	6
Health and population	305.00	5	4
Nonproject/adjustment	1,407.35	23	16
Other (flood control)	188.60	3	3
Total commitments 1/	6,203.13 1/	100	134

Source: Data provided by the World Bank.

1/ Of which $446.8 million was cancelled.

Table 3. Bangladesh: Disbursements from and Debt Service Payments to the World Bank, 1987/88-1992/93

(In millions of U.S. dollars)

	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93
IBRD (net)	-1.3	-1.7	-1.3	-2.0	-2.0	-2.0
Disbursements	--	--	--	--	--	--
Amortization	1.3	1.7	1.3	2.0	2.0	2.0
IDA (net)	335.2	290.9	451.7	316.0	218.0	312.0
Disbursements	343.6	301.0	463.1	331.0	236.0	338.0
Amortization	8.4	10.1	11.4	15.0	18.0	26.0
Interest	32.5	28.6	28.7	32.8	36.0	37.0
IBRD	4.1	4.0	3.9	3.9	4.0	4.0
IDA	28.4	24.6	24.8	28.9	32.0	33.0

Source: Data provided by the World Bank.

Bangladesh: Relations with the Asian Development Bank 1/

The Asian Development Bank (AsDB) has assisted Bangladesh since 1973. As of September 1993, the AsDB had provided Bangladesh with 125 loans amounting to $3,830 million and $87 million for 165 technical assistance grants for project preparatory and advisory services.

The AsDB's overall operational strategy for Bangladesh focuses on poverty reduction in the long run. To achieve this goal, over the medium-term operational program aims to promote a faster rate of economic growth through greater market orientation, sustainable improvements in domestic resource mobilization, accelerated human resource development, and improved physical infrastructure. Finally, the AsDB promotes the participation of nongovernmental organizations (NGOs) in the development process, especially with regard to the role of women in development, the environment, and poverty reduction program.

In the agricultural sector, the AsDB's operational program continues to accord high priority to agricultural production, rural infrastructural development, and natural resource management. The policy agenda to support this strategy includes private sector participation in the provision of agricultural inputs and marketing of agricultural output through policy reforms, improved delivery of rural credit, rationalization of output pricing, and adequate resources, both institutional and financial, for maintenance of assets created in the sector.

In the energy sector, the AsDB's objectives are to promote efficient growth through an improvement of policies and institutions before investing in power and gas development projects. The AsDB will focus on development and distribution of natural gas through an integrated approach for the long-term development of the subsector.

In the transport and communications sector, the emphasis is on: (i) development of the road sector, including bridges; (ii) restructuring of the railways; and (iii) providing appropriate support to the telecommunications sector.

In the social sector, the main thrust is on human resource development through improving the access of the poor to education and training, health, family planning, new technologies, and credit. It also assists in the development of urban infrastructure, including water supply, sanitation, drainage, solid waste management, and flood protection.

In the AsDB's industrial sector operations, the primary focus is on policy reforms, privatization, and restructuring of public manufacturing enterprises. The AsDB will seek to expand the role of the private sector by promoting private investments in critical areas that had previously been

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1/ Prepared by the Asian Development Bank staff.

reserved for public investments. Direct equity and loan assistance for export-oriented or economically efficient import-substitution projects with significant development impact will be encouraged.

The AsDB has broadened its policy dialogue with the Bangladesh Government in various sectors. In agriculture, it has supported reforms to enhance the role of the private sector by liberalizing and deregulating the supply of minor irrigation equipment, fertilizers, and seeds to farmers, improving foodgrain management policy, and reorganizing and commercializing public entities. In industry, it worked closely with the Government in restructuring and privatizing public manufacturing enterprises, and in reducing subsidies and deregulating prices. In the railway sector, the AsDB is helping the Government to reduce Bangladesh Railway's deficit by termination of open ended subsidies and creation of transparent public service obligation grants on a reducing scale; labor rationalization through voluntary retirement. Also, the AsDB is providing technical assistance to restructure the organization and operations of BR.

A policy dialogue has also been initiated to support the development of capital markets.

Table 1. Asian Development Bank: Loans to Bangladesh by Sector

Sector	Number of Loans	Amount	Percent of Total
Agriculture and agro-industry	52	1,747.88	41.1
Energy	16	805.45	21.1
Social infrastructure	18	664.75	15.6
Transport and communications	12	583.10	13.7
Industry and nonfuel minerals	7	--	6.2
Finance	7	--	3.2
Total	112	4,251.29	100.0

Source: Data provided by the Asian Development Bank.

Table 2. Asian Development Bank: Loan Approvals and Disbursements to Bangladesh, 1987-93

(In millions of U.S. dollars)

	1987	1988	1989	1990	1991	1992	1993
Loan approvals	266	268	338	358	419	258	421 1/
Loan disbursements	177	226	320	308	273	320	242 2/
Undisbursed balance at the beginning of the year	1,278	1,482	1,420	1,401	1,533	1,684	

Source: Data provided by the Asian Development Bank.

1/ Reflects position as of December 1993. So far, the Board has approved no project. It is expected that in the next few weeks six projects and the Railway Recovery Program Loan ($80 million) will be presented to the Board.
2/ Includes $40 million first tranche of the Railway Recovery Program Loan.

Bangladesh: Social and Demographic Indicators

Area	143,998 square kilometers
Of which: Agricultural land	76.0 percent
Population (1991)	111.0 million
Of which: Female	46.4 million
Rate of growth	2.1 percent per annum
Density	770 persons per square kilometer
GDP per capita (1993)	$217
Population characteristics	
Life expectancy	54.4 years
Of which: Female	54.0 years
Share of population under 15 years	43.0 percent
Of which: Female	42.3 percent
Infant mortality	103.0 per thousand
Crude birth rate	35.8 per thousand
Crude death rate	12.2 per thousand
Urban population	17.0 percent
Total fertility rate (births per woman)	4.6
Labor force (1989)	
Total labor force	51.0 million
Of which: Female	21.0 million
Overall participation rate	67.0 percent
Health (1993)	
Population per physician	6,919
Population per hospital bed	3,113
Income distribution (1989)	
Highest quintile	46.0 percent
Lowest quintile	7.0 percent
Poverty indicators (1989)	
Upper poverty line (headcount ratio)	49.0 percent
Lower poverty line (headcount ratio)	29.0 percent
Land ownership (1978)	
Owned by top 10 percent	49.0 percent
Access to piped safe water (1993)	
Rural population	37.0 percent
Urban population	89.0 percent
Nutrition (1989)	
Average caloric intake	91.0 percent of requirement
Per capita protein intake	42.0 grams per day
Education (1993)	
Adult literacy	36.0 percent
Primary school enrollment	73.0 percent

Sources: Bangladesh Bureau of Statistics, Report on the Household Expenditure Survey (1988/89) (August 1991); IBRD, World Development Report 1992 and Social Indicators of Development 1993; and AsDB, Gender Indicators of Developing Asian and Pacific Countries) (1993).

Bangladesh: Statistical Issues

The authorities agree that, despite efforts in recent years, continuing data deficiencies hamper economic analysis and need to be addressed. Some major issues are indicated below:

1. Real sector

A 1986 technical assistance mission made recommendations to update the CPI and industrial production index and revise the national accounts. Progress on these recommendations to date has been modest. The current base of these two index series is 1973-74 and should be updated. A 1990 mission on national accounts made short- and medium-term recommendations to improve GDP estimates and sectoral deflators, and subsequent assistance has been provided with a UNDP-funded project. Within this project, national accounts will be compiled according to the revised SNA. The new base year will most likely be 1988/89, since most of the sectoral surveys already performed are based on that year. The CPI, WPI, and the Industrial Production Index will also be revised and rebased, accordingly. Analysis will also be improved when better estimates are available of investment and savings, and the disaggregated data for central government, the public enterprises, and the private sector.

2. Government finance

There are numerous problems with the government finance statistics of Bangladesh, to the extent that the decision was taken not to publish a page for Bangladesh in the 1992 GFS Yearbook. In this regard, the recent request by the Minister of Finance for STA technical assistance in government finance statistics provides the opportunity to begin to address the various problems. Major issues include: (i) the consistency of the data for financing of the central government with that from the monetary survey, nonbank domestic financing, and foreign financing; (ii) discrepancies in data on foreign aid disbursements; (iii) the classification of expenditure into current and capital categories, and by economic type; and (iv) the lack of consolidated accounts for public enterprises and for the consolidated public sector.

3. Monetary accounts

Clarification is required on the treatment of suspense accounts related to disbursements of aid.

4. Balance of payments

There are large discrepancies between the World Bank's Debtor Reporting System (DRS) and Bangladesh Bank's data on disbursements and repayments relating to long-term public and publicly guaranteed loans. The May 1989 external debt statistics mission had recommended, inter alia, greater cooperation between the External Resources Division (ERD) of the Ministry of Finance and Bangladesh Bank to resolve and reconcile these differences.

In addition, the balance of payments statistics are prepared largely from banking and trade association sources. A cross check with customs data would be helpful as well as improvement in the series for various capital account items, including foreign direct investment (which is believed to be underestimated).