

FOR
AGENDA

EBS/85/251

CONFIDENTIAL

November 12, 1985

To: Members of the Executive Board
From: The Secretary
Subject: Bangladesh - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on a request from Bangladesh for a stand-by arrangement equivalent to SDR 180 million. A draft decision appears on page 20.

It is understood that the Executive Director for Bangladesh will be requesting the Executive Board for a waiver of the circulation period in order to enable this subject, together with the staff report for the 1985 Article IV consultation with Bangladesh (SM/85/264, 9/23/85), to be brought to the agenda for discussion on Monday, December 2, 1985.

Mr. Al-Eyd (ext. 7335) is available to answer technical or factual questions relating to this paper prior the Board discussion.

Att: (1)



INTERNATIONAL MONETARY FUND

BANGLADESH

Request for Stand-By Arrangement

Prepared by the Asian Department

(In consultation with the Exchange and Trade Relations,
Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by Tun Thin and Eduard Brau

November 12, 1985

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I. Introduction

Discussions on the possible use of Fund resources under a stand-by arrangement were held in Dhaka in March and June, 1985. Although an agreement in principle was reached in June on an economic program to be supported by a stand-by arrangement from the Fund, the conclusion of negotiations was delayed owing to certain important weaknesses in the monetary data which came to light in July. A more reliable monetary data base, compiled according to a new system of collecting monetary statistics, was established and agreed to with the authorities following two Fund missions to Dhaka during August 10-19, and September 19-October 3. 1/ Further discussions on implementation of the various elements of the adjustment program took place during the Annual Meeting in Seoul. Subsequently, a staff team composed of Mr. K. Al-Eyd (head, ASD), Mrs. E. Gurgen (ASD), and Ms. P. Job (secretary, ASD), visited Dhaka during October 12-21 to conclude negotiations. Meetings were held with the Advisor for Finance, Mr. M. Syeduzzaman; the Governor of Bangladesh Bank, Mr. Nurul Islam; and other senior officials. The staff team was assisted by Mr. S. Itam, the Fund Resident Representative in Bangladesh.

The Government of Bangladesh has requested a stand-by arrangement in the amount of SDR 180 million, equivalent to 62.6 percent of quota (or to an annual access of 41.7 percent of quota) for the period extending from the date of approval through June 30, 1987. The entire amount requested would come from ordinary resources. A waiver of the limitation of Article V, Section 3(b)(iii) of the Articles of Agreement is required. If the full amount available under the requested stand-by arrangement is drawn, and taking into account scheduled repurchases through June 30, 1987, total Fund credit outstanding to Bangladesh would decline from SDR 378.2 million or 131.5 percent of quota on September 30, 1985 to SDR 367.7 million or 127.9 percent of quota on June 30, 1987 (Table 1). The Government's economic and financial program for 1985/86, 2/ and the broad stance of policies for 1986/87, are described in the attached letter from the Advisor for Finance, dated November 5, 1985.

II. Background 3/

The most recent data indicate that economic performance in 1984/85 was, in certain respects, more favorable than earlier anticipated. While real GDP growth and inflation estimates remain unchanged at

1/ The August mission was composed of Mrs. E. Gurgen (head, ASD), Mr. S. Quin (STA), and Mr. R. Feldman (EP, ASD); the September mission comprised Messrs. K. O'Connor (head, STA), Quin, and Feldman.

2/ Fiscal year ending June 30.

3/ This section focuses mainly on recent revisions to the more detailed description of economic developments during 1984/85 contained in Bangladesh--Staff Report for the 1985 Article IV Consultation (SM/85/264, 9/23/85).

Table 1. Bangladesh: Fund Position During Period of Arrangement, 1985-87

	Outstanding Sept. 30, 1985	1985 Oct.- Dec.	1986				1987	
			Jan.- March	April- June	July- Sept.	Oct.- Dec.	Jan.- March	April- June
(In millions of SDRs)								
Transactions under tranche policies (net) <u>1/</u>		18.6	18.5	3.8	15.6	-1.9	9.9	-1.9
Purchases		36.0	24.0	24.0	24.0 <u>2/</u>	24.0	24.0 <u>2/</u>	24.0
Repurchases		-17.4	-5.5	-20.2	-8.4	-25.9	-14.1	-25.9
Transactions under special facilities (net)		-11.1	-11.1	-11.1	-11.1	-11.1	-11.1	-6.5
Purchases		--	--	--	--	--	--	--
Repurchases		-11.1	-11.1	-11.1	-11.1	-11.1	11.1	-6.5
Total Fund credit outstanding (end of period)	378.2	385.7	393.1	385.8	390.3	377.3	376.1	367.7
Under tranche policies	243.6	262.2	280.7	284.5	300.1	298.2	308.1	306.2
Special facilities	134.6	123.5	112.4	101.3	90.2	79.1	68.0	61.5
(In percent of quota; end of period)								
Total Fund credit outstanding	131.5	134.2	136.7	134.1	135.7	131.2	130.8	127.9
Under tranche policies	84.7	91.2	97.6	98.9	104.3	103.7	107.2	106.5
Special facilities	46.8	43.0	39.1	35.2	31.4	27.5	23.6	21.4

Source: International Monetary Fund.

1/ All under the Fund's ordinary resources.

2/ Subject to completion of review of policies with the Fund under the stand-by arrangement.

2.6 percent and 10.9 percent, respectively, the budget outcome and external developments show an improvement over previous expectations (Table 2 and Chart 1).

Preliminary actual data for 1984/85 indicate that the overall central government budget deficit was Tk 33.4 billion (8.3 percent of GDP), compared with the previous estimate of Tk 36.3 billion (9.1 percent of GDP). The approximate Tk 3 billion improvement in the deficit is attributable to a somewhat stronger revenue performance, as well as to a significantly lower food account deficit (Tk 2.6 billion below the earlier estimate). The better revenue performance is explained mostly by higher receipts from customs duties and sales taxes on imports, while the smaller food account deficit is due mainly to lower foodgrain imports and to lower operating and administrative expenditures of the Food Ministry. Reflecting these developments, the total revenue to GDP ratio increased by 0.7 percentage point to 8.9 percent in 1984/85, while total government expenditure maintained its share in GDP at just over 17 percent (Table 3). The overall budget deficit to GDP ratio decreased by 0.9 percentage point over 1983/84, and by 1.3 percentage points excluding the impact of food-stocking operations. Foreign financing of the budget deficit remained below earlier estimates mainly because of smaller food aid disbursements. Domestic financing was also less than previously anticipated owing to a net repayment of Tk 0.66 billion by the Government to the banking system compared with an earlier estimated net borrowing of Tk 1.58 billion. This turnaround stems partly from a reclassification of government accounts with the banking system under the new monetary series, which has also revealed a sizable buildup of government deposits with the banking system during 1984/85.

The revised monetary data display broadly similar trends to those indicated by the previous data for the major monetary aggregates in recent years. ^{1/} While developments in total domestic credit and broad money are approximately comparable in the two sets of monetary data, movements in some of the credit components reveal notable differences. Net government borrowing from the banking system and credit to other public sector (mostly nonfinancial public enterprises) show variations from previous data, owing to reclassification of certain accounts, as well as to the existence of larger government deposits with the banking system than indicated by the earlier data. There are also sizable differences in the net foreign assets of the banking system under the two sets of data, due largely to the expanded coverage of the new series to include workers' remittances on deposit with banks.

The revised monetary data show that domestic credit growth reached 26.2 percent during 1984/85, with credit to the public and private sectors rising by 12.3 percent and 40.2 percent, respectively

^{1/} The differences between the previous and the new sets of monetary data mainly reflect differences in source data, coverage, and classification. For a discussion of the revisions to the monetary data, see Annex II.

Table 2. Bangladesh: Selected Economic and Financial Indicators, 1982/83-1985/86

	1982/83	1983/84	1984/85 Provisional	1985/86 Program
	(Annual percentage changes: unless otherwise specified)			
National income and prices				
GDP at constant market prices	3.5	3.5	2.6	4.1
Implicit GDP deflator	5.7	15.7	12.5	10.2
Consumer prices	9.9	9.7	10.9	12.0
External sector (in U.S. dollars)				
Exports, f.o.b.	8.6	19.3	14.9	0.9
Imports, c.i.f.	-10.3	4.8	11.9	-6.6
Export volume	5.4	3.0	-4.5	24.2
Import volume	-5.0	7.1	13.2	-4.7
Terms of trade	9.2	18.2	21.8	-17.2
Real effective exchange rate <u>1/</u>	0.9	8.7	-2.6	-9.9 <u>2/</u>
Government budget				
Revenue	9.5	12.6	25.0	22.1
Tax	8.5	12.4	21.1	25.0
Nontax	14.6	13.4	43.9	10.5
Total expenditure	25.3	4.9	14.0	11.7
Current expenditure	29.7	19.9	18.9	17.0
Annual Development Program	11.2	1.0	9.3	13.6
Money and credit <u>3/</u>				
Net domestic assets	11.2	31.0	27.9	15.1
Domestic credit	11.6	30.9	26.2	15.1
Government, net	1.4	21.5	-2.8	-5.5
Other public sector	1.1	3.6	26.5	22.3
Private sector	31.0	58.7	40.2	18.7
Broad money	29.7	42.2	25.6	15.9
Income velocity (GDP/M2)	-15.5	-15.9	-8.0	-1.0
Interest rate (end of period, 1-2 year time deposits)	14.0	14.0	14.0	14.0 <u>4/</u>
	(In percent of GDP: unless otherwise specified)			
External sector				
Current account balance	-8.4	-6.8	-8.3	-7.3
External public debt (end of period) <u>5/</u>	44.1	41.6	40.9	45.4
Debt service (percent of exports of goods and services, and private transfers)	16.8	17.6	23.6	23.7
Government budget				
Revenue	8.8	8.2	8.9	9.5
Expenditure	19.9	17.4	17.2	16.8
Overall balance	-11.2	-9.2	-8.3	-7.3
Excluding food stocking	(-11.2)	(-9.1)	(-7.8)	(-7.3)
Domestic bank financing (net)	0.2	0.7	-0.2	-0.3
Foreign financing (net)	9.7	8.0	7.6	7.0
	(In millions of U.S. dollars: unless otherwise specified)			
External sector				
Current account balance	-1,026	-948	-1,270	-1,090
Overall balance	341	218	-59	30
Gross official reserves (end of period)	358	539	395	422
In months of merchandise imports	(1.9)	(2.7)	(1.8)	(2.1)

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

1/ End of period. The index is based on overall CPI for middle-income families in Dhaka City (1973/74 = 100). Negative sign indicates real effective depreciation of the exchange rate.

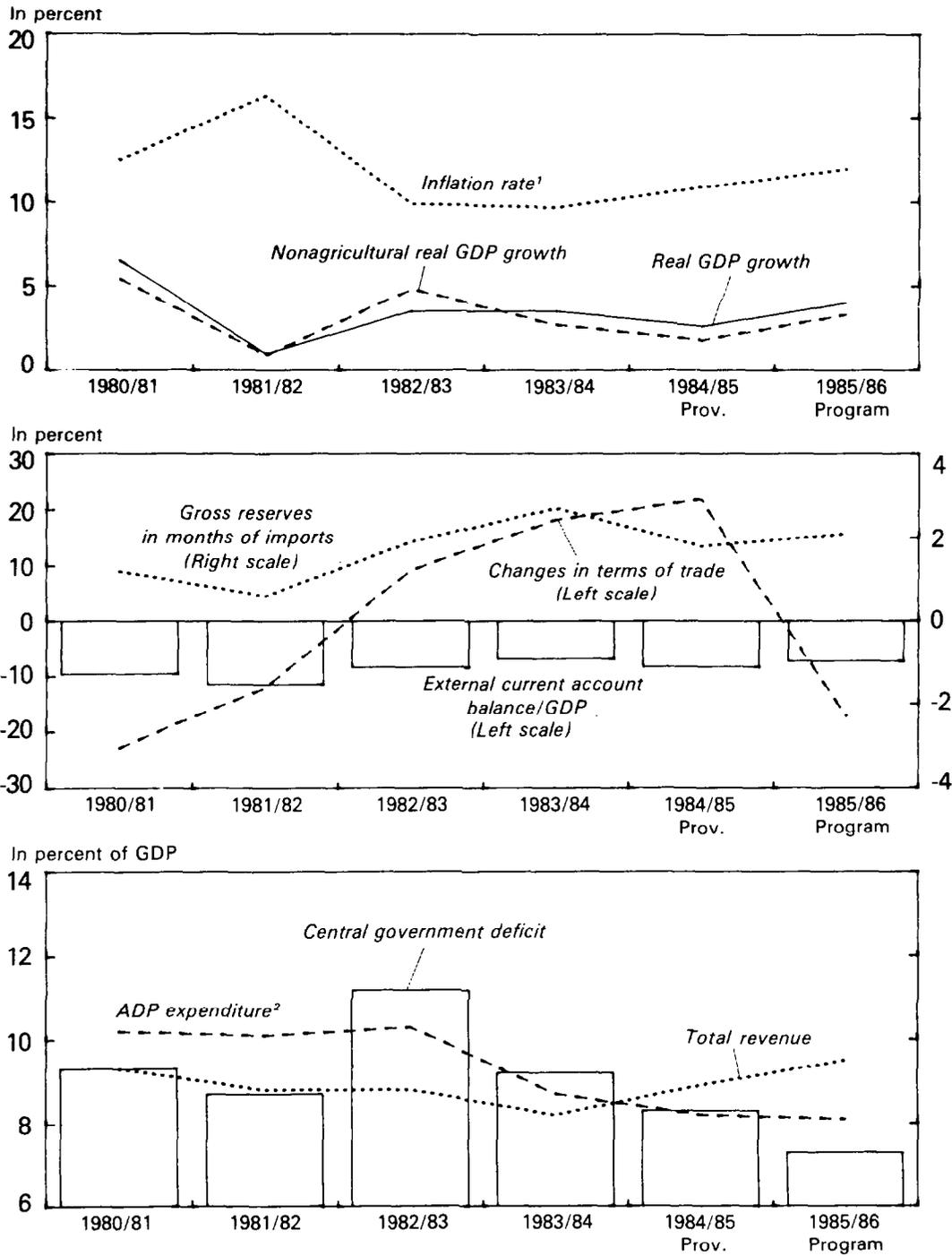
2/ During the 12-month period ended August 1985.

3/ Based on the new monetary data agreed with the authorities in September 1985.

4/ As of end-October 1985.

5/ Includes use of Fund credit and short-term debt.

CHART 1
 BANGLADESH
 SELECTED ECONOMIC INDICATORS,
 1980/81-1985/86



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

¹Based on the CPI for middle income families in Dhaka city (1973/74 = 100).

²Annual Development Program.



Table 3. Bangladesh: Central Government Operations, 1982/83-1985/86

	1982/83	1983/84	1984/85 Prelim. Actual	1985/86	
				Budget	Program ^{1/}
(In billions of taka)					
Total revenue	25.40	28.60	35.75	39.81	43.66
Tax	21.08	23.70	28.70	32.52	35.87
Nontax	4.32	4.90	7.05	7.29	7.79
Total expenditure	57.80	60.65	69.13	77.13	77.21
Current expenditure	19.20	23.03	27.38	31.53	32.03
Food account deficit	6.56	3.80	4.32	3.47	3.78
Of which: foodstock change	(-0.03)	(0.27)	(1.90)	(0.56)	(--)
Annual Development Program (ADP)	29.80	30.11	32.90	38.26	37.36
Other capital expenditure and net lending ^{2/}	2.24	3.71	4.53	3.87	4.04
Overall budget deficit Excluding foodgrain stocking	32.40 (32.43)	32.05 (31.78)	33.38 (31.48)	37.32 (36.76)	33.55 (33.55)
Net foreign financing ^{3/}	28.25	27.87	30.29	34.66	32.38
Project aid	13.44	13.31	15.75	21.30	18.52
Commodity aid	9.00	9.63	9.65	11.00	11.50
Food aid	6.40	6.97	4.92	6.55	6.55
Commercial food borrowing (net)	1.23	-0.41	2.55	-1.50	-1.50
Debt amortization	-1.82	-1.63	-2.58	-2.69	-2.69
Net domestic financing	4.15	4.18	3.09	2.66	1.17
Banking system	0.27	4.27	-0.66	-2.00	-1.30
Other domestic ^{4/}	3.88	-0.09	3.75	4.66	2.47
(Annual percentage change)					
Memorandum items:					
Total revenue	9.5	12.6	25.0	11.4	22.1
Total expenditure	25.3	4.9	14.0	11.6	11.7
Current expenditure	29.7	19.9	18.9	15.2	17.0
ADP	11.2	1.0	9.3	16.3	13.6
(In percent of GDP)					
Total revenue	8.8	8.2	8.9	8.7	9.5
Tax revenue	7.3	6.8	7.2	7.1	7.8
Nontax revenue	1.5	1.4	1.7	1.6	1.7
Total expenditure	19.9	17.4	17.2	16.8	16.8
Current expenditure	6.6	6.6	6.8	6.9	7.0
ADP	10.3	8.7	8.2	8.3	8.1
Overall budget deficit	11.2	9.2	8.3	8.1	7.3
Excluding food-stocking	(11.2)	(9.1)	(7.8)	(8.0)	(7.3)

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

^{1/} Including all new revenue measures and impact of exchange rate adjustments.

^{2/} Comprises non-ADP project expenditure, the Food for Work Program, miscellaneous investment (nondevelopment) and net loans and advances to state economic enterprises. A major part of gross lending by the Government is included within the ADP.

^{3/} Includes foreign grants.

^{4/} Includes a residual item; the sign of the residual in 1983/84 could partly be indicative of an underestimation of expenditure and/or overestimation of revenue.

(Table 4). There was a net repayment by the Government to the banking system, while growth in credit to the rest of the public sector rose to over 26 percent. The latter development was in line with the sharper deterioration in the overall financial position of public enterprises than earlier indicated. In particular, credit needs of the Bangladesh Jute Mills Corporation, the Bangladesh Jute Corporation, and the Bangladesh Agricultural Development Corporation were strong. Higher financing for jute was related mostly to the sharp increase in raw jute prices which raised production costs relative to jute goods prices. Agricultural credit demand, both in the public and private sectors, was also partly in response to additional financing needs resulting from the floods earlier in the year. The growth in credit to the private sector exceeded 40 percent during 1984/85, although remaining substantially below the rate attained in 1983/84. The deceleration occurred mostly during the final quarter of the fiscal year in response to a number of measures adopted earlier, including adjustments in interest rates and efforts to improve loan recovery. The turnaround in the external situation evidenced by the decline in the net foreign assets of the banking system was significant, although less pronounced than indicated by the earlier data. Nevertheless, total liquidity growth remained high during 1984/85 at 25.6 percent.

Provisional balance of payments data for 1984/85 indicate a more favorable outcome than earlier estimated (Table 5 and Appendix Table 6). The current account deficit was \$1,270 million (8.3 percent of GDP), compared with the previous estimate of \$1,397 million (9.1 percent of GDP). The improved outturn reflects, for the most part, lower foodgrain imports due to delays in certain shipments, a smaller net outflow on the services account, and some recovery in private transfers in the final months of the year. Nevertheless, there was a notable deterioration over the current account deficit of \$948 million (6.8 percent of GDP) recorded in 1983/84. Net nonmonetary capital inflows during 1984/85 remained below the earlier estimates, reflecting mostly larger repayments of food credits and shortfalls in project aid disbursements. The overall balance reverted to a deficit of \$59 million in 1984/85 (earlier estimated at \$73 million) from a surplus of \$218 million in the previous year. This resulted in a heavy drawdown in gross international reserves to \$395 million, equivalent to 1.8 months' imports. The debt service ratio rose to 23.6 percent from 17.6 percent in the previous year, reflecting a sharp increase in long-term debt amortization, as well as large repayments of food credits and repurchases due to the Fund.

III. The Adjustment Program for 1985/86 1/

The major objectives of the economic and financial program for 1985/86, in support of which the authorities have requested the use of

1/ This section highlights and elaborates on economic and financial policies for 1985/86 discussed in SM/85/264, 9/23/85, pp. 12-19.

Table 4. Bangladesh: Monetary Survey, 1982/83-1985/86

	1982/83	1983/84	1984/85	1985/86 Program <u>1/</u>
(In millions of taka; end-June)				
Net foreign assets	<u>-3,909</u>	<u>1,472</u>	<u>-25</u>	<u>810</u>
Net domestic assets	<u>62,892</u>	<u>82,387</u>	<u>105,367</u>	<u>121,270</u>
Domestic credit	<u>75,406</u>	<u>98,735</u>	<u>124,609</u>	<u>143,410</u>
Public sector	<u>44,431</u>	<u>49,590</u>	<u>55,702</u>	<u>61,620</u>
Government (net)	(19,805)	(24,070)	(23,408)	(22,110)
Other public sector	(24,626)	(25,520)	(32,294)	(39,510)
Of which: Jute				
Corporations <u>2/</u>	(...)	(2,236)	(4,940)	(8,140)
Private sector	30,975	49,145	68,907	81,790
Other items (net)	<u>-12,514</u>	<u>-16,348</u>	<u>-19,242</u>	<u>-22,140</u>
Broad money	<u>58,983</u>	<u>83,859</u>	<u>105,342</u>	<u>122,080</u>
Money	<u>26,343</u>	<u>35,500</u>	<u>42,318</u>	...
Quasi-money	<u>32,640</u>	<u>48,359</u>	<u>63,024</u>	...
(Annual percentage changes)				
Net domestic assets	11.2	31.0	27.9	15.1
Domestic credit	11.6	30.9	26.2	15.1
Public sector	1.2	11.6	12.3	10.6
Government (net)	(1.4)	(21.5)	(-2.8)	(-5.5)
Other public sector	(1.1)	(3.6)	(26.5)	(22.3)
Private sector	31.0	58.7	40.2	18.7
Broad money	29.7	42.2	25.6	15.9

Sources: Bangladesh Bank; and staff estimates.

1/ Projected at constant exchange rates prevailing on June 30, 1985.

2/ Includes Bangladesh Jute Mills Corporation and Bangladesh Jute Corporation.

Table 5. Bangladesh: External Indicators,
1982/83-1985/86

(In millions of U.S. dollars; unless otherwise specified)

	1982/83	1983/84	1984/85 Prov.	1985/86 Program
Exports of goods and services	910	1,090	1,242	1,230
Imports of goods and services	-2,589	-2,665	-2,989	-2,844
Workers' remittances	634	602	431	504
Current account balance	-1,026	-948	-1,270	-1,090
As percent of GDP	(-8.4)	(-6.8)	(-8.3)	(-7.3)
Gross aid disbursements	1,345	1,268	1,267	1,292
Overall balance	341	218	-59	30
External debt ^{1/}	5,388	5,795	6,291	6,738
As percent of GDP	(44.1)	(41.6)	(40.9)	(45.4)
Percentage share of non- concessional debt in total	(13.3)	(11.4)	(10.7)	(9.1)
Debt service ratio ^{2/}	16.8	17.6	23.6	23.7
International gross reserves	358	539	395	422
In months of merchandise imports	(1.9)	(2.7)	(1.8)	(2.1)

Sources: Appendix Tables 7 and 8.

^{1/} Includes use of Fund credit and short-term loans.

^{2/} As percent of exports of goods and services, and private remittances.

the Fund's general resources, are to bring about an improvement in the external position and realize a higher rate of growth. Accordingly, the program aims at reducing the external current account deficit from 8.3 percent of GDP in 1984/85 to 7.3 percent in 1985/86, while achieving a real GDP growth of approximately 4 percent. Fiscal restraint and a tight credit program will help contain growth in aggregate demand and control inflation. However, substantial wage increases, adjustments in administered prices under the program, recent exchange rate actions, and continued flexible exchange rate management will result in an initial acceleration in the average rate of inflation to 12 percent during 1985/86. The authorities are committed to pursuing demand management policies that would reduce the rate of inflation significantly in 1986/87.

The authorities' adjustment program for 1985/86 focuses on: mobilization of additional domestic resources through the adoption of new revenue measures; more efficient allocation of resources through reductions in subsidies and the pursuit of appropriate pricing policies; implementation of restrained monetary and credit policies in order to contain inflationary pressures and stimulate domestic savings; and export promotion and diversification through the provision of adequate incentives and further liberalization of the trade and payments system. The authorities are committed to flexible exchange rate management in order to restore and maintain external competitiveness.

1. Fiscal policy

The authorities' fiscal policy in 1985/86 is designed to ensure that the level of total government expenditure is consistent with available resources. In support of this policy, efforts are being made to increase domestic resource mobilization, reduce subsidies, and restrict the size of the Annual Development Program (ADP) in line with the expected inflow of foreign assistance and the availability of domestic nonbank resources.

The 1985/86 program foresees an overall budget deficit of Tk 33.6 billion, approximately the same magnitude as in 1984/85, but the ratio of the deficit to GDP is projected to decline by 1 percentage point to 7.3 percent; excluding the impact of food-stocking operations, the ratio is projected to decline by 0.5 percentage point. Net indebtedness of the Government to the banking system is expected to be reduced further by Tk 1.3 billion (0.3 percent of GDP). Taking into account the budgetary impact of the new revenue measures and exchange rate adjustments, total revenue is projected to grow by approximately 22 percent and total expenditure by close to 12 percent. Revenue estimates for 1985/86 are substantially higher than those announced with the budget in June, owing to a more favorable 1984/85 outcome, the introduction of additional revenue measures in August and September, and the expected larger profit and dividend transfers in 1985/86. Revenues in 1984/85 were larger than earlier estimated, reflecting mainly higher receipts from customs duties and sales taxes. The additional revenue measures

include an increase in the rate of customs duty on sugar from 75 percent to 100 percent in order to contain sugar imports and capture excess profits accruing to private importers; imposition of surcharges on selected services and increases in certain fees; and introduction of a 4 percent charge on interest paid on all savings and financial instruments. Revenue measures announced earlier in the budget, which included increases in excise taxes, reductions in income tax rates to promote wider coverage and higher tax compliance, an increase in the land tax rate, modifications in customs duties and sales taxes on imports, and increases in a number of fees and charges, were estimated to yield approximately Tk 1.8 billion in additional revenue. Together with the subsequent measures, the total yield from new measures is now estimated to be in excess of Tk 2.0 billion in 1985/86, equivalent to 0.4 percent of GDP. Exchange rate adjustments are expected to also add some Tk 2.0 billion, partly offsetting the low income elasticity of the tax system. Thus, total revenue to GDP ratio is projected to rise from 8.9 percent in 1984/85 to 9.5 percent in 1985/86, with tax revenue to GDP ratio increasing from 7.2 percent to 7.8 percent.

Given the sizable salary and wage increases granted at the outset of the fiscal year, the authorities intend to apply firm control to other expenditure components in order to reduce the ratio of total government expenditure to GDP from 17.2 percent in 1984/85 to 16.8 percent in 1985/86. This projected decline is all the more significant given the impact of exchange rate adjustments on total expenditure, estimated at 0.7 percent of GDP.

In line with the recommendations of two National Pay Commissions, salaries and wages were increased with the 1985/86 budget by an average of 28 percent retroactive to June 1, 1985. The increases are estimated to entail an additional net outlay of Tk 3 billion for the Central Government (equivalent to about 37 percent of the programmed increase in total government expenditure in 1985/86), and Tk 1 billion for public sector organizations. The salary and wage increases were undertaken with the encouragement of aid donors, particularly the World Bank, with a view to improving the efficiency of the civil service. Given the tight budget situation, the staff believes that these increases were too large and not sufficiently targeted toward the highly skilled segments of the civil service.

In order to contain wage and salary expenditure, a freeze has been imposed on new hirings in most areas of the public service. Other expenditure reductions will also be undertaken. The authorities will take measures to reduce the food subsidy and the fertilizer subsidy by Tk 0.4 billion each during the fiscal year. Unit subsidies under the public food distribution system are to be reduced with adjustments in rice and wheat offtake prices. With a view to phasing out the fertilizer subsidy by the beginning of the next fiscal year, in accordance with the understanding reached with the World Bank, the average fertilizer price was raised by 3 percent effective July 1, and by a further 6 percent effective October 1, 1985.

The Annual Development Program (ADP) has been set below the 1984/85 budgeted level. Nevertheless, because of significant shortfalls in development expenditure during 1984/85, the ADP for 1985/86 is projected to increase slightly in real terms, and to approximately maintain its relative share in GDP. In the past two fiscal years, ADP expenditures were substantially below budget estimates, mainly because of bottlenecks in project preparation, approval, and implementation. The staff urged the authorities to develop, preferably in consultation with the World Bank staff, a program specifically aimed at overcoming these difficulties. Moreover, the staff encouraged the authorities to formulate an Operations and Maintenance Budget, along the lines recommended by the World Bank staff, to protect past investment and make completed projects more productive. The authorities recognize that progress in these areas will enable greater utilization of the sizable aid pipeline and significantly enhance their development effort.

A number of adjustments have recently been undertaken in the prices and tariffs charged by nonfinancial public enterprises. These include a 20 percent increase in the price of natural gas in July; an average increase of 6 percent in the electricity tariff in July, and 18 percent in September; a 25 percent increase in water and sewerage charges retroactive to June; and increases ranging from 5 percent to 20 percent in railway fares in July. Domestic air fares are also expected to be increased by 15 percent to 25 percent in the coming months. Public enterprises have been instructed to reflect actual production costs in their selling prices. Moreover, in view of the higher costs that public enterprises are expected to face this year, particularly in light of increases in wages and certain imported input costs, the Government has emphasized the crucial need to raise capacity utilization, improve management, and reduce inefficiency in the public enterprise sector.

2. Monetary policy and the credit program

The authorities are concerned with the recent rapid monetary expansion and have implemented a number of measures, beginning in late 1984, to curtail the growth in domestic credit. The monetary program for 1985/86 calls for monetary restraint and the strengthening of the measures adopted so far in order to contain inflation and improve the external balance. Accordingly, the growth in net domestic assets of the banking system will be limited to 15.1 percent during 1985/86, significantly below the 27.9 percent increase in 1984/85. Quarterly ceilings (performance criteria) have been set on net domestic assets of the banking system and on net credit from the banking system to the Government during the remainder of 1985/86. Indicative quarterly targets have also been established for credit to the rest of the public sector and total domestic credit (Appendix Table 7).

Growth in credit to the public sector as a whole is projected to slow down from 12.3 percent in 1984/85 to 10.6 percent in 1985/86. Net bank credit outstanding to the Government will be reduced by 5.5 percent during 1985/86, following a decline of 2.8 percent in 1984/85. Credit

to other public sector (mostly nonfinancial public enterprises) is programed to increase by 22.3 percent, compared with 26.5 percent in 1984/85. The relatively strong credit growth to the public enterprise sector is attributable, in large part, to the financing needs of enterprises engaged in jute operations. The jute crop during the current year is projected to far exceed earlier estimates owing to increased jute cultivation in response to the very strong raw jute prices last year. The Bangladesh Jute Corporation is required to purchase the additional quantity of raw jute, mostly to add to buffer stocks, at a certain minimum price to the grower in order to avoid the collapse of domestic raw jute prices. Financing of jute-related transactions account for approximately 44 percent of the programed increase in credit to the public sector other than the Central Government.

Credit projections for the private sector take into account the need not to unduly constrain the productive sectors of the economy, and to achieve a reduction in the present excessive proportion of overdue loans in total bank loans. Growth in credit to the private sector, therefore, is projected not to exceed 18.7 percent during 1985/86, compared with an increase of over 40 percent in the previous year. The effectiveness of monetary management has been seriously impaired in recent years by the large and growing stock of overdue agricultural and industrial loans, concentrated mostly in the private sector. ^{1/} This has resulted in inefficient resource allocation and jeopardized the solvency of financial institutions. Major aid donors, notably the World Bank and the Asian Development Bank, are also seriously concerned about this problem, and have made certain new loans contingent on improvements in loan recovery rates. In recognition of the crucial need to redress this situation, the authorities have adopted a number of measures to strengthen the legal framework and take action against defaulters; improve the accounting and monitoring of overdue amounts; and, in the case of agricultural loans, make additional refinancing through Bangladesh Bank conditional on meeting established loan recovery targets.

The credit program for 1985/86 is consistent with the projected movement in the net foreign assets of the banking system and with the expected developments in the demand for broad money. Since 1981/82, the growth in broad money has been significantly higher than the growth in nominal GDP, reflecting, in part, a moderation in inflationary expectations and the attraction of funds into the banking system with the expansion of bank branches into rural areas and the maintenance of positive real rates of return on financial savings. The steady and large decline in the income velocity of broad money experienced in recent years is expected to be virtually arrested in 1985/86; the projected growth in the demand for broad money implies an approximately stable income velocity. Such an outcome would partly reflect a rise in inflationary expectations in light of the recent price, wage, and

^{1/} For a more detailed discussion of overdue loans see SM/85/264, 9/23/85, p. 16 and SM/85/276, 10/8/85, pp. 34-35.

exchange rate adjustments. Broad money is expected to grow by 15.9 percent during 1985/86, remaining substantially below the average growth in broad money (over 30 percent per annum) observed over the preceding two years.

With the moderation of inflation in recent years, key interest rates have continued to be positive in real terms. The authorities are committed to a flexible interest rate policy to promote domestic resource mobilization and ensure an efficient allocation of financial resources. In this regard, the recent adjustments in the Bangladesh Bank rate, and the linkage of refinance rates for individual sectors to the Bangladesh Bank rate, are moves in the right direction. Interest rates will continue to be monitored during the program period, and the needed adjustments undertaken with a view to maintaining positive real interest rates.

3. External policies

a. Balance of payments outlook for 1985/86

While the balance of payments continues to be under pressure, the outlook for 1985/86 is somewhat more favorable than projected earlier. The current account deficit is expected to be reduced significantly despite an anticipated 17 percent decline in the terms of trade. The adjustment will be brought about largely by a significant decline in foodgrain imports, and a resumption in the growth of private transfers, partly in response to the more flexible exchange rate policy, but also as a result of some revival in the demand for Bangladesh workers in the Middle East. Export receipts are projected to grow only slightly to reach \$940 million. Export volume is forecast to rise by some 24 percent, led by a recovery in the sales of raw jute, tea, and leather, while export prices are expected to fall by about 19 percent, due largely to the projected sharp decline in raw jute, and tea prices. Imports are projected to fall by close to 7 percent in nominal terms and by about 5 percent in volume, due almost entirely to sharply reduced foodgrain imports following an improvement in domestic foodgrain production. With the deterioration in the net services balance fully offset by the anticipated increase in private transfers, the current account deficit is projected to be reduced from \$1.27 billion (8.3 percent of GDP) in 1984/85 to \$1.09 billion (7.3 percent of GDP) in 1985/86. Net nonmonetary capital inflows are expected to decline by close to \$90 million, reflecting sizable debt repayments coming due, which will more than offset the modest growth in aid disbursements. Heavy external debt amortization, coupled with a slight decline in exports of goods and services, will be largely responsible for the continued high debt service ratio of approximately 24 percent in 1985/86. Reflecting the improvement in the current account, the overall balance of payments will revert from a deficit of \$59 million in 1984/85 to a surplus of \$30 million in 1985/86. After allowing for a net repurchase of \$3 million to the Fund, there will be a moderate buildup in gross international reserves to \$422 million, equivalent to 2.1 months of imports. Given

the vulnerability of the balance of payments to external shocks, the authorities are fully aware of the desirability of strengthening the country's reserve position.

b. Exchange and trade policies

During the period February-October 1985, the taka was depreciated in several small steps by 13.3 percent in terms of the U.S. dollar to Tk 30 per US\$1 at end-October 1985. Preliminary staff calculations indicate that in light of the above depreciation and the recent weakening of the U.S. dollar, the real effective appreciation of the taka relative to its base level (the first quarter of 1983) ^{1/} has been mostly eliminated (Chart 2). The authorities are committed to continue pursuing a flexible exchange rate policy in order to fully restore international competitiveness as soon as feasible, and, thereafter, not to allow the official real effective exchange rate of the taka to appreciate relative to its base level. Presently, the official exchange rate is at a discount of approximately 9.5 percent relative to the secondary market rate. By adjusting the official exchange rate as and when needed, the authorities will ensure that the official rate is not at an excessive discount relative to the secondary market rate.

The staff urged the authorities to unify the exchange markets at the earliest opportunity. In recognition of the merits of unification, the scope of the secondary exchange market was expanded significantly, effective July 1, 1985. As a result, approximately 50 percent of all export earnings are now sold in the secondary exchange market, compared with about 23 percent in 1984/85. It is the intention of the authorities to transfer more transactions to the secondary market during 1986/87. The authorities have also taken steps to ensure that the secondary market is a free interbank market, with no net foreign exchange sales, on a quarterly basis, by Bangladesh Bank in this market. To further liberalize the trade and payments system, the authorities have moved from a positive import list to a negative list with effect from July 1, 1985. Despite this move, Bangladesh's trade and payments system retains certain restrictive elements owing to the foreign resource constraints and the perceived need to protect domestic industries. Balance of payments difficulties preclude the further liberalization of the system at the present time, but remaining restrictions will be eased gradually as the external situation permits.

The Exchange Rate Fluctuation Burden Absorption Scheme (EFAS) was established in August 1983. Under the provisions of the Scheme, Bangladesh Bank stands ready to provide exchange rate guarantees on certain concessional project loans against the payment of a 2.5 percent annual premium of the outstanding amount of the loan. Although very few eligible borrowers have taken option under the EFAS, the authorities agree with the staff that the Scheme could give rise to a multiple

^{1/} The average real effective exchange rate of the taka during the first quarter of 1983 was the lowest quarterly level since 1977.

CHART 2 BANGLADESH EXCHANGE RATE DEVELOPMENTS, 1980-85



Sources: Data provided by the Bangladesh authorities, and IFS.

¹Nominal effective exchange rate adjusted by relative movements in CPIs in trading partners, except for India where WPI is used



currency practice in the future, distort investment decisions, and might result in substantial losses to Bangladesh Bank. Accordingly, the authorities have taken steps to ensure that losses are not incurred under the EFAS, and that the operation of the EFAS does not affect the exchange system. Unless extended, the EFAS will expire on June 30, 1988.

c. External debt management

The ratio of outstanding external debt to GDP is projected to rise from 41 percent in 1984/85 to 45 percent in 1985/86 (Table 5). Within this total, the share of nonconcessional debt will decline slightly to 9 percent. The debt service ratio, measured as a percent of receipts from exports of goods and services and private transfers, is projected to remain at just under 24 percent in 1985/86. The high debt service ratio during 1984/85 and 1985/86 reflects mainly sizable repurchases due to the Fund and large repayments of food credits.

In order to contain external debt service obligations over the medium term, the authorities intend to strictly limit new borrowing on short-term maturity and on nonconcessional terms. Specifically, they intend to avoid borrowing in the 1-5 year maturity range, except in emergencies or to finance the rollover of existing debt. Accordingly, during 1985/86, the contracting or guaranteeing of new external loans with maturities of 1-12 years on nonconcessional terms by the public sector will be limited to \$100 million. Within this ceiling, a sub-ceiling of \$75 million will apply to loans of 1-5 year maturity. In addition, the outstanding stock of publicly guaranteed external short-term debt (i.e., with maturity of less than 1 year), including outstanding external short-term liabilities of Bangladesh Bank, will not increase by more than \$11 million during 1985/86. The projected increase is largely to allow for the financing of oil imports through short-term loans obtained from the Islamic Development Bank. The observance of the above limits, on external debt constitutes performance criteria.

4. Performance criteria and phasing of purchases

The program contains the following quantitative performance criteria for the remainder of 1985/86: (a) quarterly ceilings on net domestic assets of the banking system, including subceilings on net credit from the banking system to the Government; and (b) a continuous ceiling on the contracting or guaranteeing of public nonconcessional external debt of 1-12 years' maturity, including subceilings on external debt of 1-5 years' maturity, and a ceiling on the outstanding stock of public short-term external debt. The program contains the customary clauses regarding the intensification of exchange and trade restrictions. In addition, as performance criteria, the program provides for two reviews, the first to be completed before end-August 1986, and the second before end-February 1987. Quantitative performance criteria for the remaining period of the stand-by arrangement will be established

during the first review. During the course of the reviews, the staff will discuss with the authorities progress made toward achieving the growth, inflation, and balance of payments objectives; review progress made toward unification of the exchange markets through the transfer of more transactions to the secondary market; and, assess the need for further adjustments in exchange rate, credit, interest rate, fiscal, and pricing policies.

Purchases under the program are expected to be made as follows: SDR 36 million upon Executive Board approval of the request, and the remaining amount in six equal installments of SDR 24 million each conditional on meeting performance criteria at the end of the six successive quarters, beginning in December 1985. The fourth drawing will also be contingent on completion of the first review, and the sixth drawing on completion of the second review. Total purchases will not exceed SDR 84 million (29.2 percent of quota) until the completion of the first review, and will not exceed SDR 132 million (45.9 percent of quota) until the completion of the second review.

IV. Medium-Term Outlook

Medium-term staff projections indicate that, even on the assumption of a stable terms of trade and absence of severe external shocks, Bangladesh will continue to face serious external resource constraints during the four-year period ending 1989/90. Despite the initiation of policies to promote expansion and diversification of exports, progress is expected to be slow. Further, ready-made garments, the major source of the recent remarkable growth in nontraditional exports, will face international textile quotas. Assuming a moderate but steady growth in export volumes, the value of exports is projected to grow by about 8 percent annually over the four-year period (Appendix Table 8). In contrast, private transfers are projected to remain constant in nominal terms, largely because the demand for Bangladesh workers abroad is likely to be constrained by economic conditions in host countries. Moreover, Bangladesh will continue to face relatively high debt service payments, which are projected to exceed 16 percent of export earnings and private transfers. These projections, together with the need to maintain gross international reserves at a minimum desirable level, suggest that Bangladesh will continue to rely heavily on foreign assistance over the medium term. Assuming that real aid disbursements continue to increase by the recent trend rate of 2 percent per annum, and that gross international reserves are maintained at about two months of imports (a barely adequate level given the narrow export base and the vulnerability of the balance of payments to exogenous shocks), real import growth will need to be limited to about 2 percent per annum. Assuming normal weather, such import growth would support a 3 percent annual average real growth of GDP during the period under consideration, implying only marginal real growth in per capita income, which is one of the lowest in the world.

The above medium-term projections are highly sensitive to the underlying assumptions, especially with respect to the domestic policies pursued, aid disbursements, and other exogenous factors, including weather. The World Bank staff believes that a higher rate of economic growth over the medium term could be achieved. This, however, would entail a higher import growth and accompanying aid disbursements, and necessitate intensified adjustment efforts over the medium term. In particular, Bangladesh needs to further strengthen its efforts to promote exports and to increase productivity through appropriate maintenance of existing capital, as well as improved project implementation. In this connection, the World Bank and other major donors could play an important role.

V. Staff Appraisal

Bangladesh's economic performance markedly deteriorated during 1984/85. Heavy floods caused large losses to agricultural production, and adversely affected the rest of the economy. The growth of real output declined to a level barely above that of population growth, inflation accelerated, and the external current account deficit widened mainly because of emergency foodgrain imports and a sharp drop in workers' remittances. The rapid monetary expansion, particularly during the first half of the fiscal year, was another important factor contributing to balance of payments pressures that resulted in a significant depletion of international reserves. The authorities began to implement corrective measures in mid-1984/85. Restrictive monetary measures were introduced, and a more flexible exchange rate policy was initiated. These steps laid the groundwork for the 1985/86 economic and financial program, in support of which the authorities have requested a stand-by arrangement from the Fund.

The program focuses on mobilization of domestic resources, further tightening of monetary policy, and liberalization of the trade and payments system to be supported by flexible exchange rate management. The major objectives of the program are to reduce the ratio of the external current account deficit to GDP from 8.3 percent in 1984/85 to 7.3 percent in 1985/86, while raising the growth of real output from 2.6 percent to about 4 percent. The rate of inflation is expected to be brought under control after rising slightly to 12 percent in the initial year of the program, reflecting the impact of exchange rate and wage adjustments on domestic prices.

Fiscal measures constitute a vital component of the adjustment effort, with the overall budget deficit programed to be reduced from 8.3 percent of GDP in 1984/85 to 7.3 percent in 1985/86. Revenue measures included in the budget and announced subsequently, an Annual Development Program that is consistent with available resources, reductions in food and fertilizer subsidies in consultation with the World Bank, and significant adjustments in the prices charged by public enterprises are clear evidence of the authorities' determination to

pursue policies aimed at increasing domestic resource mobilization and improving the efficiency of resource allocation. While this package of fiscal measures is highly commendable, the staff considers that firm resolve in this area needs to be maintained in coming years. In addition, the staff believes that closer cooperation with the World Bank in the following areas will improve Bangladesh's capacity to efficiently absorb foreign assistance: phasing out the fertilizer subsidy and limiting foodgrain subsidies to meet the needs of the lowest income groups; achieving a higher level of efficiency in project design and implementation; and raising productivity of completed projects through the adoption of a well-conceived operations and maintenance program.

The staff supports the authorities' intention to further tighten monetary policy in order to contain the impact of the devaluation on domestic prices and to achieve balance of payments targets. Net outstanding credit to the Government is expected to decline by close to 6 percent, and despite the exceptional need of the jute sector, the growth in credit to public enterprises is expected to decline moderately. Most notable in this year's credit program is the significant reduction in the growth of credit to the private sector, which is intended, in particular, to encourage banks to intensify their efforts to recover overdue loans and maintain the revolving character of bank credit. The rapid accumulation of overdue loans has been a major source of concern to aid donors, particularly IDA. While it is recognized that progress in this field will inevitably be slow, the staff would, nevertheless, urge the authorities to strengthen their resolve and initiate, in consultation with the World Bank, further measures to bring about a noticeable improvement in the rate of loan recovery. Key interest rates will be maintained at positive levels in real terms. In this connection, the staff welcomes the recent increase in the Bangladesh Bank rate, the linkage of refinance rates to the Bank rate, and the authorities' decision to make additional refinancing conditional on improvements in loan recovery.

The authorities have implemented a number of external adjustment measures. During February-October 1985, the official exchange rate of the taka was depreciated by 13.3 percent in terms of the U.S. dollar. The authorities are committed to a flexible exchange rate management in order to restore and maintain external competitiveness, and to promote a shift of resources to the traded goods sector. The authorities recognize the merits of unifying the exchange markets. Toward this end, they have substantially expanded the scope of the secondary exchange market, and have undertaken not to permit the official exchange rate to be at an excessive discount to the secondary market rate. To avoid further depletion of reserves, the authorities have undertaken not to effect net sales of foreign exchange in the secondary market. These highly commendable measures were accompanied by the adoption of a negative import list--a major trade liberalization step.

Inasmuch as the Bangladesh economy will remain vulnerable to external shocks in the medium term, the staff would stress the need to maintain international reserves at an adequate level. Toward this end, it is essential to diversify exports and accelerate their growth by continuing the present course of exchange rate policy, and providing other appropriate incentives. The staff commends the authorities' long-standing policy to limit external borrowing on nonconcessional terms, and encourages the maintenance of this cautious approach to external debt management. The staff believes that the authorities' economic and financial program constitutes a comprehensive adjustment effort that will bring about an improvement in the external position and permit a moderate increase in gross reserves. The program is an important phase in the authorities' continuing effort to achieve a more satisfactory rate of economic growth and a sustainable balance of payments position. In recent years, Bangladesh has implemented significant adjustment policies. These considerations, and the need to strengthen the balance of payments, justify access to Fund resources in the amount proposed.

VI. Proposed Decision

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

1. The Government of Bangladesh has requested a stand-by arrangement in the amount of SDR 180 million for the period from December ..., 1985 to June 30, 1987.

2. The Fund approves the stand-by arrangement attached to EBS/85/251 and waives the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement.

Table 6. Bangladesh: Balance of Payments, 1982/83-1985/86

(In millions of U.S. dollars; unless otherwise specified)

	1982/83	1983/84	1984/85 Prov.	1985/86 Program
Trade balance	-1,566	-1,542	-1,701	-1,520
Exports, f.o.b.	680	811	932	940
Imports, c.i.f.	-2,246	-2,353	-2,633	-2,460
Food	(-385)	(-398)	(-452)	(-280)
Nonfood	(-1,861)	(-1,955)	(-2,181)	(-2,180)
Services (net)	-113	-33	-46	-94
Receipts	230	279	310	290
Payments	-343	-312	-356	-384
Of which: Interest	(-126)	(-112)	(-121)	(-117)
Private transfers	653	627	477	524
Of which: Workers' remittances	(634)	(602)	(431)	(504)
Current account balance	-1,026	-948	-1,270	-1,090
Nonmonetary capital movements (net)	1,282	1,224	1,208	1,120
Aid disbursements	1,345	1,268	1,267	1,292
Food aid	(255)	(277)	(244)	(228)
Commodity aid	(452)	(439)	(432)	(425)
Project aid	(638)	(552)	(591)	(639)
Amortization payments	-73	-72	-107	-91
Trust Fund (net)	-1	-8	-13	-25
Food credits (net)	47	-9	91	-66
Other (net)	-36	45	-30	10
SDR allocation	--	--	--	--
Errors and omissions (net) ^{1/}	85	-58	3	--
Overall balance	341	218	-59	30
Financing items	-341	-218	59	-30
Fund credit (net)	48	19	-11	-3
Others	-389	-237	70	-27
Memorandum items:				
Current account balance				
In percent of GDP	(-8.4)	(-6.8)	(-8.3)	(-7.3)
Gross reserves	358	539	395	422
In months of merchandise imports	(1.9)	(2.7)	(1.8)	(2.1)
Debt service as percent of exports of goods and services and private transfers	16.8	17.6	23.6	23.7
Terms of trade index (Percentage change)	9.2	18.2	21.8	-17.2

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

^{1/} Includes valuation adjustments.

Table 7. Bangladesh: Monetary Survey, June 1985-June 1986

(In millions of taka; end of period)

	1985 June Actual	1985 August Actual	1985 Dec.	1986 March Program <u>1/</u>	1986 June
Net foreign assets	<u>-25</u>	<u>-3,089</u>	<u>-1,220</u>	<u>-460</u>	<u>810</u>
Net domestic assets	<u>105,367</u>	<u>104,045</u>	<u>114,600</u> <u>2/</u>	<u>116,100</u> <u>2/</u>	<u>121,270</u> <u>2/</u>
Domestic credit	<u>124,609</u>	<u>124,741</u>	<u>134,680</u>	<u>137,300</u>	<u>143,410</u>
Public sector	<u>55,702</u>	<u>55,972</u>	<u>59,280</u>	<u>59,660</u>	<u>61,620</u>
Government (net)	<u>(23,408)</u>	<u>(23,996)</u>	<u>(22,300)</u> <u>2/</u>	<u>(21,320)</u> <u>2/</u>	<u>(22,110)</u> <u>2/</u>
Other public sector	<u>(32,294)</u>	<u>(31,976)</u>	<u>(36,980)</u>	<u>(38,340)</u>	<u>(39,510)</u>
Of which: Jute Coporations <u>3/</u>	<u>(4,940)</u>	<u>(...)</u>	<u>(...)</u>	<u>(...)</u>	<u>(8,140)</u>
Private sector	<u>68,907</u>	<u>68,769</u>	<u>75,400</u>	<u>77,640</u>	<u>81,790</u>
Other items (net)	<u>-19,242</u>	<u>-20,696</u>	<u>-20,080</u>	<u>-21,200</u>	<u>-22,140</u>
Broad money	<u>105,342</u>	<u>100,956</u>	<u>113,380</u>	<u>115,640</u>	<u>122,080</u>
<u>(Annual percentage changes)</u>					
Net domestic assets	27.9	...	14.9	23.3	15.1
Domestic credit	26.2	...	19.3	21.1	15.1
Public sector	12.3	...	10.8	13.2	10.6
Government (net)	<u>(-2.8)</u>	<u>(...)</u>	<u>(--)</u>	<u>(4.2)</u>	<u>(-5.5)</u>
Other public sector	<u>(26.5)</u>	<u>(...)</u>	<u>(18.5)</u>	<u>(18.9)</u>	<u>(22.3)</u>
Private sector	40.2	...	27.0	28.0	18.7
Broad money	25.6	...	12.7	22.0	15.9

Sources: Bangladesh Bank; and staff estimates.

1/ Projected at constant exchange rates prevailing on June 30, 1985.

2/ Credit ceilings under the proposed stand-by arrangement.

3/ Includes Bangladesh Jute Mills Corporation and Bangladesh Jute Corporation.

Table 8. Bangladesh: Medium-Term Projections, 1982/83-1989/90

(In millions of U.S. dollars; unless otherwise indicated)

	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
			Prov.	Program		Staff Projections		
External resources								
Availability	2,700	2,604	2,620	2,584	2,684	2,888	3,099	3,343
Export of goods ^{1/}	680	811	932	950	982	1,071	1,175	1,299
Private transfers	653	627	477	524	525	525	525	525
Capital account (net) ^{2/}	1,367	1,166	1,211	1,120	1,177	1,292	1,399	1,519
Of which: aid disbursements	(1,345)	(1,268)	(1,267)	(1,292)	(1,369)	(1,444)	(1,549)	(1,663)
Uses	2,359	2,386	2,679	2,554	2,644	2,788	3,489	3,203
Imports ^{3/}	2,246	2,353	2,633	2,460	2,547	2,691	2,892	3,105
Services (net) ^{4/}	113	33	46	94	97	97	97	98
Monetary movements (increase) ^{5/}	-341	-218	59	-30	-40	-100	-110	-140
Of which: IMF	(48)	(19)	(-11)	(-3)	(-18)	(-77)	(-64)	(-106)
Debt service payments								
Payments on existing debt	263	303	406	404	386	293	260	253
Interest ^{6/}	126	112	121	105	95	84	77	72
Of which: IMF charges ^{7/}	(38)	(38)	(36)	(27)	(19)	(11)	(6)	(3)
Amortization	137	191	285	299	290	210	184	181
Of which: IMF repurchases ^{7/}	(53)	(51)	(66)	(87)	(114)	(77)	(52)	(46)
Payments on new borrowings ^{8/}	--	--	--	12	34	46	66	110
Interest	--	--	--	12	24	36	43	50
Of which: IMF charges	--	--	--	2	11	15	15	12
Amortization	--	--	--	--	10	10	23	60
Of which: IMF repurchases	--	--	--	--	--	--	13	60
Total	263	303	406	416	419	339	326	363
Of which: IMF ^{7/}	(91)	(89)	(102)	(116)	(144)	(102)	(85)	(121)
Debt service as a percent of current receipts								
Excluding private transfers	28.9	27.8	32.7	33.8	32.7	24.5	21.7	22.1
Including private transfers	16.8	17.6	23.6	23.7	23.2	17.7	16.1	16.7
External debt as a percent of GDP								
	44.1	41.6	40.9	45.4	46.2	46.3	45.4	44.7
Memorandum items:								
Gross reserves (in millions of US\$)	358	539	395	422	444	468	514	548
In months of merchandise imports	(1.9)	(2.7)	(1.8)	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)
Current account deficit as a percent of GDP	8.4	6.8	8.3	7.3	7.3	7.2	7.1	7.0
Debt outstanding (end of period)	5,388	5,795	6,291	6,738	7,191	7,664	8,202	8,759
Of which: IMF ^{7/}	(401)	(406)	(388)	(386)	(368)	(291)	(227)	(121)

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

^{1/} In 1986/87 and beyond, the value of exports is projected to grow by about 8 percent annually (i.e., an increase of 4 percent in both volume and price).

^{2/} With the exception of an expected short-term loan of \$21 million in 1985/86, assumptions through 1989/90 are: no short-term borrowing; 2.2 percent real annual increase in project and commodity aid disbursements; and no real increase in food aid disbursements. For 1982/83-1984/85, net errors and omissions are included under capital (net).

^{3/} Import projections are consistent with an average real GDP growth of 3.2 percent per annum during the period 1986/87-1989/90.

^{4/} Includes interest payments on projected new borrowing.

^{5/} Assumes maintenance of gross international reserves at approximately eight weeks' imports during 1985/86-1989/90.

^{6/} Includes interest on short-term debt (i.e., debt of less than one-year maturity).

^{7/} Excludes Trust Fund and repayments of short-term debt.

^{8/} With the exception of a projected food credit of \$30 million and a short-term loan disbursement of \$21 million in 1985/86, all projected borrowings are assumed to be on concessional terms, with an average interest rate of 1.2 percent and a grace period of at least five years.

Bangladesh - Fund Relations
(As of October 31, 1985)

(Amounts in millions of SDRs, unless otherwise indicated)

I. Membership status

- (a) Date of Membership: August 17, 1972
(b) Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

- | | | |
|----------------------------------|--|---------|
| (a) Quota: | | 287.5 |
| (b) Total Fund holdings of taka: | | 643.1 |
| (As percent of quota) | | (223.7) |
| (c) Fund credit: | | 378.1 |
| (As percent of quota) | | (131.5) |
| Credit tranches | | 68.4 |
| (As percent of quota) | | (23.8) |
| Extended Fund Facility | | 103.0 |
| (As percent of quota) | | (35.8) |
| Supplementary Financing Facility | | 72.1 |
| (As percent of quota) | | (25.1) |
| Compensatory Financing Facility | | 134.6 |
| (As percent of quota) | | (46.8) |
| (d) Reserve tranche position: | | 22.4 |
| (e) Current operational budget: | | None |
| (f) Lending to the Fund: | | None |

III. Stand-By and extended arrangements

- (a) There is no current arrangement.
(b) Previous stand-by and extended arrangements during the last ten years.

<u>Type of Arrangement</u>	<u>Date of Approval</u>	<u>Duration</u>	<u>Amount</u>	<u>Utilization</u>
SBA	07/28/75	1 year	62.50	62.50
SBA	07/30/79	1 year	85.00	85.00
EFF	12/08/80	3 years ^{1/}	800.00	220.00
SBA	03/28/83	5 months	68.40	68.40

^{1/} Arrangement became inoperative in June 1981 and was cancelled in June 1982.

(c) Special facilities

<u>Type of Special Facility</u>	<u>Date of Approval</u>	<u>Amount</u>
CFF	02/17/82	60.00
CFF	08/30/82	71.20
CFF	04/10/85	54.95

IV. SDR Department

(a) Net cumulative allocation:	47.1
(b) Holdings:	6.4
(As percent of net cumulative allocation)	(13.5)

V. Administered accounts

(a) Trust Fund loans:	
(i) Disbursed	122.2
(ii) Outstanding	90.1
(b) SFF Subsidy Account:	
(i) Donations to Fund	--
(ii) Loans to Fund	--
(iii) Payments by Fund	14.8

VI. Overdue obligations to the Fund NoneB. Nonfinancial RelationsVII. Exchange rate arrangement

Since August 13, 1979 the taka has been pegged, within margins, to a currency-weighted basket. The exchange rate of the taka in terms of the pound sterling, which had been the intervention currency from 1972 to January 10, 1982, was changed from Tk 38.422 to Tk 39 per pound sterling on August 24, 1982. On January 11, 1983, the intervention currency was changed to the U.S. dollar and initial buying and selling rates of Tk 24.48 and Tk 24.52 per U.S. dollar, respectively, were announced. The authorities also maintain a secondary exchange market in which proceeds from workers' remittances and nontraditional exports are auctioned off. At the end of October 1985, the exchange rate was Tk 30.00 per U.S. dollar in the official market and Tk 32.58 per U.S. dollar in the secondary market.

VIII. Last Article IV consultation

The 1984 Article IV consultation report (SM/84/151) was discussed by the Executive Board on July 20, 1984 (EBM/84/113). The following decision (Decision No. 7460-(84/113)) was adopted:

1. The Fund takes this decision relating to Bangladesh's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with Bangladesh, in the light of the 1984 Article IV consultation with Bangladesh conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Bangladesh maintains certain restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/84/160. The Fund encourages Bangladesh to eliminate the margin requirements of import letters of credit, to channel more imports through the secondary exchange market, and to terminate the bilateral payments arrangements with Fund members.

IX. Consultation cycle

A consultation cycle of 12 months was indicated in the Summing Up of the 1984 Article IV consultation.

X. Technical assistance

(a) CBD and Legal: A mission led by Mr. Sundararajan visited Bangladesh in February 1985 to review bank regulations and financial developments. There was a follow-up mission in late-June, headed by Ms. Lachman, to help draft proposed legislative changes.

(b) Fiscal: Mr. Premchand visited Bangladesh in January 1985 to identify technical assistance requirements in the area of revenue forecasting. Messrs. Garnier and Wilson visited Bangladesh in March-April 1985 to suggest ways of improving revenue forecasting and tax administration management. Mr. Feeney, a member of the panel of fiscal experts is currently stationed in Dhaka for three months to follow up on the implementation of the recommendations made by the earlier missions.

(c) Other: Mr. Gurgun (STA) visited Bangladesh in December 1984 in order to document the sources and methods used in the compilation of balance of payments statistics, and to make recommendations for improvement. A mission led by Mr. O'Connor (STA) visited Bangladesh in September-October 1985 to establish a new monetary data base, and to determine areas where further technical assistance from the fund would be desirable.

XI. Resident representative

The Resident Representative's office was established in Dhaka in 1972. The current Resident Representative, Mr. Samuel Itam, was appointed in August 1984.

Bangladesh--Summary of the 1985/86 Economic and
Financial Program

	1984/85	1985/86 Program
<u>I. Targets</u>		
(In millions of U.S. dollars)		
External current account balance	-1,270	-1,090
Overall balance of payments	-59	30
Gross official reserves	395	422
(In months of imports)	(1.8)	(2.1)
(Percentage change)		
Real GDP	2.6	4.1
CPI (annual average)	10.9	12.0
<u>II. Assumptions</u>		
Export volume	-4.5	24.2
Import volume	13.2	-4.7
Of which: Nonfood imports	(12.0)	(0.9)
Terms of trade	21.8	-17.2
Income velocity of broad money	-8.0	-1.0

III. Principal Elements of the Program

1. Central government budget

a. New revenue measures introduced in the 1985/86 budget on June 30, 1985, and subsequently in August and September, are expected to generate additional revenue in excess of Tk 2 billion, or 0.4 percent of GDP in 1985/86. The measures include increases in excise tax rates, particularly on natural gas, reductions in income tax rates to promote wider coverage and higher tax compliance, an increase in the land tax rate, modifications in customs duties, increases in a number of fees and charges, and the introduction of a charge on interest income paid on all savings and financial instruments. The ratio of total government revenue to GDP is expected to rise by 0.6 percentage point to 9.5 percent.

b. A freeze has been imposed on new hiring in most areas of the public service in order to contain the increase in expenditure on account of wage and salary adjustments introduced with the 1985/86 budget. In addition, subsidies on foodgrain and fertilizers will be reduced by Tk 0.8 billion, and development expenditure will be increased

only slightly in real terms. The ratio of total government expenditure to GDP is expected to decline by 0.4 percentage point to 16.8 percent.

c. The overall budget deficit is projected to remain approximately at the 1984/85 level, but its ratio to GDP is expected to decline by 1 percentage point to 7.3 percent.

2. Public enterprises

a. The following prices and tariffs charged by nonfinancial public enterprises have been raised recently: natural gas by 20 percent in July, electricity tariff by 6 percent in July and by 18 percent in September, water and sewerage charges by 25 percent in July (retroactive to June), and railway fares by 5 percent to 20 percent in July. In addition, domestic air fares are scheduled to increase by 15 percent to 25 percent in the coming months. Moreover, public enterprises are expected to adjust their prices to reflect increases in production costs.

b. A special unit has been established in the Ministry of Finance to monitor the performance of public enterprises. The Government also intends to introduce consistent administrative, management, accounting, and financial rules for public enterprises during the current fiscal year.

3. Money and credit

a. As performance criteria, there will be quarterly ceilings on net domestic assets of the banking system and on net credit of the banking system to the Government during 1985/86. For the year as a whole, the increase in net domestic assets will be limited to 15.1 percent, while the stock of net credit outstanding to the Government will decline by 5.5 percent. Quarterly ceilings on the same monetary aggregates will be set at the time of the first review for the remaining period of the stand-by arrangement.

b. The Government has taken steps to apply more effectively the existing laws and regulations to deal with the problem of overdue loans. In the case of agricultural loans, recovery targets have been set for individual banks, and refinancing through Bangladesh Bank has been made contingent on meeting these targets.

c. Key interest rates will be maintained at positive levels in real terms in order to encourage domestic resource mobilization, and to promote an efficient allocation of resources.

4. External sector

a. During the period February-October 1985, the authorities implemented a flexible exchange rate policy, which resulted in a 13.3 percent depreciation of the taka in terms of the U.S. dollar to

Tk 30 per US\$1 by end-October 1985. This policy will be pursued to fully restore international competitiveness as soon as is feasible and, thereafter, not to allow an appreciation of the official real effective exchange rate of the taka during the program period. Moreover, by adjusting the official exchange rate as and when needed, the official rate will not be permitted to be at an excessive discount to the rate prevailing in the secondary market. Exchange rate policy will be reviewed with the Fund before August 31, 1986, and again, before February 28, 1987, in order to reach understandings with the Fund on the exchange rate policies to be followed during the remainder of the program period.

b. The Government has transferred a large portion of exports to the secondary exchange market beginning in July 1985. As a result, approximately 50 percent of all export earnings are now sold in the secondary market, compared with the equivalent of about 23 percent in 1984/85. The Government intends to transfer more transactions to the secondary market during 1986/87. Moreover, the secondary market will be a free interbank market, with no net sales, on a quarterly basis, by Bangladesh Bank in the market.

c. All import transactions will continue to be carried out according to the negative list which was introduced with effect from the beginning of 1985/86.

d. The Government will take the required steps to ensure that losses are not incurred under the Exchange Rate Fluctuation Burden Absorption Scheme (EFAS), and that the operation of the EFAS does not affect the exchange system.

e. During 1985/86, the contracting or guaranteeing of new external loans with maturities of 1-12 years on nonconcessional terms by the public sector will be limited to \$100 million; within this ceiling, a subceiling of \$75 million will apply to new commitments of 1-5 year maturity (both ceilings constitute performance criteria). In addition, the outstanding stock of publicly guaranteed external short-term debt with maturity of less than one year, including outstanding external short-term liabilities of Bangladesh Bank, will not be increased by more than \$11 million during 1985/86.

Bangladesh: Revisions to the Monetary Data1. Background

In June 1985, agreement in principle was reached with the Bangladesh authorities on the possible use of Fund resources under a stand-by arrangement. In telex communications with the Fund in July, the authorities reported significant revisions to the quarterly monetary series beginning in June 1984. These included substantial changes to the June 1985 estimates earlier agreed to with the authorities as the basis for the quarterly credit projections through June 1986, observance of which would have constituted performance criteria under the proposed stand-by arrangement. While a number of explanations were offered by the authorities, including revisions to the source data and corrections for certain misclassifications not noted earlier, the magnitude of the changes cast doubt on the reliability of monetary statistics in Bangladesh. A staff team visited Dhaka in August to identify the reasons for the revisions and examine ways of avoiding similar data problems in the future.

Following discussions with Bangladesh officials and eight major commercial banks, the mission identified three discrepant sets of monetary data. These differences were quantified on a bank-by-bank basis for specified dates. A number of important weaknesses were revealed in the system of reporting and compiling monetary data, including the absence of established procedures for consistency checks. The initial findings and recommendations of the mission were presented to the authorities who were in broad agreement with the assessment and receptive to the suggestion of further technical assistance in this area. A second mission on monetary statistics took place in September to expand on the work initiated. The mission had three major objectives:

(1) to establish base-period monetary data for end-June 1985, based on comprehensive and complete sectorized balance sheet returns (SBS-1) of commercial banks, and to ensure that such returns can be prepared on a continuing monthly basis to enable a monetary program to be effectively monitored;

(2) to derive quarterly historical monetary data for the three most recent years based on the new methodology described above; and

(3) to determine, in coordination with officials of Bangladesh Bank and the Government, areas where further technical assistance from the Fund would be desirable.

The following sections summarize the findings of the two missions on the system of reporting and compiling monetary statistics in Bangladesh and its weaknesses, and the progress made so far in

accomplishing the above objectives with a view to establishing a more reliable monetary data base.

2. Reporting and compilation of monetary data

Monetary data in Bangladesh are produced in three reporting formats: The Bangladesh Bank Banking Control Department returns (BCD); sectorized balance sheet returns of scheduled banks (SBS-1); and, scheduled banks statistics on deposits (SBS-2) and advances (SBS-3).

a. BCD returns: These returns, which include certain major monetary aggregates, are not in balance sheet form. They are compiled by bank branches from general ledgers on a weekly basis and telexed to head offices of banks for aggregation and submission to the BCD. Confirmation copies of these returns, also received by the head offices, are used as the basis for final submission to the BCD, and to correct for errors discovered in earlier submissions. In addition, separate returns showing loans and advances to the Government are submitted to the BCD.

b. SBS-1 returns: These returns are in balance sheet form and sectorize assets and liabilities. They are also compiled by branches from general ledgers and sent to head offices within five working days after the close of the month to which they apply. Each head office then aggregates returns from its branches and submits a provisional consolidated SBS-1 return for the bank to the Statistics Department of Bangladesh Bank by the 15th day of the following month. As some branches are not able to provide returns to head offices in time, the provisional returns make substantial use of estimation techniques, such as carry forward routines. A final consolidated SBS-1 return, which includes the most current information from all branches, is submitted to Bangladesh Bank at the end of the following month.

c. SBS-2 and SBS-3 returns: These returns, which contain details of deposits and advances, respectively, are not in balance sheet form. They are compiled quarterly by branches from detailed ledger accounts and sent directly by the branches, or through head offices to Bangladesh Bank. Head offices neither compile nor cross check the SBS-2 and SBS-3 returns. Bangladesh Bank aggregates these figures on a bank-by-bank basis. This reporting system thus precludes cross checking of SBS-2 and SBS-3 returns against SBS-1 returns, after these returns leave the branches, since bank head offices do not consolidate SBS-2 and SBS-3 returns, and Bangladesh Bank does not receive SBS-1 returns from branches.

3. Findings of the Fund missions

Examination of the above three sets of data on a bank-by-bank basis revealed substantial discrepancies in the various monetary aggregates reported, despite instructions for identical figures for the comparable categories and the totals (Tables 1-3). Discrepancies were established

also at the branch level for the major monetary aggregates. The explanations offered for the differences included: inconsistent instructions for compiling the various forms; data compilation, transaction, and classification errors by both scheduled banks and Bangladesh Bank; inability to resolve sectorization issues at the branch level; and failure to cross-check at the branch level. The many errors discovered in the SBS-2 and SBS-3 returns cast serious doubt on the reliability of the quarterly SBS-1 data revised on the basis of SBS-2 and SBS-3 returns. It was such a revision during July 1985 which first brought to light this practice, and which raised serious questions about the quality of the monetary data. Despite the discovery of errors in the SBS-1 returns, their quality appeared to be far superior to that of other sources, since they reflected full balance sheet data and could be checked more readily against internal accounting records. Moreover, it appeared that some improvement in the quality of data could be achieved in future reporting with fairly minor changes in SBS-1 reporting.

4. Revisions to the historical monetary data

In light of the above findings, a quarterly monetary survey was prepared jointly by the staff and Bangladesh Bank officials for the three-year period June 1982-June 1985 based on data contained in final consolidated SBS-1 returns. ^{1/} Corrections for earlier misclassifications and sectorization errors were also incorporated.

A comparison of the previous and new monetary surveys for the period covered reveals largely similar movements in broad money and domestic credit (Table 4). However, certain components show notable differences in the two surveys. Net claims on government differ substantially due to the inclusion of the special Treasury bonds previously misclassified under other investment of the public sector, and the netting of government deposits with scheduled banks formerly included under liquidity. The differences between the two surveys with respect to credit to other public sector and the private sector mainly reflect improved sectorization of certain transactions. The treatment of foreign accounts has been affected mainly by changes in the recording of workers' remittances on deposit with banks. As a result, the stock of net foreign assets is substantially lower in the new series, and shows a tendency for smaller swings from year to year. The offsetting adjustments are under other items (net) and quasi-money. The differences between the two monetary surveys, other than those highlighted above, reflect mostly differences in the source data (i.e., use of SBS-1 returns rather than the previous practice of combining SBS-1, SBS-2, and SBS-3 returns).

^{1/} The authorities have agreed to carry the series back to earlier dates in order to provide a consistent set of data for analysis and publication in the IMF, International Financial Statistics.

5. Summary of recommendations and future technical assistance on monetary statistics

The authorities were in general agreement with the recommendations of the staff that:

- (1) The SBS-1 data should constitute the core of the data system on which monetary policy and analysis is based. In order to improve the comprehensiveness and accuracy of SBS-1 returns, the preliminary SBS-1 submission now required of banks within 15 days should be replaced by one submission within 30 days of the end of the preceding month. The submission of SBS-1 returns should be subject to the same statutory requirements and penalties for noncompliance as is currently the case for Banking Control data submissions.
- (2) A preliminary indication of monetary developments should be provided by data collected by the Banking Control Department, but it should be recognized that these data are subject to a substantial margin of error due to the short time period in which they are compiled, and the partial coverage of each bank.
- (3) The SBS-2 and SBS-3 returns, providing details of deposits and advances, should continue to be collected and compiled on a quarterly basis, but should not be used to revise the primary data collected through SBS-1 returns. Data reported in SBS-2 and SBS-3 returns should be consistent with data reported in SBS-1 returns on the same date.

The staff left a summary outline of instructions and revised report forms for each of the submissions by banks with the objective of ensuring a single, consistent set of definitions of accounts, sectorization, and other reporting requirements to cover all the above-mentioned submissions. In order to achieve these objectives and to link the requested information to the banks' internal ledger accounts, Bangladesh Bank officials agreed to establish a detailed set of revised instructions following further discussions with the scheduled banks' head offices and selected branches. A follow-up technical assistance mission is scheduled for early 1986 to review the operation of the new system of reporting and to identify any remaining areas of weakness.

Table 1. Bangladesh: Comparison of Deposits Reported by Scheduled Banks in SBS-1 and SBS-2 Returns

(In billions of taka)

	June 30, 1984			September 30, 1984			December 31, 1984			March 31, 1985			June 30, 1985		
	SBS-1	SBS-2	Difference	SBS-1	SBS-2	Difference	SBS-1	SBS-2	Difference	SBS-1	SBS-2	Difference	SBS-1	SBS-2	Difference
Nationalized banks	49.8	50.5	0.7	49.9	49.4	-0.5	60.8	62.7	1.9	56.0	56.4	0.4	64.4	66.0	1.6
Agrani	11.3	11.3	--	11.2	11.0	-0.2	14.5	14.1	-0.4	13.0	12.7	-0.3	15.3	15.0	-0.3
Janata	14.0	13.8	-0.2	14.0	13.3	-0.7	17.9	17.8	-0.1	15.5	15.7	0.2	18.1	18.7	0.6
Rupali	6.8	6.9	0.1	7.0	7.0	--	8.6	8.7	0.1	7.7	7.8	0.1	8.1	8.2	0.1
Sonali	17.7	18.5	0.8	17.7	18.1	0.4	19.8	22.1	2.3	19.8	20.2	0.4	22.9	24.1	1.2
Foreign banks	5.4	4.8	-0.6	5.9	5.1	-0.8	6.6	5.5	-1.1	6.8	5.7	-1.1	6.8	6.2	-0.6
American Express	1.1	1.0	-0.1	1.1	0.9	-0.2	1.2	1.1	-0.1	1.2	1.1	-0.1	1.3	1.3	--
Grindlays	1.1	0.9	-0.2	1.2	1.2	--	1.1	1.0	-0.1	1.1	1.1	--	1.2	1.1	-0.1
Standard Charter Bank	0.2	0.2	--	0.2	0.2	--	0.2	0.2	--	0.2	0.2	--	0.2	0.2	--
State Bank of India	0.2	0.2	--	0.1	0.1	--	0.2	0.2	--	0.2	0.2	--	0.1	0.1	--
Habib Bank	0.2	0.2	--	0.2	0.2	--	0.2	0.2	--	0.3	0.3	--	0.3	0.2	-0.1
BCCI	1.8	1.8	--	2.1	1.9	-0.2	2.3	2.1	-0.2	2.2	1.9	-0.3	2.2	2.3	0.1
Banque Indosuez	0.8	0.5	-0.3	1.0	0.6	-0.4	1.4	0.7	-0.7	1.6	0.9	-0.7	1.5	1.0	-0.5
Specialized banks	4.1	4.6	0.5	4.1	4.2	0.1	4.5	4.7	0.2	4.3	4.2	-0.1	4.8	4.8	--
Bangladesh Krishi Bank	3.1	3.4	0.3	3.1	3.3	0.2	3.5	3.8	0.3	3.3	3.3	--	3.7	3.8	0.1
Bangladesh Shilpa Bank	1.0	1.2	0.2	1.0	0.9	-0.1	1.0	0.9	-0.1	1.0	0.9	-0.1	1.1	1.0	-0.1
Private banks	12.1	11.6	-0.5	11.6	11.5	-0.1	15.0	16.1	1.1	14.4	14.4	--	16.1	16.4	0.3
Arab Bangladesh	1.5	0.9	-0.6	1.1	1.0	-0.1	1.5	1.3	-0.2	1.5	1.3	-0.2	1.5	1.2	-0.3
Islami	0.3	0.3	--	0.4	0.4	--	0.6	0.6	--	0.8	0.8	--	1.0	1.0	--
National Bank	1.6	1.6	--	1.5	1.5	--	2.4	2.4	--	1.9	1.9	--	2.3	2.3	--
City Bank	0.6	0.6	--	0.6	0.6	--	0.8	0.9	0.1	0.8	0.8	--	0.9	0.9	--
IFIC	0.4	0.4	--	0.4	0.5	0.1	0.7	0.9	0.2	0.7	0.9	0.2	0.9	1.1	0.2
United Commercial Bank	0.6	0.6	--	0.6	0.6	--	1.0	1.0	--	1.0	1.0	--	1.2	1.2	--
Pubali	4.6	4.7	0.1	4.6	4.6	--	5.1	5.3	0.2	4.9	5.0	0.1	3.2	5.6	2.4
Uttara	2.5	2.5	--	2.4	2.3	-0.1	2.9	3.7	0.8	2.8	2.7	-0.1	5.1	3.1	-2.0
Total	71.4	71.5	0.1	71.5	70.2	-1.3	86.9	89.0	2.1	81.5	80.7	-0.8	92.1	93.4	1.3

Source: Data provided by Bangladesh Bank, Statistics Department.

Table 2. Bangladesh: Comparison of Advances Reported by Scheduled Banks in SBS-1 and SBS-3 Returns
(In billions of taka)

	June 30, 1984			September 30, 1984			December 31, 1984			March 31, 1985			June 30, 1985		
	SBS-1	SBS-3	Differ- ence	SBS-1	SBS-3	Differ- ence	SBS-1	SBS-3	Differ- ence	SBS-1	SBS-3	Differ- ence	SBS-1	SBS-3	Differ- ence
Nationalized banks	34.8	36.8	2.0	40.6	48.8	4.3	44.0	47.9	4.3	44.0	47.9	3.9	47.7	51.0	3.3
Agrani	6.5	7.7	1.2	8.2	9.9	0.8	8.5	9.8	1.3	8.5	9.5	1.0	9.5	10.5	1.0
Janata	10.2	11.1	0.9	11.8	13.7	0.7	12.0	12.9	0.9	12.0	12.9	0.9	12.0	13.8	1.8
Rupali	4.5	4.9	0.4	5.4	6.5	0.5	6.0	6.5	0.5	6.0	6.5	0.5	6.0	6.4	0.6
Sonali	13.6	13.1	-0.5	15.2	18.7	2.3	16.4	18.7	2.3	17.9	18.7	0.8	20.4	20.3	-0.1
Foreign banks	3.6	3.7	0.1	4.0	4.2	-0.1	4.3	4.3	-0.1	4.3	4.3	--	4.5	4.5	--
American Express	0.9	0.9	--	0.9	0.8	-0.2	1.0	0.8	-0.2	0.8	0.8	--	1.0	1.0	--
Grindlays	0.6	0.6	--	0.7	0.7	--	0.7	0.7	--	0.7	0.7	--	0.7	0.7	--
Standard Charter Bank	--	--	--	0.1	0.1	--	0.1	0.1	--	0.1	0.1	--	0.1	0.1	--
State Bank of India	0.1	0.1	--	0.1	0.1	--	0.1	0.1	--	0.1	0.1	--	0.1	0.1	--
Habib Bank	0.2	0.2	--	0.2	0.2	--	0.2	0.2	--	0.2	0.2	--	0.2	0.2	--
BCCI	1.2	1.3	0.1	1.3	1.4	0.1	1.3	1.4	0.1	1.4	1.5	0.1	1.4	1.5	0.1
Banque Indosuez	0.6	0.6	--	0.7	0.7	--	0.9	0.9	--	1.0	0.9	-0.1	1.0	0.9	-0.1
Specialized banks	17.0	17.5	0.5	17.9	19.2	0.7	18.5	19.2	0.7	19.6	20.8	1.2	22.3	22.9	0.6
Bangladesh Krishi Bank	12.5	12.4	-0.1	13.2	13.7	-0.3	14.0	15.0	-0.3	15.0	15.3	0.3	17.4	17.4	--
Bangladesh Shilpa Bank	4.5	5.1	0.6	4.7	5.5	1.0	4.5	4.6	1.0	4.6	5.5	0.9	4.9	5.5	0.6
Private banks	8.6	7.4	-1.2	8.0	10.1	-0.1	10.2	10.1	-0.1	10.3	10.3	--	11.2	11.0	-0.2
Arab Bangladesh	1.2	0.8	-0.4	0.9	0.9	-0.1	1.0	1.1	-0.1	1.1	1.1	--	1.1	1.0	-0.1
Islami	0.2	0.2	--	0.3	0.4	0.4	0.4	0.6	0.6	0.6	0.6	--	0.7	0.7	--
National Bank	0.9	0.9	--	1.1	1.4	1.4	1.4	1.5	0.1	1.4	1.5	0.1	1.6	1.6	--
City Bank	0.3	0.3	--	0.4	0.4	--	0.4	0.5	0.5	0.5	0.5	--	0.6	0.6	--
IFIC	0.3	0.1	-0.2	0.3	0.6	0.3	0.3	0.4	0.3	0.4	0.6	0.2	0.5	0.7	0.2
United Commercial Bank	0.3	0.4	0.1	0.3	0.4	0.1	0.4	0.5	0.1	0.5	0.5	--	0.5	0.7	0.2
Pubali	3.6	2.9	-0.7	3.6	3.0	-0.6	4.1	3.7	-0.4	3.9	3.6	-0.3	2.0	3.7	1.7
Uttara	1.8	1.8	--	1.5	2.2	2.2	2.2	1.9	--	1.9	1.9	--	4.2	2.0	-2.2
Total	64.0	65.4	1.4	70.5	82.3	4.8	77.5	83.3	4.8	78.2	83.3	5.1	85.7	89.4	3.7

Source: Data provided by Bangladesh Bank, Statistics Department.

Table 3. Bangladesh: Comparison of Major Items in SBS-1 Returns and Banking Control Returns, January 31, 1985 ^{1/}

(In millions of taka)

	Deposits			Loans and Advances			Investments		
	SBS 1	Banking Control	Difference	SBS 1	Banking Control	Difference	SBS 1	Banking Control	Difference
Sonali Bank	19,843	20,183	-340	17,904	19,008	-1,104	3,775	3,832	-57
Janata Bank	15,833	15,124	709	12,408	13,076	-668	3,029	2,934	95
Rupali Bank	7,885	7,845	40	5,919	6,103	-184	1,625	1,625	--
Agrani Bank	12,945	12,755	190	7,668	9,452	-1,784	2,954	2,954	--
Uttara Bank	2,654	2,654	--	1,929	1,925	4	690	690	--
Pubali Bank	4,918	4,994	-76	4,077	4,097	-20	778	847	-69
Arab Bangladesh Bank	1,390	1,110	280	1,027	950	77	204	204	--
Islami Bank	595	596	-1	400	451	-51	52	52	--
City Bank	733	729	4	425	425	--	135	135	--
National Bank	1,828	1,828	--	1,367	1,457	-90	212	212	--
IFIC	737	756	-19	327	582	-255	167	153	14
United Commercial Bank	892	928	-36	430	567	-137	192	191	1
Bangladesh Krishi Bank	3,291	3,314	-23	14,301	14,323	-22	279	190	89
Bangladesh Shilpa Bank	1,019	1,019	--	4,500	4,500	--	51	51	--
American Express Bank	1,174	1,021	153	724	724	--	234	234	--
Banque Indosuez	1,343	1,018	325	880	880	--	246	246	--
BCCI	2,191	2,254	-63	1,279	1,680	-401	427	427	--
Standard Charter Bank	230	230	--	53	53	--	70	70	--
Grindlays	1,232	1,156	76	619	610	9	304	341	-37
Habib Bank	259	201	58	212	212	--	38	38	--
State Bank of India	208	130	78	101	101	--	45	44	1
Total	81,200	79,845	1,355	76,550	81,176	-4,626	15,507	15,470	37

Source: Data provided by the Bangladesh authorities.

^{1/} Since Banking Control returns are required by law to be reported every Thursday (close of week), the comparison with the monthly SBS-1 returns is for January 31, 1985 when the final day of the month falls on a Thursday.

Table 4. Bangladesh: Comparison of the Previous and New Data for the Major Monetary Aggregates, 1981/82-1984/85

	1981/82		1982/83		1983/84		1984/85	
	Previous	New	Previous	New	Previous	New	Previous	New
(In millions of taka; end-June)								
Net foreign assets	-7,932	-11,062	-1,595	-3,909	2,241	1,472	451	-25
Net domestic assets	53,613	56,550	61,861	62,892	83,763	82,387	108,344	105,367
Domestic credit	68,706	67,538	78,801	75,406	101,135	98,735	128,395	124,609
Public sector	43,614	43,891	46,180	44,431	51,472	49,590	56,814	55,702
Government (net)	(22,216)	(19,540)	(22,861)	(19,805)	(25,213)	(24,070)	(26,788)	(23,408)
Other public sector	(21,398)	(24,351)	(23,319)	(24,626)	(26,259)	(25,520)	(30,026)	(32,294)
Private sector	25,092	23,647	32,621	30,975	49,663	49,145	71,581	68,907
Other items (net)	-15,093	-10,988	-16,940	-12,514	-17,372	-16,348	-20,051	-19,242
Broad money	45,681	45,488	60,266	58,983	86,004	83,859	108,795	105,342
Money	20,252	20,121	28,272	26,343	36,901	35,500	44,447	42,318
Quasi-money	25,429	25,367	31,994	32,640	49,103	48,359	64,348	63,024
(Annual percentage changes)								
Net domestic assets	21.5	...	15.4	11.2	35.4	31.0	29.3	27.9
Domestic credit	21.5	...	14.7	11.6	28.3	30.9	27.0	26.2
Public sector	19.9	...	5.9	1.2	11.5	11.6	10.4	12.3
Government (net)	(12.7)	(...)	(2.9)	(1.4)	(10.3)	(21.5)	(6.2)	(-2.8)
Other public sector	(28.5)	(...)	(9.0)	(1.1)	(12.6)	(3.6)	(14.3)	(26.5)
Private sector	24.3	...	30.0	31.0	52.2	58.7	44.1	40.2
Broad money	6.5	...	31.9	29.7	42.7	42.2	26.5	25.6
Money	(-1.1)	(...)	(39.6)	(30.9)	(30.5)	(34.8)	(20.4)	(19.2)
Quasi-money	(13.5)	(...)	(25.8)	(28.7)	(53.5)	(48.2)	(31.0)	(30.3)

Sources: Data provided by Bangladesh Bank; and staff estimates.

Bangladesh--Stand-By Arrangement

Attached hereto is a letter dated November 5, 1985 from the Advisor for Finance of Bangladesh, requesting a stand-by arrangement and setting forth the objectives and policies that the authorities of Bangladesh intend to pursue for the period of this stand-by arrangement, the policies and measures that the authorities of Bangladesh intend to pursue for the first seven months of this stand-by arrangement, and understandings of Bangladesh with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Bangladesh will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period from December ..., 1985 to June 30, 1987, Bangladesh will have the right to make purchases from the Fund in an amount equivalent to SDR 180 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of: SDR 36.0 million until February 20, 1986; SDR 60.0 million until May 20, 1986; SDR 84.0 million until August 20, 1986; SDR 108.0 million until November 20, 1986; SDR 132.0 million until February 20, 1987; and SDR 156.0 million until May 20, 1987.

(b) None of the limits in (a) above shall apply to a purchase under the stand-by arrangement that would not increase the Fund's holdings of Bangladesh's currency in the credit tranches beyond 25 percent of quota.

3. Purchases under the stand-by arrangement shall be made from ordinary resources.

4. Bangladesh will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Bangladesh's currency in the credit tranches beyond 25 percent of quota:

(a) During any period in which the data at the end of the preceding period indicate that the limit on net domestic assets of the banking system specified in paragraph 20 and Table 2 in the attached letter, the limit on net credit to the Central Government from the banking system specified in paragraph 20 and Table 2 in the attached letter, are not observed; or

(b) if Bangladesh fails to observe the limits on contracting of new public or publicly-guaranteed external loans with maturities of

1-12 years and 1-5 years, and on the outstanding stocks of external public debt and of external liabilities of Bangladesh Bank, both of less than one-year maturity, specified in paragraph 19 and Table 1 in the attached letter; or

(c) during any period after August 19, 1986 and February 19, 1987 respectively, until understandings have been reached with the Fund on appropriate policies for the succeeding period, and suitable performance criteria have been established in consultation with the Fund, as contemplated by paragraph 26 of the attached letter, or after such performance criteria have been established, while they are not being observed; or

(d) during the entire period of this stand-by arrangement, if Bangladesh

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices other than the modifications contemplated in paragraph 16 of the attached letter, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Bangladesh is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Bangladesh and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Bangladesh will not make purchases under this stand-by arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Bangladesh's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Bangladesh. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Bangladesh and understandings have

been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Bangladesh, the Fund agrees to provide them at the time of the purchase.

8. Bangladesh shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Bangladesh shall repurchase the outstanding amount of its currency that results from a purchase under this arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Bangladesh's balance of payments and reserve position improves.

(b) Any reductions in Bangladesh's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

10. During the period of the stand-by arrangement, Bangladesh shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Bangladesh, or of representatives of Bangladesh to the Fund. Bangladesh shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Bangladesh in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 26 of the attached letter, Bangladesh will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of this stand-by arrangement and while Bangladesh has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Bangladesh's balance of payments policies.

Dhaka, Bangladesh

November 5, 1986

Dear Mr. de Larosiere:

1. In 1982/83 Bangladesh successfully implemented an adjustment program supported by a stand-by arrangement from the Fund in the amount of SDR 68 million, equivalent to 30 percent of the quota then in effect. With the objectives of reducing the external imbalance and reviving a substantially weakened economy, the Government adopted a comprehensive set of measures which included increases in taxes; reductions in subsidies on fertilizer and foodgrains; upward adjustment of key administered prices, notably prices of electricity, natural gas and petroleum products; monetary restraint; and more flexible exchange rate management. In addition, with a view to expanding the scope of private investment, a New Industrial Policy was promulgated under which a number of jute and cotton textile mills were denationalized, certain sectors previously reserved for public enterprises were opened to private investment, and approval procedures for domestic and foreign investment were simplified.

2. The economic outturn in 1982/83 was favorable. Real GDP growth was resumed at over 3 percent, mostly on the strength of the recovery in the agricultural sector. The rate of inflation declined to 10 percent, due to a moderation in domestic food prices and lower import prices. Balance of payments pressures eased reflecting strong export performance, a sharp increase in workers' remittances, and a drop in imports. The external current account deficit declined from over 11 percent of GDP in the previous year to about 8 percent of GDP which, combined with a significant increase in aid flows, resulted in a substantial balance of payments surplus and the accumulation of gross international reserves to the equivalent of two months' imports.

3. Economic policy in 1983/84 was directed toward sustaining the gains achieved in the previous year. Real GDP growth was maintained, reflecting a further sharp improvement in the terms of trade, and a recovery in the nonagricultural sectors, which compensated for the much slower growth in agriculture. Inflation was contained at the previous year's level, and the external current account deficit declined to under 7 percent of GDP. Notwithstanding a reduction in foreign aid flows, associated partly with delays in project implementation, the overall balance of payments continued to be in substantial surplus, resulting in a further build up of gross international reserves to the equivalent of 2.8 months' imports. The 1983/84 government budget was envisaged to provide some fiscal stimulus to growth. However, there were shortfalls in both revenue and expenditure, and the overall budget deficit declined slightly in terms of GDP. The broad stance of monetary policy was to accommodate credit demand in order to sustain the economic recovery.

Credit extension, particularly to the private sector, was strong, and liquidity growth accelerated. The inflationary impact of the rapid monetary expansion was partly mitigated by the notable increase in financial savings, reflecting high real interest rates.

4. Economic performance in 1984/85 was affected by the large food-grain and jute production losses caused by the severe floods. Real GDP growth was lower than in the previous year, and remained substantially below the initial target of 6 percent. Inflation accelerated to almost 11 percent, reflecting the flood-induced domestic supply shortages, as well as rapid monetary expansion fueled by strong credit demands of the private sector and some public enterprises, mostly in response to higher jute prices. A number of monetary measures, including adjustments in certain interest rates, were taken in late 1984 and early 1985 which helped curtail monetary expansion in the latter part of the fiscal year. The budgetary performance was satisfactory, with the overall budget deficit declining in relation to GDP for the second year in succession. Total revenue collection increased by 25 percent, while total expenditure growth was contained at 14 percent, or about 6 percent below the budget estimate, due largely to the significant shortfall in Annual Development Program spending from the budgeted amount. There was an increase in both foreign financing and in domestic nonbank financing of the deficit, with the result that the Government's net outstanding debt to the banking system was reduced by Tk 660 million. The external position deteriorated, due mainly to additional food imports and a sharp drop in workers' remittances. The current account deficit rose to 8.3 percent of GDP, and the overall balance of payments reverted to a deficit of \$59 million. Gross international reserves declined sharply to the equivalent of 1.8 months' imports.

5. Notwithstanding some improvements in overall performance in recent years, Bangladesh's underlying economic situation continues to be under stress. The balance of payments is characterized by a narrow export base and heavy reliance on external aid. Despite the concessional nature of most external borrowing, the debt service ratio has been in excess of 20 percent. The economy remains highly vulnerable to weather conditions, and to adverse shifts in the terms of trade. Over the medium term, it will be essential to achieve a modest increase in the very low level of per capita income while attaining external viability.

6. In recognition of the need to pursue external adjustment within the framework of sustained growth and price stability, the Government has formulated a comprehensive financial and economic program for 1985/86. In support of this program, which is described below, the Government of Bangladesh hereby requests from the International Monetary Fund a stand-by arrangement for the period December 1985 through June 1987 in the amount of SDR 180 million. In view of Bangladesh's additional resource requirement during the program period, the Government

has requested and received assurances of continued financial support from its major aid donors.

7. The Government's adjustment program for 1985/86 focuses on mobilizing additional domestic resources, promoting efficiency of resource use, and strengthening the competitiveness of the traded goods sector. These objectives will remain the basis of the Government's economic policies for 1986/87. The program for 1985/86 is designed to reduce the external current account deficit to 7.3 percent of GDP (by 1 percentage point). This will be consistent with an increase in real GDP growth to at least 4 percent, and an initial slight acceleration in the inflation rate to about 12 percent, taking into account the impact of the wage and other policy adjustments. It will be the Government's objective to significantly reduce the rate of inflation in 1986/87. The overall balance of payments is expected to record a surplus of \$30 million in 1985/86, and the coverage of gross international reserves to increase moderately to 2.1 months' imports.

8. In recognition of the importance of fiscal restraint to the success of the proposed adjustment program, the Government has undertaken to reduce the ratio of the overall budget deficit to GDP by 1 percentage point from 8.3 percent in 1984/85 to 7.3 percent in 1985/86. It is the Government's objective to further reduce the budget deficit to GDP ratio in 1986/87. The budget deficit in 1985/86 is projected at approximately Tk 33.6 billion. Given the anticipated inflows of foreign aid in 1985/86, the Government will be in a position to further reduce its net outstanding debt to the domestic banking system by about Tk 1.3 billion. In order to achieve the fiscal targets, a number of measures have been taken affecting government revenue, expenditure, and the financial position of the public enterprises.

9. New revenue measures were announced in the 1985/86 budget, including increases in excise taxes, particularly on natural gas; changes in income tax rates and coverage; an increase in the rates of land tax; modifications in customs duties and sales tax; and increases in a number of fees and charges. Supplementing these measures, further changes were introduced in August and September 1985. The rate of customs duty on sugar was increased from 75 percent to 100 percent. Surcharges were imposed on a number of selected services, and a charge was introduced at the rate of 4 percent on interest paid on all savings and financial instruments. In adopting these revenue measures, which altogether are expected to yield an additional Tk 2 billion in 1985/86, the Government has taken into account the objective of raising the tax/GDP ratio progressively from its current level of 7 percent to 10 percent over the period of the Third Five-Year Plan (through June 1990). The tax/GDP ratio is expected to reach 7.8 percent in 1985/86, and to increase further in 1986/87. It is also the Government's objective to reduce the present heavy dependence on foreign trade taxes through a shift toward domestic taxes, including broadening the base of such taxes.

10. The salary recommendations of the National Pay Commission have been carefully examined by the Government, and it has been decided to implement these to the extent permitted by available resources. Government employees received increases averaging about 28 percent effective from June 1, 1985. The net cost of these increases is estimated at Tk 3 billion, which accounts for 37 percent of the programmed increase in total government expenditure in 1985/86. No further wage rate adjustments are planned for the current fiscal year. In order to contain wage and salary expenditure, a freeze has been imposed on new hirings in most areas of the public service. The Annual Development Program is projected to approximately maintain its relative share in GDP. The relatively modest growth in development spending, together with restraint in other areas, including reduced subsidies and other capital spending, is expected to result in a decline in total government expenditure as a proportion of GDP by 0.4 percentage point to 16.8 percent.

11. The Government is committed to the phasing out of the fertilizer subsidy by July 1, 1986 in accordance with its understanding with the World Bank. To this end, the average fertilizer price was increased by 3 percent on July 1, and by 6 percent on October 1, 1985; further increases in fertilizer prices will be considered during the remainder of the fiscal year in light of developments in this sector. Price adjustments will also be made in 1986/87 as necessary, with a view to avoiding the need for fertilizer subsidy payments in that year. In order to reduce the burden on the budget of the public food distribution system, steps are being taken to reduce unit subsidies. During 1985/86 the average offtake price is expected to rise from Tk 5,864 per metric ton to Tk 6,225 per metric ton for rice, and from Tk 4,123 per metric ton to Tk 4,694 per metric ton for wheat.

12. The recent performance of the public enterprises has been mixed; a number of enterprises have generated significant surpluses while others, notably the Bangladesh Jute Mills Corporation, have incurred sizable losses. The Government is determined to improve the efficiency and the financial performance of the public enterprise sector. It is the Government's intention to introduce during the year consistent administrative, management, accounting, and financial rules for public enterprises. In addition, a special unit has been established in the Ministry of Finance to monitor the performance of public enterprises. Moreover, the following prices charged by enterprises have been recently raised: natural gas by 20 percent in July, electricity tariff by an average of 6 percent in July and by 18 percent in September, and water and sewerage prices by 25 percent in July (retroactive to June). In addition, railway fares were increased by 5 percent to 20 percent in July, and domestic air fares are scheduled to increase by 15 percent to 25 percent in the coming months. The present practice of reflecting production costs in the sales price of public sector enterprises will be continued during the program period.

13. Despite the anticipated modest growth in foreign assistance and the projected significant decline in foodgrain imports, the balance of payments is expected to remain under pressure in 1985/86, mainly because of the projected 20 percent decline in the terms of trade. In order to allow for a modest buildup in gross international reserves, it is the Government's objective to reduce the current account deficit from \$1.27 billion (equivalent to 8.3 percent of GDP) in 1984/85 to approximately \$1.09 billion (equivalent to 7.3 percent of GDP) in 1985/86, and to realize an overall surplus of \$30 million, compared with an overall deficit of \$59 million in 1984/85. For 1986/87, it is the Government's intention to further contain the current account deficit, and to attain a moderate increase in the overall balance of payments surplus.

14. The terms of trade are expected to deteriorate over the next two years, based on the projected decline in jute prices. Further, workers' remittances, which are an important source of foreign exchange earnings, are expected to grow only moderately in the years immediately ahead. Accordingly, an appropriate exchange rate policy will be crucial to the attainment of the current account objectives, and, in particular, to the promotion and diversification of exports. Bangladesh has followed a flexible exchange rate policy, with the taka being pegged to a basket of currencies. However, the several small devaluations of the taka during the two-year period ended January 31, 1985 were insufficient to compensate for the unfavorable inflation differential relative to major trading partners and for the strength of the U.S. dollar (the intervention currency), with the result that the official exchange rate of the taka appreciated in real effective terms over this period. Accordingly, as of February 1985, the Government embarked upon a policy of steadily depreciating the taka, so that by end-October 1985 the taka was devalued by some 13.3 percent in terms of the U.S. dollar relative to its value at end-January 1985. We intend to pursue this policy with a view to restoring competitiveness as soon as is feasible and, thereafter, not to allow an appreciation of the official real effective exchange rate of the taka during the program period. Moreover, by adjusting the official exchange rate as and when needed, we will not permit the official rate to be at an excessive discount to the rate prevailing in the secondary market. We recognize that an active exchange rate policy is needed to promote external adjustment, and we will review exchange rate policy with the Fund before August 31, 1986, and again, before February 28, 1987, in order to reach understandings with the Fund on the exchange rate policies to be followed during the remainder of the program period.

15. A dual exchange market has existed in Bangladesh for some time. The secondary market was established to encourage the flow of workers' remittances and promote nontraditional exports by allowing a premium over the official rate. Prior to July 1984, the rate in the secondary market was a free interbank auction market rate. During the fiscal year 1984/85 the rate was set by a committee of authorized dealers, with Bangladesh Bank acting as an observer. In the period

since July 1984, the premium (over the official rate) in this market had ranged from 10 percent to 15 percent. Workers' remittances are sold in this market, as are (since February 1985) tourist receipts. Under the Export Performance Licensing Scheme, all registered nontraditional exporters received a share of their export earnings in the form of Import Entitlement Certificates, which were fully negotiable. The premium on these certificates had generally followed the premium in the secondary market. The funds purchased in the secondary market were for the importation of specified goods and for certain invisibles, mainly for foreign travel. Although the secondary market has proved useful for the purpose it has served up to now, we recognize that a dual exchange market should not become a permanent feature of our exchange system. Accordingly, the Government will pursue a policy of moving toward unification of the markets at an appropriate time and under appropriate circumstances.

16. In recognition of the merits of unification of the exchange markets, we have considerably expanded the scope of the secondary market. As of July 1, 1985, the Export Performance Licensing Scheme and the issuance of Import Entitlement Certificates were replaced by the Export Performance Benefit Scheme, under which export receipts from 51 export items (mainly nontraditional) are sold in the secondary exchange market. Export receipts from raw jute, loose tea, and wet leather continue to be sold entirely in the official market; all other export receipts are given a secondary market sale coefficient of either 70 percent or 40 percent. All foreign exchange receipts from jute carpets and carpet backing are now sold in the secondary market. Some 40 percent of export receipts from all other jute goods, and from ready-made garments are also transacted at the secondary market rate. As a result of these measures, approximately 50 percent of all our export earnings are now sold in the secondary exchange market, compared with the equivalent of about 23 percent in 1984/85. We have also taken steps to ensure that the secondary market is a free interbank market, with no net sales on a quarterly basis by Bangladesh Bank in the market. Presently, payments for the following imports of goods and services are effected at the official exchange rate: food; the major portion of petroleum imports; government imports; imports against loans, grants, barter and special trading agreements; the import requirements of industries essential to the economy; debt service payments; and all other service payments with the exception of those for nonofficial travel, medical and education expenses. All other import payments are financed through the secondary market. All import transactions are carried out according to the negative list which we have introduced with effect from the start of the fiscal year 1985/86. It is the Government's intention to shift additional transactions from the official to the secondary market during 1986/87.

17. The Import Policy Order for 1985/86 has simplified existing import procedures. In particular, and as noted above, it introduced a negative list which freely allows for the importation of all items not

on the list by an importer in possession of a valid Import Registration Certificate. Despite these measures, our exchange and trade system still retains restrictive elements largely because of the foreign resource constraint and the need to protect domestic industries. However, it is our intention to relax these restrictions during the period of the stand-by arrangement as the balance of payments position permits. During the period of the stand-by arrangement, the Government does not intend to impose or intensify restrictions on payments and transfers for current international transactions, or introduce or modify multiple currency practices other than as stated above, or conclude new bilateral agreements which are inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons.

18. Since August 1983, the Exchange Rate Fluctuation Burden Absorption Scheme (EFAS) has been in effect. Under the provisions of the EFAS, Bangladesh Bank stands ready to provide exchange rate guarantees on certain loans against payment of a 2.5 percent annual premium of the outstanding amount of the loan. Although participation in the scheme by eligible borrowers has not been too significant to date, we recognize that the guarantees could give rise to a multiple currency practice in the future, distort investment decisions, and might result in considerable losses to Bangladesh Bank. In light of these latter considerations, we shall, during the program period, take the required steps to ensure that losses are not incurred under the EFAS, and that the operation of the EFAS does not affect the exchange system. Losses are not envisaged under the EFAS during the current fiscal year. However, to the extent that the operation of the EFAS has fiscal implications in subsequent years, we shall ensure that these are neutralized by appropriate adjustments elsewhere in the budget. Presently, the EFAS is scheduled to be in effect until June 30, 1988.

19. Bangladesh has relied extensively on official concessional external assistance to finance the current account deficit. Despite this policy, the debt service burden has been heavy, and is projected to increase in the coming year. Our policy, therefore, is to strictly limit new borrowings with short maturities, and on nonconcessional terms. Through end-June 1986, the contracting or guaranteeing of new external loans on nonconcessional terms by the public sector will be limited to the amount set forth in Table 1. During the fiscal year 1985/86, new borrowing on nonconcessional terms directly contracted or guaranteed by the public sector with maturities of 1-12 years will be limited to \$100 million. Within this ceiling, a subceiling of \$75 million will apply to new commitments of 1-5 years' maturity. It is our intention, however, to avoid borrowings with maturity of 1-5 years except in emergencies or to finance the rollover of existing debt. In addition, the outstanding stock of publicly-guaranteed short-term debt, i.e., with maturity of less than one year, will not be increased by more than \$11 million during the fiscal year 1985/86. Moreover, the short-term liabilities of Bangladesh Bank will not be increased during the fiscal year 1985/86.

20. The monetary program for 1985/86 will significantly reduce domestic credit expansion in order to contain inflation and improve the external balance. Accordingly, the growth of net domestic assets of the banking system will be limited to 15.1 percent during 1985/86. This increase, which allows for the anticipated large financing of jute buffer stocks, is consistent with the expected increase in the demand for broad money and the projected developments in net foreign assets of the banking system. Within the global net domestic asset ceiling, the envisaged expansion of credit to the public and private sectors is consistent with the objectives of realizing a net reduction in outstanding bank credit to the Government; containing the growth of public enterprises' recourse to the banking system; and achieving a substantial reduction in the rate of growth of credit to the private sector, partly through a reduction in the present excessive level of overdue loans. By end-June 1986, the stock of net credit outstanding to the Central Government will decline by about Tk 1.3 billion from its end-June 1985 level of Tk 23.4 billion. The quarterly ceilings on net domestic assets of the banking system and on net credit to the Government are set out through June 1986 in the attached Table 2.

21. We are concerned that the effectiveness of credit policy has been seriously impaired in recent years by the large and growing stock of overdue loans. This has also resulted in inefficient resource allocation. Moreover, the solvency of financial institutions may be jeopardized by the increasing share of delinquent loans in their asset portfolios, and the capital adequacy of the banks concerned may become questionable. The Government is seriously concerned about the deterioration in loan recovery, and has taken steps to apply more effectively the existing laws and regulations to deal with this problem. Furthermore, in the case of agricultural loans, recovery targets have been set for individual banks with the understanding that refinancing limits will be reduced for those banks failing to meet their targets.

22. Refinance facilities through Bangladesh Bank have been made widely available to financial institutions in recent years, mostly with the purpose of ensuring credit to priority sectors. Refinancing was particularly pronounced in the second half of 1984 in response to the needs of the agricultural sector arising from higher jute prices and credit needs associated with the floods. Since November 1984, Bangladesh Bank has imposed a moratorium on further refinancing, with some exceptions for agricultural and trade related credits. However, this policy has not been very effective in curtailing refinance credit. A more restrictive refinancing policy will be implemented during the program period.

23. Key interest rates continue to be positive in real terms. The Government believes that a flexible interest rate policy is needed to encourage domestic resource mobilization and ensure an efficient allocation of financial resources. Accordingly, interest rates will

continue to be monitored, and the needed adjustment undertaken to ensure that they remain positive in real terms.

24. The Third Five-Year Plan has commenced on July 1, 1985. The priorities assigned to agricultural and rural development will continue under the Third Plan. The Government will take steps to promote food-grain production as well as expand the cultivation of jute, cotton, tea, and tobacco; diversification to subsidiary crops such as oilseeds, pulses, and spices will continue to be encouraged. Livestock, fishery, and forestry sectors will be promoted with a view to alleviating nutritional deficiencies and overcoming the shortage of forestry products. Provision of inputs and special credit facilities to farmers initiated under the Government's Agricultural Rehabilitation program following the floods last year will be continued. The objective of the Government is to ensure food self-sufficiency at the earliest time.

25. While agricultural growth will continue to receive priority, the Government realizes the importance of developing the industrial sector. A vigorous export promotion effort will form the basis of Bangladesh's industrial development strategy. The recent expansion of nontraditional exports, notably exports of garments, is a move in this direction. However, efforts to promote garment exports are facing serious obstacles due to quota restrictions in industrial countries. Sustained expansion of manufactured exports will necessitate private sector investment in the export sector which, in turn, will depend on adoption of appropriate trade and industrial policies. The Government's policy of providing expanded opportunities to the private sector has been demonstrated by the recent transfer of a number of nationalized banks to the private sector and the granting of permission for the setting up of insurance companies. Joint investment companies with foreign participation are also being encouraged. Only recently, two such joint investment companies have been formed: an industrial development leasing company with the participation of the IFC and the Korean Development Bank, and an agricultural and industrial investment company established jointly with the Kingdom of Saudi Arabia.

26. The Government of Bangladesh believes that the policies set forth in this letter are adequate to achieve the objectives of the program, but will take any further measures that may become appropriate for this purpose. During the period of the requested stand-by arrangement, the Government will consult with the Fund, in accordance with the Fund's policies on such consultations, on the adoption of any measures that may be appropriate, on the progress made in the implementation of the program, and on any policy adaptations judged to be appropriate for the achievement of its objectives. The Government will complete two reviews with the Fund by end-August 1986, and by end-February 1987, to assess performance under the program, and to reach understandings on appropriate policies and performance criteria for the

remaining period of the stand-by arrangement. The completion of these reviews will constitute performance criteria.

Yours sincerely,

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Table 1. Bangladesh: Ceilings on External Public and Publicly-Guaranteed Debt, June 1985-June 1986

(In millions of U.S. dollars; end of period) 1/

	June 1985 Actual	Dec. 1985	March 1986 Program	June 1986
Contracting or guaranteeing of new nonconcessional public external debt				
Over 1 year and no more than 12 years	...	100 <u>2/</u>	100 <u>2/</u>	100 <u>2/</u>
Of which:				
Over 1 year and no more than 5 years	(...)	(75) <u>2/</u>	(75) <u>2/</u>	(75) <u>2/</u>
Outstanding stock of external public debt of less than one-year maturity	10	21 <u>2/</u>
Outstanding stock of external liabilities of Bangladesh Bank of less than one-year maturity	120	120 <u>2/</u>	120 <u>2/</u>	120 <u>2/</u>

1/ End of period refers to the last working day of the month.

2/ Performance criteria.

Table 2. Bangladesh: Ceilings on Net Domestic Assets and Net Credit to the Central Government, June 1985-June 1986

(In millions of taka; end of period) 1/

	June 1985 Actual	Dec. 1985	March 1986 Program	June 1986
Net domestic assets	105,367	114,600 <u>2/</u>	116,100 <u>2/</u>	121,270 <u>2/</u>
Net credit to the Central Government <u>2/</u>	23,408	22,300 <u>2/</u>	21,320 <u>2/</u>	22,110 <u>2/</u>

1/ End of period refers to the last working day of the month.

2/ Performance criteria.