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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/77-1

10:00 a.m., September 9, 2019

1. Bangladesh—2019 Article IV Consultation

Documents: SM/19/209 and Supplement 1; and Supplement 1, Correction 1; and Supplement 2; SM/19/210

Staff: Kihara, APD; Fletcher, SPR

Length: 43 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	**Alternate Executive Directors**
	I. Mannathoko (AE)
M. Raghani (AF)	
	E. Rojas Ulo (AG), Temporary
	C. White (AP)
	P. Fachada (BR)
	P. Sun (CC)
	A. Arevalo Arroyo (CE), Temporary
L. Levonian (CO)	
R. Kaya (EC)	
H. de Villeroché (FF)	
	K. Merk (GR)
	M. Siriwardana (IN)
	M. Psalidopoulos (IT)
T. Tanaka (JA)	
	M. El Qorchi (MD)
	M. Merhi (MI), Temporary
	L. Voinea (NE), Temporary
T. Ostros (NO)	
	S. Potapov (RU), Temporary
	R. Alkhareif (SA)
A. Mahasandana (ST)	
P. Inderbinen (SZ)	
	D. Ronicle (UK)
	D. Crane (US), Temporary

C. McDonald, Acting Secretary
J. Morco, Summing Up Officer
E. Mannefred, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: A. Gulde, J. Jonas, D. Kihara, R. Moussa, C. Rhee, B. Zhu. Institute for Capacity Development: E. Tanner. Legal Department: D. McDonnell. Office of Strategy, Policy, and Review Department: K. Fletcher. World Bank Group: F. Blum. Alternate Executive Director: P. Rozan (FF). Senior Advisors to Executive Directors: Z. Mohammed (BR), M. Sidi Bouna (AF). Advisors to Executive Directors: K. Badsi (MD), O.

Bayar (EC), J. Essuvi (AE), I. Fragin (GR), H. Mori (JA), B. Singh (IN), M. Sylvester (CO), S. Yoe (ST), K. Lok (CC), A. Tola (SZ), A. Clark (UK).

1. BANGLADESH—2019 ARTICLE IV CONSULTATION

Mr. Siriwardana and Mr. Singh submitted the following statement:

Our Bangladesh authorities thank staff for the candid and constructive discussions and convey their appreciation to the management and staff for their continued engagement. Our authorities look forward to continuing this engagement. The authorities broadly agree with staff's assessment and recommendations regarding the economy, although there are some divergences in views. Broadly, they reiterate their strong commitment to maintaining macroeconomic stability and promoting inclusive growth.

Bangladesh economy seems to be in a sweet spot by maintaining a high growth trajectory with stability, notwithstanding adverse global environment and domestic challenges. The macroeconomic performance continues to be robust, with strong GDP growth, moderate inflation and a narrowing current account deficit. Real GDP growth further increased from 7.9 percent in FY18 (July 2017-June 2018) to 8.1 percent in FY19 (provisional estimates). High growth in the manufacturing sector has played an important role in achieving this growth trajectory. With end-June 2019 inflation at 5.47 percent - below the central bank's target of 5.6 percent - and current account deficit at 1.7 percent of GDP (3.2 percent of GDP in FY18), the economy is further poised for macroeconomic stability. The stock of foreign exchange reserves stood at US$ 32.72 billion at the end of FY2019, providing a cover of 5.9 months of imports. From the financial stability angle, moderating broad money and domestic credit growth indicate a welcome decline in frothiness of dubious quality lending in the domestic credit market.

In staff's assessment as well, GDP growth is expected to be above mid-7 percent in FY19 and FY20 with average annual inflation projected close to the central bank's 5.5 percent target and current account deficit around 2 percent of GDP. However, weaker-than-expected global growth presents downside risks, though trade tensions have not negatively affected export growth. Slow progress in domestic banking sector reforms could also undermine growth. In staff's view, the central bank should monitor inflation developments closely and stand ready to adjust its policy promptly.

According to the authorities, robust economic activity will be sustained. The provisionally estimated GDP growth of 8.1 percent for FY19 was supported by strong domestic demand, high growth in exports and remittances, and political stability, which is expected to extend in FY20. The authorities have set the targets for GDP growth and inflation at 8.2 percent

and 5.5 percent, respectively for FY20. The policy focus will be on increased domestic demand through consumption and investment, and increased external demand by enhancing exports. Authorities have broadly shared staff's assessment on risks, including sluggish global growth and unsteady remittance inflows due to weaker growth in source countries.

In staff's view, following the easing of monetary policy in April 2018, inflation has remained broadly stable at around the Bangladesh Bank's (BB) target. However, several sources of potential inflationary pressures persist. The authorities also recognize several potential sources of inflationary pressures, including elevated inflation expectations, gradually increasing non-food inflation, and strong growth supported by robust domestic demand. However, growth of monetary and credit aggregates has been decelerating until recently, while a bumper harvest in FY19 has led to declining food inflation. Agreeing to the staff advice, the authorities emphasize that they will be monitoring economic and financial developments closely and adjust monetary policy promptly as needed.

On the external front, the staff report finds the position in CY18 broadly in line with fundamentals and desired policies. Reserve coverage is adequate with gross official reserves covering 5.9 months of prospective imports in FY18 but is expected to gradually decline as imports continue to grow without further accumulation in reserves. In staff's view, current account deficit is estimated to have narrowed to around 2 percent of GDP in FY19 and is projected to remain broadly at the same level over the medium term. Although the rapid growth in the readymade garment sector has significantly supported growth, concentrated exports pose a risk as well. A broader and more complex export base would help start integration into global supply chains and increase potential growth. The authorities are also advised to continue to gradually expand exchange rate flexibility, which will help buffer the economy against external shocks.

The authorities perceive remittances and export growth to accelerate further. Although, they concurred with the staff that current account would be in a deficit over the medium term, the ongoing mega infrastructure projects will attract Foreign Direct Investment (FDI), which will further strengthen export growth, while remittance inflows are likely to remain robust. The authorities emphasize that their goal is to maintain an adequate level of reserves to support confidence in the economy and increase FDI flows. Given the low debt-to-GDP ratio and projected high medium-term growth, the authorities express confidence that there will be no risks of external debt distress.

On the fiscal situation, the FY20 budget is again anchored at 5 percent fiscal deficit-GDP ratio. However, in staff's view, revenue target appears ambitious primarily because of the assumed increase in revenues by more than 3 percent of GDP - much higher than staff projections. In staff's view, tax policy reforms should focus on tax base broadening and reducing tax concessions and tax avoidance. It needs to be noted that the implementation of the new VAT law on July 1, 2019, is a step towards modernization of the tax regime.

Our authorities reconfirm their commitment to keep the fiscal deficit at 5 percent of GDP. The government has taken various important reform measures to modernize the revenue and expenditure management. They acknowledge that revenue target for FY20 is high but several policy initiatives, including the launch of the new VAT and VAT automation, the rollout of the electronic modes for VAT taxpayers, improvements in tax administration and tax compliance, and the increase in the number of local tax offices, will all help boost tax revenues. The authorities also point to their efforts to increase recurrent expenditure savings through recently increased gas tariffs, lower interest payments due to expected reduced issuance of high-yielding NSCs, and termination of the current practice of providing advanced payments to autonomous bodies. We would also like to mention that external and domestic debt indicators are below their respective thresholds under the baseline and stress test scenarios conducted by the fund staff.

Staff assesses that financial situation in the banking sector continues to deteriorate despite strong growth. The NPL ratio has increased from 9.3 percent at end-2017 to 10.3 percent at the end-2018. In the view of staff, there has been a growing trend of loan rescheduling and restructuring. They suggest a comprehensive time-bound action plan including: avoidance of regulatory forbearance; comprehensive review of the banking sector's assets; tightening the criteria for rescheduling/restructuring of loans; strengthening of corporate governance and legal systems; transparent budgetary support for state owned banks and adherence to commercial principles.

The authorities do agree that persistently high NPLs are a source of concern, though they expect that ongoing measures will address the situation effectively. The NPLs are concentrated, particularly in state owned banks. Most banks maintain a sufficient level of provisions and that the level of net NPLs is relatively moderate. In view of the authorities, loan rescheduling and restructuring is targeted at borrowers who are unable to abide by the original loan terms because of adverse events outside of their control and its objective

is to prevent unnecessary loss of output and employment. The limit of maximum three loan rescheduling is now strictly being enforced and that all rescheduled loans are required to be adequately provisioned. BB does not allow any regulatory forbearance, but at the same time, they take into account potential economic costs when deciding whether to provide a relief to borrowers. They are now working on a legal definition of willful defaulters that would allow them to take more effective steps. A bank merger policy is also being discussed to promote consolidation of the banking sector and setting up an asset management company to take over NPLs.

On the issue of improving public financial management, the authorities emphasize that implementation of the new Budget Accounting and Classification System (BACS) will support better public financial management by providing additional and better-quality information, including on a broader set of government entities, financial assets and liabilities, and location of spending.

The staff views that control of corruption in Bangladesh has improved in recent years but remains modestly below the average for South Asia and low-income countries. The authorities argue that controlling corruption is a priority of the current government. They are working to enhance public awareness on the need to reduce corruption, though challenges remain, particularly in lack of capacity and the judicial process. In this respect, the Bangladesh Financial Intelligence Unit has initiated several changes. The authorities have expressed concerns on use of some third-party indicators on corruption perception, emphasizing their subjective judgments.

Improving the business environment continues to be important to facilitate investment outside the garment industry despite some progress over the past year. Under the One Stop Service virtual platform, procedures such as company registration, online payment of registration fees, tax identification number, and online VAT registration have all been merged into a single process. Reform priorities are still in the pipeline to enhance the judicial system.

The authorities are fully committed to addressing the vulnerabilities arising from climate change and its commitments are well articulated in its overarching national plans. The government is implementing ‘Vision 2021’, incorporating the environmental development as one of the most important goals. Furthermore, a detailed work plan has been formulated with a view to achieving environmental targets of SDG’s. The economy has developed enhanced resilience to natural disasters and provisions have been made in the

budget each year to respond to possible extreme weather events. On energy subsidies, provision of affordable energy remains essential over the medium term to sustain rapid economic growth.

Mr. Merk and Mr. Fragin submitted the following statement:

We thank staff for the informative set of reports, and Mr. Siriwardana and Mr. Singh for their helpful buff statement.

We broadly concur with staff's assessment. Economic growth in Bangladesh has continued to be strong in 2018 with stable inflation. While the expansion is projected to continue, and inflation and the current account deficit are expected to remain contained, risks to the outlook persist.

We concur with staff that there is a pressing need to increase tax revenues to improve public infrastructure, as well as to adequately invest in climate change mitigation activities and adaptation infrastructure. Bangladesh's domestic revenue – at less than ten percent of GDP – is significantly below that of peer countries. At the same time, the country faces a challenging geography[1] which requires large public investments in transportation and climate change adaptation infrastructure, in addition to investments needed in the energy, health and education sectors. We agree with staff that increased revenue mobilization should mainly be based on broadening the tax base, notably reducing tax concessions and tax avoidance. We underline that Bangladesh should continue to keep the public debt ratio broadly stable.

With regard to financial sector stability, there are serious concerns about growing NPL ratios, especially in State-Owned Commercial Banks (SOCBs) that require prompt and comprehensive action. We largely concur with staff's proposed action plan, which we encourage the authorities to take into serious consideration. In particular, the authorities would be well-advised to reconsider the recent easing of loan classification rules, which effectively might have negative implications for financial sector resilience.

Going forward, we concur with staff that diversification of the Bangladeshi economy into more complex products will be necessary to increase potential growth. To facilitate this process, reforms improving the business climate and investments in human capital would be instrumental.

[1] Such as low elevation threatened by rising sea levels, large flood-prone rivers and deltas, high population density and rapid urbanization.

Additionally, we wonder what role public sector or joint public-private research initiatives might play in encouraging diversification and what initiatives currently exist in Bangladesh to promote R&D. Staff comments are welcome.

Last but not least, on governance, we encourage the authorities to continue their efforts to improve the AML/CFT framework and to enhance their efforts to reduce vulnerabilities to corruption, while increasing transparency. In this context, and to support the effectiveness of Fund surveillance more generally, a timely publication of the report would be helpful.

Mr. Fachada and Ms. Mohammed submitted the following statement:

We thank staff for the comprehensive reports and Mr. Siriwardana and Mr. Singh for their informative statement. Bangladesh continues to experience solid macroeconomic performance with robust growth, moderate inflation and a narrowing of the current account deficit. This notwithstanding, important challenges stemming from suppressed revenue mobilization, weaknesses in the financial sector, limited diversification and climate change remain.

We welcome the authorities' commitment to prudent fiscal policies, but agree with staff that additional efforts are necessary to increase revenue mobilization. We take note that whilst public debt is sustainable and risks of debt distress are low, spending needs remain high with low levels of tax revenue. Reforms to boost domestic revenue mobilization are crucial to upgrade infrastructure, support the vulnerable and meet the potential costs of climate change. We welcome the implementation of the VAT law. Nonetheless, we agree with staff that expanding the tax base and modernizing tax administration would further help boost tax revenue. Improved revenue mobilization together with constrained expenditure and ongoing efforts to improve public financial management would also help increase fiscal space for vital development and social spending.

The Bank of Bangladesh should closely monitor inflation developments and be ready to adjust its monetary policy stance should it be necessary. We take note that although inflation has been broadly stable and credit growth is decelerating, inflation expectations remain relatively high as non-food inflation is gradually increasing with robust domestic demand. We welcome the authorities' efforts to bring the National Saving Certificates (NSC) under control. Reforming the NSC scheme and the development of a capital market should help improve the monetary transmission mechanism.

Prompt actions are required to address banking sector's stability risks. The high NPL ratio and the increasing amount of restructured and rescheduled loans are concerning. We take note of the worsening of the financial soundness of State-Owned Commercial Banks (SOCBs), which could impede their ability to engage in new lending and limit access to credit. A comprehensive plan should be adopted to help maintain confidence in the banking system by enhancing banking regulation and supervision to include the adoption of risk-based supervision, SOCB reforms, tighter criteria for loan rescheduling/restructuring, and enhanced legal systems to accelerate loan recovery. We commend the authorities for their efforts regarding the AML/CFT framework and encourage them to continue their efforts in this regard.

Reforms to improve the business climate and boost human capital can enhance productivity on higher technological intensive sectors. We take note that Bangladesh comparative advantage lies in a set of labor-intensive goods, and that moving the production chain towards more technological intensive sectors could bolster diversification, potential growth and exports. Enhance human capital and targeted training for sectors to be developed would support diversification. We also encourage the authorities to promote measures to raise female labor force participation.

We take note that climate change poses significant risk to Bangladesh's economy, as considerable part of its territory is below sea level. We are encouraged by the authorities' commitment to addressing vulnerabilities arising from natural disasters and climate change and the ongoing implementation of 'Vision 2021', as indicated by Messrs. Siriwardana and Singh. This notwithstanding, the authorities should intensify their efforts to mobilize resources for mitigation and adaptation. We believe that the international community has a great role to play in supporting the efforts of low and middle-income countries cope with climate change.

We take note of the slow progress in resolving the Rohingya refugee crisis. We commend the Bangladeshi authorities for sheltering the refugees from Myanmar and agree that this situation could add to social tensions, as well as spending pressures in Bangladesh. We underscore that donor support remains vital in dealing with this humanitarian crisis.

Ms. Pollard and Ms. Crane submitted the following statement:

We thank staff for the papers and Mr. Siriwardana and Mr. Singh for the helpful buff statement. Bangladesh has enjoyed solid growth and declining poverty rates, benefitting from prudent macroeconomic management. Nonetheless, banking sector weaknesses weigh on the economy and there is room for strengthening governance and macroeconomic policy frameworks. In addition, the authorities face the longer-term challenge of diversifying the economy beyond the ready-made garment sector, into more complex industries that can better support sustained, inclusive growth into the future. We welcome the inclusion in the staff report of a brief update on the Rohingya refugee crisis. We concur with the thrust of the staff appraisal and would like to highlight several points.

Fiscal and Debt Management. In light of low domestic revenues relative to peers and large development spending needs, we encourage the authorities to adopt growth-friendly measures to improve tax administration, broaden the tax base and reduce exemptions to boost revenues. We welcome the implementation of the long-awaited VAT law. On the spending side, we underscore staff's advice on strengthening public financial management. Bangladesh's large infrastructure needs point to the importance of strengthening project selection and appraisal processes for public investment. Has Bangladesh undertaken a Public Investment Management Assessment (PIMA) in recent years? We welcome the authorities' efforts on updating the medium-term debt strategy. We take note of the low risk of debt distress in the Debt Sustainability Analysis and emphasize the importance of comprehensive data on debt and contingent liabilities. We welcome the authorities' plans to expand debt data to include non-guaranteed SOE debt. We also welcome planned IMF TA on managing contingent liabilities.

Financial Sector. Banking sector weaknesses need immediate attention. We remain concerned about the high levels of NPLs in state owned commercial banks, contributing to significant financial stability risks. We urge the authorities to adopt a comprehensive, time-bound action plan, as recommended by staff. This should include adhering to international standards on NPL classification and provisioning and avoiding repeated loan rescheduling and restructuring.

Economic diversification. We encourage the authorities to adopt measures to promote economic diversification and boost potential growth. We welcome plans to improve the business environment by streamlining registration processes under the One Stop Service platform, and encourage

follow-through on efforts to improve the judicial system. We also underscore the need for targeted training and education to enhance human resource capacity and boost youth employment and female labor force participation.

Mr. Tanaka, Mr. Chikada and Ms. Mori submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Siriwardana and Mr. Singh for their informative buff statement. It is encouraging that Bangladesh continues to demonstrate strong economic performance and makes steady progress in reducing income poverty. At the same time, considerable downside risks and challenges for future growth such as fragile financial sector, weak revenue mobilization capacity, heavy reliance on the ready-made garment (RMG) sector and climate change remain. Taking this opportunity of favorable economic conditions and political stability, implementing necessary reforms are essential to pursue the transition from low-income to lower-middle income status. As we broadly concur with the thrust of the staff appraisal, we will limit our comments to the following points:

We agree with staff that prompt actions are required to address the banking sector's financial stability risks and associated fiscal risks. Enlarging the scope of NPL, we appreciate staff for their focus on the "stressed advances", which clearly show growing trend of loan rescheduling and restructuring (i.e., forbearance), and thus capture the more accurate picture of the health of banking system. While asset share of the State-Owned Commercial Banks (SOCBs) in the Bangladeshi banking sector is not outstanding, persistent and highly concentrated stressed advances in the SOCBs are source of concern. In this light, we would like to ask some clarifications.

Could staff elaborate more on the reason behind the increase of stressed advances despite relatively strong economic growth?

Are there any specific sectors or characteristics of borrowers whose loans were restructured or rescheduled?

Given the significantly high level of stressed advances in the SOCBs, we wonder what are factors that encourage or force the SOCBs to lend to non-profitable borrowers. Also, how does the government support the implementation of such a strategic lending, for example, from financing aspect.

Are there any clear division of labors between the SOCBs and private banks?

Against the background of risks stemming from SOCBs, we share staff's view that a comprehensive time-bound action plan should help maintain confidence in the banking system.

While welcoming the authorities' commitment to maintain fiscal deficits within 5 percent of GDP, much efforts for revenue mobilization are needed to cover necessary capital spending for development and protect social spending. Given the low tax-to-GDP ratio compared to its peer countries, it is indispensable to significantly increase tax revenues through a coordinated approach in both tax administration and tax policy areas. In this context, introduction of VAT is a welcoming step. However, as staff point out, the revenue impact is uncertain due to multiple rates, a significant increase in the VAT threshold and implementation challenges. We encourage the authorities to continue their work toward a simpler VAT structure.

Considering the Bangladeshi economy's high dependency on the RMG sector, diversification and upgrading of the manufacturing sector is necessary to make exports more robust to changes in global demand patterns and ensure the transition from low-income to lower-middle income status. To this end, improving business environment and investing in human capital are crucial, and we would like to urge the authorities to continue and strengthen their initiatives.

It is commendable that the government has undertaken several initiatives to confront climate changes and incorporate risk mitigation and adoption measures in their budget. We also welcome that staff analyze the authorities measures so far and provides some policy options in the selected issue paper as climate change is macro critical for the country. From a perspective of investment for mitigation and adaption, increasing domestic revenue is needed.

Ms. Mahasandana and Ms. Yoe submitted the following statement:

We thank staff for the comprehensive reports and Mr. Siriwardana and Mr. Singh for the informative buff statement.

Bangladesh's solid economic performance is commendable. The important challenge ahead for the authorities is to ensure sustainability and resilience of growth. Sustained economic growth is key to support the country's continued progress in poverty reduction and social development. To achieve this, it is important to boost infrastructure investment, address

banking sector vulnerabilities and promote economic diversification. We broadly agree with staff's appraisal and offer a few comments for emphasis.

Further efforts to boost tax revenue is crucial to support needed infrastructure investment. We welcome the authorities' commitment to keep fiscal deficit within 5 percent of GDP. Fiscal discipline has kept public debt broadly stable. We agree with staff on the significant need to raise tax revenue, as a low tax-to-GDP ratio could constrain public investments needed to boost growth potential. There is also a need to increase fiscal space to create room to address the Rohingya refugees situation and to deal with climate change and natural disasters. In this regard, we welcome the policy initiatives to boost tax revenues including the launch of the new VAT and measures to increase recurrent expenditure savings. What is staff's projection of the tax receipt expected from the new VAT, taking into account the multiple rates, increase in VAT registration threshold and implementation challenges. We also welcome staff's comment on whether the authorities have plans to streamline the new VAT. At the same time, we encourage further efforts to broaden tax base by reducing tax concession and to strengthen tax administration.

Asset quality problem must be addressed promptly to avoid worsening banking sector vulnerabilities in the future. Despite strong economic growth, the non-performing loan (NPL) ratio, particularly for the State-owned Commercial Banks (SOCBs), continues to rise and remains persistently high. The growing trend of loan rescheduling and restructuring further masks the extent of asset quality problem in the banking sector. This raises concerns as weak asset quality could undermine financial stability and growth. Some of the measures aimed at reducing NPLs such as the loan rescheduling scheme, relaxation of loan write-off policy and easing of loan classification rules create moral hazard for borrowers without addressing the root of the problem. We therefore fully support staff's recommendation to address the banking sector weakness promptly through a comprehensive time-bound action plan. We note the authorities' objective to prevent unnecessary loss of output and employment. We wonder if staff can provide further analysis on the economic costs and benefits of addressing the asset quality problem today (i.e. short-term impact on employment and growth, longer term benefits of financial stability on growth) versus the costs of allowing the asset quality problem to linger.

Reforms to promote economic diversification are key to sustain robust economic performance. Strong export growth and remittance inflows have helped to boost the Bangladesh economy and strengthened its external

position. However, uncertainty in the global economy and weaker-than-expected global growth present downside risks to the economic outlook. To enhance the sustainability and resilience of growth, we encourage the authorities to press on with reforms to improve the business environment and boost human capital so as to promote economic diversification. In particular, we are interested in staff's advice on plans to boost human capital so as to support the growth of the more complex sectors and to promote inclusive growth. Can staff also elaborate on measures to improve income inequality?

With these comments, we wish the authorities all the best in their future endeavors.

Mr. Di Tata and Mr. Rojas Ulo submitted the following statement:

We thank staff for the well-written set of papers and Mr. Siriwardana and Mr. Singh for their helpful buff statement.

Bangladesh's economy continues to show a strong performance, with sustained growth and stable inflation. Real GDP growth is estimated at 8.1 percent in FY 2019 owing to strong domestic demand and high growth in exports and remittances. Inflation remained below the central bank target at end-June 2019, the external current account deficit declined to 1.7 percent of GDP in FY 2019, and gross international reserves stand at an adequate level. There is low risk of debt distress and the country has made steady progress in reducing poverty and improving social indicators. Looking ahead, economic growth is projected by staff in the mid-7 percent over the medium term, with average inflation close to the central bank's 5.5 percent target and the current account deficit at around 2 percent of GDP. Main downside risks include weaker-than-expected global growth, slow progress in domestic banking sector reform, and natural disasters. We concur with staff on the need to deepen structural reforms to improve the business environment, boost private investment, and promote export diversification to sustain long-term growth.

We welcome the authorities' commitment to keep the fiscal deficit at 5 percent of GDP in FY 2020 but agree with staff that the revenue target appears ambitious. The FY 2019 fiscal deficit remained within the budget target of 5 percent of GDP because significantly lower revenues were compensated by lower capital spending. The FY 2020 budget is anchored on a similar deficit of 5 percent of GDP, but the revenue projections look difficult to achieve, which may endanger the deficit target unless any revenue shortfall is compensated again by lower spending. Although the authorities recognize

that the revenue target is ambitious, they believe that several policy measures, including the new VAT law and improvements in tax administration, constitute important supporting measures. In addition, they have emphasized their efforts to reduce spending through increased gas tariffs and lower interest payments, among other initiatives. Staff is of the view, however, that meeting the deficit target this time could be more challenging, including because of additional spending pressures. Could staff elaborate on whether the authorities have identified contingency measures to meet the budget deficit, protecting social spending? Going forward, we concur with staff on the importance of increasing the tax-to-GDP ratio, which is below 10 percent of GDP, by improving tax administration, broadening the tax base, and reducing tax concessions. We welcome the new Budget Accounting and Classification System and the improvements in public procurement and encourage the authorities to strengthen public investment management to enhance efficiency. Could staff provide an estimate of total tax expenditures in Bangladesh?

In view of potential inflationary pressures, we agree with the authorities and staff on the need to monitor economic and financial developments closely and adjust monetary policy promptly in case these pressures were to develop. Going forward, we encourage the authorities to modernize the current monetary policy framework by adopting an interest rate targeting regime with market-based monetary instruments to improve the transmission of Bangladesh Bank's policy. Could staff comment on the current exchange rate policy and the reaction by the authorities to the staff's advice to continue to gradually allow for exchange rate flexibility to help buffer the economy against external shocks?

We agree with staff that comprehensive reform is necessary to address financial stability concerns and improve confidence. The nonperforming loan (NPL) ratio remains above 10 percent at end-2018, with most NPLs concentrated in the State-Owned Commercial Banks (SOCBs). Moreover, staff notes that the published NPL ratio is likely to underestimate potential problems because of a growing trend of loan rescheduling and restructuring. In this regard, we concur with staff that the authorities should develop an action plan to avoid regulatory forbearance, proceed with a comprehensive review of the banking sector's assets, tighten the criteria for rescheduling/ restructuring loans, strengthen banks' governance and legal systems to support the recovery of NPLs, and reassess the role of state-owned commercial banks. Could staff provide an update on the steps being considered by the authorities to promote a consolidation of the banking system and set up an asset management company to take over NPL management from banks? We encourage the authorities to continue with their efforts to bring NSC issuance

under control and revise their medium-term debt management strategy. We take positive note of the progress that has been made in improving the AML/CFT framework and would emphasize the importance of sustaining the reform efforts in this area, including by adopting risk-based AML/CFT supervision and establishing a clear definition of beneficial ownership.

We welcome the importance the authorities attach to controlling corruption. Although corruption indicators have improved in recent years, further progress is necessary to address this issue, including by strengthening capacity and the judicial process.

Further progress on structural reforms is also needed to help diversify the economy and increase competitiveness and resilience. Although Bangladesh has made significant advances toward a manufacturing-based economy, exports are still of low complexity and are increasingly concentrated in the Ready-Made Garment sector. As noted by staff, production of more complex products could facilitate integration into global value chains, increasing export resilience. In this regard, we encourage the authorities to press ahead with reforms to improve the business environment and strengthen human capital to help enhance productivity and economic diversification.

Lastly, we commend the authorities for the measures adopted in recent years to adapt to climate change and mitigate its impact, which are described in detail in the Selected Issues paper. Going forward, efforts should continue by designing appropriate fiscal policies, developing fiscal buffers and resorting to insurance mechanisms, and stimulating climate-friendly investments.

With these comments, we wish the Bangladesh authorities every success in their future endeavors.

Mr. Ostros and Ms. Karhapaa submitted the following statement:

We thank staff for the interesting set of reports and Mr. Siriwardana and Mr. Singh for their insightful BUFF statement. Bangladesh's economic performance over the past few years has been impressive with strong growth, moderate inflation, and decline in poverty levels. As Bangladesh transitions from low-income to lower-middle income country status developing a more diversified economic structure, promoting conditions for productive investments and upgrading macroeconomic policy frameworks should be the focus areas of policy. Continuing to build resilience against consequences of

climate change is very important given Bangladesh's high vulnerability to natural disasters. We broadly share staff's assessment and would like to offer the following comments for emphasis.

We take note of the Bangladesh authorities' commitment to keep the budget deficit at 5 percent which combined with strong growth supports keeping risk of debt distress at low levels. With tax revenues only at 10 percent of GDP, the focus of fiscal policy should be on broadening the tax base, improving tax collection and compliance, and reducing inefficient subsidies and exemptions. Introduction of the new VAT law is a step in the right direction, though we encourage considerations to a more simplified structure with fewer exemptions to enhance its revenue generating effect. Higher revenues would support infrastructure investments, education and healthcare spending and strengthened social protection and climate change adaption and mitigation efforts, which are needed for strong and sustainable economic development. Reforms to public investment management would improve efficiency and the economic impact of the government's investment activities.

Monetary policy should ensure that inflation remains prudently managed with an appropriate support to economic growth. Strong domestic demand and elevated inflation expectations call for careful monitoring of inflation pressures and readiness to adjust policy stance should risks of higher inflation materialize. We would encourage the Bangladesh authorities to make assertive efforts to improve the effectiveness of monetary policy transmission by adapting a rules-based interest rate targeting regime and by developing further debt and interbank markets. An upgraded monetary policy regime should be complemented by a more flexible FX regime to improve the ability to adjust to external shocks.

The deteriorating situation in the banking sector is a concern and requires attention to ensure that banks are supportive and not hindering actors for the real economy. NPL ratios are worryingly high in state-owned commercial banks which creates fiscal risks to the government. We agree with staff that prompt action is needed to improve the situation. Strengthening banking regulation and supervision, improving independence of the financial authority, and strengthening banks' corporate governance should be part of the comprehensive package for the banking sector.

The ready-made garment sector has been the power house of the Bangladesh economy, but concentration of the export base on one particular sector creates vulnerabilities and limits the ability of the Bangladesh economy

to make continuous progress on the development ladder. More diversified and complex manufacturing would help integration to global value chains, support productivity, and reduce vulnerabilities to shifts in global demand patterns. Investing in human capital, improving the business environment, and promoting productive investments would be beneficial. Tackling corruption is crucial for improving the business environment and attracting foreign investments.

We appreciate the special attention to the climate change issue in the Article IV reports. It is sobering to read that the projected annual cost of climate change to the Bangladesh economy is estimated between 1.5 and 3.0 percent of GDP by 2030. The government's proactive stance and meaningful budget allocations to climate change measures are strongly supported. The authorities' actions to promote green financing in the financial sector will help engage the private sector on environmental issues. We encourage continuation of these efforts with the required intensity. Going forward, an introduction of a carbon tax could be considered in order to raise additional revenues available for adaption and mitigation investments and to give the right incentives for emission-saving technology. We also agree with staff that dedicated fiscal buffers, reduction of energy subsidies, and some form of insurance mechanism for natural disasters would be beneficial. Other measures to promote climate-friendly investments and the use of clean technologies could be considered as well.

Mr. Beblawi and Ms. Merhi submitted the following statement:

Bangladesh continues to show impressive and sustained growth performance led by private consumption, strong remittance inflows, and rebound in exports. Furthermore, the economy has shown steady progress in poverty reduction and in social development and has improved many Sustainable Development Goals indicators. Weaker global growth, slow progress in resolving the Rohingya refugee crisis, and weaknesses in state banks' balance sheets are the main downside risks facing the economy. We concur with staff that upgrading the macroeconomic policy framework and advancing a range of structural measures are needed to ensure sustainability and resilience of the economy, including the ability to adjust to climate change. We welcome in this regard the authorities' continued commitment to prudent policies to safeguard fiscal sustainability, enhance resilience, and promote further economic diversification and inclusive growth. Since we broadly agree with staff's findings, we offer the following comments mainly for emphasis:

Given the robust domestic demand, the central bank should remain vigilant to inflation dynamics. We welcome the authorities' readiness to adjust policy rates as appropriate. Gradually increasing exchange rate flexibility will also improve resilience to external shocks and enhance monetary policy efficiency.

Despite strong growth, weaknesses in the banking sector are increasing. NPL ratios continue to grow reaching 30 percent in state-owned commercial banks. It is worrisome to note that total stressed advances, which include NPLs and restructured/rescheduled loans, now exceed 20 percent of total loans. Furthermore, weak due diligence as well as reduced compliance with risk management practices are contributing to worsening asset quality. We encourage the authorities to promptly address these weaknesses as they limit banks' ability to engage in new lending, compromise the banking sector's role in private sector development, and have associated fiscal risks. To that end, we welcome the ongoing special audit for state-owned commercial banks in trade finance and see merit in proceeding with a comprehensive review of the banking sector's assets, adopting risk-based supervision, and avoiding regulatory forbearance with strict and prompt remedial actions imposed on banks. We also welcome the discussion of a bank merger policy to promote the consolidation of the banking sector as well as the setting up of an asset management company to take over NPLs.

We commend the authorities on their commitment to sustain fiscal discipline. However, and given the low revenue-to-GDP ratio compared to peers, efforts should continue to increase domestic revenue mobilization, continue with tax policy and administration reforms including by expanding the tax base and strengthening tax administration in order to finance the needed upgrade of infrastructure, support the vulnerable, and meet the potential cost of climate change. We therefore, welcome the implementation of the new VAT law at the beginning of the year, as well as the measures taken by the authorities to modernize and increase the efficiency of revenue and expenditure management. We also welcome the Fund's continuing TA and capacity development in these areas.

We welcome the authorities' continued commitment to address the vulnerabilities arising from climate change. The climate fiscal framework provides a roadmap for climate finance in the country, and we commend the authorities for making yearly provisions in the budget to respond to possible extreme weather events. However, more efforts are needed to create additional fiscal space for adaptation and mitigation, manage the impact of natural disasters, and promote climate-friendly investments.

With these remarks, we wish the authorities the best in their reform efforts.

Mr. Sun and Ms. Lok submitted the following statement:

We thank staff for the comprehensive set of reports, and Mr. Siriwardana and Mr. Singh for the useful buff statement. We take positive note that Bangladesh continues to make steady progress in poverty reduction and social development. Growth remains strong, inflation is largely stable, and the external position is broadly in line with fundamentals and desirable policies. Nevertheless, challenges lie ahead, with the economy facing downside risks from uncertainties in the global environment, while country-specific challenges including climate change could also weigh on growth. Maintaining robust economic activity and promoting sustained long-term development require a sound macroeconomic policy framework supported by prudent management, as well as structural measures to raise potential growth. We broadly agree with staff's appraisal and would confine our comments as follows.

On the monetary side, the Bangladesh Bank's (BB) policy has been supportive of growth, and inflation has remained largely stable at around the BB target. In the face of potential inflationary pressures stemming from several sources, the BB should remain vigilant and stand ready to adjust the monetary stance as appropriate. Meanwhile, we support staff's call for a gradual expansion in exchange rate flexibility to help buffer against external shocks to the economy and preserve the level of reserves.

On the fiscal side, raising tax revenues remains a key priority, and requires a coordinated approach both in terms of strengthening tax administration and policy reforms. The implementation of the new VAT law and related complementary measures is a welcome step towards modernizing the tax regime and boosting revenues. What are the authorities views regarding staff's suggestion to simplify the VAT structure? Going forward, we encourage the authorities to continue to enhance efficiency on both revenue and expenditure management.

Measures on various fronts would help sustain growth and development in the longer term. Addressing the persistently high non-performing loans and maintaining prudent financial system oversight are essential for the banking sector to effectively play its role in supporting the economy. Meanwhile, we encourage the authorities to continue to modernize

the monetary policy framework and promote capital market development. Reforming the National Savings Certificates schemes would help support efforts in this regard. To ensure resources are directed to areas with greatest growth impacts, prudent public financial management is essential, particularly in view of ongoing large-scale infrastructure projects. To fully reap the country's potential, efforts would be needed to improve the business climate, support human capital development, as well as strengthen institutions and governance. We also see scope in boosting youth and female employment. Finally, we commend the authorities' commitment and actions to tackle challenges arising from climate change and look forward to continued progress in strengthening the country's climate resilience.

With these remarks, we wish the authorities every success in their policy endeavors.

Ms. Levonian, Ms. McKiernan and Mr. Williams submitted the following statement:

We thank staff for their comprehensive set of papers and Messrs. Siriwardana and Singh for their insightful buff statement. The Bangladeshi economy continues to grow robustly, which alongside disciplined fiscal policy, has maintained debt on a sustainable path, contributed to a steady decline in poverty, and propelled the country to mid-income status. However, downside risks, including from natural disasters and unfavorable trends in the banking sector, remain elevated. To counter these risks and build on the growth momentum, the authorities are encouraged to strengthen macrofinancial and fiscal policies. We broadly concur with staff's assessments and recommendations and offer the following remarks for emphasis.

Durable and credible fiscal policy is key to underpinning debt sustainability while supporting development objectives. Revenues are currently below 10 percent of GDP. This is low compared to peers and insufficient to sustain progress on the macroeconomic and social fronts. Moreover, we are concerned that revenues continue to underperform leading to significant cutbacks in public investment, and likely undermining fiscal and budget credibility. To this end, we support staff's call for revenue mobilization to focus on broadening the tax base and limiting exemptions. Additionally, we hope that the recently launched VAT, complemented by the menu of ongoing administrative improvements outlined in the buff, will bolster revenue flows. Relatedly, efforts to enhance the public financial management framework are welcome, and we echo staff's call for the authorities to strengthen oversight of SOEs.

We encourage the authorities to take timely and decisive actions to address financial sector risks. Rising NPLs, particularly among state-owned commercial banks (SOCBs), threaten the stability of the financial sector. In this context, we welcome - among other recently enacted measures to strengthen resilience of the system - the ongoing special audit of SOCBs. At the same time, we note with concern staff's assessment that some of the recent actions could weaken banking system resilience. Can staff comment on the authorities' stance regarding this assessment?

Addressing shortcomings in the governance framework in tandem with other structural reforms will be integral to preserve macroeconomic gains and enhance the business environment. In this context, we welcome the report's findings of progress in controlling corruption, as well as the priority that Bangladesh assigns to this endeavor. Looking ahead, the authorities are advised to advance efforts toward improving the procurement system and enhancing the AML/CFT framework. These, alongside the recently established One Stop Service platform, will help to strengthen the business environment and support efforts toward economic diversification and resilience. We note the report's limited discussion on gender issues. We invite staff's comment on steps being taken to promote female labor force participation.

The authorities' proactive efforts toward countering the ever-present dangers posed by climate change are commendable. We welcome their approach of integrating adaptation and mitigation strategies into the budgetary framework. Greater fiscal space will allow for increased budgetary allocations to enhance financial and structural resilience, which further underscores the criticality of revenue mobilization going forward. We are however concerned that accessing donor support toward resilience building remains a key challenge. Can staff expand on the key impediments preventing Bangladesh from unlocking more resources?

Finally, efforts to bolster capacity development (CD) must continue vigorously. The CD strategy outlined in Annex V appears well suited to address key areas of weaknesses. In this context, we welcome the tailored training for Bangladeshi officials and support the priority assigned to building capacity in revenue administration and financial sector oversight.

Mr. de Villeroché, Mr. Rozan and Mr. Sode submitted the following statement:

We thank staff for their insightful documents and Mr. Siriwardana and Mr. Singh for their informative buff statement. Bangladesh continues to

experience robust macroeconomic performances and positive social outcomes. While the income convergence process is expected to continue in the coming years, further reforms are needed to create the conditions for a sustainable and inclusive growth to ensure that the country can reach the upper-middle income category. The result of the recent general election provides a political window of opportunity to make necessary and ambitious reforms. We agree with the thrust of staff recommendations and we would like to make the following comments for emphasis:

Increasing tax revenues remains a key priority to finance the country development needs. While we welcome the launch of the new VAT and the measures taken to modernize the tax administration, we encourage the authorities to design a broader and more ambitious plan to raise additional revenues. Given the relatively low level of tax to GDP ratio, raising public revenues could be done without creating major economic distortions in the short term while raising medium term growth. Could staff elaborate on the authorities' interest in designing a medium-term domestic revenue mobilization strategy?

We commend the authorities for maintaining a broadly stable public debt, but we concur with staff's calls for improving the budgetary framework. Public financial management reforms will help to improve macroeconomic policy and the efficiency of public spending. Given its significant infrastructure needs, improving public infrastructure management and implementation of the Annual Development Program is also warranted. Could staff elaborate on the potential benefits and risks of the Belt and Road Initiative for Bangladesh?

We largely concur with staff recommendation to address the banking sector vulnerabilities, notably through an improved treatment of NPLs and a reform of State-Owned Commercial Banks. We also remain worried by the development of National Saving Certificates which unduly increases the government' financing cost and limits the development of capital markets. Could staff elaborate on developments regarding NSC since last year Article IV? Going forward, we are looking forward to the coming FSSR which will step up staff engagement with the authorities on banking sector reform.

We note that the current account balance is estimated to be in line with fundamentals. We thank staff for avoiding making ad-hoc adjustments to the CA norm as it was the case last year. Could staff explain the difference between the CA norm of this year Article IV and the one estimated last year?

We thank staff for its coverage of climate change policy issues in the Article IV, and commend the authorities for putting in place a clear, long term strategy to address these challenges. Given the high vulnerability of Bangladesh to climate change, climate adaptation and mitigation strategies are macro-critical to the medium-term macroeconomic stability of the country. Going forward, we encourage staff to maintain their dialogue with the authorities and with other development partners on climate-related issues.

We also appreciate staff analysis of governance issues. While the country has made some progress regarding the control of corruption, further efforts are needed in this area. We also encourage the authorities to tackle issues related to government effectiveness, regulatory quality and the ease of doing business. We support staff call to improve the AML/CFT framework.

Finally, we acknowledge the efforts of the authorities and of the population of Bangladesh to host the Rohingya refugees. Could staff elaborate on its recommendation to increase fiscal space to create room to address the difficult situation of the refugees in case of slow progress in resolving the crisis and of weakened donor support, notably by detailing the potential fiscal cost of such a scenario?

Mr. Inderbinen and Mr. Tola submitted the following statement:

We thank staff for the informative set of reports, and Mr. Siriwardana and Mr. Singh for the helpful buff statement. Bangladesh's economic performance continues to be strong, aided by sound macroeconomic policies. A fast-growing manufacturing sector and large inflows of remittances have further buoyed the economy through their impact on private consumption. The key challenge ahead will be to complete the shift from an economic model based on low-cost manufacturing and remittances toward more economic diversification and a higher industrial value chain.

We share staff's recommendation regarding the modernization of the monetary policy framework. Even though inflation has been broadly stable, the use of a monetary targeting regime is not optimal for guiding inflation expectations, which remain high. Hence, we agree with staff's proposal to adopt a rule-based interest rate target with market-based monetary instruments. Greater exchange rate flexibility would also be beneficial, including as a buffer against external shocks.

Tackling the high level of NPLs would strengthen confidence in the banking system and help increase credit to the private sector. Weaknesses in the banking sector persist, as evidenced by the high level of NPLs, limiting banks' lending ability. In this context, it will be of utmost importance that the authorities implement staff's recommended measures, including the introduction of a clear entry and exit strategy for banks, the establishment of an emergency financing stability for temporarily illiquid institutions, and tighter criteria for the rescheduling and restructuring of loans. In this regard, we are skeptical about the recent decision by the Bangladesh Bank to introduce an amnesty program that extends the repayment period and reduces interest rates on bad loans. The program could entail the risk of perverse incentives and higher NPLs. Staff comments are welcome.

Addressing supply side bottlenecks is necessary to release the country's economic potential. The staff report highlights a series of key bottlenecks to investment. Lending rates remain high, not least due to the impact of high yields carried by National Saving Certificates (NSCs). Measures to limit the issuance of NSCs are steps in the right direction, but they should be complemented with the reform of the NSC pricing structure, as suggested by staff. This would allow for a level playing field and help the development of the domestic capital market.

Structural reforms aimed at improving the business climate, increasing labor force participation would strengthen resilience to external shocks. We note the progress achieved in improving the business environment, which is critical in accelerating economic diversification. However, more remains to be done to fight corruption, which is singled out in the report as a major obstacle to doing business and inclusive growth.

We agree with staff's proposals to tackle the impact of climate change. Bangladesh has suffered heavily from the impact of past natural disasters. The steps already taken by the authorities should be complemented by additional measures, as suggested by staff. In particular, fuel price subsidies should be removed and replaced with direct transfers to the most vulnerable households. Other measures, such as the implementation of a carbon tax, the use of an insurance mechanism, and the promotion of climate-friendly investment, would also seem viable options.

Mr. Psalidopoulos and Mr. Di Lorenzo submitted the following statement:

We thank staff for the well-written set of papers and Mr. Siriwardana and Mr. Singh for their helpful buff statement. We agree with staff's analysis

and policy recommendations and would limit our remarks to a few issues. These concern the role of the services sector in the diversification of the economy, the reform of public finance management, and the reforms needed to strengthen the banking sector.

While the economy should move to a higher diversification of the export base, staff's analysis could have benefited more from a stronger emphasis on the role of the services sector. We agree with staff that promoting investments in industries producing more complex goods than the ready-made garment industry is critical to increase the resilience of the economy and accelerate income convergence. Having said that, we believe that more analysis should be devoted to the possibility of achieving structural transformation also through the promotion of the services sector. The paper is focused mainly on manufacturing instead, and the econometric analysis concludes that the growth in services is negatively associated with the complexity of the economy. However, moving up on the value chain is not possible without recurring to certain services as inputs. Moreover, looking at the impact that technological innovations have had on the productivity of certain services, we believe that the traditional idea about services having lower productivity may be obsolete and thus the expansion of the tertiary sector can also bring broader economic benefits in terms of potential growth. We encourage staff to devote more attention to the potential of an expansion of the services sector in future work, notably for countries at the same stage of development as Bangladesh.

A solid public finance framework and higher tax revenues are needed to ensure sound fiscal policy. Targeting a gradual reduction in the debt level is an appropriate anchor for fiscal policy. However, fiscal policy predictability and effectiveness would largely benefit from improvements in all the phases of the budget process. The authorities should also aim at increasing the efficiency of i) public investment management, and ii) tax collection, by reforming tax policy and modernizing tax administration. We welcome that the VAT law, a longstanding topic, has been eventually implemented, and support staff's advice that a broader tax base and a simpler structure could generate revenues to be used to address education and infrastructure needs. In case revenues should underperform also in the current fiscal year, the achievement of the deficit target should not come at the expense of public investment and social protection. Savings can come instead from a gradual phasing out of the energy subsides bill. What is, in staff judgement, the best way to balance the need to providing affordable energy to sustain economic growth, on one hand, and the environmental impact of the energy subsidies on the other in Bangladesh?

Immediate action to address vulnerabilities in the domestic banking sector is paramount. Worsening asset quality, more visible in the SOBs, and a decreasing level of provisions despite strong economic growth and a credit-to-GDP ratio at fully sustainable level, is a signal of underlying weaknesses in credit standards, and especially in risk assessment. Although the authorities have taken some steps to booster resilience, a thorough comprehensive review of the banking sector's assets remains warranted; consideration should be given to initiatives aimed at strengthening regulation, especially regarding the criteria for loans classification, rescheduling and restructuring, and to implement a risk-based approach to supervision Can staff provide a timeline of the FSSR mentioned in the report?

Mr. Ronicle and Mr. Clark submitted the following statement:

We thank Staff for the clear set of papers, including the helpful capacity development annex, largely aligned around staff policy recommendations, and Mr. Siriwardana and Mr. Singh for their comprehensive buff statement.

We commend the authorities on the remarkable performance of Bangladesh's economy in recent years: per capita incomes have nearly doubled over the past decade; inequality has been stable and poverty rates have fallen; the economy has diversified; inflation and debt have been stable. We encourage the Bangladeshi authorities to continue their reform efforts to help maintain the pace of convergence and deliver on their ambition to move to middle income status.

On fiscal policy, we welcome the authorities' commitment to continued fiscal discipline, but policy efforts to raise revenues should remain a key priority. Budget revenues remain very low and need to increase to be able to fund social spending and additional economic investment. Equally, the need for broader domestic resource mobilization will rise as Bangladesh graduates out of concessional financing. This will require reforms to both tax administration and tax policy, with the goal of broadening the tax base and reducing tax exemptions.

Over the medium term, Bangladesh will need to modernize its policy framework, strengthen public financial management and governance, encourage further economic diversification and mitigate the impact of climate change and natural disasters. The authorities should strengthen efforts to mitigate risks in the banking sector, especially given the increasing number of non-performing loans and need to reassess the role of State Owned

Commercial Banks. In addition, we welcome staffs' recommendations on the need for a well-functioning capital market and encourage a move to alternative financing instruments and away from the low value for money National Savings Certificates. That will support a modernization of the monetary policy framework, alongside staff recommendations for enhanced communication of policy and inflation drivers, a well-functioning interbank market and improved monitoring and forecasting of liquidity.

Investment, further export-focused economic diversification and greater efforts to address corruption will be required to realize the authorities' longer-term ambitions. We welcome the progress to date on AML/CFT which should be sustained. Corruption is still regarded as a major constraint to doing business. The Anti-Corruption Commission should be strengthened, and efforts should be made to increase compliance with asset declarations. Increasing the efficiency of public investment is another key source of potential growth. Enhancing efforts on the wider business environment and assessing the preferential treatment of the Ready-Made Garment industry could also increase the incentives for diversification.

We strongly welcome the selected issues paper and in-depth discussion of Bangladesh's long-term vulnerability to climate change and agree that the economic impact of climate change is likely to become more pronounced. Specifically, we welcome the strong emphasis and recommendations on the need to manage the impact of natural disasters and for the authorities to consider using contingent financing instruments as well as domestic resources. In this regard, the authorities should consider undertaking a Disaster Resilience Strategy, a multi-layered disaster risk finance strategy, and enhancing ex-post social protection schemes.

Finally, we welcome the focus on the ongoing Rohingya crisis and agree continued slow progress could add to social tensions. In addition, there is a need for medium-term sustainable measures and greater consideration given to wider economic and social integration policies and wider economic opportunities, to enable a movement towards an ability to self-support.

Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for the comprehensive report and Mr. Siriwardana and Mr. Singh for their informative buff statement. Bangladesh continues to benefit from robust growth, solid macroeconomic performance and stable inflation. To secure strong and resilient growth, Bangladesh needs to increase diversification of the economy, implement reforms to strengthen the banking system, as well as create buffers to mitigate climate risks and potential

impacts of a migration crisis. We broadly agree with the staff's appraisal and will provide some comments for emphasis.

While a prudent fiscal stance continues to be maintained, we agree that further efforts to boost revenue performance are needed to upgrade infrastructure and build buffers to mitigate climate change and migration issues. Compensating revenue underperformance with expenditure restrain has allowed maintaining the fiscal deficit within the budget target. We agree with staff that the revenue projections appear to be very ambitious given that revenue underperformance in FY19 was more pronounced than in the past. That said, we consider that boosting tax revenue is fundamental to allow for infrastructure investment and to face other risks. In this regard, we take positive note of the implementation of the new VAT law as a step in the right direction, as mentioned on the buff statement.

We consider that, as in other countries that have experienced a sudden and significant migration influx, it is imperative that bilateral surveillance includes an analysis of the potential macroeconomic effects of migration and to help countries develop mitigation measures. We note that staff considers that the fiscal impact of the Rohingya refugee crisis appears limited in the short-run due to donor support. However, the refugee crisis appears as a medium to high source of risk. We would like to know if the potential fiscal impact of losing donor support related to the crisis and measures to address it were discussed with the authorities.

We agree with staff that gradually increasing exchange rate flexibility will contribute to buffer the economy against external shocks and support the modernization of the monetary policy framework.

A resolute commitment on strengthening banking regulation and supervision is needed as the financial situation has deteriorated since the past report. The continued increase in the NPL ratio, namely from concentration in state-owned banks, as well as the potential underestimation of the negative impact of NPLs is concerning. We concur with the action plan outlined by staff, and underscore that the independence and autonomy of the central bank is crucial for a strong and effective supervision and regulatory framework.

Taking advantage of the favorable juncture through improvement of the business environment and diversification of the economy is crucial to support strong and sustainable growth. We thank staff for the insightful SIP on economic diversification and take note on the need for human capital investment. Staff comments are welcome on policies focused on boosting

human capital investment, in particular related to female labor force participation.

We support the authorities' commitment to address climate change and encourage them to enhance efforts, in particular through domestic revenue mobilization and the gradual elimination of energy subsidies. We thank staff for the inclusion of climate change related shocks in this report and the SIP on this issue.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

We thank staff for the well-written set of reports and Mr. Siriwardana and Mr. Singh for their informative buff statement. We broadly share staff's analysis and policy recommendations and would limit our remarks to a few issues.

We welcome continued strong growth with stable inflation. In this context, we are encouraged by the steady progress in reducing poverty and improving many SDG indicators. Looking ahead, the authorities should continue to pursue prudent policies and further advance structural reforms to build upon the impressive macroeconomic performance and social development achieved so far. It is also important to remain vigilant as risks continue to be tilted to the downside.

The authorities deserve to be commended for keeping the public debt ratio broadly stable, but a significant increase in tax revenues is essential to help create space for priority infrastructure investment and additional social spending. Indeed, the tax-to-GDP ratio remains below 10 percent, which is below the average for LICs as well as for middle- and upper-middle-income countries. To increase tax revenues, the authorities should continue their efforts in both tax administration and tax policy areas. To this end, we agree with staff that priorities include tax base broadening and reducing tax concessions and tax avoidance. However, the rationale for staff's recommendation to consider a phased introduction of carbon taxes (paragraph 37) to address climate change is not clear as Bangladesh accounts for only 0.35 percent of global greenhouse gas emissions (Box 2). Rather, the focus should be on adaptation measures as Bangladesh is one of the countries most affected by natural disasters. Staff comments would be appreciated.

Addressing banking sector weaknesses remains a priority. The rise in the NPL ratio with most of NPLs in the State-Owned Commercial Banks (SOCBs) and the continued increase in the amount of restructured and

rescheduled loans highlight the importance of implementing comprehensive measures. In this connection, we concur with staff that priorities include SOCB reforms, tighter criteria for loan rescheduling and restructuring, strong corporate governance in the banking sector, and enhanced legal systems to accelerate loan recovery. On AML/CFT, we welcome the progress and encourage continued efforts to strengthen the framework.

Increasing export diversification would help in increasing potential growth. While the rapid expansion of the ready-made garment (RMG) sector has transformed the economy, it is evident that manufacturing of more complex products will increase integration into global value chains and help achieve more strong and sustainable growth. In this context, we welcome the coverage of this issue in the SIP. We agree that priorities include further improving the business environment to ease the entry of new firms and investment in human capital to prepare the labor force for new industries.

Finally, we note the update on the Rohingya refugee crisis. We look forward to progress in resolving the crisis in the period ahead.

With these remarks, we wish the authorities further success.

Mr. Razafindramanana and Mr. Sidi Bouna submitted the following statement:

We thank staff for a comprehensive set of reports and Mr. Siriwardana and Mr. Singh for their informative buff statement.

Bangladesh's economic activity remains strong but higher productive investments are needed to sustain the current growth momentum. We welcome the economy's robust growth in 2018 amid a stable inflation, driven by private consumption and exports. Fiscal deficit was contained within the 5-percent budget target. While remittances inflows remained elevated, the current account deficit widened due in part to higher imports of capital goods. The country's overall economic outlook remains positive. However, risks to the outlook remain tilted to the downside, and mostly stem from external sources notably a potential weakening of global growth and trade protectionism which could adversely affect the country's exports and remittances. Strengthening macroeconomic stability over the medium-term will require decisive actions, notably in the fiscal area. We share the staff's assessment that there is a need to enhance the macroeconomic policy framework and support productive investments, including through addressing weaknesses in the financial sector and in governance. Further efforts are also

needed to increase the resilience of the economy of Bangladesh against external and climate-related shocks.

The authorities should monitor inflation expectations while continuing to improve the monetary policy framework. Inflation in Bangladesh has remained stable and close to the central bank target following the monetary policy easing in April 2018. However, the recent indications of a buildup of inflationary pressures, particularly nonfood prices as well as the introduction of the new VAT, require increased vigilance from the central bank which should be ready to tighten the monetary policy stance if conditions warrant it. They should also pursue their efforts to further modernize the monetary policy framework to help improve the monetary policy transmission mechanism. Staff has recommended the adoption of an interest targeting regime given the weaknesses and inefficiencies of the current monetary targeting regime highlighted in paragraph 25. Could staff elaborate on the authorities' views on a possible transition to an interest targeting regime?

We welcome the robust external position of Bangladesh and the authorities' commitment to preserve an adequate level of reserves going forward. We also take note of their expectation of an increase in FDIs, exports, and remittances inflows which will contribute to a more rapid narrowing of the current account deficit over the medium-term. Staff has called for greater exchange rate flexibility to help absorb potential external shocks and build up foreign exchange reserves. However, during last year's Article IV consultation, staff indicated in their report that the authorities viewed excessive exchange rate fluctuations as undesirable and that they would intervene in the markets to avoid large exchange rate movements. Could staff clarify whether they have reiterated during this year's Article IV consultation their preference for a stable exchange rate?

The authorities are encouraged to create the needed fiscal space for capital expenditure and for climate change adaptation and mitigation while continuing to enhance the fiscal framework. We commend the government for maintaining the fiscal deficit at 5 percent of GDP and keeping the debt ratio stable. However, they have achieved this outcome by cutting capital expenditures in response to revenue underperformance. We welcome the new VAT which should help boost tax revenues as rightly underscored by the authorities. However, additional measures will be needed to raise Bangladesh's tax-to-GDP ratio which remains low, in order to create the necessary fiscal space for much-needed infrastructure spending and to address the adverse effects of climate change. On the latter, staff has highlighted in paragraph 37 and Box 2 of the main report a number of policy options to

mobilize more domestic revenue and external funding to increase mitigation and adaptation investments. We would appreciate staff's elaboration on the progress made in the implementation of those policy options. We also take positive note of their plans to reinforce tax administration by expanding the income tax department. That said, more needs to be done to strengthen the fiscal framework and in particular to improve public financial management, including through ensuring that public investment projects are in line with the priorities outlined in the country's national plan.

Bold measures should be implemented to address the banking sector's vulnerabilities. We share the staff's assessment that the recent increase in the NPL ratio and in the level of stressed assets hampers lending by the banking sector and therefore is a drag on growth. We encourage a strict implementation of the regulations governing the banking sector and conduct a thorough review of the assets of the whole sector. The authorities should consider strengthening the criteria for rescheduling and restructuring of loans.

To sustain strong and inclusive growth, the authorities are urged to accelerate the diversification of the economy and improve the business climate. While the economic development of Bangladesh is increasingly led by the manufacturing sector, the country needs to promote higher value-added activities. In this regard, more investment in sectors other than the garment industry is crucial. Moreover, further efforts in strengthening governance and the business climate —notably by enhancing the capacity of the anti-corruption commission, improving the AML/CFT framework and reforming the judiciary system— to attract private investment both foreign and domestic will also be needed.

With these remarks, we wish the authorities of Bangladesh success in their future endeavors.

Mr. Mozhin and Mr. Potapov submitted the following statement:

We thank staff for a set of insightful reports and Mr. Siriwardana and Mr. Singh for providing additional information in their buff statement. Bangladesh's economy continues to grow at a brisk pace fueled by strong private consumption, garment exports, and large remittance inflows. Important progress has been achieved in reducing poverty levels and improving social indicators, underpinned by sound macroeconomic policies. GDP per capita has doubled in five years. While the growth outlook is favorable, significant downside risks remain, as presented by staff in the Risk Assessment Matrix. Proactive policy measures are needed to promote

sustainable and inclusive growth and address vulnerabilities in the banking sector. We broadly agree with staff's recommendations.

Fiscal policy should continue to be prudent to preserve macroeconomic stability and ensure debt sustainability. Although the risks of public debt distress are limited and the size of this year's fiscal deficit is contained, the reforms to boost domestic revenue mobilization are crucial to allow additional capital and social spending. Bangladesh's low tax revenue/GDP ratio suggests ample room for additional base broadening, including through the modernization of tax laws and tax administration. Despite several initiatives in these areas over the recent years, the persistent revenue underperformance has been a source of concern. Against this background, we welcome the recent implementation of the new VAT law and the adoption of the new Budget Accounting and Classification System (BACS). We also support the authorities' efforts to increase recurrent expenditures savings. The authorities are well advised to work toward a simpler VAT structure by reducing multiple rates and exemptions. Could staff elaborate on how the revenue performance in Bangladesh compares to its peers?

We are encouraged that inflation has remained broadly stable at around the Bank of Bangladesh's target since the easing of monetary policy last year. As highlighted by Mr. Siriwardana, growth of monetary and credit aggregates has also decelerated. At the same time, the authorities are aware of potential inflationary pressures and continue to closely monitor inflation dynamics. We generally agree with staff's recommendations to allow greater exchange rate flexibility and to distribute the response to external shocks more evenly between exchange rate adjustments and the use of foreign exchange reserves. Although reserve coverage is broadly adequate according to the reserve adequacy metrics, we would invite staff comments on whether there is the need for further reserve accumulation, given structural changes to the external sector (Annex IV)?

The risks in the banking sector remain elevated. The NPL ratio remains high, particularly for SOCBs, and the amount of restructured and rescheduled loans continues to increase. We encourage the authorities to adopt a comprehensive, time-bound action plan, in line with staff's recommendations (paragraph 23). We welcome the forthcoming FSSR as it can help strengthen banking supervision and regulation and advance necessary reforms in the banking sector.

Another serious risk to the health of the financial sector in Bangladesh is the high and rising National Saving Certificates (NSCs) issuance. Excessive issuance of NSCs may lessen the efficiency of the fiscal policy, hamper the development of financial markets and constrain private investments. It also limits the ability of the central bank to conduct monetary policy. In this context, we welcome the authorities' recent measures to reduce the incentives for buying the NSCs. Could staff elaborate on their recommendation to separate the NCSs issuance from direct budget financing?

Bangladesh's further integration in the global value chains would require substantial improvements in the business environment and regulation. Efforts in this area would also be helpful in addressing challenges associated with governance and institutional weaknesses. We agree with staff that investments in human capital would be instrumental for promoting diversification. We also support the authorities' efforts to address challenges related to climate change.

Mr. Mojarrad and Mr. Badsi submitted the following statement:

We thank staff for the well-written set of reports and Mr. Siriwardana and Mr. Singh for their informative buff statement. We commend the Bangladesh authorities for their strong economic performance and for their renewed commitment to maintaining macroeconomic stability and promoting inclusive growth. Backed by robust domestic demand, high exports and remittances, and supportive monetary policy, Bangladesh economy continues to enjoy impressive economic growth while making significant strides towards economic diversification, reducing poverty and improving sustainable development goals indicators. Sound macroeconomic policies are reflected in the moderate inflation, stable primary surplus, declining current account deficit and low public debt. Risks in the medium-term are skewed to the downside mainly driven by rising protectionism, weaker-than-expected global growth, slow progress in resolving the Rohingya refugee crisis and weakened donor support. We broadly concur with the thrust of staff appraisal and limit our comments to the following points for emphasis.

We welcome the authorities' commitment to fiscal discipline and keeping the fiscal deficit within 5 percent of GDP. Maintaining fiscal and debt sustainability require strengthening public revenue, which could be achieved through enhancing tax collection and modernizing the tax administration, broadening the tax base, and streamlining VAT procedures. While preserving the priority social spending is paramount, the authorities' efforts in increasing recurrent expenditure savings should be acknowledged. We note from the

staff report that the expected decline in both projected public capital spending and credit to private sector would have no impact on the projected real GDP growth in 2019. Could staff provide some clarification on this issue?

While noting that the monetary policy framework needs to be substantially strengthened, we take comfort in the authorities' awareness of potential sources of inflationary pressures and in their readiness to promptly adjust monetary policy. We take positive note that the authorities plan to continue to gradually increase exchange rate flexibility as indicated by Mr. Siriwardana and Mr. Singh in their buff statement. Meanwhile, the banking sector is still facing major challenges, including undercapitalized SOCBs, high NPLs and governance shortcomings, which are posing high risk to financial stability. We welcome the authorities' intention to address effectively the vulnerabilities in the financial sector and agree that the implementation of the proposed corrective measures is key to maintain confidence in the banking sector. We support the authorities' policy option to resolve NPLs and efforts to implement strict conditions on loan rescheduling and restructuring.

We commend the authorities for the significant decline of poverty levels over the past decades and encourage them to implement bold structural reforms to boost sustainable growth and increase economic resilience while pursuing sound and prudent macroeconomic policies. Further economic diversification away from the agricultural sector while rising productivity and improving the business environment is central. We welcome the authorities' firm commitment to addressing climate change and encourage them to step up efforts to improve the PFM and the AML/CFT framework and to combat corruption.

We wish the authorities success in their future endeavors.

Mr. Kaya and Mr. Bayar submitted the following statement:

We thank staff for their comprehensive set of reports and Messrs. Siriwardana and Singh for their helpful buff statement. Bangladesh has set an impressive track record of high economic growth and social development, has significant potential. The authorities' commitment to maintaining macroeconomic stability and inclusive growth would help realize that potential and facilitate the country's graduation from low-income status. Going forward, we agree that the authorities' ambition to reach upper middle-income status requires an upgraded policy framework enabling further diversification of the Bangladeshi economy and entrenching resilience

vis-à-vis the downside risks. We agree with the thrust of the staff appraisal and would like to highlight the following comments for emphasis.

While the authorities are maintaining overall fiscal discipline, they need to redouble their efforts on mobilizing tax revenues. Notwithstanding the broadly-stable headline fiscal and debt indicators, Bangladesh lags behind its peers in revenue collection, with the tax-to-GDP ratio remaining below 10 percent. We therefore agree with staff on the need for raising tax revenues to address Bangladesh's significant infrastructure gaps as well as large social spending needs. In this vein, we welcome the authorities' recent initiatives to improve the tax policy and administration, particularly the delayed implementation of the new VAT law. Nevertheless, we note with concern that staff's revenue projections diverge significantly from those of the authorities, reflecting inter alia the design complexities of the new VAT law. We agree that a simpler design, with fewer rates and exemptions could have helped to mobilize more revenues and ease the implementation challenges, particularly at the initial stages. Could staff comment on the early implementation results, if available? It is also crucial to review the direct taxes (e.g. Personal, and Corporate Income Taxes) through coordinated policy and administration efforts.

The authorities need to remain cautious about potential inflationary pressures. We note that the accommodative monetary policies of Bangladesh Bank (BB) have served the economy broadly well as inflation hovers at around the BB's official target and credit to the private sector slowed to more sustainable levels. Nonetheless, as also recognized by the authorities, several factors (e.g. strong domestic demand, rising non-food inflation, and near-zero real rates on money market instruments) could risk unanchoring the inflation expectations and thus, call for close monitoring of pricing developments and readiness to adjust the policy stance as needed. We support continued progress toward exchange rate flexibility, which should serve as a first line of defense against external shocks.

Notwithstanding strong growth, the banking sector continues to suffer from balance-sheet problems. The stock of non-performing loans (NPLs) is growing on particular account of the very-high NPLs in the State-Owned Commercial Banks (SOCBs) – reaching 30 percent as of end-2018. We are encouraged by the authorities' recognition of the issue and encourage them to tackle the NPL problem with more ambitious policies as well as effective insolvency procedures. On a similar note, the authorities should act swiftly to repair the SOCBs' balance sheets, while refraining from unduly straining budgetary resources with unconditional recapitalizations. We support staff's

call that the regulatory framework needs to be strengthened overall, with a particular attention on the monitoring of SOCBs.

Finally, we reiterate our appreciation to the Bangladeshi authorities and people for hosting a large number of refugees from Myanmar's Rakhine State and underscore the importance of continued support by the international community and donors.

Mr. Doornbosch and Mr. Voinea submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Siriwardana and Mr. Singh for their informative buff statement. We broadly agree with staff's assessment and main recommendations and would like to make the following points for emphasis.

We agree with staff that the macroeconomic performance is solid, based on strong economic growth, stable and moderate inflation and a narrowing current account deficit. The primary balance appears to be contained, and last year's rise in the current account deficit was driven by imports determined by a one-off natural disaster event, while gross official reserves are sufficient. We also take note that the Debt Sustainability Analysis indicates a low risk of external debt distress and a low overall risk of debt distress.

From our perspective, two major issues need attention at the macro-economic level: the very low level of tax revenues (below 10 percent of GDP) and the weakening financial stability in the banking sector.

Raising the tax revenues is imperative, not only for allowing to accommodate current spending pressures of a catching-up economy, but also to create fiscal room for future investments required to further mitigate the impact of climate change, including those envisaged under the Bangladesh Delta Plan 2010 (80 projects mounting to USD 37 billion of total capital investment until 2031). Higher revenues can be achieved through a series of measures, such as eliminating the current tax exemptions, introducing a carbon tax, or implementing a more progressive taxation system.

Securing financial stability is a public good; not delivering this public good would have adverse consequences on the macroeconomic stability, jeopardizing the achieved progress of recent years. More efforts are needed to fully report NPLs, to create a secondary market for NPLs, to enhance the payments discipline in particular in the state-owned companies, and to make

further progress with developing and implementing the AML/CFT framework.

We would like to commend the authorities for their efforts to address the impact of climate change, and to express our support for those policy options that would further help mitigating and adapting to these challenges.

Although significant progress has also been made with attaining the Sustainable Development Goals, the inequality level remains high and the quality of life indicators reflect severe strains, such as: proportion of urban population living in slums 55.1 percent; prevalence of undernourishment 15.2 percent, maternal mortality ratio 172 per 100,000; participation rate in organized learning 39 percent. Against this background, can staff discuss in more detail inequality and quality of life related issues such as: distribution of growth to the lower income households, progressivity of the taxation system, prevalence of the underground economy, and actions taken to improve access to basic education and health services.

The Acting Chair (Mr. Furusawa) made the following statement:

Bangladesh's continued strong growth, stable inflation, and diversification from agriculture to manufacturing have reduced poverty and improved social indicators. To achieve upper middle-income status, the authorities need to tap the country's significant potential and ensure sustainable and resilient growth. In their gray statements, Directors have touched on the need for the authorities to upgrade the macroeconomic policy framework and advance a range of structural measures. The aim is to strengthen the fiscal framework, address banking sector weaknesses, fight corruption and enhance the business environment, and create fiscal space for adaptation and mitigation of climate change.

Ms. Crane made the following statement:

We thank staff for the answers to technical questions and Mr. Siriwardana and Mr. Singh for their informative buff statement. We issued a gray statement but would like to underscore several points.

Bangladesh has benefitted from generally solid macroeconomic management, but there are several areas where strengthened policies and administration would serve Bangladesh well.

First, in the fiscal area, more systematic efforts to boost domestic revenues are warranted to provide more scope for development spending, particularly considering that Bangladesh has the lowest revenue-to-GDP ratio in South Asia. We would like to see a growth-friendly approach which focuses on reducing exemptions and broadening the base.

Second, on monetary and exchange rate policy. We are encouraged that the authorities' monetary policy statement recognizes that additional foreign exchange flexibility would help keep the currency aligned with fundamentals, foster foreign exchange market development, and allow the exchange rate to provide a buffer against shocks. We welcome continued Fund staff engagement in support of the authorities' intention to gradually increase exchange rate flexibility.

Finally, on the financial sector, we would echo staff's caution on moral hazard risks. In particular, repeated restructuring and the rescheduling of bad loans, along with easier repayment conditions on top, are not conducive to strengthening the payment discipline of borrowers. We encourage the authorities to consider stronger actions in this area, as the costs will only rise over time if poor asset quality is not addressed more decisively.

Mr. Ostros made the following statement:

I thank staff for a very good set of reports, not least, the selected issues paper was interesting to read. I thank Mr. Siriwardana and Mr. Singh for the insightful buff statement.

The Bangladeshi economy is currently on a relatively good path, with strong growth and moderate inflation and progress on many development metrics. There are many issues that are worth discussing about the Bangladeshi economy, but I would like to concentrate on the climate change issue, which was also a theme in the selected issues paper.

Let me start by commending Bangladesh's authorities for the proactive stance on climate change adaptation and mitigation efforts. That is commendable. But as the U.S. chair points out, the key constraint is the very low level of government revenue. I would encourage the authorities to increase the tax base, improve the efficiency of tax collection, and reduce inefficient exemptions.

As staff points out, the introduction of a carbon tax could be a relatively practical way of increasing tax revenue, and at the same time, deal

with energy efficiency measures. Such an implementation is politically difficult. It should be done carefully and with consideration to the negative impacts on more vulnerable people. But as staff points out, the most vulnerable are probably not the highest consumers of carbon-related energy.

It is interesting to think about how to improve crisis management capabilities and develop insurance mechanisms, such as climate-resilient debt instruments. It would be interesting to see further analytical input on this issue from the Fund. That would be beneficial, particularly if we go deeply into Debt Sustainability Analyses (DSAs) and take into account climate change risks and the implications of different insurance options.

I wish the authorities success in their further endeavors.

Ms. Mannathoko made the following statement:

We thank staff for the interesting reports and Mr. Siriwardana and Mr. Singh for the insightful buff statement. We commend the authorities on Bangladesh's strong economic growth. An important test will be in preserving this growth and ensuring fiscal and climate resilience. Therefore, we encourage the authorities to sustain their focus on meeting fiscal targets and maintaining the reform momentum needed to boost the infrastructure investments that they are envisaging, and to promote economic diversification but also to sustain the reforms needed to address banking sector vulnerabilities.

We wanted to ask three questions.

First, on the fiscal targets, we welcome the commitment that the authorities have made to keep the fiscal deficit within 5 percent of GDP and encourage effective tax base and revenue measures, like Mr. Ostros mentioned. But we also noted the differences between staff and the authorities on the likelihood of achieving the revenue target. We did note the staff's responses to Directors' technical questions but wonder if staff could elaborate on whether there is some underlying reason for the difference in views.

The authorities cited various value-added tax (VAT) tax compliance, tax administration revenue measures, which they believe will contribute. I would like more elaboration on that and the measures needed to meet the 5 percent target.

Second, on the financial sector, we concur with other Directors that vulnerabilities need to be addressed promptly and we share concerns regarding the implications of growing nonperforming loans (NPLs) in state-owned banks. While noting the risks, the buff statement highlighted a range of measures that the authorities believe will alleviate this problem. I ask the staff to comment on why expectations are different.

Finally, on governance, we were pleased to note the recent improvements cited by staff in the control of corruption. We would like to encourage further reforms going forward. We noted that the authorities expressed some concern regarding third-party indicators (TPIs). Staff's views on this would be welcome.

With these comments, we wish the authorities success.

Mr. Razafindramanana made the following statement:

I thank staff for the informative set of reports and for their written responses to our questions. I also thank Mr. Siriwardana and Mr. Singh for their insightful statement. We have issued a gray statement and would like to make the following additional comments for emphasis.

We commend Bangladesh for its solid economic performance. On fiscal policy, like many other Directors, we encourage the authorities to take the necessary measures to increase tax revenues, as efforts in this area are needed to create the fiscal space required for public investment and also to mitigate the effects of climate change.

On the financial sector, we would like to emphasize the importance of taking decisive steps to address banking sector vulnerabilities and to tackle the growing stock of NPLs and stressed assets, with a particular focus on state-owned commercial banks (SOCBs), as also underscored by many other Directors in their gray statements, including Mr. Kaya and Mr. Tanaka.

Finally, to sustain the ongoing strong growth momentum, we encourage the authorities to accelerate their efforts to diversify the economy. Like other Directors, including Mr. Fachada and Ms. Mahasandana, we believe that boosting human capital will be essential to raising Bangladesh's growth potential.

With these remarks, we wish the authorities every success going forward.

Mr. White made the following statement:

We thank staff for the comprehensive set of reports and Mr. Siriwardana and Mr. Singh for their informative buff statement.

We did not issue a gray statement, but I would like to make a few remarks on climate change arising from staff's excellent selected issues paper.

We note Bangladesh's extreme vulnerability to climate change, a vulnerability shared by many in our own constituency, and the disproportionate risk faced by many of the poorest communities. We commend the Bangladeshi authorities for their early planning and action on climate change, both in terms of international commitments and domestic budgeting under the climate fiscal framework. We also note the significant further financing required between now and 2030, some US$15 billion for adaptation and US$26.5 billion for mitigation, and that significant responsibility for financing the latter falls on advanced economies. In this context, we have a few questions for staff.

On insurance mechanisms, we are pleased to hear that the insurance market for natural disasters has expanded. Nevertheless, current disaster risk premiums remain costly for low-income countries (LICs). We encourage Fund staff to continue to work closely with the World Bank and other organizations to develop an affordable and appropriate insurance framework. Could staff elaborate on what might assist in improving the pricing of risk?

We agree that the authorities should, over time, reduce distorting subsidies and enhance local revenue to finance mitigation and adaptation. At the same time, we support staff's view that the authorities should intensify their efforts to mobilize concessional financing from the international community. Could staff elaborate on what further assistance the Fund or other international institutions could provide in this area?

Mr. Tanaka made the following statement:

We thank the mission chief, Mr. Kihara, and his team for their great work to write the staff report with comprehensive research and analysis, including on banking sector vulnerabilities and climate change. We also thank Mr. Siriwardana and Mr. Singh for their informative buff statement.

We commend Bangladesh for its stable macroeconomic performance with strong growth, low inflation, and low public debt. Taking the opportunity of a favorable macroeconomic situation, we encourage the authorities to implement the necessary reforms. We would like to make three comments.

First, on the banking sector, we appreciate staff's detailed answers to our technical questions. The SOCBs' problems should be addressed promptly, with a comprehensive and time-bound action plan. We share staff's view that such an action plan should include an assessment of the role of SOCBs. The role of SOCBs should be clearly defined, and the activities of SOCBs should be limited to eight years, in areas private banks cannot cover, and transparent budget support for public policy lending should be provided. In addition, given that more than half of the rescheduled loans were to large firms and rescheduled loans tend to become NPLs, the potential misallocation of resources should be considered.

On top of these points, strengthening corporate governance and risk management in SOCBs is indispensable. We share staff's view that the current situation provides some space for the government to address NPL issues without a significant deterioration in economic activity, and we expect the authorities' decisive action.

Next, on the fiscal sector. Given the role of tax revenue, improving revenue mobilization is crucial. While welcoming the authorities' commitment to maintain a 5 percent fiscal deficit, as that is achieved by restricting capital expenditure, it has a negative impact on medium-term growth. Therefore, we encourage the authorities to continue their efforts, including simplifying the VAT, broadening the tax base, and strengthening tax administration.

Finally, addressing corruption is important, as it is a major inhibitor to doing business and inclusive growth. Against this backdrop, we appreciate staff for that statement on corruption, in line with Fund policy.

With these comments, we wish the authorities all success in the future.

Mr. de Villeroché made the following statement:

I thank staff for this excellent report and answers to our questions. I thank Mr. Siriwardana and Mr. Singh for their buff statement.

I would like to commend the macroeconomic performance of Bangladesh. It has been remarkable over the last few years. We have experienced continuous progress toward the goal of achieving higher middle-income status. However, we see Bangladesh as being at a crossroads and significant reforms are needed to continue this path.

I will start with the public revenue discussion on the public revenue-to-GDP ratio, which is very low in comparison with peers. This is limiting the financing for much-needed spending and investments. We encourage the authorities to go beyond the planned improvement of tax administration and to design an ambitious Medium-Term Revenue Strategy with concrete measures to increase the tax bases and raise revenues further.

Second, on the banking sector, if not addressed, we see a risk that the sector will be a drag on investment and growth. We strongly encourage the authorities to reform state-owned banks and to solve the structural issue at the root of the high level of NPLs.

Third, we see a need to continue on the diversification of the economy. To this end, we encourage the authorities to improve the business climate—notably, by tackling governance issues—and to invest more in human capital.

Lastly, we commend the authorities for their adaptation efforts to climate change. Domestic revenue mobilization, along with external donor support, will be key to properly finance the necessary adaptation investments for climate change. I would like to congratulate staff for emphasizing that in the report. This is particularly warranted for Bangladesh, and we believe that Article IV reviews for many countries should have a greater focus on climate change.

Mr. Alkhareif made the following statement:

I join others in thanking staff for their focused report and for answering the Directors' technical questions. I take this opportunity to thank Mr. Siriwardana and his colleague Mr. Singh, for their informative buff statement.

We issued a gray statement, in which we commended the authorities for their impressive economic performance and social development. We encourage the authorities to continue to pursue prudent policies and to further advance structural reforms to increase potential growth.

Bangladesh is one of the countries most affected by climate change-related natural disasters, as highlighted by the staff report. Like Mr. Ostros, Mr. White, and Mr. de Villeroché, we are encouraged by the authorities' full commitment to address the vulnerabilities related to climate change and natural disasters, as also reflected by the authorities' own national plans. This is important, as each country has to determine its policy tools to meet its goals based on national circumstances. In our view, this may include one or more market and non-market measures, considering economic efficiency, political economy, and distributional aspects.

In this context, we do not find staff's response to our question persuasive—that the introduction of a carbon tax would create positive incentives to reduce significant domestic health costs linked to urban pollution. We would suggest other, more effective approaches to achieve a reduction in urban pollution, such as local pollution standards and regulations. In our view, distributional considerations are very important, as imposing carbon taxes over and above the existing taxes, especially for LICs will make the situation even more regressive. In this context, we welcome the authorities' view that the provision of affordable energy over the medium term remains a priority for them to sustain rapid economic growth.

Finally, like Mr. White, we would encourage staff to further expand their collaboration with the World Bank on issues where the Fund does not have the comparative advantage.

With these remarks we wish the authorities further success.

The staff representative from the Asia and Pacific Department (Mr. Kihara), in response to questions and comments from Executive Directors, made the following statement:

I would like to thank Directors for the helpful gray statements and Mr. Siriwardana and his staff for the close and constructive interaction with the staff. As pointed out in the gray statements and emphasized by the Acting Chair, Bangladesh has achieved impressive progress in economic growth and improvements in social indicators. However, the economy still faces several structural challenges to sustain robust growth. In this regard, staff has been emphasizing to the authorities that growth needs to be not just strong but also sustainable and resilient. Staff highlighted several key challenges, such as tax revenue mobilization, banking sector reform, improvements in the economic policy framework, particularly in areas of governance and corruption, export diversification, and climate change.

On the questions from the Directors, I would like to start with one question staff could not address in the written responses. Mr. Doornbosch asked for more details on inequality and quality-of-life issues, such as education and health. Income inequality in Bangladesh has been regarded as relatively low. However, as the economy continues to grow, there have been growing signs of increased inequality in the country. At the same time, about 24 million people still live below the poverty line, which is at US$1.9 per person per day. Tax policy is part of the authorities' policy action to address income inequality, which also contributes to tax revenue mobilization.

Income tax has five tiers in Bangladesh, from 10 percent to 30 percent. However, it would be more important to increase the number of taxpayers in Bangladesh, where about 2 million people out of a 160 million population currently pay income tax. The government expects the number of taxpayers will be more than 10 million in the next few years. The government is making efforts, including through making tax identification numbers compulsory for receiving utility services and is also encouraging tax identification number holders to file tax returns. Ongoing automation in tax administration will also help to create a taxpayer-friendly environment.

This is also related to the still significant presence of the informal economy. The authorities estimate the informal economy still employs about 88 percent of workers in Bangladesh. For the education and health areas, Bangladesh has achieved remarkable gains in access to education, especially at the primary level and for girls. The country's net enrollment rate at the primary school level increased from 80 percent in 2000 to 98 percent in 2015, and the secondary school net enrollment is now at about 54 percent. The government continues to implement a scholarship program and school feeding programs and is also trying to improve infrastructure in schools.

For the health area, Bangladesh also improved in many indicators, such as infant mortality, maternity mortality, and nutrition. However, these indicators are still high compared with other countries, and the government's actions currently include modernizing and expanding hospitals, providing training to physicians, and expanding health services to local areas through community clinics.

Let me move to some of the questions posed in this morning's discussion.

First, Ms. Mannathoko raised three questions. The first one is on the fiscal target. The government has set a very ambitious tax revenue target for the last three or four years, usually around 30 percent or 40 percent growth in one year. The actual outturn has been broadly in line with nominal GDP growth. This has been one of recommendations by the staff—the importance of having realistic tax revenue projections, which would make the ongoing year's budgetary management much simpler and easier and would help them to predict social spending needs.

From the government's perspective, they have been emphasizing that the budget needs to be ambitious and set the goal at a very high level. They explained to the staff that this is the mechanism they tried to use to encourage the tax administration authorities to increase the tax revenues. There have been some differences in view, and we see the argument by the authorities. At the same time, we see the growing risks that an ongoing adjustment on the expenditure side could be more difficult, as social spending needs increase going forward.

The second question is on the fiscal sector or banking sector. As Ms. Mannathoko indicated, the authorities view that the ongoing measures will address the situation effectively. However, staff feel that the planned measures would not be sufficient to address the ongoing challenges in the banking sector. In particular, some Directors pointed out that some of the reforms, such as the relaxation of loan classification or the new scheme for loan rescheduling, could further damage incentives for the banks to improve loan standards and enhance loan collection efforts. On the side of the borrowers, this new rescheduling scheme could further disincentivize the borrowers from keeping regular repayments and increase moral hazard problems. Those are the concerns from the staff's side on the current measures implemented by the authorities.

The third point concerns the governance indicators. As staff wrote in the staff report, the authorities expressed some concerns, particularly on the perception index of corruption. From the authorities' point of view, those perception indicators do not necessarily reflect the authorities' understanding of the situation on the ground. There have been some differences of view between the authorities and those perception indicators.

Turning to the question by Mr. White on climate change, with regard to the question on the insurance mechanism, I understand this is a relatively new mechanism and that both the Bangladeshi side and also the international community need to learn more details about the scheme. From the

Bangladeshi side, what the authorities could do is share more information on their risk perception and their past track record on how the budget has responded to those disasters. There have been several incidents where Bangladesh faced severe damage from the monsoon lands that flood. Sharing that information with the international community, the World Bank, the Asian Development Bank would be helpful.

From the international community's side, the potential challenge is how to pool risks from the different countries. In that respect, while it is not limited to climate change, in general, regional cooperation in South Asia still lags other regions, such as the ASEAN countries. This could be one area that the authorities could think about moving forward.

The next question is on the energy subsidies or other measures to address emissions. From the authorities' side, they see some need to implement reforms in this area, but at the same time, they have to be concerned about the fuel price levels and the implications for the population in general.

One thing the staff could think about going forward is to present best practices in these areas. The Fiscal Affairs Department (FAD) is a wealth of information on best practices in these areas of reforms. The staff could initiate engagement with the authorities and present those best practices, including on how to address the potential impact on the vulnerable sectors of the population.

On Bangladesh's side, the government is still at an early stage in the consideration of those reforms, and they want to proceed in a careful manner to avoid any strong political ramifications. That might be one way. Providing those presentations by the staff, not only for the authorities but other stakeholders or congress members, might be one way that the staff could proceed to promote or to at least to encourage these reforms.

Mr. Siriwardana made the following concluding statement:

On behalf of our Bangladesh authorities, let me first thank management and the staff for the constructive policy discussions during the recent Article IV consultation. We thank the staff for their report and for having candid discussions with our authorities. We also thank the staff for their responses and feedback, as well as for their excellent cooperation in resolving some technical issues in the paper. Our authorities broadly concur

with the staff assessment and its conclusions. They value the Fund's policy advice as they pursue their national development agenda.

We also thank all the Directors who have made valuable comments and recommendations. We will pass all of them on to our authorities. I can assure you that they will accord the highest consideration to your views.

Bangladesh has made significant progress in achieving macroeconomic stability, supported by monetary policy management and fiscal discipline. The economy achieved 7.4 percent average GDP growth over a five-year period up to FY2019, which has helped in pulling a large share of the population out of poverty. Consumer price index inflation has moderated, and the current account deficit is narrowing. The FY2020 budget is anchored at a 5 percent fiscal deficit-to-GDP ratio. Foreign exchange reserves remain at a comfortable level, providing an import cover of 5.9 months. A welcome decline in frothiness of dubious quality lending in the domestic credit market is observed. The authorities are, however, committed to implement continued reforms to sustain the progress.

We are grateful to the Directors for their appreciation and support for the efforts made by Bangladesh to emerge successfully in its economic performance and its steady improvement in development indicators. We are especially thankful for their understanding and support for the authorities' sheltering of the Rohingya refugees and for recognizing that a slow resolution of the Rohingya crisis is a risk to the macroeconomy, making expanded and sustained donor support a crucial need.

We take note of some key policy challenges highlighted by the Directors in their gray statements, particularly, the NPL problems in the state-owned banks; the need for fiscal consolidation, focusing on streamlining the taxation system to release resources for social and infrastructure spending; a need for greater exchange rate flexibility; a greater diversification of the ready-made garment-led manufacturing sector; climate change; as well as governance and corruption.

Most Directors have expressed their concern on the stressed assets of the banking sector. Our authorities do agree that persistent high NPLs are a source of concern, though they expect that ongoing measures will address the situation effectively. The NPLs are concentrated in the state-owned banks. Most banks maintain a sufficient level of provisions, and the level of net NPLs is relatively moderate. We would like to emphasize that loan rescheduling and restructuring is targeted at borrowers who are unable to abide by the original

loan terms because of adverse events outside of their control, and its objective is to prevent unnecessary loss of output and employment. The maximum limit of three loan reschedulings is now strictly enforced and all rescheduled loans are required to be adequately provisioned. The authorities are now working on a legal definition of willful defaulters, which would allow them to take more effective steps. A bank merger policy is also discussed to promote consolidation of the banking sector as is setting up an asset management company to take over NPLs. The authorities are ready to take further actions, as necessary.

Our authorities also recognize the concern that, though rapid growth in the ready-made garment sector has significantly supported growth, concentrated exports pose a risk as well. Our authorities believe that ongoing mega-infrastructure projects will attract foreign direct investment, which will further strengthen export performance. Improving the business environment continues to be an important priority to facilitate investment outside the garment industry, despite some progress over the past year. Enhancing the judicial system also remains a reform priority.

The authorities have taken important reform measures to modernize the revenue as well as expenditure management to strengthen their fiscal position. The recent policy initiatives, including the launch of the new VAT and VAT automation, as well as the improvements in tax administration are expected to boost tax revenues. The authorities also make efforts to increase recurrent expenditure savings through several measures. The external and domestic debt indicators are below their respective thresholds under the baseline and stress test scenarios conducted by Fund staff.

Finally, in response to the concerns about the impact of climate change raised by several Directors, I wish to inform you that this is a high priority for our authorities, and several systematic steps have been taken to effectively address the issue. Provisions have been made in the budget each year to respond to possible extreme weather events. On energy subsidies, the provision of affordable energy remains essential over the medium term to sustain rapid economic growth.

Let me conclude by, once again, thanking the staff and Directors for their comments and continuous support.

The Acting Chair (Mr. Furusawa) noted that Bangladesh is an Article VIII member and maintained one exchange restriction subject to Fund approval under Article VIII. Staff

was not recommending approval of that exchange removal, and therefore, no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for Bangladesh's strong and stable economic performance, which has resulted in reduced income poverty and improving social indicators. Looking ahead, Directors noted that, to realize the country's growth potential and reach upper middle-income status, the authorities will need to promote productive investments and upgrade the economic policy framework.

Directors commended the Bangladesh Bank for keeping inflation broadly stable. However, with inflation expectations remaining elevated, they urged the Bangladesh Bank to monitor inflation developments closely and stand ready to adjust its policy promptly if warranted. Directors encouraged the authorities to continue efforts to gradually increase exchange rate flexibility to help buffer the economy against external shocks, preserve foreign reserves, and support the modernization of the monetary policy framework.

Directors commended the authorities for fiscal discipline and encouraged them to keep the public debt ratio broadly stable. In this context, they stressed the need to step up the effort to increase revenues to finance the upgrade of infrastructure, support the vulnerable, and meet the potential costs of climate change. They highlighted the need to expand the tax base by reducing exemptions, and to modernize tax administration. While the launch of the new VAT is welcome, Directors noted that simplifying the multiple rates would facilitate administration and improve revenue intake.

Directors expressed concern about the continued weak financial situation in the banking sector, including high nonperforming loans and the rising amount of restructured and rescheduled loans. They called for resolute steps to enhance banking regulation and supervision, reform state-owned commercial banks, tighten the criteria for loan rescheduling and restructuring, strengthen banks' corporate governance, and enhance legal systems to accelerate loan recovery. Directors encouraged the authorities to continue to develop a well-functioning capital market to reduce the economy's dependence on bank financing. In this context, they welcomed the ongoing reform of the National Savings Certificates system and called for further steps, including reform of the pricing mechanism.

Directors underscored that further improvements in public financial management and strengthening governance will be crucial for continued growth. They highlighted the importance of better public investment management and tax administration, and welcomed the work to revise the authorities' medium-term debt management strategy. They urged continued progress in strengthening the AML/CFT framework.

Directors emphasized the importance of greater export diversification for stronger and more sustainable economic growth. They noted that improving the business environment and boosting human capital would help increase Bangladesh's integration into global value chains and make exports more resistant to changes in global demand patterns.

Directors welcomed the authorities' effort to address the country's vulnerability to climate change and natural disasters. They recommended continued efforts to create fiscal space for adaptation and mitigation, managing the impact of natural disasters, and promoting climate-friendly investments.

It is expected that the next Article IV consultation with Bangladesh will take place on the standard 12-month cycle.

APPROVAL: October 6, 2021

CEDA OGADA
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook

1. ***We note from the staff report that the expected decline in both projected public capital spending and credit to private sector would have no impact on the projected real GDP growth in 2019. Could staff provide some clarification on this issue?***

- Staff project that growth in FY19 and 20 is driven mainly by strong growth in exports and steady growth in remittances which boosts private consumption. Fiscal policy remains broadly supportive of growth with robust growth in the annual development plan allocation.

Fiscal Policy

2. ***Could staff elaborate on whether the authorities have identified contingency measures to meet the budget deficit, protecting social spending?***

- The authorities are confident that they will be able to meet their budget deficit target without significant cuts in budgeted social spending. As has been the case in the past, lower-than-budgeted development spending is expected to offset some part of the eventual revenue underperformance. The authorities also keep 0.2 percent of total FY20 budget as contingency. However, staff sees some risks in protecting social spending with very ambitious revenue target.

3. ***Could staff provide an estimate of total tax expenditures in Bangladesh?***

- Staff does not have the estimate of total tax expenditure, but its size is likely to be significant. Staff emphasized to the authorities the need to obtain a good understanding of the revenue forgone as a result of tax exemptions and tax holidays. The 2018 UN Economic and Social Survey of Asia and the Pacific estimates the tax gap to be close to 8 percent of GDP, as a result of tax incentives and concessions, but also tax avoidance/evasion.

4. ***Could staff elaborate on how the revenue performance in Bangladesh compares to its peers?***

- At around 10 percent of GDP, Bangladesh's (tax and nontax) revenue is the lowest in South Asia. In other South Asia countries, budget revenues amount to 15-30 percent

of GDP, and the average for ASEAN countries is about 20 percent of GDP. Revenue collection in Bangladesh has been similarly low in the past: the 2001-10 average revenue/GDP ratio has been below 10 percent.

5. ***Could staff elaborate on the authorities' interest in designing a medium-term domestic revenue mobilization strategy?***

- The authorities are concerned about the weak revenue performance and are interested in strengthening revenue collection. While they are not considering a formal medium-term revenue mobilization strategy, they are taking a number of tax policy and tax administration initiatives to boost revenues with technical assistance from the IMF.
- The 2017 Tax Administration Diagnostic Assessment Tool (TADAT) identified the main weaknesses in tax administration, and the 2019 technical assistance on modernizing revenue administration has provided further recommendations.

6. ***Could staff elaborate on developments regarding NSC since last year Article IV?***

- The authorities have introduced National Savings Scheme Online Management System in this year to check possible abuses in NSC investments. In February 2019, the system was launched on a trial basis and subsequently introduced country-wide. In addition, authorities increased the tax on NSC interest from 5 to 10 percent, though subsequently reduced the tax rate back to 5 percent for NSC investment up to Tk 500,000 (US$ 5,920). Data for July show a significant decline in NSC sales by 57 percent compared to July 2018.

7. ***Could staff elaborate on their recommendation to separate the NCSs issuance from direct budget financing?***

- Under the current "on tap" system, NSC issuance is guided by investors' demand. As the proceeds from the NSC sales are used directly to finance the budget, it is difficult to predict government funding needs from other sources – mainly the issuance of government securities. This prevents a formulation of government borrowing plan with predictable government securities issuance, and of a medium-term debt management strategy.
- The main objective of the NSC, to provide assistance to a certain segment of the population, could be met even if NSC issuance is separated from direct budget financing. Instead, money collected from NSC issuance would be used to invest in government securities and other designated assets, and this would allow the government to formulate a predictable securities issuance plan.

VAT Reform

8. ***What is staff's projection of the tax receipt expected from the new VAT, taking into account the multiple rates, increase in VAT registration threshold and implementation challenges. We also welcome staff's comment on whether the authorities have plans to streamline the new VAT.***
What are the authorities views regarding staff's suggestion to simplify the VAT structure?

- There are significant uncertainties from implementation challenges of the new VAT which make projecting its revenue impact difficult. The authorities' FY20 budget projects a VAT collection at about 13 percent higher than the revised FY19 budget estimate. While the authorities expect that the rollout of the electronic fiscal devices (EFDs) will improve tax compliance, the increase in the VAT registration threshold from 80 lakh ($95,000) to 3 crore ($354,000), with taxpayers below the threshold subject to lower 4 percent turnover tax, will likely have a negative impact on revenue collection.
- As for the VAT streamlining, the authorities agree that, in principle, it would be preferable to have a single VAT rate. However, they do not have yet a specific timeline for the VAT simplification at this stage.

9. ***Could staff comment on the early implementation results of the VAT reform, if available?***

- Staff does not yet have data available about VAT revenue collection since the launch of the VAT reform. However, we understand that there have been some difficulties in the implementation, including difficulties and glitches with the online system that slows down the registration and problems with the refund mechanism for the advance tax on imports.

Rohingya Refugee Crisis

10. ***Could staff elaborate on its recommendation to increase fiscal space to create room to address the difficult situation of the refugees in case of slow progress in resolving the crisis and of weakened donor support, notably by detailing the potential fiscal cost of such a scenario?***

- If there is slow progress in addressing the refugee crisis and donor support weakens in the future, the need for tax revenue mobilization would further strengthen. Additional revenues will be necessary to provide social services, maintain infrastructure, and mitigate the consequences of environmental degradation in areas close to refugee camps.

11. ***We would like to know if the potential fiscal impact of losing donor support related to the crisis and measures to address it were discussed with the authorities.***

- During discussions with staff, the authorities indicated their appreciation for the support of development partners to mitigate the humanitarian impact of the crisis. While they are confident that they can currently manage the fiscal impact of the crisis, they are more concerned about the political risks and rise in social tensions that a prolonged crisis and waning external support would entail.

Monetary Policy

12. ***Could staff elaborate on the authorities' views on a possible transition to an interest targeting regime?***

- Bangladesh Bank has recently initiated a work on the modernization of their monetary policy framework, recognizing that the current framework based on targeting monetary aggregates will not be appropriate as Bangladesh moves to a middle-income country. With IMF technical assistance, the authorities are preparing the ground for replacing the monetary (quantity-based) targeting with interest rate (price-based) targeting. The exact timeline of the transition has not yet been specified.

External Assessment

13. ***Could staff explain the difference between the CA norm of this year Article IV and the one estimated last year?***

- Staff uses the new EBA-lite model from this year's Article IV consultation. The CA norm in the last year with the old EBA-lite model was -4.4 percent, while this year's CA norm under the new model is -3.5 percent.
- The revised EBA-lite CA methodology improves the fit of the CA-norm for Bangladesh. This improvement is driven by new variables in the model, such as the conflict dummy and the public health expenditure variable. It is also driven by a change in the coefficient on some variables that are in both old and new model, such as terms of trade and reserves variables.

Exchange Rate Policy

14. ***Could staff comment on the current exchange rate policy and the reaction by the authorities to the staff's advice to continue to gradually allow for exchange rate flexibility to help buffer the economy against external shocks?***

- Bangladesh Bank intervenes in the foreign exchange market to limit the volatility and to supply foreign exchange to the market. The BB officials agree – and stated publicly in the Monetary Policy Statement – that additional foreign exchange flexibility would be needed to ensure that the Taka rate remains aligned with economic fundamentals, to foster forex market development and to allow the exchange rate to play a more active role in supporting external stability.

15. ***During last year's Article IV consultation, staff indicated in their report that the authorities viewed excessive exchange rate fluctuations as undesirable and that they would intervene in the markets to avoid large exchange rate movements. Could staff clarify whether they have reiterated during this year's Article IV consultation their preference for a stable exchange rate?***

- As noted above, the authorities attach importance to avoiding large exchange rate fluctuations, but at the same time recognize that, as Bangladesh moves towards middle-income country status, a gradual increase in exchange rate flexibility will be desirable.

16. ***We would invite staff comments on whether there is the need for further reserve accumulation, given structural changes to the external sector (Annex IV)?***

- Reserves are broadly adequate and are projected to remain well above 3 months of imports into the medium term. Further progress in export diversification, along with an improvement in the business environment that would attract FDI, could further strengthen the external position. In addition, a move toward greater exchange rate flexibility would help buffer the economy against external shocks and preserve the level of reserves.

Banking Sector

17. ***Could staff elaborate more on the reason behind the increase of stressed advances despite relatively strong economic growth?***

- The increase in stressed advances reflects growth of both NPLs and restructured/rescheduled loans. As for the NPLs, poor risk assessment and compliance by banks are an important reason. As for the increase in restructured/rescheduled loans, this reflects banks' preference to normalize poorly performing loans rather than to strengthen loan collection efforts or write-off. In turn, this leads to borrowers' lower willingness to repay loans.
- In cases of adverse shock to borrowers that hampers their capacity to repay, the authorities also accept the banks to restructure the loans, to avoid employment and

output losses. However, it should be noted that about 30 percent of rescheduled loans turned nonperforming again between December 2017 and December 2018.

18. ***Are there any specific sectors or characteristics of borrowers whose loans were restructured or rescheduled?***

- At the end of 2018, about 27 percent of rescheduled loans was in industry, and 21 percent in RMG and textile sector. About 58 percent of rescheduled loans were to large firms and 15 percent to medium firms.

19. ***Given the significantly high level of stressed advances in the SOCBs, we wonder what are factors that encourage or force the SOCBs to lend to non-profitable borrowers. Also, how does the government support the implementation of such a strategic lending, for example, from financing aspect.***

- High stressed advances in SOCBs partly reflect their role in public policy, such as financial services to government and support for developmental goals, without adequate compensation to cover their costs. Also, SOCBs are tasked to promote financial inclusion: they serve as a source of credit to borrowers, such as SMEs and agriculture, who are riskier and tend to have limited access to financing from private commercial banks. Weak corporate governance and risk management in SOCBs further exacerbate the asset quality problem.

20. ***Are there any clear division of labors between the SOCBs and private banks?***

- The division of labor between SOCBs and private banks is not necessarily clear. SOCBs provide loans not only to SMEs and agriculture, but also to large borrowers. However, SOCBs tend to have a large rural branch network and are an important recipient of rural deposits.

21. ***Can staff comment on the authorities' stance regarding this assessment on the recent policy actions in baking sector?***

- The authorities emphasized that the recent measures are aimed at reducing the NPLs and strengthen the banking sector, while providing borrowers who have been hit by adverse external shocks to recover and maintain production and employment. They plan to consider additional policies to reduce the risk that some of the recently introduced measures would worsen moral hazard problems and lead to more NPLs in the future.

22. ***We are skeptical about the recent decision by the Bangladesh Bank to introduce an amnesty program that extends the repayment period and reduces interest rates on***

bad loans. The program could entail the risk of perverse incentives and higher NPLs. Staff comments are welcome.

- Staff shares this assessment. Repeated restructuring and rescheduling of bad loans, with easier repayment conditions on top, is not conducive to strengthening payment discipline of borrowers and could lead to further increase in NPLs in future.

23. ***Could staff provide an update on the steps being considered by the authorities to promote a consolidation of the banking system and set up an asset management company to take over NPL management from banks?***

- The authorities are discussing possible options for banking sector consolidation. The recent increases in paid-in capital requirement is one policy measure to promote mergers. The authorities are also discussing the possibility of setting up asset management company (AMC) to take over NPLs, though this option could entail fiscal costs in Bangladesh to absorb the AMCs losses.

24. ***We wonder if staff can provide further analysis on the economic costs and benefits of addressing the asset quality problem today (i.e. short-term impact on employment and growth, longer term benefits of financial stability on growth) versus the costs of allowing the asset quality problem to linger.***

- Current strong growth, low level of public debt, and relatively small size of banking sector provide some space for the government to address NPL issues without significant deterioration in economic activities. In addition, credit intensity of growth appears to be increasing, while credit quality has been deteriorating. This points to potential misallocation of resources, which would negatively affect growth performance and its potential. In this respect, staff view that the costs of waiting are likely to increase, and future adjustment costs could be much higher if the problems are allowed to linger.

25. ***Could staff provide a timeline of the FSSR mentioned in the report?***

- The FSSR mission took place during August 25–September 6, 2019.

Public Financial Management

26. ***Has Bangladesh undertaken a Public Investment Management Assessment (PIMA) in recent years?***

- Bangladesh PIMA Report has been completed in November 2018. Staff's public financial management recommendations have been guided by the PIMA findings and recommendations.

27. ***Could staff elaborate on the potential benefits and risks of the Belt and Road Initiative for Bangladesh?***

- Bangladesh still has significant financing needs to build and improve its infrastructure. However, as the country shifts toward middle-income country, available donor financing is expected to be smaller and less concessional.
- In this respect, having various source of donor financing, including from the Belt and Road Initiative, can be potentially useful for Bangladesh. However, the authorities should continue to seek concessional financing to the extent possible and improve public financial management with due consideration to ensure debt sustainability.

Climate Change

28. ***Can staff expand on the key impediments preventing Bangladesh from unlocking more resources?***

- The main impediments identified by the authorities include the criteria to qualify for grant resources under the Green Climate Fund, which are not always compatible with country systems and practices for public financial management. Further progress in realizing pledges made by the international community under the December 2015 Paris Agreement would also help to unlock more resources.

29. ***We would appreciate staff's elaboration on the progress made in the implementation of the policy options in paragraph 37 and Box 2.***

- Regarding energy subsidies, the authorities' preference is at present to incrementally raise tariffs and gradually reduce the need for subsidies, while promoting the development of renewable energy, including in particular solar power.
- Implementation of a carbon tax is under consideration, as indicated by the suggestion to introduce a carbon tax at a symbolic low rate in the Ministry of Finance's 2019 Updated Climate Fiscal Framework. While the same document also discusses the possibility to introduce insurance mechanisms to manage the impact of natural disasters, it is still not clear who should bear the cost of such mechanisms and to what extent they would be subsidized.
- While some private sector investments have taken place, including to harness solar power, recycle waste garments, and develop climate-resilient seeds and crop varieties, the limited capacity of financial institutions to evaluate climate-friendly projects

remains a key challenge. FDI in this area also remains limited and will depend on further efforts to enhance the business environment.

30. ***What is, in staff judgement, the best way to balance the need to providing affordable energy to sustain economic growth, on one hand, and the environmental impact of the energy subsidies on the other in Bangladesh?***

- Staff advice combining a reduction and eventual elimination of energy subsidies with the provision of well-targeted transfers for more vulnerable segments of the population affected by higher energy prices, and investment in cleaner sources of energy, including natural gas and renewable energy.
- Moreover, focus should be placed on regional cooperation to enhance access to cheaper hydropower resources, as well as mobilizing public and private sector investment for the development of renewable energies. Without gradual price adjustment, increased imports of LNG would lead to sizable increase in subsidies, limiting the spending on productive investment in infrastructure and social spending, and adversely affecting fiscal sustainability.

31. ***The rationale for staff's recommendation to consider a phased introduction of carbon taxes (paragraph 37) to address climate change is not clear as Bangladesh accounts for only 0.35 percent of global greenhouse gas emissions (Box 2). Rather, the focus should be on adaptation measures as Bangladesh is one of the countries most affected by natural disasters. Staff comments would be appreciated.***

- Purpose of a carbon tax is not limited to contribute to a reduction in global greenhouse gas emissions. It would also create positive incentives to reduce significant domestic health costs linked to urban pollution and raise government revenues that could be used to finance climate change adaptation measures or other policy priorities.

Export Diversification

32. ***We wonder what role public sector or joint public-private research initiatives might play in encouraging diversification and what initiatives currently exist in Bangladesh to promote R&D. Staff comments are welcome.***

- Both public and private think tanks have carried out research on export diversification. For example, Bangladesh Institute of Development Studies (BIDS), an autonomous public organization, has conducted research in this area.
- The authorities also recognize the importance and need for research that would spur diversification and investment in R&D to increase the value-added of their

production. BIDS and General Economic Division under the Ministry of Planning have been playing vital roles to promote R&D.

33. ***In particular, we are interested in staff's advice on plans to boost human capital so as to support the growth of the more complex sectors and to promote inclusive growth. Can staff also elaborate on measures to improve income inequality?***

- Several factors will contribute to improving human capital and boosting the growth of more complex sectors. This includes measures to improve health and education, particularly the skill of workers (either through on the job training or vocational training that is targeted toward specific industries).
- Income inequality in Bangladesh is relatively low but has increased in recent years, In addition to improving health and education, better infrastructure would ease access to educational facilities and increase inclusion of rural communities in growth. These efforts would require higher revenue mobilization of government, which has been below average for peers.

Female Labor Force Participation

34. ***We invite staff's comment on steps being taken to promote female labor force participation. Staff comments are welcome on policies focused on boosting human capital investment, in particular related to female labor force participation.***

- The government has been making efforts to improve female labor force participation. It has been incorporating gender budgeting which ensures budget allocations to improve female empowerment. In FY19, the government spent around 100 million USD on stipends for students, and 70 percent of recipients were female. As of February 2019, the government had 4,706 daycare centers set up in factories to facilitate female employment.
- The 2018 Article IV staff report included an annex on female labor force participation and identified several government initiatives aimed at improving job prospects for women and closing the gender gap.