

Bangladesh: 2003 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bangladesh

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2003 Article IV consultation with Bangladesh and request for a three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the combined consultation and 2003 Article IV Consultation and request for a three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **April 22, 2003**, with the officials of Bangladesh on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 5, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of **July 19, 2003** updating information on recent economic developments.
- a Public Information Notice (PIN) and Press Release, **summarizing the views of the Executive Board as expressed during its June 20, 2003, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director of Bangladesh.

The document(s) listed below have been or will be separately released.

Interim Poverty Reduction Strategy Paper
Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper
Letter of Intent sent to the IMF by the authorities of Bangladesh*
Memorandum of Economic and Financial Policies by the authorities of Bangladesh*
Statistical Appendix
Technical Memorandum of Understanding*
*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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BANGLADESH

Staff Report for the 2003 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the Asia and Pacific Department

(In consultation with other departments)

Approved by Steven Dunaway and Shigeo Kashiwagi

June 5, 2003

- Discussions for the 2003 Article IV consultation and on a program to be supported by a three-year PRGF arrangement were held in Dhaka during January 28–February 11 and April 8–22, 2003. The staff team comprised Ms. Puckahtikom (Head), Ms. Liu and Mr. Heenan (all APD), Ms. Bhattacharya (FAD), Mr. Mlachila (PDR), and Ms. Tan (Administrative Assistant). Mr. Burton (APD) joined some of the policy discussions in the first mission, and Mr. Coats (MFD) participated in both missions, including to present the findings of the FSAP mission. The mission was assisted by Mr. Verhoeven, the resident representative, and worked closely with the World Bank’s resident mission that was preparing a Development Support Credit (DSC).
- The missions met with Prime Minister Zia, Finance and Planning Minister Rahman, Finance Secretary Khan, Bangladesh Bank Governor Ahmed, other senior officials, and civil society and donor representatives.
- The last Article IV consultation was concluded on April 29, 2002. Bangladesh accepted the obligations under Article VIII , Sections 2, 3, and 4 on April 11, 1994.
- In the attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP), the authorities have set out the economic program for which they request support under a three-year PRGF arrangement in an amount of SDR 347 million (65 percent of quota). The MEFP is based on the government’s National Strategy for Economic Growth, Poverty Reduction, and Social Development (the I-PRSP) that was finalized in March 2003.
- The authorities intend to publish the staff report, LOI, MEFP, and Joint Staff Assessment of the I-PRSP; they also intend to publish the Fiscal Transparency Module of the Report on Observance of Standards and Codes (ROSC).
- The main authors of this report are Ms. Puckahtikom and Ms. Liu.

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ABBREVIATIONS

AD	Authorized dealer
ADP	Annual Development Program
AML	Anti-money laundering
AsDB	Asian Development Bank
BB	Bangladesh Bank
BNP	Bangladesh National Party
CAS	Country Assistance Strategy
CFT	Combating the financing of terrorism
CGA	Comptroller General of Accounts
DSC	Development Support Credit
FMRP	Financial Management Reform Program
FSAP	Financial Sector Assessment Program
GDDS	General Data Dissemination System
IAS	International Accounting Standards
ISA	International Standards on Auditing
LC	Letter of credit
LTU	Large Taxpayer Unit
MDGs	Millennium Development Goals
MFA	Multi-Fiber Agreement
MoF	Ministry of Finance
MOUs	Memoranda of Understanding
MTEF	Medium-term expenditure framework
NCBs	Nationalized commercial banks
NFRE	Nonfarm rural economy
NPLs	Nonperforming loans
NSCs	National Savings Certificates
PCBs	Private commercial banks
PSIA	Poverty and Social Impact Assessment
RIBEC	Reforms in Budgeting and Expenditure Control
RMG	Ready-made garments
ROSC	Report on Observance of Standards and Codes
SMEs	Small and medium-sized enterprises
SOEs	State-owned enterprises
TA	Technical assistance
TMU	Technical Memorandum of Understanding

EXECUTIVE SUMMARY

Over the last decade, Bangladesh achieved steady GDP growth with manageable inflation, and improved social indicators, thanks to cautious macroeconomic policies and structural reform early in the decade. However, poverty incidence today remains very high, requiring much faster economic growth if the Millennium Development Goals (MDGs) are to be met by 2015. Growth and investment have been held back by a combination of a high cost of borrowing, bottlenecks in physical infrastructure, inadequate investment in human capital, and poor economic governance.

The current government has strengthened macroeconomic policies and is renewing structural reform, and an economic recovery is now under way. Fiscal policy has been tightened, through improved revenue performance and expenditure restraint. Monetary policy has remained firm, interest rates have been allowed to rise and be more market-based, and the exchange rate has been managed more flexibly. Bangladesh Bank (BB) has gained greater autonomy and expanded authority to supervise the nationalized commercial banks (NCBs), key loss-making state-owned enterprises (SOEs) have been closed, and adjustments made to utility tariffs and energy prices.

Discussions for the Article IV consultation and for the proposed PRGF-supported program were focused on the structural reforms critical for putting the economy onto a higher growth path with faster poverty reduction. In line with the I-PRSP, the policy agenda addresses the factors that have impeded growth, and is centered on four areas:

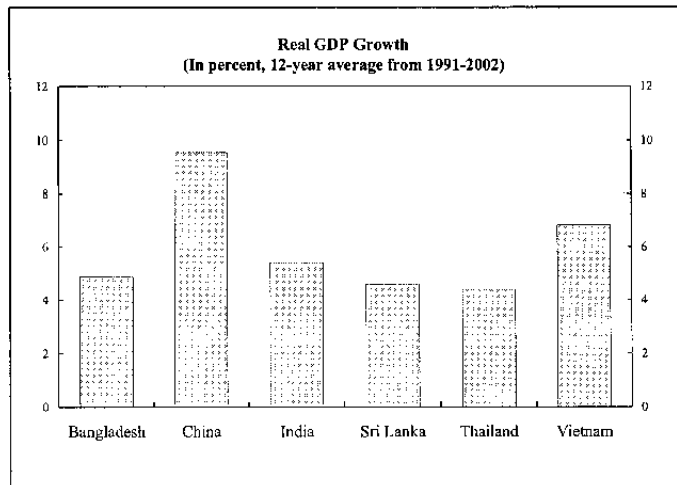
- **Fiscal reform**, involving a sustained revenue effort (at least 1½ percentage points of GDP over three years) and a shift in spending toward infrastructure and human capital to better support growth and the MDGs, while keeping public debt sustainable.
- **NCB reform**, including defining bank-by-bank resolution strategies by April 2004, and in the interim, steps to strengthen bank management and restrain lending to help stem the flow of new bad loans.
- **SOE reform**, particularly closing/privatizing SOEs in manufacturing, and reforming SOEs in the energy sector, starting with putting in place appropriate pricing and regulatory frameworks, to be followed by a medium-term restructuring program to provide the basis for renewed investment in the sector.
- **Exchange and trade reform**, by moving to a floating exchange rate regime and continued trade reform, to reduce external vulnerability.

Tackling the economic governance issues associated with these reforms will be key. Besides the specific measures designed to address such issues as transparency and accountability in public resource management, the planned establishment of an anti-corruption commission is also important for the policy agenda.

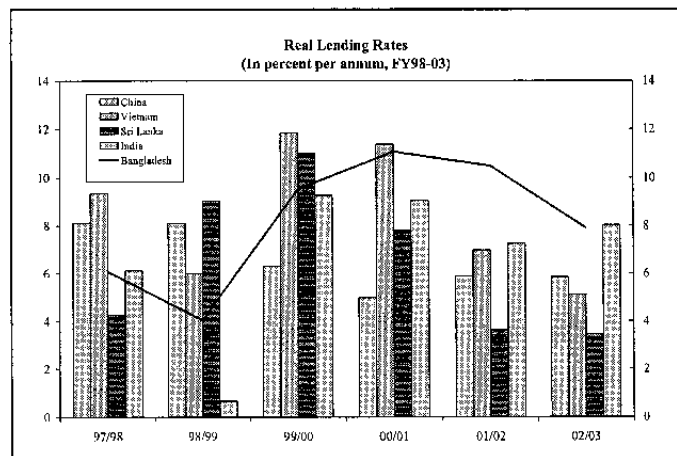
I. INTRODUCTION AND PERSPECTIVE

1. **Bangladesh's economic performance and social indicators strengthened during the 1990s, due mainly to reform measures adopted early in the decade** (Tables 1 and 2, and Figure 1). Real GDP growth accelerated to an average of about 5 percent, from 4 percent in the 1980s, and inflation was moderate. In the first half of the decade, fiscal and monetary policies were cautious and reform steps were taken to open up the economy and deregulate the private sector. As a result, agricultural production and exports of ready-made garments (RMG) grew rapidly, and official reserves were built up to a peak of \$3.5 billion in 1995. Along with these achievements, poverty incidence fell steadily from 59 percent to 50 percent by 2000. Moreover, there were notable increases in primary education enrollment and girls' education, and marked reductions in fertility and infant mortality rates.

2. **However, the pace of structural reform slowed from the mid 1990s, keeping economic growth below the path needed for a meaningful reduction in poverty**, even though the macro-economic conditions remained broadly satisfactory (Box 1). As a consequence, Bangladesh did not receive further PRGF support after the completion of an ESAF arrangement in 1994. Overall, GDP growth per capita during the decade fell short of the record set by such regional economies as China, India, and Vietnam. At the end of the decade, GDP per capita remained low at \$366, and poverty incidence remained very high, requiring much more rapid progress if the MDGs are to be met by 2015.



3. **Four key structural weaknesses have constrained investment and growth below potential.** Private investment has been held back by a combination of a high cost of borrowing, bottlenecks in physical infrastructure, inadequate human capital investment, and poor economic governance. Thus, Bangladesh has not attracted substantial foreign direct investment in spite of its low labor costs. Real lending rates in Bangladesh have been kept high, averaging 8 percent, owing to inefficiencies in the financial system—especially the NCBs, an underdeveloped capital market, and rigidities in the interest rate structure. Infrastructure bottlenecks have raised



the relative cost of doing business, for example, in terms of power disruptions, telecommunications cost, and transport time. These problems reflect not only inadequate maintenance of and investment in infrastructure, but also the poor quality of past investment, and inefficiency in the SOEs, where investment was concentrated.

4. **Inadequate investment in human capital is linked to the low fiscal revenue base** (Table 3 and Figure 2). While the overall fiscal position has been generally manageable from a macroeconomic standpoint, the revenue ratio at 10 percent of GDP is among the lowest in the world, whereas the coverage of income tax is among the smallest, at a mere 1 percent of the population. As a result, public investment in human capital has lagged comparable countries, even though such spending accounts for a relatively large share of Bangladesh's budget. Notably, in 2000, spending on education and health in Bangladesh amounted to only 2.3 percent and 1.1 percent of GDP, respectively, compared with an average of 3.5 percent and 1.7 percent for all PRGF-supported countries.

5. **Poor economic governance permeates most aspects of public resource management.** For instance, revenue collections have been depressed by widespread rent-seeking. Similarly, expenditure management is flawed, in the absence of effective mechanisms to ensure transparency and accountability. With respect to SOEs, strong vested interests have led to large fiscal losses, as well as poor service delivery. In the energy sector, service delivery has suffered from collection problems and system losses, as well as inadequate pricing policy. In port operations, inefficiency and corruption have resulted in a high cost of shipping. Moreover, in the NCBs, the high level of nonperforming loans has been traced to corrupt lending practices, as well as poor credit risk assessment.

6. **These longstanding difficulties were compounded by a marked deterioration in macroeconomic performance in the run-up to national elections in 2001.** The central government budget deficit rose to 5.1 percent of GDP in FY01, and it was financed by relatively costly funds from domestic nonbank sources.¹ At the same time, gross official reserves came under pressure, falling to a low point of \$1 billion (under one month of imports) in October 2001, and exchange restrictions were introduced to help contain the pressure.

7. **Against this background, in concluding the last Article IV consultation in April 2002,** Executive Directors urged the new government to embark decisively on a comprehensive medium-term economic program. Priority should be given to putting the public finances on a sound footing, strengthening the effectiveness of monetary policy, moving to a more market-oriented exchange system, strengthening the banking system, and reducing the budgetary burden posed by the SOEs.

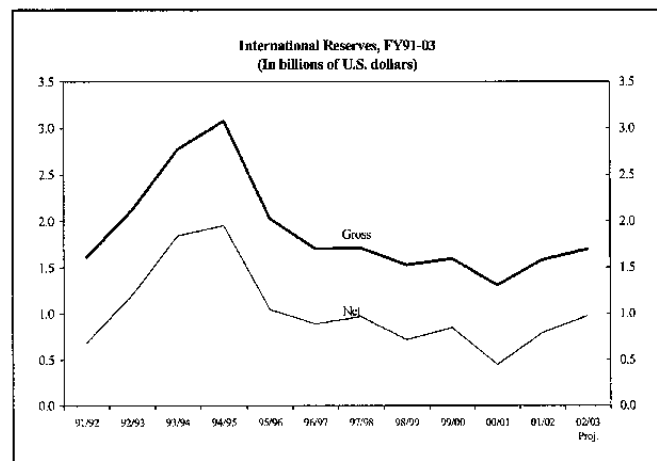
¹Fiscal year runs from July to June.

8. **The political environment for reform has shown recent signs of improvement, even though the situation remains fragile.** The new government, a coalition led by the Bangladesh National Party (BNP), was elected in October 2001 with a two-thirds parliamentary majority on a platform to improve governance and law and order, and to strengthen economic management. In the first eighteen months of its five-year term, the government sought to stabilize the macroeconomic situation and pushed through a number of overdue, but sensitive economic measures, notably the closure of Adamjee jute mills and adjustments in utility tariffs and energy prices. However, political tensions between the government and the opposition remain high, law and order continues to be a major concern, and human rights issues have emerged.

II. RECENT ECONOMIC DEVELOPMENTS

9. **Since the last Article IV consultation, economic performance has improved and macroeconomic policy implementation has strengthened, broadly in line with the recommendations of the Board.** The economy has been in a recovery, led by the agricultural and industrial sectors and aided by the strength of domestic and external demand. So far in FY03, growth in agricultural output has picked up on account of adequate availability of fertilizer, increased areas under cultivation, and timely rainfall. Manufacturing output has also rebounded by nearly 5 percent in the first half of FY03 from a year earlier. Real GDP growth is thus projected to accelerate to 5.2 percent for FY03 from the 4.4 percent growth rate recorded in FY02. At the same time, inflation remains manageable, although it is on a slight upward trend to around 5¼ percent, owing to rising food prices which were linked to adjustments in utility tariffs and energy prices.

10. **The external position has also strengthened over the past year.** Following a fall in exports in FY02, due to a sharp decline in RMG prices, exports have recovered, rising by 5 percent in the first eight months of FY03 relative to a year earlier (Box 2, Table 4, and Figure 3). At the same time, remittances continue to be strong, growing at an annual rate of 29 percent, in part reflecting a further shift in such flows to official channels. The current account is projected to remain in a small surplus for FY03. International reserves have risen to \$1.8 billion as of mid-May, and are projected to rise further to \$2.1 billion by end-June 2003, aided by a prospective disbursement under the DSC.²

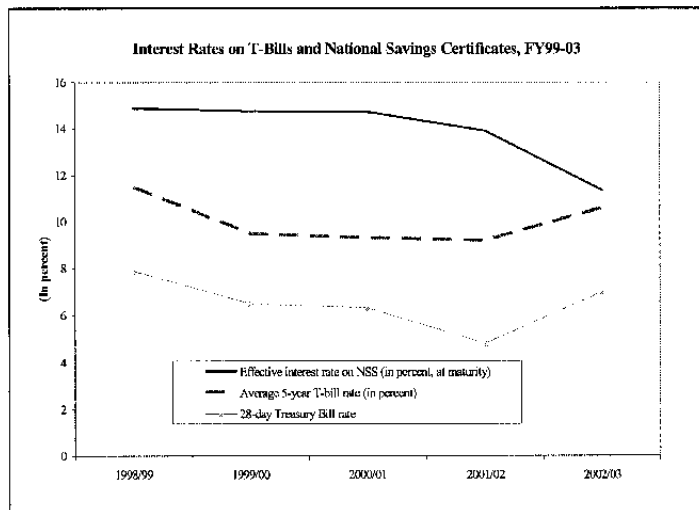


²Net international reserves reflect deductions from gross reserves of Asian Clearing Union balances and foreign currency deposits of domestic commercial banks at BB.

11. **Prudent macroeconomic policies have contributed to these outcomes.** In particular, fiscal policy has been tightened beginning in FY02; revenue was raised by 1 percentage point of GDP, mainly in the nontax area. As a result, the central government deficit (excluding grants) fell to 4.7 percent of GDP. At the same time, the monitoring of fiscal developments was strengthened, with financial management units established in the major line ministries to better monitor Annual Development Program (ADP) spending.

12. **Moreover, the deficit is on course to fall further in FY03 in line with the budget as a result of significant revenue measures combined with expenditure discipline.** The related budget benchmarks for March agreed with the staff have been met (MEFP Table 2). Key revenue measures introduced with the budget included, notably, the withdrawal of tax holidays for expansion of existing enterprise units, the lifting of zero duty rates, and the extension of the VAT within the retail sector. Tax administration also has been strengthened, especially in customs and VAT. Thus, tax revenue in the first seven months of the year rose by 16.7 percent, compared to the same period of FY02, suggesting that tax revenue for the year is on track to improve by 0.6 percentage points of GDP. At the same time, expenditure has been restrained, with expenditures in the first seven months falling by 0.8 percentage points of GDP, reflecting discipline in ADP spending. This result was achieved despite a marked increase in expenditure to meet SOE reform costs (0.4 percent of GDP). More recently, the ADP budget has also been revised downward, to further prune lower priority spending. Overall, the central government deficit is set to fall to 4.2 percent of GDP as budgeted.

13. **The structure of financing for the deficit in FY03 has also improved.** Domestic financing is expected to be cut further from 2.5 percent of GDP in FY02 to 1.9 percent. Moreover, based on trends so far, the share of domestic financing through costly national savings certificates (NSCs) is expected to fall to 31.5 percent from 36.5 percent in FY02. In addition, to reduce the future interest burden, interest rates on new NSCs were reduced by 1 to 3 percentage points and the four most costly NSC schemes (out of a total of nine) were withdrawn in July 2002. These steps effectively reduced NSC interest rates by about 2 percentage points, and brought them closer to treasury bill rates.



14. **Monetary policy has been restrained since early 2002, and treasury bill rates have been allowed to rise, reflecting market conditions.** In the year to March 2003, reserve money is estimated to have grown by 6 percent, as BB sterilized its accumulation of foreign reserves with sustained auctions of treasury bills (Tables 5 and 6, and Figure 4). As

a result, short-term treasury bill yields rose from 4 percent to 8 percent over the period; at the same time, commercial lending rates remained at about 12 percent. Broad money grew by 15 percent in the year to February 2003, buoyed by strong growth in credit to the private sector.

15. **Exchange restrictions have recently been eased, and exchange rate management has been more flexible, helping to strengthen the external position.** In particular, the scope of the margin requirements on letters of credit for imports has been reduced (Annex I), and limits were lifted in August 2002 on travel, educational and medical expenses, and on payments for other invisibles. Nonetheless, Bangladesh continues to maintain exchange restrictions subject to Fund jurisdiction (see Section V below). The official band for the taka remained unchanged from January 2002 through May 29, 2003. During the last eight months, however, exchange rates in the interbank market were allowed to move outside this band. Furthermore, effective May 31, 2003, BB announced that it would no longer set a band for its foreign exchange transactions, thus effectively allowing the taka to float. During the period January 2002–May 2003, especially with the recent weakening of the U.S. dollar, the taka has depreciated in nominal effective terms by a total of 12 percent, and by an estimated 8 percent in real effective terms.

16. **The authorities recently have limited the contracting of new nonconcessional external debt.** Soon after taking office, the current government froze all construction and other loan contracts under suppliers' and buyers' credit signed by the previous government.³ During FY03, new loan commitments and guarantees on nonconcessional terms are projected to be at most \$150 million, down from an estimated \$350 million in FY02, for projects in the power, telecommunications, transport, and water sectors.⁴ External public debt at end-June 2003 is projected at \$17 billion (33 percent of GDP). In view of its concessional nature, debt in NPV terms is about 20 percent of GDP and 101 percent of exports, while the debt-service ratio remains relatively low at 6.5 percent.

17. **Steps have been taken to renew structural reforms, mainly with the support of the World Bank, although the agenda remains very full.**

- **With respect to SOEs in manufacturing,** the government has initiated a four-year program to largely phase out SOEs from this sector, starting with the closure/privati-

³In August 2002, the government canceled a contract awarded to a Chinese company and a Japanese company for two fertilizer plants after partial implementation of the contract; subsequently, and in the absence of agreement on obligations linked to these cancellations, Nippon Export and Investment Insurance decided to go off cover for medium- to long-term commitments for Bangladesh.

⁴As defined under the Technical Memorandum of Understanding (TMU), which excludes loans from the Asian Development Bank (AsDB) that are partly on near-concessional terms.

zation of key loss-making units.⁵ In addition to Adamjee, another 24 out of a total of 150 SOEs have been closed so far in FY03. To ease this process, a severance scheme has been adopted to provide safety nets for retrenched workers.⁶

- **In the energy sector, the focus so far has been on tariff and pricing adjustments**, to stem financial losses. Since October 2001, utility tariffs have been raised by 8 percent, and the prices of a wide range of energy products have been substantially increased (by 22 percent for motor spirits, 10 percent for diesel and kerosene, and 10 percent for natural gas in January and September 2002, and by a further 17 percent for petrol and diesel in January 2003).
- **In the banking sector, the priority has been on improving the legal framework and upgrading prudential standards** (Box 3). The Bangladesh Bank Order was amended to provide greater operational autonomy to BB. The Banks (Nationalization) Act and the Banking Companies Act were also amended to strengthen BB's regulatory powers by bringing NCBs within its purview and to improve capital adequacy and governance in private commercial banks. Moreover, a new Money Loans Court law was enacted that establishes specialized courts to deal with loan defaults and streamlines the recovery process.
- **Trade reform was given renewed impetus** in the FY03 budget, when the top customs duty rate was reduced by 5 percentage points to 32.5 percent, and the number of rates reduced to five (including a zero rate). The structure of supplemental duties was also simplified by reducing the number of rates from 31 to 5. The effective average tariff rate (including supplemental duties) was thus reduced to 24 percent.

III. REFORM STRATEGY UNDER THE I-PRSP/PRGF

18. **The near-term economic outlook is favorable but subject to some downside risks.** Business confidence in economic management has improved, and on present trends, economic recovery should continue. Moreover, the quick resolution of the Iraqi conflict has lifted a major source of risks through higher oil prices and lower remittances. Growth in FY04, however, could be adversely affected if the projected rebound in exports does not materialize due to weaker-than-expected external demand. Looking ahead, a key risk to exports and employment stems from the removal of Multi-Fiber Agreement (MFA) quotas by end-2004. The impact of the removal of protected market access for Bangladesh's exports of

⁵SOE losses are largely sustained by transfers from the ADP, borrowing from NCBs, and defaults on debt services and other current liabilities to the government.

⁶The retrenchment scheme, developed in consultation with the World Bank staff, consists of two months of salary for every year of service plus a redundancy payment; the average cost of retrenchment per worker is Tk 0.2 million (\$3,500).

RMG could be significantly negative, based on a preliminary analysis. The authorities, however, believed that the impact could be cushioned by the continued preferential access to the European Union market, or if Bangladesh could take advantage of niche markets.⁷

19. **Against this outlook, discussions for the Article IV consultation and on the proposed PRGF-supported program were centered on the policy challenges** for keeping the economy on a sound footing over the near term, and for moving it onto a higher growth path with faster poverty reduction over the medium term. In the discussions, the authorities underlined their recent effort to restore macroeconomic stability and the initiatives taken in the past year to begin tackling difficult structural issues. They also stressed their commitment to achieving private sector-led and pro-poor growth with low inflation. There was broad agreement between the authorities and staff on the near-term objectives and the policies that would have to be adopted to meet the policy challenges the country faces. In particular, discussions were focused on the pace and sequencing of specific structural reform measures, where the authorities emphasized the political economy considerations, and argued for a measured phasing of policy steps to sustain and build the impetus for broader reform.

20. **Under the program, in line with the I-PRSP, poverty reduction will hinge above all on achieving faster, more broadly based growth, and on investment in human capital.** The strategy in the I-PRSP identified five priorities: accelerating pro-poor growth, fostering human development, promoting women's advancement, providing safety nets, and strengthening participatory governance.⁸ Specifically, the I-PRSP targets a set of MDGs tailored for Bangladesh. These include an ambitious goal of halving the income-poverty incidence during 2000–15, requiring a doubling of the pace of reduction in the poverty incidence observed in the 1990s. On the current income inequality trend, this implies a sustained GDP growth rate of 7 percent per year.

21. **In line with this overall strategy, the program is aimed at maintaining macro-economic stability while accelerating key structural reforms needed to strengthen the investment climate and improve economic governance.** Under the program, real GDP growth is targeted to rise to 6.5 percent by FY06, and inflation is to be kept under 4 percent (MEFP Table 1). The external current account deficit is projected to widen to about 1.5 percent of GDP during FY04–06, to be met largely by external assistance on concessional terms, and official reserves would be built to over three months of imports by end-FY06. To achieve these goals, the four key elements in the program are: fiscal reform (with revenue

⁷The staff intent to assist the authorities to undertake a more detailed assessment of the potential impact of the removal of MFA quotas in the coming months.

⁸As outlined in the Joint Staff Assessment, the I-PRSP has been prepared in a broad consultative process over an eighteen-month period. Given the challenges that lie ahead and Bangladesh's capacity constraints, the full PRSP is targeted to be completed by December 2004.

mobilization and expenditure rationalization), NCB reform, SOE reform, and more liberal exchange and trade regimes to strengthen competitiveness. Improving economic governance is essential to effective implementation of these reforms. Moreover, to attain the growth objective and the MDGs, the proposed program should be seen as part of a broader reform strategy, which is being supported by other initiatives by the World Bank, the AsDB, and bilateral donors.

IV. MACROECONOMIC OBJECTIVES AND POLICIES FOR FY04

22. **Consistent with this medium-term framework, macroeconomic policies for FY04 are being geared to slightly reducing inflation while supporting economic recovery.**

Fiscal policy is programmed to be moderately accommodative, taking advantage of additional concessional financing partly in support of structural reforms. Monetary policy is to remain tight, to support low inflation, a more flexible exchange rate, and a further buildup of reserves, while still allowing adequate room for private sector growth.

A. Fiscal Reform

23. **The medium-term fiscal strategy is centered on boosting revenue performance and reorienting expenditure to better support growth and the MDGs.** In view of Bangladesh's low revenue base and the pressing need for a higher level of spending to aid poverty reduction, revenue is targeted to increase by at least 1.5 percentage points of GDP over three years, in order to help keep the deficit within manageable bounds. This target will require a major and sustained effort, especially in tax administration, and is contingent on effectively tackling related governance issues. Even with this effort, the central government deficit is targeted to rise initially to 4.8 percent of GDP in FY04, but would fall to 4.5 percent by the end of the PRGF arrangement in FY06 (Table 7). This is needed to support an increase in spending in areas critical for growth (e.g., for structural reforms and maintenance of infrastructure), and for meeting the MDGs (for instance, greater access of the poor to education, health, and nutrition). Such deficits would be consistent with medium-term debt sustainability if financed mainly by a higher level of concessional assistance and supported by enhanced domestic debt management, including efforts to reduce the cost of domestic nonbank borrowing (Box 4). Beyond the program period, with a tapering off of structural reform costs, the budget deficit should continue to fall, to under 4 percent of GDP after FY08.

24. **The FY04 budget targets an increase in revenue** from both changes in tax policy and improved administration, based partly on recommendations of the Revenue Reform Commission (MEFP ¶16). Additional revenues are expected to come from an expansion of the VAT mainly to cover additional services and a broadening of the income tax net. Furthermore, to strengthen customs administration (a key source of revenue) the bonded warehouse system is being revamped and tightened. General tax administration is also being upgraded to include a bigger and more modern Large Taxpayer Unit (LTU), and strong efforts to improve tax compliance (Box 5). These revenue measures are expected to yield ½ percentage point of GDP in revenue for FY04. Looking ahead, additional revenue measures will need to be identified, including with technical assistance from FAD. In

addition, utility prices and administrative fees and charges will need to be raised on a timely basis to protect nontax revenues.

25. **The authorities are attaching expenditure priorities to areas that are pro-growth and pro-poor.** Accordingly, the budget is aiming at obtaining a better balance between recurrent and capital spending, focusing on providing adequate maintenance spending for physical infrastructure and for the MDG-related social sectors, and continuing to give the highest priority to education and health. Poverty reducing spending (on human capital development and social safety nets), in particular, is targeted to rise by at least 1 percentage point of GDP in FY04 (MEFP ¶19). The authorities intend to improve project selection and closely scrutinize ADP spending to enhance its quality and impact on growth and on poverty reduction. In addition, some pay increases (about 10 percent) are envisaged to be accommodated, given the current low pay scale.

26. **Appropriate funding for the costs of reforming the SOEs and NCBs, as well as other costs for poverty reducing programs, will need to be incorporated fully in the expenditure framework over the medium term, in the move toward the full PRSP.** Tentative estimates by the staff suggest that the current costs of reform over three years could be around 2 percent of GDP, and capital costs in the range of 6–8 percent of GDP. These estimates depend on the loan recovery rates achieved in the NCBs and assume a curtailment of new nonperforming loans (NPLs) and appropriate pricing for energy. A significant share of the current costs is expected to be met out of external concessional assistance.

27. **Domestic financing of the deficit is expected to be contained, to help bring down domestic interest rates over time.** In the event external budget support on concessional terms is greater than envisaged, the budget deficit may be somewhat higher but domestic financing would be contained at 2 percent of GDP. Moreover, the domestic cost of financing is being restrained, including by the introduction in December 2003 of an automatic formula that will align interest rates on new NSCs with treasury bill rates. In the authorities' view, delaying this move to end-year should not imply significant additional interest costs, given the reduction in NSC interest rates so far, the abolition of the more costly schemes, and the fact that NSC rates are now close to prevailing treasury bill rates.

B. Monetary and External Sector Policies

28. **Monetary policy will need to keep inflation in check and to support orderly conditions in the exchange market** (MEFP ¶21). BB's money program is designed to maintain the current level of excess reserves by targeting 10 percent growth in the monetary base in FY04. BB will continue to use the weekly treasury bill auction and the newly introduced reverse repo facility to help manage reserve money in line with the liquidity forecasting framework that is being developed with Fund technical assistance. Broad money growth is expected to slow to 12 percent in FY04, but private sector credit growth should be strong enough to support the forecast improvement in economic activity. Also, linking the NSC rates to the yields on treasury bills would remove a major rigidity in the structure of interest rates. However, given the uncertainty about money demand, due to increasing

monetization and the ongoing banking sector reform, the monetary framework will be closely monitored and will be revisited in the program reviews.

29. **The recent move to a floating exchange rate system has been aimed at protecting competitiveness and enhancing resilience to shocks.** The current exchange rate is broadly appropriate in real effective terms, especially in view of the depreciation in the U.S. dollar. The move to a float should further strengthen the external sector, facilitate a buildup of reserves to a more prudent level over the medium term, and better prepare Bangladesh to cope with the removal of textiles quotas. Intervention in the foreign exchange market will be undertaken only to address disorderly market conditions and will be consistent with achieving the targeted increases in net international reserves (MEFP ¶22).

30. **The authorities are committed to managing external debt in a prudent manner.** They recognized that the nonconcessional debt ceiling under the program of \$250 million (0.4 percent of GDP) for FY04 is on the high side. On staff analysis, this ceiling is consistent with Bangladesh's medium-term debt sustainability in light of the moderately low ratio of NPV debt to exports. The authorities considered the room provided under the ceiling as a safeguard for meeting the urgent need for investment in the critical power, water, and telecommunications sectors in the event that concessional funding for such purposes could not be secured on a timely basis; in fact, two power projects (\$90 million) to be financed on nonconcessional terms by the Islamic Development Bank are being finalized. In any case, given the track record of prudent debt management, they intend to minimize such borrowing, especially under suppliers' credits, so as to remain well below the ceiling by adhering to the existing guidelines that limit this type of borrowing (MEFP ¶23). They also plan to significantly improve external debt management especially in recording, monitoring, and evaluation of new debt proposals with Fund technical assistance.

V. STRUCTURAL AGENDA AND ECONOMIC GOVERNANCE

A. NCB Reform

31. **In the banking sector, reform under the program will focus on the NCBs, in view of their weak governance and financial conditions, their dominance in the sector, and the implications for banking efficiency.** As noted above, the overall legal framework for banking supervision and loan recovery has been upgraded over the past year. Looking ahead, the authorities are attaching priority to reforming the NCBs, focusing initially on curbing the flow of new NPLs, while strengthening bank management and developing detailed resolution strategies for each bank (MEFP ¶27). The medium-term goal is to eventually divest these banks, including by partial or complete privatization.

32. **To lay the groundwork for developing bank-by-bank resolution strategies,** audits of the four NCBs will be conducted by February 2004, consistent with international accounting and auditing standards. Based on these findings, a comprehensive strategy for the resolution of each NCB and to deal with the existing stock of NPLs will be adopted by April 2004. This strategy is expected to draw on the recommendations of the joint Bank/Fund

Financial Sector Assessment Program (FSAP) and follow-up technical assistance. Its implementation will be supported by a World Bank credit for banking reform expected to be developed in FY04.

33. In the interim during the first year program, the authorities intend to take concrete measures to restrict lending by NCBs and to strengthen their management:

- **Growth in net lending by NCBs will be restricted** to at most 5 percent during FY04, thereby reducing their market share from 44 percent to 40 percent by end-FY04 (MEFP ¶27). This limit balances the need to contain NPLs and to avoid economic disruption given NCBs' involvement in key sectors. This will be achieved through bank-by-bank specific lending limits and prudential measures. The latter include limiting individual exposures to 5 percent of paid-up capital and requiring that syndication of large loans involve participation of private or foreign banks. BB will develop, in consultation with Fund and World Bank staffs, interim Memoranda of Understanding (MOUs) with each NCB to set lending limits and other performance targets and will monitor their compliance. The closure of loss-making and duplicate NCB branches will continue, with the aim of closing a total of 125 out of 3,000 branches by end-2003.
- **With financial and technical support from the World Bank, new professional management will be secured** for Agrani Bank (the third largest NCB) by October 2003. For Janata Bank and Sonali Bank, management support, by the appointment of outside professional banking experts, will be arranged by December 2003. Further, management in all of the NCBs will be subject to performance-based criteria, and will be provided with sufficient authority to implement staffing changes at senior levels in order to strengthen bank performance.
- **The process of divesting the NCBs will begin by bringing Rupali Bank (6 percent of banking system assets) to the point of sale in whole or in part by June 2004.** This process is expected to begin with a transparent due diligence to be conducted according to international best practice. An action plan to achieve this will be adopted by June 2003.

34. The authorities are pursuing a pragmatic approach to strengthening management of the NCBs, entailing different options across the banks. In adopting this approach, they noted the limited pool of talents from which to draw management expertise, which could make it difficult to plan for a wholesale change in management for all four banks at the same time. The new management option, which has been chosen for Agrani, could be extended to the others depending on the experience in this case. Further, the option of management support through experts (funded under the envisaged NCB reform credit from the World Bank) could prove equally effective in strengthening management, depending on how such management support is structured. In any case, all banks will be subject to detailed MOUs with BB and closer supervision and oversight, including by the Ministry of Finance (MoF).

35. **Efforts will continue to strengthen bank supervision, including of the private commercial banks.** Through the rest of 2003, BB will issue guidelines to all banks on best practice in credit risk assessment, foreign exchange risk management, asset and liability management, internal audit and control, and anti-money laundering procedures.

B. SOE Reform

36. **The authorities are pursuing a two-pronged approach to SOE reform and are taking initial steps to address SOE arrears.** The overall approach to SOE reform has been developed with World Bank assistance, and key upfront actions have already been taken. The approach is aimed at containing fiscal risks and improving infrastructure and service delivery. Nonetheless, the reform agenda is medium term and complex, given deep-seated problems, and will require substantial external assistance, both technically and financially, to be carried out successfully.

37. **The first prong of the approach is to continue downsizing SOEs in manufacturing.** With the initial success in the closure/privatization of 24 manufacturing SOEs so far in FY03, the plan is to close or privatize an additional 11 SOEs in the remainder of FY03 and another 105 SOEs over FY04–06 (MEFP ¶28). This process is expected to affect about 75,500 workers (25 percent of all SOE workers). The total budgetary costs associated with this plan are estimated at 2 percent of GDP, of which one-half would be current cost, mainly in retrenchment benefits, and the other half in capital cost, through absorption of debt (to NCBs and other creditors).

38. **The second prong focuses on reforming the pricing and regulatory frameworks for SOEs in the energy sector.** This entails four key elements: (i) timely price adjustment to improve cost recovery and reduce implicit subsidies; (ii) adoption of a transparent regulatory framework for the electricity, gas, and petroleum markets; (iii) sustained improvement in operational efficiency; and (iv) improvement in corporate governance. The recent rounds of energy price increases have already stemmed losses and are estimated to stabilize arrears in the sector. Moreover, in the context of the DSC, the authorities have adopted a formula-based framework for the pricing of all energy-related products to ensure cost recovery by FY04. The authorities are making this formula operational, starting with the adoption of an interim pricing framework. In addition, with the recent passage of the Energy Regulatory Commission Act, an independent regulatory body is envisaged to be established with licensing and pricing authority over the power and gas sectors. Over the medium term, a comprehensive strategy to reform SOEs in the energy sector will need to be defined and implemented to effectively deal with serious infrastructure bottlenecks.⁹

⁹This includes adoption of a competition law for the petroleum sector, deregulation of crude and products imports, unbundling of the key petroleum and gas companies, refinement of the gas tariff framework, and privatization of at least two electricity distribution companies.

39. **Resolution of government and SOE arrears is an integral part of the SOE reform agenda.** The authorities have already identified all payment arrears in the budget (mainly to utility companies), amounting to Tk 4 billion (or 0.1 percent of GDP), and are planning to clear them by end-FY03. In turn, SOEs would regularize a large share of their debt obligations to the budget. However, arrears of SOEs (i.e., inter-SOE arrears and those owed to banks and other creditors) are substantial, estimated at about Tk 110 billion (or 3 percent of GDP) and are concentrated in the manufacturing sector and in the few major SOEs in the energy sector (Tk 62 billion). Resolution of SOE arrears in the manufacturing sector is being addressed in the framework of the reform plan for this sector. For the energy sector, the authorities intend to draw up a plan to resolve the sector's arrears in the context of the energy reform program, with external assistance.

C. Exchange System and Trade Reforms

40. **The authorities intend to further liberalize the exchange system during the period of the PRGF arrangement.** The authorities have eliminated import licensing, and looking ahead, in conjunction with the float, they intend to progressively dismantle exchange controls and other distortionary measures (MEFP ¶22). With respect to the three exchange restrictions subject to Fund jurisdiction, the margin requirements on the opening of letters of credit (LCs) will be lifted by November 2003, at the latest.¹⁰ The second restriction with respect to nonresident taka accounts will be lifted by the end of the PRGF arrangement period. The third restriction on advance payments on imports is being assessed in the context of the ongoing review of foreign exchange regulations. Finally, export surrender requirements and export subsidies will also be phased out in due course.

41. **Further progress is also envisaged in the trade area, but at a moderate pace, given the heavy dependence on trade taxes.** Under the FY04 budget, the authorities are planning to again reduce the average import tariff rate and to further rationalize the tariff structure by moving to a four-tier tariff rate and reducing the top rate to 30 percent. Further tariff reform is envisaged during subsequent years, and is to be defined following the envisaged FAD technical assistance on tax policy and administration. The staff supports a cautious approach to tariff reform given the dependence of the budget on trade taxes (about 37 percent of revenue) and the time needed to develop alternative sources of revenue. In this connection, the authorities have already streamlined and pruned the list of goods subject to export and import controls, by reducing the list from 134 to about 70 items.¹¹ As a result of

¹⁰These comprise: (i) margin requirements for the opening of LCs for the import of goods; (ii) restrictions on the convertibility and transferability of proceeds of current international transactions in nonresident accounts; and (iii) restrictions on advance payments for imports of goods and services. See also Annex I, Section VIII.

¹¹Only four items (eggs, chicks, salt, and carton packaging/paper bags) are now subject to controls for reasons other than health, culture, environment, security, and religion, and under the WTO agreement, these restrictions can remain in place until 2007.

these actions, the trade restrictiveness index for Bangladesh has been reduced from 8 to 7 (on a scale of 1 to 10, with 10 being the most restrictive).

D. Economic Governance

42. **For many of the key policy measures envisaged under the program, their effectiveness would also depend on substantially improving the underlying economic governance.** For instance, measures aimed at improving tax administration and expenditure priorities will require reducing the related scope for corruption and a political will to deal with governance issues. Similar considerations apply to the envisaged approach to strengthening management at the NCBs.

43. **At a more systemic and institutional level, efforts are being aimed at improving transparency and accountability in the management of public resources.** Recent gains in fiscal reporting will be consolidated through implementing the action plan recommended by the Fund's Fiscal ROSC (MEFP ¶20 and Annex V). In particular, the authorities are planning to consolidate the fiscal reporting system and incorporate formal assurances of data reliability in fiscal reports. In addition, they are committed to meeting the key benchmarks set under a donor-financed Financial Management Reform Program (FMRP). Specifically, internal control of the MoF over public expenditures will be strengthened, as will the capacity of the Office of the Auditor-General to carry out more effectively its independent audit functions. With the support of an IDA credit, the government is also moving to put in place a policy and institutional framework to improve public procurement. Finally, at the broadest institutional level, the Cabinet has approved a draft act to establish an independent anti-corruption commission to be vested with the authority to investigate allegations of corruption.

VI. OTHER ARTICLE IV AND PROGRAM ISSUES

44. **Despite recent progress and the adequacy of the statistical base for the purpose of program monitoring, there is scope for further improvements.** Bangladesh participates in the General Data Dissemination System (GDDS), and there has been improvement in fiscal reporting and in the balance of payments statistics. Nonetheless, weaknesses remain in most areas of statistics (Annex VI). In particular, specific recommendations of the STA multisector statistics mission should be followed through. Looking ahead, there is also a need to develop a statistical and monitoring framework to better track poverty-reducing expenditure.

45. **Progress has been made in anti-money laundering (AML) and combating the financing of terrorism (CFT), but AML legislation and implementation capacity in this area need to be upgraded.** An assessment of the AML/CFT regime, conducted as part of the FSAP, commended the enactment of the Money Laundering Prevention Act in April 2002 and the formation of an AML department within BB. However, the implementation of AML/CFT measures continues to be hampered by weak capacity and interagency cooperation. In addition, there is a need for clearer powers in the AML law for international cooperation and better training and equipment for law enforcement agencies. Technical

assistance will be needed to strengthen AML legislation and its implementation and monitoring.

46. **The Fund has provided considerable technical assistance (TA) to Bangladesh over the past year, but further support is needed**, especially to help implement the measures envisaged under the program. So far, TA has concentrated on monetary operations, the exchange rate regime, and statistics. Good progress has been made in implementing TA recommendations, especially in monetary and exchange operations. In the coming year, further assistance is planned on liquidity management and monetary statistics, NCB reform, debt management, and on tax policy and administration.

47. **The poverty and social impact of the reform program should be positive as a whole and over the medium term.** In the near term, the adverse impact of SOE reform, and potentially of prospective NCB reform, should be eased by appropriate retrenchment schemes which are now in place. Over time, higher growth and investment should create jobs in the private sector. A more flexible exchange rate arrangement would also ensure a more competitive export structure and protect employment. Moreover, increased budgetary spending on poverty alleviation and on health and education should go a long way in helping the poor to benefit from new opportunities. Starting from the revised FY03 budget, allocations for health and education are to be increased and development expenditures rationalized, targeting projects that benefit the poor and vulnerable segments of the population. Furthermore, the authorities and staff agree on the need to assess the poverty and social impact of specific key reform measures, particularly on the increases of utility tariffs and energy prices and the recent move to monetize food-based social protection programs. Such an analysis should help the design of well-targeted social safety net measures in the outer years of the program.

VII. PROGRAM RISKS, MONITORING, AND SAFEGUARDS

48. **The requested access under the PRGF arrangement is SDR 347 million (65 percent of quota), to be disbursed semi-annually in seven equal installments** (Table 8). For FY04, the projected financing gap of \$655 million is expected to be covered by PRGF disbursement, the World Bank (\$400 million), the AsDB (\$100 million), and other bilateral donors (Table 9). The financing need over the remaining program period (FY05–06) is projected at \$1.5 billion, and would be covered by further support from other IFIs, including adjustment operations, and by bilateral donors.

49. **The main risks to program implementation stem from political resistance and capacity constraints**, in addition to the economy's vulnerability to natural disasters. As program measures take hold, particularly in revenue and NCB and SOE reforms, strong resistance from vested interests can be expected to arise. Addressing entrenched governance problems can also be expected to encounter strong political opposition. In this environment, forging and maintaining consensus behind reform may be time-consuming. All these risks could therefore delay or even derail implementation. Furthermore, administrative capacity in Bangladesh is constrained, in part because of the low pay scale in the civil service. Moreover,

many of the reform issues are technically complex, particularly in the NCBs and the energy sector, and defining resolution strategies could take longer than now expected under the program.

50. **To help mitigate these risks**, in developing the program, the authorities have held extensive consultations with stakeholders, including in the context of the I-PRSP. Further, as noted above, safety nets for retrenched workers are in place, and assessment of other social implications of the reform is planned. In addition, extensive TA will need to be ensured to upgrade capacity in critical reform areas, from other IFIs, bilateral donors, as well as the Fund.

51. **In view of the implementation risks, the program will be monitored closely**, combining semi-annual reviews by the Board with staff reviews in the interim. Appropriate prior actions have also been taken by the authorities to pave the way for the program (MEFP Table 3). Quantitative and structural performance criteria and benchmarks have been proposed through June 2004 (MEFP ¶34–35). Structural conditionality is focused on the reforms of the tax system, the NCBs, and the exchange system (Box 6). The envisaged measures are critical for attaining the medium-term revenue target, containing fiscal risks, and improving growth prospects. The first review in December 2003 will focus on the implementation of the FY04 budget, NCB reform, and tax reform. The second review will be completed by June 2004, to set program targets for FY05 and allow a more comprehensive assessment of program implementation and policies.

52. **The priority recommendations of the Safeguards Assessment have partly been implemented**, and the authorities have committed to addressing the most critical remaining areas as part of the first-year program (MEFP ¶33). BB's FY02 financial statements have been restated, and further technical assistance will be provided for the preparation of the FY03 statements. A timetable has been set for the BB Board to adopt International Accounting Standards (IAS) and International Standards on Auditing (ISA) by FY04. An audit of FY03 statements will be conducted by the first review of the PRGF in accordance with ISA and IAS by a local accounting firm and signed off by an international partner. Further, reserve management functions have been separated between the dealing room and back office and a separate middle office is being developed.

53. **Bangladesh should be able to meet its obligations to the Fund under the proposed access** (Table 10). Under the program, total use of Fund resources would peak at 0.7 percent of GDP in FY06, and debt service to the Fund as a proportion of exports would be minimal during the next four years.

VIII. STAFF APPRAISAL

54. **Over the past year, Bangladesh's economic performance has strengthened, despite weakness in the global environment**. GDP growth is rising, inflation remains moderate, and international reserves have been rebuilt to a more adequate level. Moreover,

downside risks notwithstanding, the near-term outlook is favorable, given recovering exports and industrial production and improved business confidence.

55. **These results are due in large measure to prudent macroeconomic management and a renewal of structural reform.** The authorities have brought down the central budget deficit to a manageable level through strong revenue efforts and expenditure restraint. Monetary policy has also been appropriately tightened, interest rates have been made more market-based, and the exchange rate has been managed with greater flexibility. Furthermore, BB has gained greater operational autonomy and the legal framework for bank supervision has been strengthened. Measures have been taken to raise utility tariffs and energy prices to bring them closer to cost recovery levels. In addition, an agenda is being set for SOE reform through the orderly closure of several loss-making units so far this fiscal year.

56. **The proposed PRGF-supported program builds on this record of policy implementation, and is focused on the structural reforms critical for putting the economy onto a higher growth path to achieve faster poverty reduction.** Attaining a sustainable and rapid growth necessary for halving poverty by 2015—a goal in the I-PRSP—will require not only maintenance of macroeconomic stability but also a major improvement in the investment climate. For this, the authorities will need to accelerate structural reforms that are central to addressing the high cost of borrowing, bottlenecks in physical infrastructure, inadequate investment in human capital, and poor economic governance, all of which have been identified as key impediments to growth and poverty reduction efforts.

57. **Under the program, the principal structural elements comprise fiscal reform, NCB and SOE reforms, more liberal exchange and trade regimes, and improved economic governance.** In particular, for structural reforms to be successfully implemented, the underlying economic governance issues will need to be decisively tackled. More broadly, institutional changes to improve public resource management will be needed. In this context, the envisaged creation of an anti-corruption commission could be an especially helpful step.

58. **Fiscal reform will be vital, centering on a sustained revenue effort and a shift in spending toward investments in infrastructure and human capital,** to better support growth and the MDGs. The budget framework for FY04 is in line with this strategy, but there is little room for slippage in view of the need to cap costly domestic financing. The envisaged revenue measures—chiefly an extension of the coverage of the VAT and income tax and a strengthening of tax administration—are well-designed and should assure the target of increasing revenues by ½ percent of GDP for the year. However, these measures will need to be firmly implemented, which will require curbing corruption and overcoming resistance from vested interests. On the expenditure side, budget allocations are being shifted to support structural reforms and to increase poverty-reducing purposes by at least 1 percentage point of GDP. To achieve the targeted prioritization, better ADP project selection will be key, as are additional steps to improve the transparency and accountability in expenditure management.

59. **For public debt sustainability, domestic financing for the budget will need to be curtailed and prudence exercised in external debt management.** To contain the burden of

domestic nonbank financing, it will be critical to follow through with the envisaged move to link interest rates on new NSCs with treasury bill rates. Further, as part of external debt management, the authorities should strive to minimize recourse to suppliers' credits and to rely more on external support on concessional terms, including for the energy sector, so as to stay well below the programmed ceiling on nonconcessional debt. Moreover, they should further strengthen the mechanism for public debt management, starting with improving the debt information system.

60. **The proposed approach to NCB reform is cautious but represents a meaningful start to addressing the weaknesses in this area.** The envisaged audits of these banks should help in defining a resolution strategy for each bank by April 2004, drawing also on the findings of the FSAP. In the interim, attention will need to be placed on effectively strengthening oversight of NCBs and bank management, and restricting NCB lending, so as to curb the flow of new NPLs. The staff urges the authorities to press ahead on the envisaged timetables with securing new professional management for Agrani Bank, arranging management support for Sonali Bank and Janata Bank, and privatizing Rupali Bank, with technical and financial assistance from the World Bank. It will be particularly important to protect new/strengthened managements in these banks from outside interference, and give them sufficient authority to follow best practice credit risk management. In addition, interim MOUs should be agreed soon with each of these banks to ensure compliance with lending limits and observance of other performance benchmarks. Branch rationalization should also continue.

61. **The ongoing momentum in reforming SOEs in the manufacturing sector should be reinforced, in order to curtail their losses and the burden on the budget.** The authorities' SOE reform plan in this sector is well-conceived and credible, in view of the orderly closure/privatization of key loss-making units so far. Given this momentum and external support now in place, the reform plan should be further pursued with vigor, so as to substantially withdraw SOEs from this sector within three years as planned and make room for the private sector.

62. **The serious problems of SOEs in the energy sector will also need to be decisively addressed, if the fiscal risks are to be contained and critical infrastructure bottlenecks are to be eased.** The policy agenda in this sector is very large and complex with significant social implications, and requires substantial technical and financial assistance. Recent pricing actions have provided a basis for initiating this agenda, by stemming the financial losses of the sector and limiting the scope for subsidies. The authorities will need to make further progress, in consultation with the World Bank, by moving in a timely way to implement an automatic pricing framework for energy, starting with adoption in the near term of an interim pricing formula. An effective regulatory body should also be installed soon, now that the legal framework is in place. In addition, attention will need to be given to resolving the inter-enterprise arrears of SOEs in this sector in the context of an appropriate financial and operational restructuring, and to defining the next phase of reforms so as to permit a higher level of investment in this crucial sector.

63. **The authorities should be commended for the more flexible management of the exchange rate**, which has ensured an appropriate level of the rate so far. Looking ahead, the move to a floating exchange rate regime would offer greater flexibility in macroeconomic policy management, better protect competitiveness, and enhance resilience to shocks. In this context, the envisaged trade reform measures for FY04 are welcome, but more will need to be done over the next two years to remove anti-export bias, so as to effectively diversify exports away from RMG and reduce external vulnerability.

64. **Removing the remaining exchange restrictions within the PRGF period** will also be essential for a more liberal regime and improved business confidence. Given that the authorities have proposed timetables for eliminating the restrictions with respect to the margin requirements for imports and the nonresident taka accounts, the staff recommends the temporary extension of the approval of these restrictions, until November 30, 2003 for the former, and for the latter until the second PRGF review or June 30, 2004, whichever is earlier. In addition, the staff urges the authorities to set a timetable for eliminating the remaining restriction on advance payments for imports.

65. **The I-PRSP has been prepared in a broad consultative process and represents a cohesive poverty reduction strategy.** In moving toward the full PRSP targeted for December 2004, the authorities will need to strive for a sharper prioritization of pro-poor policies, and ensure a full costing of these programs in a medium-term budget framework.

66. **The program is subject to significant but manageable and acceptable risks**, in view of the authorities' commitment to reform as evident in the policy actions already taken. The main risks to program implementation derive from resistance from vested interests and entrenched governance problems, especially in revenue, NCB and SOE reforms, and from capacity constraints. The envisaged safety nets for retrenched workers should help mitigate these risks. Extensive TA from the World Bank, the Fund, and bilateral donors will also be needed to boost capacity. Moreover, close monitoring of the program will be important, including through quarterly staff reviews, and in close coordination with the World Bank's DSC and future adjustment operations.

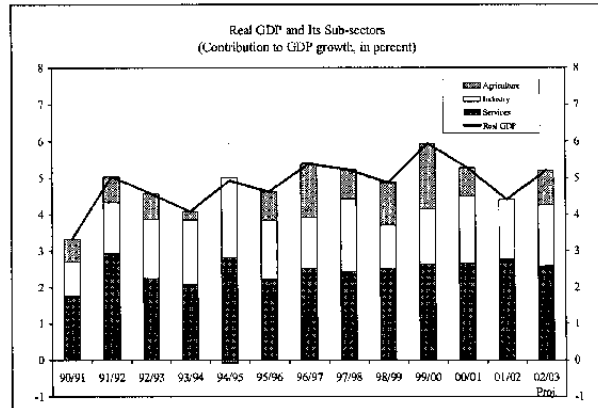
67. **The staff considers the proposed policy program to be appropriately comprehensive and realistic for achieving the program's objectives.** On the basis of the authorities' recent record of macroeconomic management, the strength of the proposed reform program, and completion of the prior actions, the staff recommends Board approval of the authorities' request for an arrangement under the PRGF.

68. **It is proposed that the next Article IV consultation** with Bangladesh will be held subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

Box 1. Bangladesh: Sources of Growth

Bangladesh is among the most vulnerable economies that are characterized by high population density, low resource base, and a high incidence of natural disasters. During the 1990s, notable progress was made in economic performance. Real GDP growth accelerated to an annual average of 5 percent (from 4 percent in the 1980s and 3 percent in the 1970s), and real per capita GDP rose during this period by 36 percent (or double the average rate for low-income countries in the same period) to \$366 by 2000. Several factors were instrumental to this acceleration of real growth:

- Cautious macroeconomic policies helped to stabilize the economy, after the successful completion of the SAF and ESAF arrangements in late 1980s and early 1990s.
- Improvement in education, health, and nutrition through public and nonpublic (mainly NGO) interventions contributed to a better educated and more skilled labor force and a steady progress in nonincome social indicators.
- Rapid growth in the export-oriented RMG helped to expand the manufacturing and services sectors.
- A marked increase in agricultural output, especially rice, due to improved quality and availability of inputs in response to government agricultural policies.



These successes were considerable, but partial. With inadequate political cohesion, the pace of structural reform slowed from the mid-1990s. Severe impediments to private investment (including FDI) were widely recognized, including the high cost of doing business, weak financial conditions of the NCBs and SOEs, and governance problems. In addition, public finances suffered from chronically weak revenue performance and inadequate provision of public services. These factors, together with poor infrastructure, became a serious drag on economic growth.

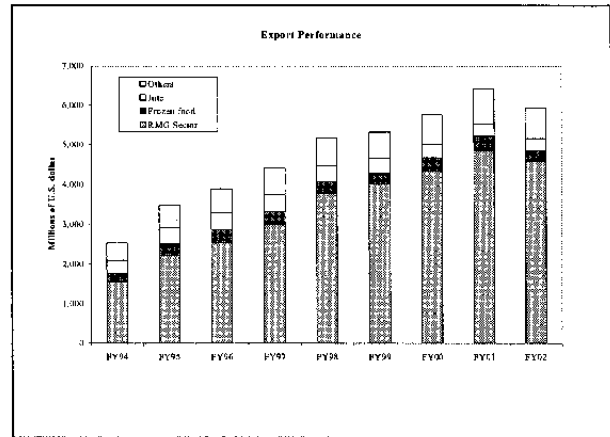
Reaching the I-PRSP's goal of halving poverty by 2015 will require a pro-poor, high rate of GDP growth of 7 percent on a sustained basis over FY03–15. To this end, the government will need to speed up a broad range of structural reforms and improve economic governance substantially. The government's program, to be supported by a PRGF arrangement, focuses on reforming the fiscal system, NCBs and SOEs, and exchange and trade regimes, to establish the basis for a higher growth path.

Higher and pro-poor growth is expected to be broadly based, and result from the program's policies in the following key sectors:

- **Agriculture** is expected to remain the primary source of income and employment for the poor. Improvement in crop yields and product diversification are critical for agricultural growth, and will be aided by increased poverty-reducing spending for the rural sector. With the poor being landless, a better functioning land market is also important for boosting agricultural productivity.
- The **nonfarm rural economy**, including trade and services, holds vast potential for growth. Priorities will also need to be given to the promotion of **small and medium-size industries** and **export diversification**. Financial sector and SOE reforms will be key for these purposes, as will improved economic governance.
- Attracting **private investment**, especially FDI, will be essential for accelerating growth and raising productivity through modern technology and management skills. The focus will thus need to be placed on improving the investment climate and tackling corruption.
- **Financial and physical infrastructure** will need to be substantially upgraded. Specifically, targeted micro-credit and lower borrowing costs will be needed to promote access to credit by the private sector. Public investment and appropriate participation by the private sector in key physical infrastructure (roads, electricity, water, and telecommunications), with significant improvement in maintenance, will also be critical. This will require, in particular, reorientation of spending, sustained revenue efforts, and energy sector reform.

Box 2. Bangladesh: Export Competitiveness

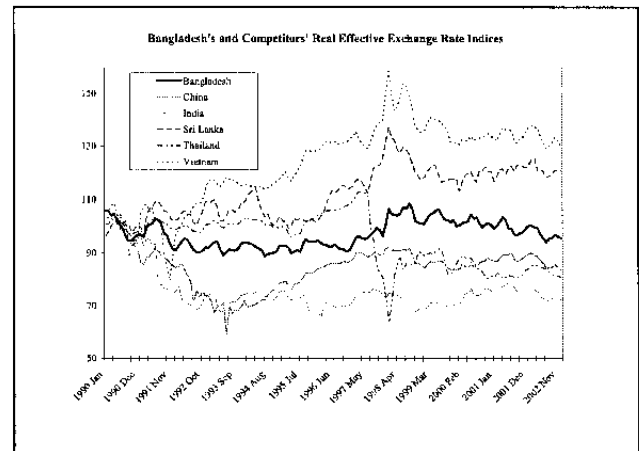
Bangladesh's export performance during most of the 1990s was strong. Exports grew at an average annual rate of 14.5 percent during the period to 1998, led by the ready-made garments sector, which grew by 22 percent per year. The RMG sector's share in exports has grown from about 40 percent in 1990 to over 75 percent in 2002. This was helped by FDI, which took advantage of Bangladesh textile export quotas and preferential access in the major markets (the European Union and the United States), as well as an abundance of low-cost labor.



However, starting in 1998, export performance has slackened markedly, to an annual growth rate averaging 3.5 percent through FY02. For the first time in more than 20 years, export levels actually declined in FY02. As a result of increasing competition, especially from China and India, prices and profit margins have been squeezed significantly. More recently, the value of Bangladesh's RMG exports has been maintained by higher volumes compensating for lower prices.

In order to maintain external competitiveness, the authorities followed a pegged exchange rate regime with small periodic devaluations until the taka was floated on May 31, 2003. There was some nominal

appreciation during mid-1997 to early 2003 which, combined with relatively higher domestic inflation, led to an appreciation in the REER. During that time, Bangladesh's key competitors, including China, India, and Pakistan, maintained lower REER, and only Vietnam and Sri Lanka had higher REER. With the recent weakness in the U.S. dollar, the taka has depreciated in real effective terms by an estimated 8 percent since January 2002. However, costs in Bangladesh are relatively high, due to the weak infrastructure, and FDI has been held back by the poor investment climate. As a consequence, there has been limited export diversification so far.



Medium-term prospects for Bangladesh's exports have worsened in view of the prospective elimination of MFA quotas by January 1, 2005. The impact of the removal of protected access to advanced country markets could be significantly negative for Bangladesh. The authorities believe, however, that the impact would be cushioned by the continued preferential access to the European Union market and if Bangladesh could take advantage of niche markets. Nonetheless, in view of the potential losses from the removal of quotas, the authorities and the staff are analyzing the potential impact, based on more detailed export data to be collected, and considering more fully the policy implications.

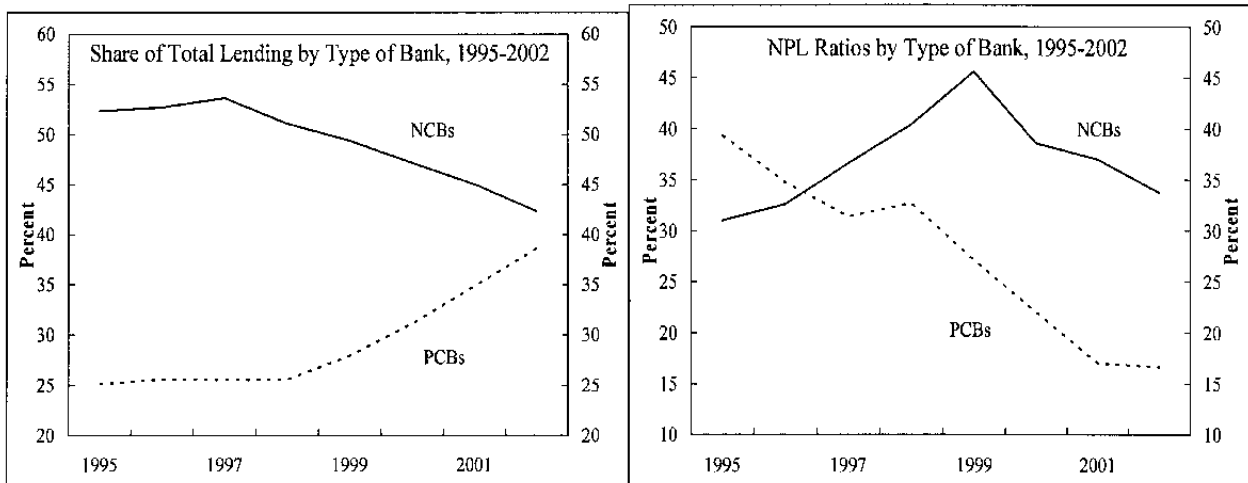
To alter this challenging medium-term picture, sound macroeconomic policies must continue and be accompanied by changes in exchange rate and trade policies, and major structural reforms. Such a policy program is critically needed to encourage and facilitate the diversification of the economy into more promising and profitable areas, e.g., leather goods and agroprocessing.

Box 3. Bangladesh: FSAP Findings on the NCBs

The banking sector in Bangladesh is dominated by four NCBs accounting for 47 percent of the sector's assets. There are also five state-owned specialized development banks (9 percent of assets), 30 private commercial banks (PCBs) (35 percent of assets), and 10 foreign commercial banks (FCBs). The banking sector includes both banks in weak financial condition and sound banks making substantial profits, based on the FSAP report (for details, see Annex IV). The first generation of PCBs (licensed between 1991 and 1996) had serious financial problems, including inside lending and other widespread owner abuses. With the second and third generations of private banks, and changes in the first generation banks, earlier abuses have been substantially reduced and prudential standards and supervision were strengthened. As a group, PCBs now are in reasonably good financial condition, with a few exceptions for which the BB is taking corrective actions through improved supervision and regulation.

Several recent steps have been taken to reform the banking sector. In addition to legislative reforms that have strengthened BB's regulatory powers and streamlined loan recoveries, BB has recently issued circulars that: (i) raised capital adequacy requirements to 9 percent (from 8 percent) on a risk-weighted basis; (ii) reduced the maximum size of individual loans allowed as a proportion of paid up capital to 25 percent; (iii) increased the minimum level of capital for each bank to Tk 1 billion (from Tk 200 million), and permitted dividend declaration by banks in excess of 20 percent only if an equivalent amount is set aside for reserves; (iv) encouraged the write-off of loans that have been nonperforming for over five years; and (v) reduced the number of directors on bank boards and raised the qualifications for board membership.

The FSAP recommends that the initial focus of reform be placed on the NCBs. This reflects both the continued importance of NCBs in the banking system and the significant improvement in PCBs' performance over the past few years. While the NCBs still dominate the banking sector, their share of total lending has been shrinking over the past four years due to increased competition from PCBs. PCBs also have substantially reduced their nonperforming loans (NPLs).



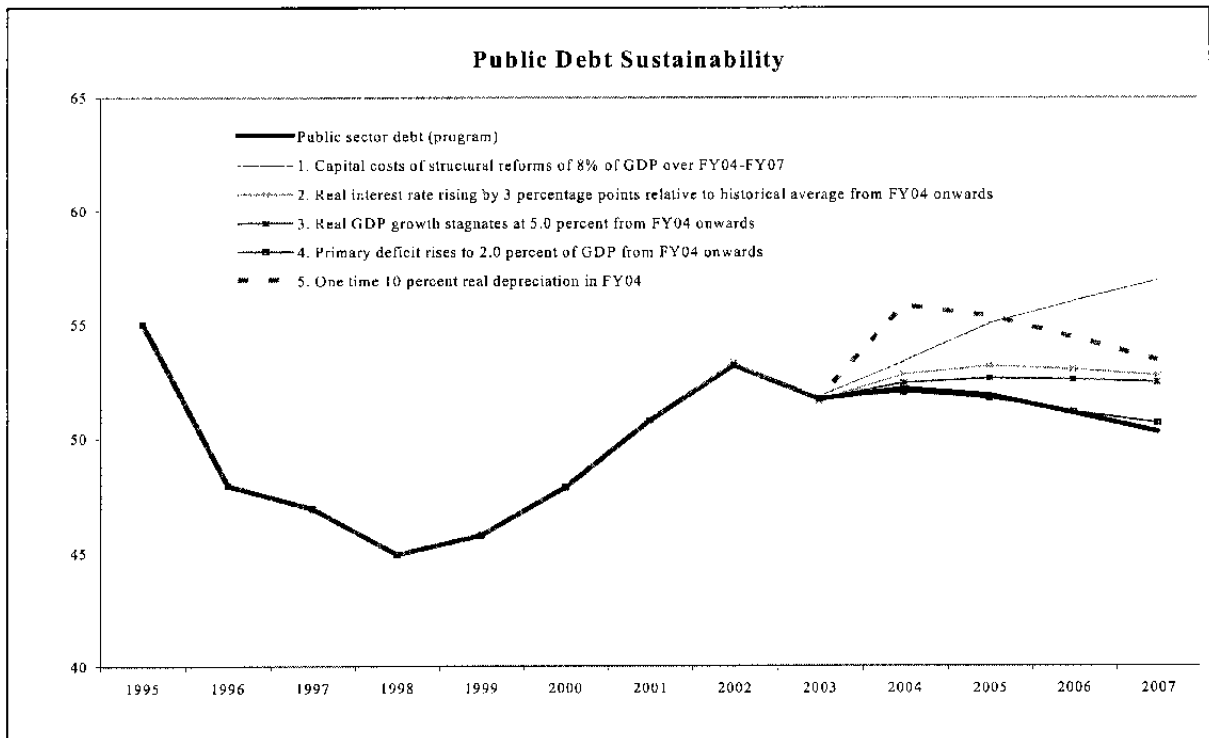
The FSAP report highlights two main problems facing the NCBs: low levels of reported capital and under-provisioning for NPLs; and continued poor lending and loan recovery practices, which contribute to an inefficient financial system that inhibits economic growth. According to BB reports, at end-2002 NCBs had capital shortfalls relative to prudential requirements of about 0.5 percent of GDP. However, NCBs also had a gross NPL ratio of 34 percent, or a net NPL ratio (classified loans less provisions as a proportion of total loans) of 19 percent, corresponding to a further capital deficiency of up to 2.5 percent of GDP, under the staff's assumptions on loan recoveries. This is likely to be an underestimate because NPLs may be substantially understated due to widespread evergreening of loans.

The high stock of net NPLs reflects: poor and corrupt lending practices; directed lending; poor management, with little emphasis on profitability; a default culture facilitated by an inadequate legal framework for loan recovery; regulatory forbearance that allowed the NCBs to declare profits despite suffering from capital and provisioning shortfalls; and difficulty in writing off loans that have been nonperforming for many years.

Box 4. Bangladesh: Public Sector Debt Sustainability

To help assess the sustainability of public sector debt over the medium term, the staff conducted a sensitivity analysis on the profile of the public sector debt-to-GDP ratio relative to the program scenario. The program scenario projects a gradual decline in public debt, from about 53 percent of GDP in FY02 (33 percent external and 20 percent domestic) to 50 percent of GDP in FY07, due mainly to the reduction in the budget deficit and the decline in the average interest rate on public debt as a result of the programmed improvement in the structure of deficit financing. The potential capital costs of SOE and NCB reforms are tentatively estimated at up to 8 percent of GDP to be absorbed during FY04–07, mainly below the line in the budget through issuance of government bonds for eventual NCB recapitalization and resolution of SOE arrears. When factoring in such potential costs, the public debt ratio would increase to 57 percent of GDP by FY07. This debt ratio is judged manageable because over half of the debt burden is external on highly concessional terms.

The sensitivity analysis on the program scenario applies individual adverse shocks to key economic variables from FY04 onward. Specifically, the analysis assumes adverse shocks arising from: (i) a slower real GDP growth during FY04–07 at 5 percent per annum (relative to the historical mean of 5.2 percent during FY96–02 and the 6.2 percent programmed for FY04–07); (ii) a higher real interest rate by 3 percentage points during FY04–07 (above the historical mean); (iii) a primary budget deficit of 3 percent of GDP during FY04–07 (compared with the programmed average deficit of 2½ percent of GDP); and (iv) a one-time 10 percent real depreciation of the exchange rate in FY04.



The sensitivity analysis suggests that, even with significant adverse shocks, the public debt would remain manageable. The greatest impact to the program scenario would come from a large real depreciation of the exchange rate (adding 4 percentage points of GDP to the public debt ratio), which, if occurred in a single year and in conjunction with full funding for the capital costs of reforms, could raise the public debt ratio to just under 65 percent of GDP. Individual shocks to the real interest rate, to real GDP growth, and to the primary budget balance would have a modest impact on the debt dynamics. Among these individual shocks, a rise in the real interest rate by 3 percentage points from FY04 onward would only raise public debt by about 1 percentage point of GDP, owing mainly to the large component of concessional external debt.

Box 5. Bangladesh: Revenue and Expenditure Measures Under the First-Year PRGF

A key feature of the program is to boost revenues on a sustainable basis, raising the revenue-to-GDP ratio by 1.5 percentage points over FY04–06. This medium-term effort is expected to draw on the recommendations of a Revenue Reform Commission set up in FY03. These include: (i) encouraging wider use of the present Tax Identification Number (TIN) system, and placing greater reliance on self-assessment for income tax collection; (ii) abolishing all tax holiday facilities, and replacing them with either an accelerated depreciation allowance or a uniform reduced tax rate; (iii) implementing immediately the recommendations of the Customs Administration Modernization (CAM) Project with regard to automation, reform, rules, regulations, and procedures; (iv) significantly modifying the bonded warehouse system to reduce smuggling and customs duty evasion; (v) extending VAT to various goods and services that are currently exempt; (vi) recruiting at least 200 new VAT auditors, and appointing more chartered accountancy firms to carry out audits in order to identify VAT evasion in the services and manufacturing sectors; and (vii) abolishing circle offices and merging them with division offices, while increasing the number of division offices from the current 30 to around 50.

To meet the program target of raising an additional ½ percentage point of GDP in revenue in FY04, the authorities intend to: (i) modernize and expand the coverage of the Large Taxpayer Unit for income tax; (ii) set up, and make fully operational, the Central Intelligence Audit and Monitoring Cell, covering 1,000 large taxpayers for all taxes; (iii) revamp the bonded warehouse system (withdraw warehouse licenses for imports for domestic consumption, and require bank guarantees for export-oriented imports); (iv) register an additional 100,000 new income taxpayers, and around 200,000 new VAT taxpayers; (v) post audit around 20,000 income tax files; and (vi) continue automation of customs and other modernization measures under the CAM project. These measures, when fully implemented, could potentially yield additional revenue on a sustained basis of 1 percent of GDP per annum. Additional revenue measures for FY05-06 are expected to be based on FAD technical assistance planned for early FY04.

The FY04 budget is also expected to focus on strengthening the pro-poor focus of government expenditure, as well as the effectiveness of capital spending. Specific measures, drawing in part on the interim report of an Expenditure Review Commission, include: (i) strengthening the project selection and approval procedures for the ADP; (ii) cutting down substantially the number of unapproved projects in the ADP; (iii) removing micro credit-related projects from the ADP to the Revenue Budget; (iv) combining the Revenue and Development Budgets; (v) replacing food distribution with cash in social protection programs; (vi) cutting down the size of the civil service; (vii) taking effective steps to reduce waste in the nationalized industrial sector; and (viii) establishing, and making operative, Parliamentary Permanent Committees on Public Expenditure and Accounts.

The authorities intend to raise poverty-reducing spending by at least 1 percentage point of GDP in FY04. In addition, the FY04 budget will be based on more realistic projections, particularly for goods and services, to limit overspending by line ministries and to prevent accumulation of new arrears. Further, spending allocations will be rationalized to give priority to spending on repairs and maintenance. Projects to be included in the ADP will be closely scrutinized to ensure best use of available funds, and no new unapproved ADP projects will be added to the program. Adequate funding will be ensured to cover SOE reform costs.

The Planning Commission is preparing a “Mid-Term Plan for Economic and Social Development,” which will be broader than the I-PRSP in that it will incorporate broader indicators of social development linked to the MDGs. The document is expected to set out in detail the public sector development program and lay out the objectives, strategies and policy thrusts for each of the 17 main economic sectors.

Box 6. Bangladesh: Structural Conditionality

Coverage of structural conditionality in the first year of the PRGF-supported program

Structural conditionality in the first year program is detailed in Table 3 of the MEFP. The focus of conditionality is on the tax system, NCBs, and exchange and trade systems—all considered critical to medium-term macroeconomic stability and for improving growth prospects. Specific measures in tax reform include modernizing and expanding the Large Taxpayer Unit, making operational the Central Intelligence Audit and Monitoring Cell, and revamping the bonded warehouse system. Elements in NCB reform include audits based on international auditing and accounting standards, improvement in NCB management, privatization of one NCB, and adoption of a resolution strategy for each NCB. The exchange and trade systems will be further liberalized through the floating of the exchange rate and the phasing out of margin requirements on the opening of letters of credits for imports.

Looking beyond the first-year PRGF, structural conditionality is expected to focus on:

- **Tax reform**—to ensure that the current reform is sustained and deepened, especially following forthcoming Fund and external technical assistance.
- **NCB reform**—to ensure that the resolution strategy to be adopted during the first year is adequately implemented.
- **SOE reform**—to improve financial performance and governance, and resolve arrears. The energy sector reform will receive special attention; the World Bank and the AsDB are expected to play key roles in providing policy advice for reforming this sector, in the context of likely adjustment operations.

Structural conditionality covered by the World Bank

PRGF conditionality has been coordinated with conditions under the World Bank's Development Support Credit (DSC), which is scheduled for discussion by the Bank's Board on June 19, 2003. DSC conditionality centers on reforms of the banking, SOEs, energy sector, and broad-based governance. The authorities have implemented the measures proposed under the DSC conditionality as prior actions. Future lending operations are expected to focus on the same areas to ensure sustained implementation of the reform strategy. The key measures under the DSC include:

Financial sector

- Amendments to BB order, granting operational autonomy to BB on exchange and monetary policies, bank supervision, and its personnel affairs.
- Amendments to Banking Companies Act, enhancing BB's supervisory power over NCBs and SDBs.
- Initial steps for NCB reforms, including selection of auditors, inviting tenders for a management contract for Agrani, and preparation of Rupali for privatization.

SOE reform

- Cabinet approval of new Privatization Policy, and closure of at least 15 major enterprises.

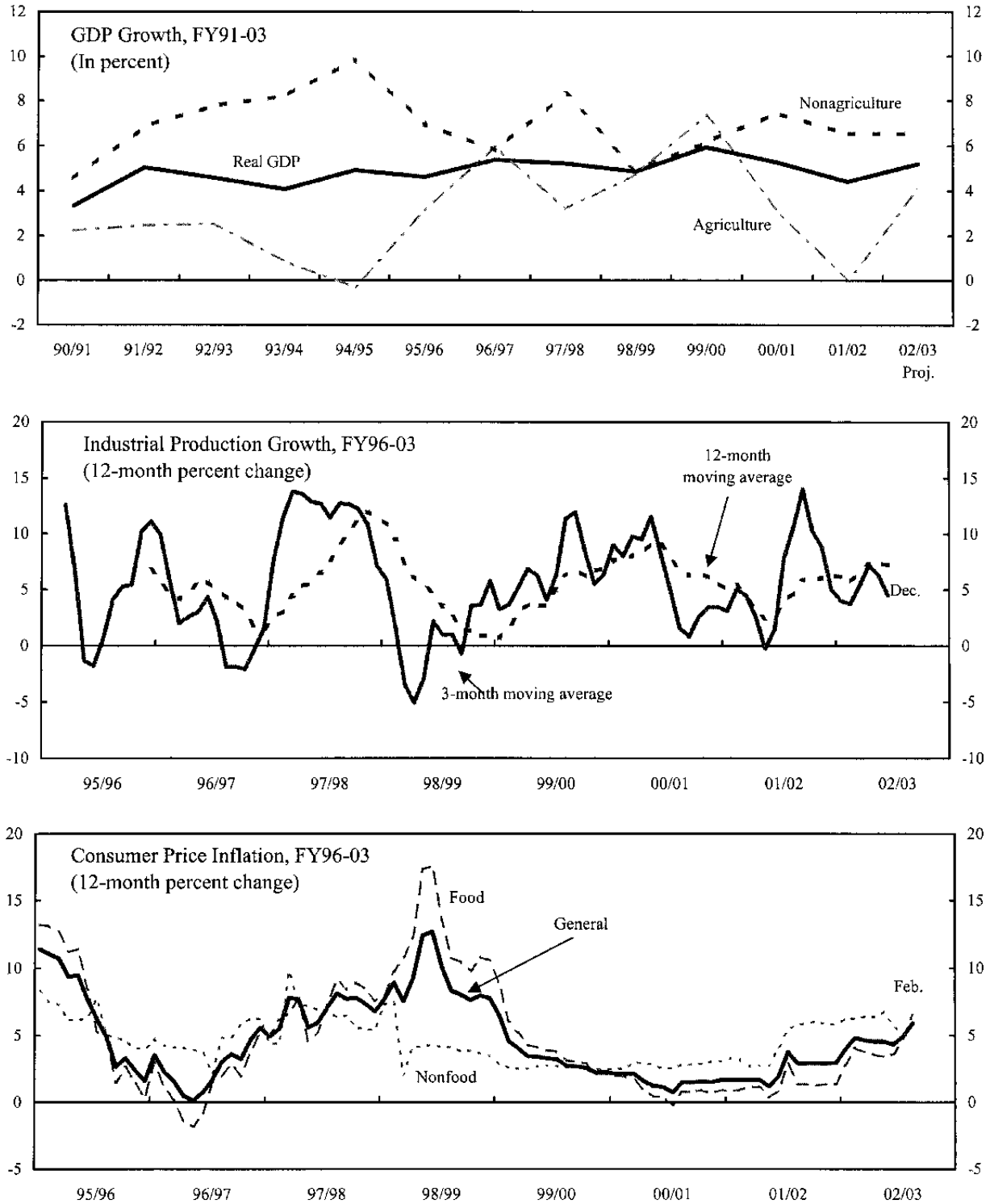
Energy sector

- New (interim) petroleum, gas, and power pricing framework, to ensure efficiency and financial viability of the sector consistent with the new energy pricing framework.
- Passing an Energy Regulatory Commission Act, aimed at establishing an independent Energy Regulatory authority to set regulated tariffs.
- Adoption of an energy sector reform plan covering the next three years.

Broad-based governance

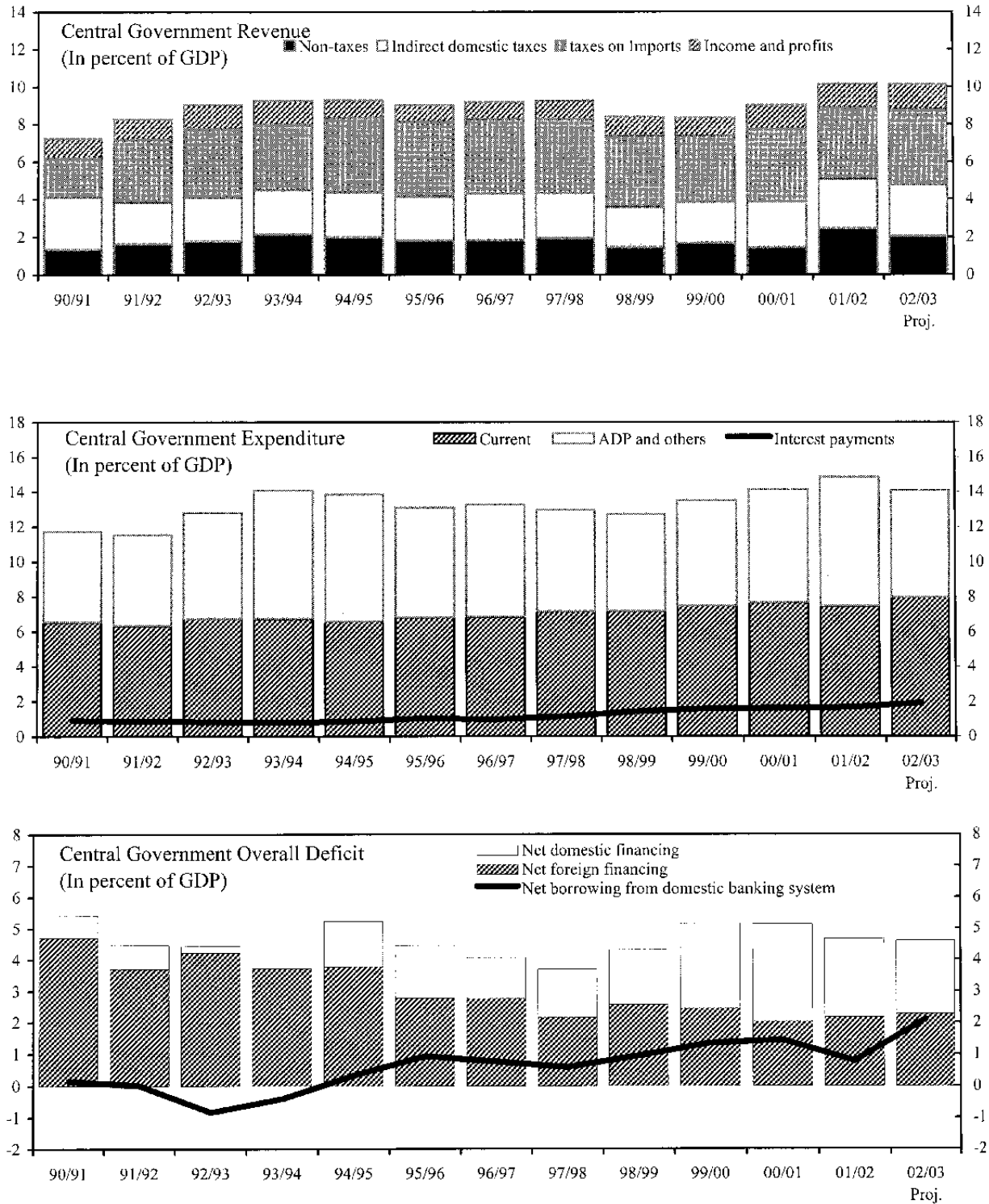
- Cabinet approval of legislation establishing an independent anti-corruption commission, and steps laying out scope and sequencing of procurement reform.
- Continued progress in implementing the Supreme Court directive on the separation of the judiciary and the executive.

Figure 1. Bangladesh: Real Sector Indicators, FY91-03



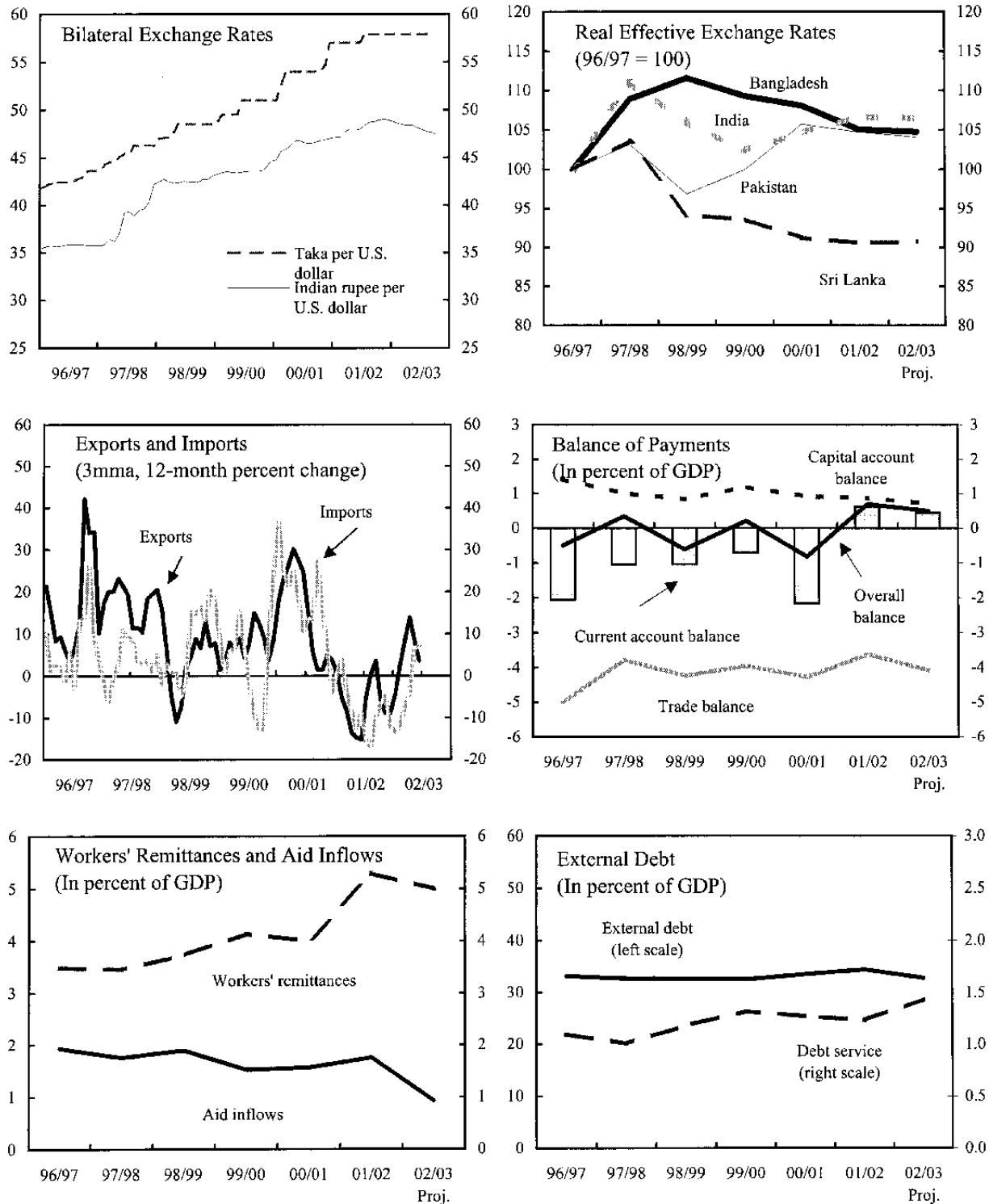
Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

Figure 2. Bangladesh: Fiscal Sector Indicators, FY91-03



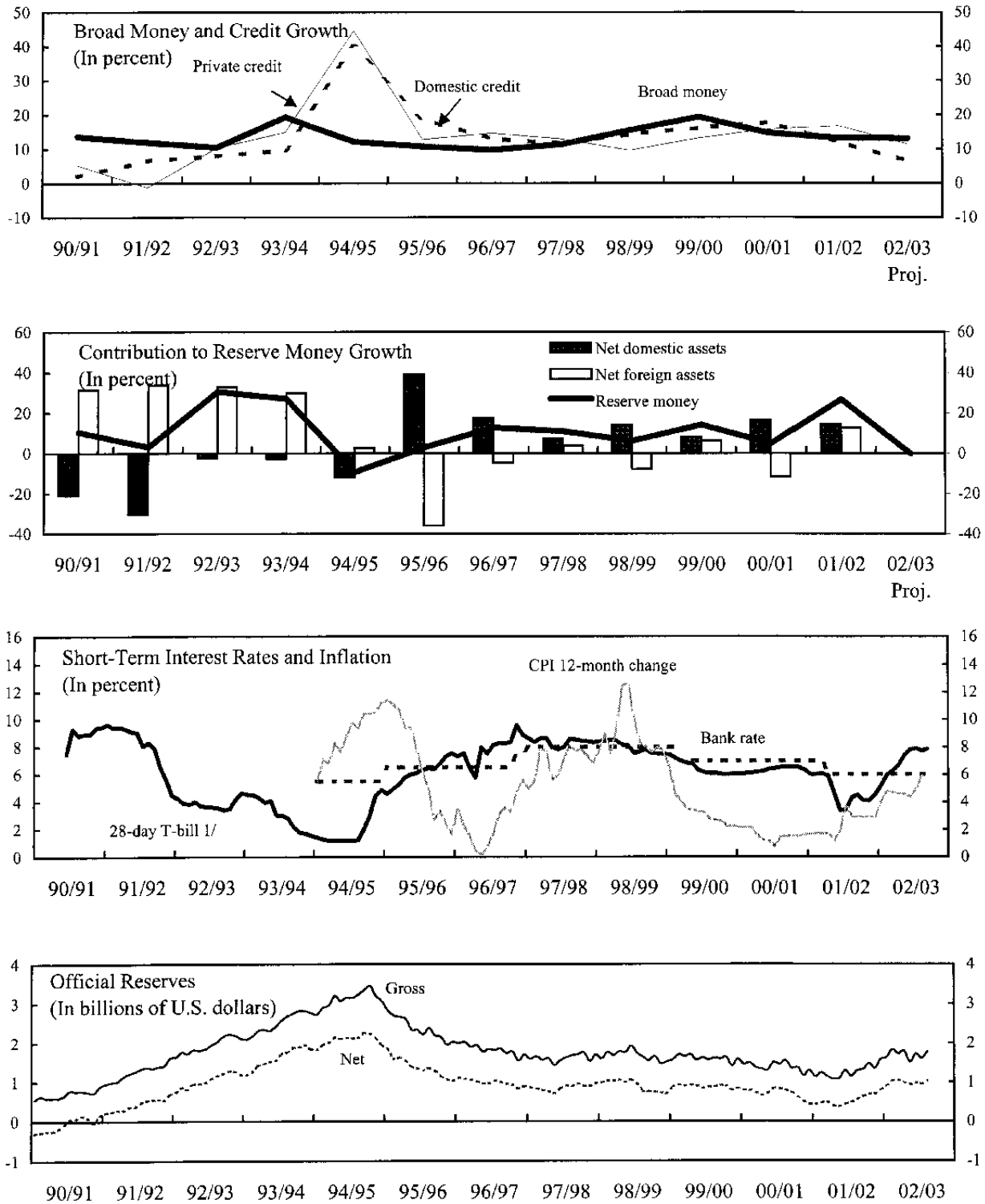
Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

Figure 3. Bangladesh: External Sector Indicators, FY97-03



Sources: Data provided by the Bangladesh authorities; IMF, Information Notices System, *International Financial Statistics*; and Fund staff estimates and projections.

Figure 4. Bangladesh: Monetary Sector Indicators, FY91-03



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

1/ Bangladesh Bank Bill rates until 1998.

Table 1. Bangladesh: Key Social Indicators, 1970–00

	1970–75	1980–85	1994–2000 1/	Low- Income 2/
Population				
Total population, mid-year (millions)	75.6	97.1	131.1	2,459.8
Growth rate (percent annual average for period)	2.6	2.6	1.7	2.0
Urban population (percent of population)	9.8	17.0	24.5	31.9
Total fertility rate (births per woman)	6.6	5.3	3.1	3.6
Poverty (percent of population)				
National headcount index	...	...	35.6	...
Urban headcount index	...	...	14.3	...
Rural headcount index	...	...	39.8	...
Income				
GNI per capita (US\$)	200	200	370	410
Income/consumption distribution				
Gini index	...	...	33.6	...
Lowest quintile (percent of income or consumption)	...	...	8.7	...
Highest quintile (percent of income or consumption)	...	...	42.8	...
Social indicators				
Public expenditure				
Health (percent of GDP)	...	...	1.7	1.2
Education (percent of GDP)	0.8	1.4	2.4	3.4
Net primary school enrollment rate 3/ (percent of age group)				
Total	50	56	104	...
Male	66	65	106	...
Female	33	47	102	...
Access to an improved water source (percent of population)				
Total	...	...	97	76
Urban	...	...	99	88
Rural	...	...	97	70
Immunization rate (percent under 12 months)				
Measles	...	1	71	57
DPT	...	2	72	57
Child malnutrition (percent under 5 years)	...	68	61	...
Life expectancy at birth (years)				
Total	46	52	61	59
Male	47	52	61	58
Female	45	51	62	60
Mortality				
Infant (per 1,000 live births)	138	114	60	76
Under 5 (per 1,000 live births)	239	173	83	115
Adult (15–59)				
Male (per 1,000 population)	473	383	278	294
Female (per 1,000 population)	486	388	272	261
Maternal (per 100,000 live births)	...	...	600	...

Source: 2002 World Development Indicators, World Bank.

1/ Latest available single year data.

2/ Countries with 2001 gross national income (GNI) per capita of \$745 or less, calculated using the World Bank Atlas method.

3/ Net enrollment ratios exceeding 100 indicate discrepancies between the estimates of school-age population and reported enrollment data.

Table 2. Bangladesh: Key Economic Indicators, FY00–08 1/

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
							Proj.		
National income and prices (percent change)									
Real GDP 2/	5.9	5.3	4.4	5.2	5.5	6.0	6.5	6.5	6.5
GDP deflator	1.9	1.6	2.7	4.8	4.0	4.0	4.0	4.0	4.0
CPI inflation (annual average)	3.4	1.6	2.4	5.2	4.5	4.0	4.0	4.0	4.0
Central government operations (percent of GDP) 3/									
Total revenue	8.4	9.0	10.2	10.4	10.9	11.4	12.0	12.2	12.3
Tax	6.7	7.6	7.7	8.3	8.7	9.3	9.8	10.0	10.1
Nontax	1.7	1.4	2.4	2.0	2.1	2.1	2.1	2.2	2.2
Total expenditure	13.5	14.1	14.8	14.5	15.7	16.1	16.5	16.5	16.4
Current expenditure	7.5	7.7	8.0	8.4	8.5	8.5	8.5	8.6	8.6
<i>Of which</i> : Interest payments	1.6	1.6	1.8	2.0	2.0	2.0	2.0	2.0	1.9
Annual Development Program	5.4	6.5	5.6	5.8	6.1	6.5	6.9	7.0	7.0
Extraordinary expenditures	...	...	...	0.4	0.5	0.6	0.5	0.3	0.2
Other expenditures 2/	0.6	-0.2	1.2	-0.1	0.6	0.6	0.6	0.6	0.6
Overall balance (excluding grants)	-5.1	-5.1	-4.7	-4.2	-4.8	-4.7	-4.5	-4.2	-4.0
Primary balance	-3.6	-3.5	-2.9	-2.2	-2.8	-2.7	-2.5	-2.2	-2.1
Financing (net)	5.1	5.1	4.7	4.2	4.8	4.7	4.5	4.2	4.0
Domestic	2.7	3.1	2.6	1.9	2.0	1.9	1.9	1.9	1.9
External	2.4	2.0	2.1	2.3	2.8	2.8	2.6	2.3	2.1
Total central government debt (percent of GDP)	47.9	50.8	53.2	51.7	52.2	51.8	51.0	50.1	49.2
Money and credit (end of year; percent change)									
Net domestic assets	13.6	20.2	11.9	10.6	11.9	11.7	11.9	12.0	12.1
Private sector	10.5	16.3	13.9	11.4	11.3	11.5	11.8	11.9	12.1
Broad money (M2)	18.6	16.6	13.1	12.5	12.1	12.1	12.0	12.0	12.0
Money velocity	3.2	2.9	2.8	2.7	2.7	2.6	2.6	2.6	2.5
Balance of payments (in millions of U.S. dollars) 4/									
Exports, f.o.b.	5,701	6,419	5,986	6,110	6,512	7,061	7,648	8,325	9,080
(Annual percent change)	7.9	12.6	-6.7	2.1	6.6	8.4	8.3	8.9	9.1
Imports, f.o.b.	-7,566	-8,430	-7,697	-8,224	-9,600	-10,284	-10,920	-11,547	-12,107
(Annual percent change)	4.8	11.4	-8.7	6.8	16.7	7.1	6.2	5.7	4.8
Gross official reserves (in millions of U.S. dollars)	1,596	1,306	1,582	2,100	2,566	3,060	3,445	3,755	4,184
In months of imports of goods and nonfactor services	1.9	1.7	1.8	2.6	2.7	3.0	3.2	3.3	3.5
Memorandum item:									
Nominal GDP (in billions of taka)	2,371	2,535	2,717	2,996	3,284	3,636	4,023	4,450	4,920

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

1/ Fiscal year begins July 1.

2/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).

3/ Starting FY02, central government fiscal positions are presented on a gross basis.

4/ Balance of payments is presented on the basis of BPM5.

Table 3. Bangladesh: Central Government Operations, FY99-04 1/

	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
				Est.	Proj.	
	(In billions of taka)					
Total revenue	185	198	228	277	310	356
Tax revenue	153	158	193	210	249	286
NBR taxes	144	149	183	199	237	273
VAT, supplementary duties, excises	73	84	100	111	124	145
Customs duties	46	42	50	52	63	70
Taxes on income and profits	23	24	32	35	48	55
Non-NBR taxes	9	10	10	11	12	13
Nontax revenue	32	40	36	66	61	70
Total expenditure	256	314	374	390	435	515
Current expenditure	158	178	194	218	252	278
Pay and allowances	41	56	59	69	73	81
Goods and services	15	24	27	33	44	48
Interest payments	31	38	41	49	59	66
Subsidies and transfers	38	52	57	58	62	65
Block allocations	32	7	10	8	15	20
Food account surplus(-)/deficit(+)	7	0	2	2	-1	4
Annual Development Program (ADP)	90	127	166	152	173	200
Non-ADP capital and net lending	1	9	12	17	9	19
Structural adjustment expenditures	0	0	0	0	12	15
Check float plus discrepancy	24	6	-16	14	-11	0
Overall balance (excluding grants)	-95	-122	-130	-127	-125	-159
Primary balance (excluding grants)	-64	-84	-89	-78	-66	-93
Net financing	95	122	130	127	125	159
External	56	57	50	58	68	93
Domestic	39	64	79	68	56	65
Bank	21	32	37	22	18	30
Nonbank	18	32	42	46	38	35
Privatization receipts	0	0	1	1	1	1
	(In percent of GDP)					
Total revenue	8.4	8.4	9.0	10.2	10.4	10.9
Tax revenue	7.0	6.7	7.6	7.7	8.3	8.7
NBR taxes	6.6	6.3	7.2	7.3	7.9	8.3
Non-NBR taxes	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenue	1.4	1.7	1.4	2.4	2.0	2.1
Total expenditure	11.6	13.2	14.8	14.3	14.5	15.7
Current expenditure	7.2	7.5	7.7	8.0	8.4	8.5
Pay and allowances	1.9	2.4	2.3	2.5	2.4	2.5
Goods and services	0.7	1.0	1.1	1.2	1.5	1.5
Interest	1.4	1.6	1.6	1.8	2.0	2.0
Subsidies and transfers	1.7	2.2	2.3	2.1	2.1	2.0
Block allocations	1.5	0.3	0.4	0.3	0.5	0.6
Food account surplus(-)/deficit(+)	0.3	0.0	0.1	0.1	0.0	0.1
Annual Development Program	4.1	5.4	6.5	5.6	5.8	6.1
Non-ADP capital and net lending	0.0	0.4	0.5	0.6	0.3	0.6
Structural adjustment expenditures	0.0	0.0	0.0	0.0	0.4	0.5
Check float plus discrepancy	1.1	0.3	-0.6	0.5	-0.4	0.0
Overall balance (excluding grants)	-4.3	-5.1	-5.1	-4.7	-4.2	-4.8
Primary balance (excluding grants)	-2.9	-3.6	-3.5	-2.9	-2.2	-2.8
Net financing	4.3	5.1	5.1	4.7	4.2	4.8
External financing (net)	2.5	2.4	2.0	2.1	2.3	2.8
Domestic financing	1.8	2.7	3.1	2.5	1.9	2.0
Memorandum item:						
Nominal GDP (in billions of taka)	2,197.0	2,370.9	2,535.5	2,717.0	2,996.0	3,284.0

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

1/ Fiscal year ends June 30.

Table 4. Bangladesh: Balance of Payments, FY02–08 1/

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

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	Est.				Proj.		
Trade balance	-1,711	-2,114	-3,089	-3,223	-3,272	-3,222	-3,027
Exports (f.o.b)	5,986	6,110	6,512	7,061	7,648	8,325	9,080
Imports (f.o.b)	-7,697	-8,224	-9,600	-10,284	-10,920	-11,547	-12,107
Services	-500	-732	-972	-1,056	-1,083	-1,154	-1,242
Receipts	864	780	825	862	906	950	995
Payments	-1,364	-1,512	-1,798	-1,918	-1,988	-2,104	-2,237
Income	-321	-239	-264	-281	-299	-317	-335
Receipts	50	70	95	99	104	109	115
Payments	-371	-309	-359	-381	-403	-426	-449
Transfers	2,826	3,311	3,615	3,604	3,665	3,731	3,763
Official current transfers 2/	69	91	106	53	54	55	56
Private transfers	2,757	3,220	3,508	3,550	3,611	3,676	3,707
<i>Of which:</i> Workers' remittances	2,501	2,971	3,220	3,259	3,314	3,374	3,402
Current account balance	294	226	-711	-957	-989	-961	-840
Capital and financial account balance	674	302	391	726	674	644	620
Capital account	410	370	403	349	356	363	369
Capital transfers	410	370	403	349	356	363	369
Financial account	264	-68	-12	377	318	281	251
Foreign direct investment	65	32	50	52	55	58	60
Portfolio investment	-6	2	0	0	0	0	0
Net aid flows	541	413	656	708	702	685	683
Aid disbursements 3/	963	889	1,147	1,164	1,188	1,210	1,231
Debt amortization	-422	-476	-492	-456	-485	-525	-548
Other long-term loans (net)	-42	-92	-148	0	0	0	0
Other short-term loans (net)	20	-112	-127	0	0	0	0
Other assets (net)	-52	-110	-67	-18	-32	-49	-58
Trade credits (net)	-253	-258	-275	-265	-332	-352	-384
Commercial banks (net)	-9	58	-100	-100	-75	-60	-50
Errors and omissions	-639	-271	0	0	0	0	0
Overall balance	329	257	-320	-231	-315	-317	-220
Financing items	-329	-557	-200	-381	-272	-296	-417
Bangladesh Bank	-329	-557	-200	-381	-272	-296	-417
Assets (- increase)	-276	-518	-466	-495	-385	-310	-429
Liabilities 4/	-53	-39	266	114	113	14	13
Financing gap	0	300	520	612	587	612	637
Memorandum items:							
Current account balance (percent of GDP)	0.6	0.4	-1.3	-1.6	-1.5	-1.3	-1.1
Export growth rate (percent)	-6.7	2.1	6.6	8.4	8.3	8.9	9.1
Import growth rate (percent)	-8.7	6.8	16.7	7.1	6.2	5.7	4.8
Gross official reserves (in millions of U.S. dollars) 5/	1,582	2,100	2,566	3,060	3,445	3,755	4,184
(In months of imports of goods and services)	1.8	2.6	2.7	3.0	3.2	3.3	3.5
Net international reserves (in millions of U.S. dollars)	792	1,349	1,549	1,930	2,202	2,498	2,914
Medium- and long-term external public debt (in millions of U.S. dollars)	16,276	16,988	18,163	19,483	20,773	22,070	23,389
(In percent of GDP)	34.4	32.8	33.0	32.5	31.7	30.8	29.8
(To exports of goods, nonfactor services and private transfers)	169.4	168.0	167.5	169.8	170.8	170.4	169.7
Debt-service ratio 6/	6.1	6.5	6.4	5.7	5.7	5.7	5.5
Exchange rate (taka/US\$, annual average)	57.4	...	...	...	...	...	...
Nominal GDP (in millions of U.S. dollars)	47,303	51,744	55,119	59,926	65,592	71,711	78,415

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

1/ Fiscal year begins July 1. Following an STA technical assistance mission in August 2002, presentation of the data has been modified to comply with the fifth edition of the balance of payments manual.

2/ Excludes official capital grants.

3/ Loans only.

4/ Includes Asian Clearing Union balances.

5/ Gross foreign reserves of Bangladesh Bank, including resident foreign currency deposits.

6/ In percent of current earnings defined as the sum of exports of goods, nonfactor services, and private transfers.

Table 5. Bangladesh: Central Bank Balance Sheet, FY99–04 1/

	FY99	FY00	FY01	Jun-02	Sep-02	Dec-02	Mar-03	Jun-03	Sep-03	Dec-03	Mar-04	Jun-04
				Actual			Est.	Proj.				
(End of period; billions of taka)												
Net international reserves 2/	35	43	25	46	61	57	63	78	75	81	84	90
Net domestic assets	100	111	137	160	136	146	142	136	143	145	147	145
Net credit to central government	51	64	92	108	69	75	71	69	72	71	73	74
Credit to other nonfinancial public sector	2	2	2	1	1	1	1	1	1	1	1	1
Credit to deposit money banks	46	43	44	47	48	48	49	48	48	48	48	48
Other items, net	1	2	0	3	17	22	21	19	22	25	25	23
Reserve money 2/	135	154	162	206	196	203	205	215	218	226	231	235
Currency	97	113	128	139	140	147	150	158	160	165	169	172
Reserves	38	42	34	67	56	56	55	57	58	61	62	63
(Change since start of fiscal year; billions of taka)												
Net international reserves	-10	8	-18	20	15	11	17	32	-3	3	6	12
Net domestic assets	18	11	25	23	-24	-14	-18	-23	6	8	10	9
Net credit to central government	11	13	28	16	-39	-33	-37	-39	3	2	4	5
Credit to other nonfinancial public sector	0	0	0	0	0	0	0	0	0	0	0	0
Credit to deposit money banks	9	-3	1	4	1	1	2	1	0	0	0	0
Other items, net	-2	1	-3	4	14	19	18	16	3	6	6	4
Reserve money	8	19	8	44	-9	-2	-1	9	4	11	16	20
Currency	6	16	16	10	1	8	11	19	2	7	11	14
Reserves	2	4	-8	33	-10	-11	-12	-10	1	4	5	6
Memorandum items:												
Reserve money (year-on-year percent change)	6.2	14.2	5.0	26.8	18.5	2.1	5.8	4.3	11.1	12.8	8.1	9.5
Net international reserves (in millions of U.S. dollars)	718	848	447	792.4	1,048	988	1,090	1,349	1,299	1,399	1,449	1,549
Flow in period (in millions of U.S. dollars)	-250	130	-401	165	256	-60	103	336	-50	100	50	100
Required domestic cash reserves (in millions of taka)	...	...	4	37	38	40	40	41	42	44	45	46
Excess domestic cash reserves (in millions of taka)	...	...	30	30	19	16	15	16	16	16	17	17

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

1/ Fiscal year ends June 30.

2/ For definition, see Technical Memorandum of Understanding dated May 2003.

Table 6. Bangladesh: Monetary Program, FY99–04 1/

	FY99	FY00	FY01	Jun-02	Sep-02	Dec-02	Mar-03	Jun-03	Sep-03	Dec-03	Mar-04	Jun-04
			Actual				Est.			Proj.		
	(End of period; billions of taka)											
Net foreign assets	64	85	76	96	110	101	102	124	123	130	135	142
Net domestic assets	566	662	796	891	906	967	977	985	1,013	1,063	1,081	1,102
Domestic credit	625	710	846	957	966	1,031	1,049	1,059	1,089	1,141	1,161	1,183
Net credit to central government	93	125	162	184	184	189	200	202	213	215	225	232
Credit to other nonfinancial public sector	44	45	56	59	55	63	60	61	62	63	64	65
Credit to private sector	489	540	628	715	727	780	789	797	814	863	873	886
Other items, net	-59	-48	-50	-67	-60	-64	-72	-74	-76	-78	-80	-81
Broad money (M2)	630	748	872	986	1,016	1,069	1,079	1,110	1,135	1,193	1,216	1,244
	(Change since start of fiscal year; billions of taka)											
Net foreign assets	-4	22	-9	20	14	6	6	29	-1	6	10	17
Net domestic assets	75	96	134	95	16	77	86	95	27	77	96	117
Domestic credit	76	85	135	112	9	74	91	102	29	81	102	124
Net credit to central government	21	32	37	22	0	5	16	18	11	13	23	30
Credit to other nonfinancial public sector	-2	1	11	3	-4	4	1	2	1	2	3	4
Credit to private sector	56	51	88	87	12	64	74	82	17	66	76	90
Other items, net	0	11	-2	-17	7	3	-5	-7	-2	-4	-6	-7
Broad money (M2)	72	117	124	114	30	83	93	124	26	83	106	134
	(Year-on-year percent change)											
Net foreign assets	-5.5	33.7	-11.1	25.8	55.8	39.4	26.1	30.2	12.1	27.6	31.8	14.0
Net domestic assets	15.3	16.9	20.2	11.9	11.3	11.1	14.5	10.6	11.7	10.8	10.7	11.9
Domestic credit	13.8	13.6	19.0	13.2	10.3	12.7	13.9	10.6	12.7	10.8	10.7	11.7
Net credit to central government	29.0	34.5	29.4	13.4	1.4	-1.2	16.1	9.7	15.5	13.7	12.4	15.1
Credit to other nonfinancial public sector	-3.4	3.3	23.5	4.8	2.3	12.9	12.9	4.2	13.6	2.1	6.7	6.6
Credit to private sector	13.0	10.5	16.3	13.9	13.5	16.7	13.5	11.4	11.9	10.8	10.6	11.3
Other items, net	0.6	-18.5	3.5	34.2	-2.9	45.5	6.5	10.6	26.9	10.3	11.1	9.5
Broad money (M2)	12.8	18.6	16.6	13.1	14.9	13.3	15.5	12.5	11.8	12.4	12.7	12.1
Memorandum items (in billions of taka):												
Net domestic financing of central govt. (since beginning of FY)	39	64	79	68	13	28	34	56	20	31	50	65
Bank	21	32	37	22	0	5	-2	18	11	13	23	30
Nonbanks	18	32	42	46	13	23	35	38	9	18	27	35

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

1/ Fiscal year ends June 30.

Table 7. Medium-Term Fiscal Outlook, FY02–08 1/

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	Est.			Proj.			
	(In billions of taka)						
Total revenue	276.8	310.5	356.3	413.8	479.5	541.3	605.4
Tax revenue	210.3	249.5	286.3	337.2	393.9	445.7	498.8
NBR taxes	199.2	237.5	273.1	322.6	377.7	427.8	479.0
Non-NBR taxes	11.1	12.0	13.2	14.6	16.2	17.9	19.8
Nontax revenue	66.5	61.0	70.0	76.6	85.6	95.6	106.6
Total expenditure	389.9	435.0	515.4	583.5	658.4	729.4	801.9
Current expenditure	218.2	252.5	278.3	307.0	340.3	380.1	422.5
Pay and allowances	68.8	72.9	80.7	81.7	90.5	100.3	111.1
Goods and services	33.2	43.7	47.8	52.7	59.9	69.4	80.3
Interest payments	49.3	59.0	65.6	75.0	81.0	88.6	96.1
Subsidies and transfers	58.4	61.7	64.7	76.0	85.0	95.5	105.8
Block allocations	8.4	15.2	19.5	21.5	23.8	26.4	29.2
Food account surplus(-)/deficit(+)	2.1	-0.5	3.5	2.5	2.5	2.5	2.5
Annual Development Program (ADP)	152.3	173.0	200.0	237.1	275.7	311.1	342.6
Non-ADP capital and net lending	17.2	9.4	18.7	17.0	18.4	23.4	24.9
Structural adjustment expenditures	0.0	11.6	14.9	20.0	21.4	12.4	9.4
Check float plus discrepancy	13.8	-11.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-126.9	-124.5	-159.1	-169.7	-178.9	-188.2	-196.4
Primary balance (excluding grants)	-77.6	-65.5	-93.5	-94.7	-97.8	-99.6	-100.4
Net financing	126.9	124.5	159.1	169.7	178.9	188.2	196.4
External	58.1	68.0	93.1	98.4	99.8	102.1	101.4
Domestic	68.1	55.9	65.0	68.8	76.2	84.4	93.5
Bank	21.7	17.9	30.4	29.0	32.1	35.5	39.4
Nonbank	46.4	38.0	34.6	39.8	44.1	48.9	54.1
Privatization receipts	0.6	0.7	1.0	2.5	2.9	1.7	1.5
	(In percent of GDP)						
Total revenue	10.2	10.4	10.9	11.4	12.0	12.2	12.3
Tax revenue	7.7	8.3	8.7	9.3	9.8	10.0	10.1
NBR taxes	7.3	7.9	8.3	8.9	9.4	9.6	9.7
Non-NBR taxes	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenue	2.4	2.0	2.1	2.1	2.1	2.2	2.2
Total expenditure	14.3	14.5	15.7	16.1	16.4	16.4	16.3
Current expenditure	8.0	8.4	8.5	8.5	8.5	8.6	8.6
Pay and allowances	2.5	2.4	2.5	2.3	2.3	2.3	2.3
Goods and services	1.2	1.5	1.5	1.5	1.5	1.6	1.6
Interest	1.8	2.0	2.0	2.1	2.0	2.0	2.0
Subsidies and transfers	2.1	2.1	2.0	2.1	2.1	2.2	2.2
Block allocations	0.3	0.5	0.6	0.6	0.6	0.6	0.6
Food account surplus(-)/deficit(+)	0.1	0.0	0.1	0.1	0.1	0.1	0.1
ADP	5.6	5.8	6.1	6.5	6.9	7.0	7.0
Non-ADP capital and net lending	0.6	0.3	0.6	0.5	0.5	0.5	0.5
Structural adjustment expenditures	0.0	0.4	0.5	0.6	0.5	0.3	0.2
Check float plus discrepancy	0.5	-0.4	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-4.7	-4.2	-4.8	-4.7	-4.5	-4.2	-4.0
Primary balance (excluding grants)	-2.9	-2.2	-2.8	-2.6	-2.4	-2.2	-2.0
Net financing	4.7	4.2	4.8	4.7	4.5	4.2	4.0
External	2.1	2.3	2.8	2.7	2.5	2.3	2.1
Domestic	2.5	1.9	2.0	1.9	1.9	1.9	1.9
Bank	0.8	0.6	0.9	0.8	0.8	0.8	0.8
Nonbank	1.7	1.3	1.1	1.1	1.1	1.1	1.1
Privatization receipts	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Memorandum items:							
Nominal GDP (in billions of taka)	2,717	2,996	3,284	3,621	4,010	4,442	4,920

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

1/ Fiscal year ends June 30.

Table 8. Bangladesh: Proposed Schedule of Disbursements Under the PRGF Arrangement

Amount	Available Date	Conditions for Disbursement
SDR 49.5 million (9.3 percent of quota)	June 25, 2003	Observance of the end-March 2003 quantitative benchmark, implementation of prior actions, and Board approval of arrangement.
SDR 49.5 million (9.3 percent of quota)	December 15, 2003	Observance of the end-September 2003 performance criteria and structural performance criteria for end-September and end-November 2003 and completion of the first review.
SDR 49.5 million (9.3 percent of quota)	June 15, 2004	Observance of the end-March 2004 performance criteria and structural performance criteria for end-December 2003 and end-April 2004 and completion of the second review.
SDR 49.5 million (9.3 percent of quota)	December 15, 2004	Observance of the end-September 2004 performance criteria and completion of the third review.
SDR 49.5 million (9.3 percent of quota)	June 15, 2005	Observance of the end-March 2005 performance criteria and completion of the fourth review.
SDR 49.5 million (9.3 percent of quota)	December 15, 2005	Observance of the end-September 2005 performance criteria and completion of the fifth review.
SDR 49.5 million (9.3 percent of quota)	June 15, 2006	Observance of the end-March 2006 performance criteria and completion of the sixth review.

Table 9. Bangladesh: External Financing Requirements, FY03–08 1/
(In millions of U.S. dollars)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Total financing requirements	1,664	2,119	2,177	2,186	2,243	2,296
Gross financing requirements	1,146	1,654	1,682	1,801	1,933	1,867
Current account deficit	-226	711	957	989	961	840
Medium- and long-term debt amortization	476	492	456	485	525	548
Trade credits (net)	258	275	265	332	352	384
UFR (abstracting from expected Fund financing)	35	25	0	0	0	0
Other Bangladesh Bank liabilities (net)	74	-290	-114	-113	-14	-13
Other long-term loans (net)	92	148	0	0	0	0
Other short-term loans and assets (net)	222	194	18	32	49	58
Commercial banks' foreign exchange assets (net)	-58	100	100	75	60	50
Errors and omissions	271	0	0	0	0	0
Buildup in gross reserves (+, increase in assets)	518	466	495	385	310	429
Resources	1,293	1,600	1,565	1,598	1,630	1,660
Aid disbursements	1,259	1,550	1,513	1,544	1,573	1,600
Foreign direct and portfolio investment	34	50	52	55	58	60
Financing gap						
Without expected Fund financing	371	655	746	722	612	637
With expected Fund financing	300	520	612	587	612	637
Identified financing	300	520	520	520	500	500
Loans	300	500	500	500	500	500
World Bank	300	400	400	400	400	400
AsDB	0	100	100	100	100	100
Grants	0	20	20	20	0	0
Residual financing gap	0	0	92	67	112	137
Memorandum items:						
Gross official reserves	2,100	2,566	3,060	3,445	3,755	4,184
Expected Fund financing	71	135	134	135	...	...

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

1/ Fiscal year ends June 30.

Table 10. Bangladesh: Projected Fund Transactions Under the Proposed PRGF, FY03–08 1/

(In millions of SDRs)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Total use of Fund resources (UFR) outstanding	74.0	148.5	247.5	346.5	346.5	346.5
SBA	24.5	0.0	0.0	0.0	0.0	0.0
PRGF	49.5	148.5	247.5	346.5	346.5	346.5
Proposed PRGF						
Disbursements	49.5	99.0	99.0	99.0	0.0	0.0
Debt service	0.0	0.5	1.0	1.6	2.0	2.0
Rcpayments	0.0	0.0	0.0	0.0	0.0	0.0
Charges	0.0	0.5	1.0	1.6	2.0	2.0
Total debt service to the Fund	61.0	26.0	1.8	2.4	2.8	2.8
SBA	51.6	24.8	0.0	0.0	0.0	0.0
Repurchases	49.1	24.5	0.0	0.0	0.0	0.0
Charges	2.5	0.2	0.0	0.0	0.0	0.0
PRGF	8.6	0.5	1.0	1.6	2.0	2.0
Principle	8.6	0.0	0.0	0.0	0.0	0.0
Interest	0.0	0.5	1.0	1.6	2.0	2.0
Other SDR charges	0.8	0.8	0.8	0.8	0.8	0.8
Memorandum items:						
Total UFR as a percentage of quota	13.9	27.8	46.4	65.0	65.0	65.0
Total UFR as a percentage of GDP	0.2	0.4	0.5	0.7	0.6	0.6
Debt service to the Fund as a percentage of exports of goods and services	1.2	0.5	0.0	0.0	0.0	0.0

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

1/ Fiscal year ends June 30.

Bangladesh: Fund Relations
(As of April 30, 2003)

I. **Membership Status:** Joined August 17, 1972; accepted the obligations under Article VIII, Sections 2, 3, and 4 on April 11, 1994

II. General Resources Account:	SDR million	Percent Quota
Quota	533.30	100.00
Fund holdings of currency	569.92	106.87
Reserve position in Fund	0.19	0.03
III. SDR Department:	SDR million	Percent Allocation
Net cumulative allocation	47.12	100.00
Holdings	0.97	2.06
IV. Outstanding Purchases and Loans:	SDR million	Percent Quota
ESAF arrangements	2.88	0.54
Credit tranche	36.80	6.90

V. **Financial Arrangements:**

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
ESAF	8/10/90	9/13/93	345.00	345.00
SAF	2/06/87	2/05/90	201.25	201.25
Stand-by	12/02/85	6/30/87	180.00	180.00

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	36.80	0.0	0.0	0.0	0.0
Charges/interest	1.03	0.81	0.81	0.81	0.81
Total	37.83	0.81	0.81	0.81	0.81

VII. **Safeguards Assessment**

The Safeguards Assessment Report issued in August 2002 concluded that the accounting, financial reporting, auditing and control systems, as well as the legal framework, of Bangladesh Bank (BB) suffered from widespread vulnerabilities. Its risk assessments ranged from medium-high to high. The report recommended, *inter alia*, that: (i) BB's financial statement's for FY02 be restated in accordance with International Accounting

Standards (IAS) and audited in compliance with International Standards on Auditing (ISA) by an international firm, possibly in collaboration with a local firm; (ii) the BB board should adopt IAS as BB's accounting framework beginning with FY03, and ISA should be established as the auditing standard; (iii) the statistical classification of accounting data should be regularly validated and the data to be reported to the Fund under a future arrange should be regularly reconciled against BB's accounts and audited financial statements; and (iv) the reserve management functions should be adequately segregated between the dealing room and middle and back offices, and an appropriate reporting mechanism for reserves management established.

VIII. Exchange Arrangement

Exchange regime. Until May 31, 2003, the taka was fixed to the U.S. Dollar, but was periodically adjusted. It was devalued by 5.9 percent on August 13, 2000, by 5.5 percent on May 25, 2001, and by 1.5 percent on January 5, 2002. The trading band for BB's transactions was correspondingly widened or raised on those dates. From January 2002 until May 30, 2003, the official band for the taka remained unchanged at Tk 57.4–58.4 per U.S. dollar. Authorized dealer (AD) banks set their own buying and selling rates for the U.S. dollar and other currencies generally within the band until October 2002. From November 2002, however, AD banks have set rates outside the band. Effective May 31, 2003, BB no longer announced a trading band for its foreign exchange transactions, thereby allowing the taka to float.

Exchange restrictions. In December 2000, BB introduced margin requirements on letters of credit for most commercial imports, which constitutes an exchange restriction subject to Fund jurisdiction under Article VIII, Section 2(e). In November 2001, the requirements were increased from 50 percent to 100 percent on 56 categories of imports. In February 2002, BB removed the margin requirements on letters of credit for imports of inputs to industrial production, and reduced the margin rates for imports of rice and wheat from 100 percent to 25 percent. In August 2002, limits on the availability of foreign exchange for travel, medical and educational expenses, as well as other services, were removed. However, in December 2002, margin requirements on wheat, rice, and sugar were increased to 100 percent. In January 2003, margin requirements for wheat and rice were reduced to 25 percent.

At the last Article IV consultation (April 2002), the Executive Board approved the maintenance by Bangladesh of margin requirements for the opening of letters of credit for the import of goods and of limits on the availability of foreign exchange for travel, medical, and educational expenses, as well as for other services until July 15, 2002. The Board also approved on a temporary basis (until April 30, 2003 or the next Article IV consultation, whichever was earlier) Bangladesh's restrictions on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts, as well as restrictions on advance payments for imports of goods and services. On April 28, 2003, the Board extended its approval of restrictions relating to: (i) limitations on the availability of foreign exchange for permitted advance payments for imports of goods and services; and (ii) prohibitions on the convertibility and transferability of

proceeds of current international transactions in nonresident taka accounts, until June 30, 2003 or the completion of next Article IV consultation, whichever is earlier.

On the basis of UN Security Council resolutions, all settlements with Iraq are prohibited.

IX. Article IV Consultation

Bangladesh is currently on the standard 12-month consultation cycle. The last Article IV consultation was held over three missions in February, July, and November of 2001, and was concluded on April 29, 2002 (SM/02/107).

X. Technical Assistance during 2002–03

An MFD/LEG technical assistance mission visited Dhaka during January 2002 to advise on operational steps to facilitate the adoption of a more flexible exchange rate regime. An external legal expert visited Dhaka during February 2002 to advise on amendments to the Bangladesh Bank Order to strengthen the independence of BB. In April 2002 an MFD consultant provided recommendations for the establishment of a repo market. In May 2002, a pre-FSAP mission advised on banking sector reform followed by a full FSAP mission in October. During May–November 2002, an MFD peripatetic adviser assisted in foreign exchange operations and liquidity management. In August 2002, an FAD team conducted a fiscal ROSC and STA conducted a multisector technical assistance mission. MFD sent a mission in October 2002 to provide assistance in implementing the Safeguards recommendations, missions in January and May 2003 to advise on preparations for moving to a flexible exchange rate regime, a mission in May 2003 to help BB with NCB reforms, and provided a resident adviser to assist BB with liquidity forecasting and monetary and exchange operations.

XI. Resident Representative

The resident representative office was established in 1972. The current Resident Representative, Mr. Marijn Verhoeven, took up the post in August 2001.

Bangladesh: Relations with the World Bank¹

The World Bank has an ambitious assistance program in Bangladesh covering a wide range of instruments including investment lending, advisory and analytical services, and policy dialogue on a broad range of macroeconomic and sectoral issues. This annex focuses on the Bank's activities in areas that are complementary to those of the Fund.

World Bank-Bangladesh relations and policy dialogue

Shortly after the new Government took office in October 2001, the government appointed a team of senior bureaucrats to identify priority areas for reform and accelerated the preparation of the national poverty reduction strategy. The government formed a committee of five Secretaries and embarked upon a 100-day program to address the most urgent issues facing the country. In parallel, the Bank initiated a process of intensive dialogue with the authorities based on a set of 18 policy briefs prepared by Bank staff, covering macro issues such as governance, performance of state-owned enterprises, financial sector, globalization and trade, and sectoral priorities in health, education, agriculture and infrastructure. Together with the Asian Development Bank, it also embarked upon a Public Expenditure Review and a Poverty Assessment to provide inputs into the preparation of the poverty reduction strategy.

A team consisting of the Finance Secretary, the Secretary of the External Relations Division and the Governor of the Central Bank then fine-tuned the initial menu of reform proposals prepared by the five Secretaries and developed a time-bound implementation plan for future reform. The reform actions were discussed and endorsed by the Cabinet Committee on Economic Affairs, the country's main economic decision making body, and implementation began shortly thereafter. The Bank has been regularly interacting with the government team and has been providing inputs into the design and sequencing of reforms, as requested by the authorities.

To build ownership of the proposed reforms and reach consensus, the government has organized a series of national consultations to solicit inputs for the preparation of its poverty reduction strategy. An initial draft of the interim Poverty Reduction Strategy Paper (I-PRSP) was prepared in April 2002 and posted on the government's web site, followed by an extended period during which the draft was discussed with various government and non-governmental organizations, members of civil society and Bangladesh's development partners. A final draft, incorporating the various comments received, has been prepared and posted on the government's web site in March 2003.

Restructuring state-owned enterprises. The Bank has engaged in an extensive dialogue with the authorities on SOE-related issues. A report entitled "Bangladesh: Review of Public Enterprise Performance and Strategy" (November 2002) was prepared by the Bank and widely discussed at a national seminar in Dhaka in December 2002, chaired by the Finance

¹Prepared by Enrique Pantoja, Country Officer, World Bank, (202) 473-2516.

Minister and attended by senior government officials. In response to a request from the authorities, the Bank has also provided technical assistance to the Privatization Commission and assisted it in the preparation of the government's new Privatization Policy, which has since been endorsed by Cabinet. Dialogue relating to SOEs in the energy sector has been particularly intensive and the Bank has provided detailed recommendations to the authorities in areas relating to pricing policy and the regulatory regime for energy and other utilities.

Restructuring the financial system. The Bank has been actively engaging the authorities in a dialogue on financial sector reform. Together with the Fund, the Bank co-managed the Financial Sector Assessment Program report that was prepared in October 2002. The Bank is presently preparing a technical assistance project aimed at supporting government efforts to strengthen capacity within Bangladesh Bank.

Trade liberalization. In response to requests from authorities, the Bank has been regularly providing trade-policy related analytical support to the Ministry of Finance, the National Board of Revenue, the Bangladesh Tariff Commission, and the Ministry of Commerce. The Bank-supported Export Diversification Project has a component designed to build capacity for tariff analysis and WTO-related negotiations within the Tariff Commission. In addition, the Bank has regularly provided brief trade-related policy notes to the government as inputs into the annual budget preparation process.

Strengthening governance. The Bank has engaged the government in an active dialogue aimed at improving the investment climate by strengthening accountability and transparency. The Bank has prepared several analytical reports on the subject including an Institutional and Governance Review, a Country Financial Accountability Assessment, a Country Procurement Assessment, and user surveys on the quality of service delivery. In addition, the Bank is providing technical assistance to the government for improving its procurement policies and practices.

The World Bank's Country Assistance Strategy

The Bank's country assistance strategy (CAS) for Bangladesh for FY01–03 identifies four main thrusts for the Bank Group's assistance to Bangladesh. These include: (i) helping to build stronger institutions and governance across sectors; (ii) consolidating gains in human development and supporting initiatives to address the next generation of development challenges in education, health, and nutrition; (iii) implementing an integrated approach to rural development, including supporting growth in agriculture and nonfarm activities, making opportunities and assets available to the poor, and improving rural infrastructure; and (iv) accelerating and broadening private sector-led growth by helping to remove structural impediments and establish an environment conducive to private investment, strengthen the financial sector, and support private investments in energy, infrastructure, manufacturing, and services.

In particular, the CAS notes, "unless the underlying institutional and governance issues are addressed, neither foreign nor domestically funded programs will achieve their potential for accelerating economic growth and reducing poverty." In this regard, it stresses the need for

government to improve the law and order situation; tackle corruption in banking, power, and revenue administration; reform the civil service, public audit and accounting bodies, public procurement, and the civil justice system; and ensure that policies provide incentives for increasing efficiency, accountability, and transparency.

Implementation of the CAS is being facilitated through a judicious mix of lending and nonlending instruments. Substantial nonlending activities, particularly related to governance and public sector reform, have been completed to further improve the quality of the policy dialogue, enhance the impact of Bank Group's lending interventions, and build consensus on reforms. Financial support is being provided through IDA technical assistance and investment credits, Learning and Innovation Loans (LILs), IDA guarantees, and IFC equity investments and loans.

A CAS progress report will be presented to the Bank Board on June 19, along with the DSC and the joint staff assessment of the I-PRSP.

The World Bank's Assistance Program

The Bank has assisted Bangladesh since FY1973. As of April 2003, the World Bank Group has lent \$10 billion for 192 projects to Bangladesh. Net commitments were \$1.9 billion and the undisbursed amount of Bank assistance was \$1.2 billion. During FY2002, new commitments totaled \$321.4 million and disbursements \$322.7 million. The Bank is currently supporting 24 projects in key sectors, including social development, rural development, energy and infrastructure, private sector development, finance, and environment. These operations emphasize policy and institutional reforms in line with the CAS objectives.

Four IDA Credits were approved by the Bank in FY2002: Second Female Secondary School Assistance (\$121 million); Rural Electrification and Renewable Energy Development (IDA \$191 million and GEF \$8 million); Public Procurement Reform (\$4.5 million); and Financial Services for the Poorest (\$5 million). During FY 2003, one credit has been approved, the Social Investment Program (\$18.2 million), and three more operations are scheduled to go to the Board in June: Rural Transport Improvement (\$190 million); Central Banking Strengthening (\$37 million); Telecommunications TA (\$9.1million); and the Development Support Credit I (\$300 million). The new lending operations currently planned for FY2004 delivery are: Education Sector Development Support Credit (\$100 million); SOE and Banking Reform (\$180 million); Water Sector Management Improvement (\$80 million); Strengthening Economic Management TA (\$20 million); Export Development (\$20 million) and the Development Support Credit II (\$150).

The current portfolio of the IFC amounts to \$97 million in loans, \$13 million in equity, and \$37 million in B-loans outstanding. The portfolio includes ten projects in sectors such as power, telecommunications, cement, gas, and financial markets. IFC is considering new investments in another mobile telecommunications company, and in ceramic tile manufacturing. In mid-2002, with the support of several bilateral donors, IFC started a regional SME technical assistance facility covering Bangladesh, Bhutan, Nepal, and north-east India. IFC has committed \$5 million to the facility for the duration of the initiative.

The Bank continues to be involved in providing technical and advisory assistance to the government in a number of areas, including banking, energy, privatization, taxation, tariff and trade policy, poverty monitoring and analysis, and financial management.

World Bank-Fund collaboration

The Bank and the Fund have been working closely in Bangladesh, particularly in areas related to macroeconomic management, financial sector, reform of state-owned enterprises, public expenditure management, and issues relating to financial accountability. Bank staff routinely participate in Article IV missions and provide feedback, as requested, on the macroeconomic framework and other aspects of the Fund's macroeconomic dialogue with the authorities. The Bank co-managed the Financial Sector Assessment Program report and Fund staff were regularly consulted during the preparation of the Public Expenditure Review, which was a joint initiative of the Bank and the Asian Development Bank.

Dialogue between the two institutions has intensified in recent years, especially in the context of the preparation of the country's poverty reduction strategy. In addition, Fund and Bank staff collaborated closely in preparing the Joint Staff Assessment of the I-PRSP, and in completing the complementary Development Support Credit and PRGF.

Bangladesh: Relations with the Asian Development Bank

Lending operations

The Asian Development Bank (AsDB) has assisted Bangladesh since 1973. The cumulative commitment, disbursement and outstanding credit to Bangladesh stood at \$6.67 billion, \$4.80 billion and \$4.25 billion respectively, on December 31, 2002. The overarching objective of AsDB in Bangladesh is poverty reduction. The medium-term priorities are: (i) to promote faster private sector-led economic growth; (ii) to create better development opportunities for the poor; (iii) to improve human development; and (iv) to improve and protect the environment. A Partnership Agreement on Poverty Reduction (PAPR) was signed on April 3, 2000, under which AsDB supports the government with a substantial aid package subject to resource availability and country performance.

The AsDB's lending program for 2003 is about \$495 million (\$265 million Ordinary Cash Resources (OCR) and \$230 million Asian Development Fund (ADF)) for the following projects: Second Participatory Livestock Development (\$20 million), Power Sector Development Program (\$265 million), Primary Education Sector Improvement III (\$100 million), Road Network Improvement and Maintenance II (\$110 million).

2003–05 Program

The lending program of the AsDB for 2003–05 includes 17 loans amounting to \$1,240 million (\$550 million OCR and \$690 million ADF) and covering several sectors: \$365 million for energy, \$250 million for transportation, \$100 million for agriculture and natural resources, \$375 million for social infrastructure, and \$150 million for finance and industry.

Technical assistance

As of December 31, 2002, the AsDB had provided 281 technical assistance (TA) grants for project preparatory and advisory services amounting to \$150.45 million. The 2003 TA program includes four advisory TAs and six project preparatory TAs, for a total amount of about \$4.3 million. The TA program for 2003–05 includes total grants of \$14.2 million.

Economic and sector work program

The AsDB has produced a number of studies of Bangladesh's macroeconomic and sectoral policies. The AsDB publishes its Asian Development Outlook every year in which it assesses macroeconomic performance. Beginning in 2001, the AsDB has also prepared quarterly economic updates.

In support of AsDB's Country Strategy and Program exercise, several new thematic assessments and sector studies have been undertaken, and have been completed, or nearing completion. These include: thematic assessments for poverty, private sector development, governance, environment, and gender, and sector studies for transport, information and communications technology, water resource development, agriculture and rural development, fisheries, regional cooperation, and the finance, industry and trade sectors.

Bangladesh: Key FSAP Recommendations

The report of the October 2002 FSAP mission focused mainly on the parlous state of the banking system. It found that all four nationalized commercial banks (NCBs) and most of the four specialized development banks (SDBs) were in weak financial condition. A full due diligence valuation would be required to provide accurately the value of the true deficiency, but the report estimates that the cost of raising the capital ratios of the NCBs to 6 percent may be as high as 4 percent of GDP.

The FSAP team recommended that all NCBs be restructured to eliminate losses and ultimately sold off as a whole or in pieces. The details of their resolution should be developed by management teams, in consultation with Ministry of Finance (MoF) and Bangladesh Bank (BB). Any such reforms should be designed to minimize the cost to taxpayers, avoid a liquidity crisis, and strengthen the banking system as a whole in the medium term.

Private commercial banks (PCBs) are in better financial condition than the NCBs, with a capitalization of 5 percent on average, and earnings performance is reasonably strong. However, several PCBs have been in trouble for a number of years. **The report recommended that BB supervise the PCBs effectively and should force any insolvent bank whose owners cannot recapitalize within a short period of time to exit the system.**

With regard to monetary policy and its implementation, the FSAP report made the following recommendations:

- **BB should be made independent and its capabilities strengthened.** In this regard, the mission made comments on the draft amendments to the BB order that was subsequently enacted, and urged the authorities to press ahead with reform of the central bank with World Bank assistance.
- **BB's monetary policy instruments should be improved to facilitate bank liquidity management and monetary policy implementation.** The Statutory Liquidity Requirement should be phased out. BB should introduce a standing lending facility, and the new repurchase facility should be further developed for open market operations and reverse repurchase operations introduced to reduce liquidity. The cash reserve requirement should be amended to allow banks to satisfy it on an average basis every two or four weeks rather than on a daily basis. Daily liquidity monitoring and weekly and monthly liquidity forecasting should be improved and provide the basis for determining open market operations.
- **MoF should determine the manner, terms, and conditions of the government's borrowings from the market, allowing BB to hold any of government securities consistent with its own monetary objectives.**

The FSAP report noted that there was no coherent strategy for public debt management, and this had contributed to higher borrowing costs and increased risk. **The report recommended that a Public Debt Office be established in the MoF.** This office would report directly to the Finance Secretary, and be responsible for all public debt, including national savings certificates and external debt. It would develop policies for public debt management, including choice of instruments and marketing strategy, and undertake the analysis needed to support debt policies.

Bangladesh: Summary of Fiscal ROSC Report

Bangladesh has made significant progress in recent years in improving the budgeting, financial reporting, and auditing capacity of the government, under the DFID-supported RIBEC (Reforms in Budgeting and Expenditure Control) program. The main achievements under RIBEC have been to:

- Establish a working reconciliation process for Comptroller General of Accounts (CGA) accounts.
- Attain more timely within-year reporting of fiscal data, and to improve the timeliness of submission of audited accounts to parliament—the authorities are taking measures to present audited accounts from FY03 onward within 12 months of year-end, and monthly reports are now being produced within 5–8 weeks of month-end.
- Separate the accounting and audit function.
- Improve the quality and timeliness of audit reporting.
- Establish Financial Management Units in ministries with heavy ADP spending.

However, there remain significant weaknesses in the present system:

- Weak coordination, monitoring and reporting of foreign-financed projects.
- Weak coordination between the line ministries and the Chief Accounting Officers.
- The budget documents do not reveal the key macroeconomic and policy assumptions underlying the budget estimates, and there is no medium-term expenditure framework (MTEF) to guide fiscal policy over the medium term.
- No estimates of tax expenditures, contingent liabilities or the extent of quasi-fiscal activities are included in the budget documents or in the annual accounts.
- Local government is subject to considerable central direction, administrative capacity is weak, and local government data are not systematically compiled, reported or analyzed.
- Rundown of the net worth of the public sector through the nexus of direct subsidies and quasi-fiscal activities of nonfinancial public enterprises and public financial institutions is the single greatest source of long-term loss and fiscal risk. Data collection in this area, however, is inadequate and is not focused on clearly representing government policies and their costs.
- Internal audit mechanisms are weak, and the capacity and quality of audits by the Comptroller and Auditor-General need to be strengthened.
- Parliamentary mechanisms for oversight of public finances are greatly in need of strengthening.
- Finally, progress in improving fiscal transparency—and in many other areas—is impeded by the widely recognized prevalence of corruption in both the public and private sectors.

The authorities have agreed to an action plan for improving transparency, setting out measures over the next three years, and to the publication of the fiscal transparency module of the ROSC. They have also taken steps to implement the most immediate recommendations, particularly to implement improved reconciliation procedures for fiscal reports and establish clear assurances of data reliability as part of the reporting system.

Bangladesh: Statistical Issues

Bangladesh is a participant in the General Data Dissemination System, and its metadata has been posted on the Fund's Dissemination Standards Bulletin website since March 2001 and was updated in August 2002.

Multisector Statistics mission

A STA Multisector Statistics mission visited Dhaka during August 14–22, 2002. Its key overall recommendations were:

- The enactment of legislation to define the role of the Bangladesh Bureau of Statistics (BBS) and to provide it with sufficient powers to fulfill its mandate.
- More resources should be provided to BBS and its management strengthened.
- Both inter-agency cooperation and collaboration within BBS should be improved.
- An adequately funded unit needs to be established to collect adequate and consistent monthly and annual fiscal data on stocks and flows.

The mission developed a dated action plan to deal with these broader issues, as well as more specific sectoral recommendations.

National accounts

Bangladesh has a reasonably comprehensive system of national accounts statistics, but it still lacks quarterly estimates of GDP. In April 2000, BBS published the national accounts for the period 1989/90 onward using a revised 1995/96 benchmark. The August STA mission recommended that the data dissemination process be streamlined to allow the more timely release of national accounts estimates, more frequent business surveys, and a review of deflation techniques.

Prices, wages, and employment

Price series include a consumer price index (CPI), a producer price index (PPI), a wholesale price index (WPI), and unit value indices for external trade. The CPI and WPI are published with lags of two and three months, while unit values of exports and imports are available on an annual basis. The CPI and PPI weights are outdated, and the August STA mission recommended that the CPI be recompiled using weights derived from a household and expenditure survey completed in 2002.

Data for wages are prepared monthly, but employment and unemployment data are only available at irregular intervals.

Government finance and debt

Fiscal data continue to have shortcomings. Reporting on budget execution during the fiscal year is incomplete and subject to delays for certain components. The lag in publishing the government's audited accounts on the budgetary central government has been reduced to one year. The National Board of Revenue produces monthly data on revenue of the budgetary central government on a cash basis with a lag of one month, and the Comptroller General of Accounts (CGA) produces monthly data on recurrent expenditure with a lag of five weeks. However, the coverage of above-the-line items is not consistent with financing data. No comprehensive estimates are available on spending for the ADP. Annual data on the government's external financing for the budget and foreign grants are available with a lag of one year. Domestic financing data, provided by BB and the National Savings Directorate with a lag of six weeks, were found to have shortcomings that are being addressed. There is no specific unit in charge of compiling fiscal statistics. Efforts continue to address the need to improve the quality and timeliness of the external financing data, which remains weak. The UNCTAD electronic external debt management system is expected to be implemented soon.

Bangladesh was found to have serious deficiencies regarding its ability to compile Government Financial Statistics (GFS), and it does not report GFS to STA for either the *Government Financial Statistics Yearbook* or the *International Financial Statistics*. No GFS data are collected on local governments, and there is no capability to compile consolidated data on general government operations.

Three important ongoing efforts are under way which are aimed at improving the quality and monitoring of data: the Financial Management Reform Program (FMRP) and its predecessor, the Reforms in Budgeting and Expenditure Control (RIBEC) project, the Debt Management and Financial Analysis System (DMFAS), and the Task Force on Monitoring of Economic Data (TMED).

Under the RIBEC (implemented during 1993–01), a significantly improved budget classification was introduced. The CGA system has been strengthened and computerized and, since the start of FY02, produces meaningful monthly accounts disaggregated by economic code, function, and region on a timely basis (with the lag now reduced to five weeks). On the basis of these monthly accounts, the Finance Division of the Ministry of Finance produces monthly budget reports for policy purposes. The newly established Financial Management Units (FMUs) in seven line ministries also provide key information for policy formulation. The FMRP aims to: improve the audit function to support parliamentary and public scrutiny of budgetary processes; enhance fiscal management and financial and performance management; improve resource allocation and utilization; enhance the financial management reporting system; and build training capacity.

Implementation of the DMFAS started in November 2001 with donor support. In the course of the current fiscal year, it will capture public debt, guarantees, and contingent liabilities. Information on private debt will also be added.

The government established the TMED in November 2001, with the purpose of creating an interagency system for monitoring macroeconomic data. The emphasis is on data that are

relevant in the dialogue with Fund staff. The task force is chaired by the Joint Secretary in charge of the budget, and includes members from the Ministries of Finance and Planning, CGA, BB, and the National Savings Directorate. Its meetings were also attended by the Fund Resident Representative. Building on the RIBEC project, the task force has helped shorten the lag in availability of budget data; initiated a framework for monitoring SOEs and public arrears; enhanced the quality of existing data, including through more systematic reconciliation of data between sources and across agencies; and increased the exchange of information between organizations.

Monetary accounts

Monthly accounts of BB and other depository corporations are available with a lag of six weeks. In addition, BB also produces a weekly publication (shared with the Fund) which is available with a lag of about five to six weeks. In line with the August 2002 STA mission's recommendations, BB has commenced reporting its monetary accounts to the Fund electronically.

Balance of payments

Since August 2002, BB has changed its BOP reporting to be more consistent with the fifth edition of the *Balance of Payments Manual* (BPM5), in line with the August STA mission's recommendations. Apart from export shipments data, most other statistics are recorded on a cash basis, with the banking and exchange control records being the primary source of data. Summary balance of payments data are compiled and disseminated on a monthly basis. Quarterly statistics for all the major accounts are available, while annual data present a detailed classification. Official foreign direct investment data continue to be underreported by BB, although more comprehensive data are available from the Board of Investment. Nontrade activities of companies operating in the export processing zones are excluded. Data on private sector external borrowing, the transactions of foreign direct investors, and workers' remittances through the informal *hundi* banking system are for the most part not included in the published data.

**Bangladesh: Survey of Reporting of Main Statistical Indicators
(As of May 12, 2003)**

	Exchange rates	International reserves	Reserve/ base money	Central Bank balance sheet	Broad money	Interest Rates 1/	Consumer price index	Exports/ Imports	Current account balance	Overall government balance	GDP/GNP	External debt
Date of latest observation	May 11, 2003	May 11, 2003	Mar. 27, 2003	Mar. 27, 2003	Feb. 2003	Dec. 2002	Feb. 2003	Jan. 2003	Jan. 2003	Jan. 2003	2001/02	Jan. 2003
Date received	May 12, 2003	May 12, 2003	May 7, 2003	May 7, 2003	Apr. 12, 2003	Apr. 15, 2003	May 5, 2003	Apr. 20, May 4, 2003	May 4, 2003	Apr. 7, 2003	Apr. 10, 2003	Apr. 27, 2003
Frequency of data 2/	D	D	W	W/M	M	W	M	M	M	M	A	A
Frequency of reporting 3/	D	D	W	W/M	M	W	M	M	M	M	A	A/M
Source of data 4/	A	A	A	A	A	A	A	N	A	A	A/N	A/N
Mode of reporting 5/	M	M/T	M	M	M/V	M	M	M	M	M	M/V	M/V
Confidentiality 6/	C	A	D	D	D	C	C	C	D	B	C/D	C/D
Frequency 2/ of Publication	D	D	M	M	M	W	M	M	M	O	A	A

1/ Interest rates at weekly auctions of Treasury bills.

2/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, or O-other.

3/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, V-irregularly in conjunction with staff visits, or O-other irregular basis.

4/ A-direct reporting by central bank, Ministry of Finance, or other official agency, N-official publication or press release, P-commercial publication, C-commercial electronic data provider, E-IMF's Economic Information System (EIS), O-other.

5/ E-electronic data transfer, C-cable or facsimile, T-telephone, M-mail, V-staff visits, O-other.

6/ A-for use by the staff only, B-use by the staff and the Executive Board, C-unrestricted use, D-embargoed for a specified period and thereafter for unrestricted use, E-subject to other use restrictions.

P/ Provisional.

Dhaka, Bangladesh
June 4, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, DC
USA

Dear Mr. Köhler:

The Government of Bangladesh has adopted an economic reform program for FY04–FY06, which aims to accelerate economic growth and poverty reduction. To achieve these goals, the Government assures you of its determination to pursue sound macroeconomic policies, take actions to enhance the climate for investment, strengthen economic governance, and reform the tax system, nationalized commercial banks, and the state-owned enterprises. This overall strategy is laid out in our National Poverty Reduction Strategy (I-PRSP). The details of the program are set out in the attached Memorandum on Economic and Financial Policies (MEFP). In support of this program, we are requesting a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) arrangement in an amount equivalent to SDR 347 million (65 percent of quota).

The Government will provide the Fund with information on a timely basis as might be requested in connection with the progress in implementing the PRGF-supported program.

The Government believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of the program, but will take supportive measures as necessary for this purpose. During the period of the arrangement, the Government will consult with the Managing Director, on its own initiative or at your request, concerning the adoption of appropriate measures. The Government will conduct with the Fund staff the first review of the PRGF-supported program, to be completed no later than December 2003 and the second review, to be completed no later than June 2004. Moreover, while the Government has financial obligations to the Fund arising from loans under this arrangement, it will consult with the Fund from time to time, on its own initiative or at the request of the Managing Director on Bangladesh's economic and financial policies.

To facilitate wider distribution of the MEFP and the I-PRSP, the Government has authorized their publication by the Fund.

With my best regards,

Yours sincerely,

/s/

M. Saifur Rahman
Minister for Finance and Planning

BANGLADESH

Memorandum of Economic and Financial Policies for May 2003–June 2004

June 4, 2003

I. INTRODUCTION

1. Since taking office in October 2001, the BNP-led government has made progress in restoring macroeconomic stability and renewing structural reforms, in spite of a difficult global environment. Building on this record, the government is now ready to embark on a comprehensive reform program to reinforce the initial gains and to address the medium-term challenges of moving the economy to a higher growth path and faster poverty reduction. This program is based on the strategy articulated in our interim Poverty Reduction Strategy Paper (I-PRSP). To implement this program, we are seeking support through a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). This memorandum lays out the medium-term macroeconomic and structural policy framework, and the main objectives and policies that we intend to pursue for the remainder of FY03 and for FY04.

II. RECENT ECONOMIC PERFORMANCE

2. The economy of Bangladesh is undergoing a recovery and inflation remains manageable. Over the first half of FY03, industrial production and exports have rebounded by 5 percent. Real GDP growth is thus expected to recover to an estimated 5.2 percent for FY03, driven by agricultural production and strong domestic demand. Meanwhile, CPI inflation has risen to 5.9 percent as of February, due largely to higher food prices linked to weather factors and fuel price adjustment. Nonetheless, inflation for FY03 on average should be around 5 percent. Gross international reserves have been rebuilt to around \$1.8 billion (or two months of import cover) at mid-May, from the low of \$1 billion reached in November 2001.

3. Fiscal prudence has contributed to achieving this stability. Specifically, the central government deficit (excluding grants) was reduced from 5.1 percent of GDP in FY01 to 4.7 percent (or 3.7 percent including grants) in FY02, on account of both revenue measures and expenditure discipline. In particular, Annual Development Program (ADP) spending was cut by 8 percent in nominal terms, or 0.9 percentage points of GDP. The FY03 budget targets a further reduction in the deficit to 4.2 percent of GDP, and in domestic financing of the budget to 1.9 percent of GDP (from 2.5 percent in FY02).

4. Revenue measures announced in the budget included withdrawal of tax holidays for expansion of existing enterprise units, lowering of the minimum income tax threshold, abolition of zero duty rates and supplementary duties on many imports, lowering of the top customs duty rate from 37.5 percent to 32.5 percent, withdrawal of some income tax exemptions, and extension of the VAT net within the retail sector. Moreover, measures to reduce discretion of officials in tax administration were introduced.

5. In addition, budget management has been improved, including through monthly monitoring of fiscal performance based on a computerized budgeting and accounting system, and through systemic monitoring of releases of ADP-related funds. For the first time, a comprehensive mid-year review of the budget has been undertaken to ensure attainment of budget targets. In addition, to help design the medium-term budget strategy, Revenue and Expenditure Commissions have been established, and their initial reports have been received. Their interim recommendations are being taken into account in developing the FY04 budget.

6. Monetary policy has also been kept tight, and excess bank reserves have been reduced substantially. Reserve money remained flat over 2002, through sales of treasury securities by Bangladesh Bank (BB). Along with fiscal restraint, this facilitated the rebuilding of NIR, and interest rate on treasury bills has risen to about 8 percent (from 4 percent in May 2002). A repo facility was introduced in June 2002 and a reverse repo in April 2003 to improve liquidity management. The firm fiscal and monetary stances have contributed to the stability of the exchange rate, following the 1.5 percent devaluation in January 2002. In November 2002, the interbank and curb rates moved significantly above the official rate due to large volumes of opening of letters of credit, reflecting depreciation expectations, and a temporary increase in the government's domestic financing requirement. However, exchange pressures have abated and the rate has been kept at appropriate, broadly stable levels over the last six months, with the curb market premium remaining below 2 percent, thanks to timely tightening of financial policies.

7. Significant steps have also been taken to renew the momentum of structural reforms. In particular:

- Adamjee jute mills was closed in July 2002. This was the largest jute mill in the world and accounted for 10 percent of annual SOE losses. The retrenchment package for 26,000 workers of Adamjee is estimated to cost about Tk 4 billion (0.1 percent of GDP). In addition, closure/privatization of an additional 34 SOEs is estimated under the revised budget to cost a further Tk 7.6 billion (0.2 percent of GDP), mostly on retrenchment.
- SOEs are being subject to harder budget constraint as reflected in reduced credit from the nationalized commercial banks (NCBs). Also, government guarantees, including suppliers' credits, are being restricted.
- Energy prices were raised in January and September 2002 on motor spirits (22 percent), diesel and kerosene (10 percent), power and electricity tariffs (7–8 percent), and natural gas (10 percent). In January 2003, petrol and diesel prices were increased by a further 17 percent. These actions are expected to substantially reduce losses in the energy sector.
- In the banking area, the Bangladesh Bank Order was amended to strengthen BB's operational autonomy and bank supervision. Furthermore, the Banking Companies Act and Banks (Nationalization) Act were amended to bring the NCBs and development finance institutions (DFIs) under the greater supervision of the BB and to improve corporate governance. The Money Loans Court Act has also been

modified to speed up debt recovery, and the Money Laundering Prevention Act has been passed, aimed at preventing illegal financial transactions. To strengthen private commercial banks, the BB has raised minimum capital requirements from eight to nine percent of risk-weighted assets, and has taken steps to reduce insider lending and introduce rules for writing off bad debt. With respect to the NCBs, 65 loss-making branches have been closed so far this fiscal year.

III. MEDIUM-TERM MACROECONOMIC FRAMEWORK AND POVERTY REDUCTION STRATEGY

8. Despite encouraging economic results so far, the economy is fragile and the outlook is clouded by external uncertainties. Moreover, economic growth remains below potential and poverty incidence, while reduced substantially, remains high. In these circumstances, our reform strategy is aimed at putting the economy on a firmer footing, and at laying the basis for higher sustainable growth and a tangible reduction in poverty.

9. In order to halve the poverty rate by 2015, a goal set in our I-PRSP, growth over the medium to long term must be raised to at least 7 percent in conjunction with pro-poor policies. To attain this ambitious target, larger investment by a more vibrant private sector (including FDI) will be required, as well as a further building up of human and physical capital. To these ends, under the PRGF, priorities will be given to the following: ensuring a stable macroeconomic environment and prudent management of public resources—particularly through tax reform and improved composition of public expenditure; more liberal exchange and trade regimes; reforms of the NCBs and SOEs; and addressing problems of economic governance.

10. By the end of the PRGF period, we aim to raise GDP growth to 6.5 percent, up from 5 percent on average during the second half of the 1990s, and to contain inflation to under 4 percent. The external current account deficit is projected to widen, on account of higher capital imports, to slightly above 1 percent of GDP, but would be financeable by a prospective higher level of external assistance on concessional terms. To reduce external vulnerability, gross official reserves are targeted to build up to at least three months of import cover by the end of FY05.

11. Raising economic growth must also be complemented by other pro-poor measures in order for poverty to be meaningfully reduced over the short to medium term. To this end, public resources will be shifted toward poverty reducing areas, particularly to improve access to essential public services such as basic education and health. Over the PRGF period, we will target an overall budget deficit of no more than 5 percent of GDP, and will increase pro-poor spending by at least 2.5 percent of GDP (Table 1). We are committed to pursuing a major revenue effort, on the order of 1.5 percent of GDP over the next three fiscal years. This revenue effort is vital for the budget to adequately support human capital, physical infrastructure, and anti-poverty programs on a sustainable basis without threatening debt sustainability over the medium term. To secure the needed improvement in revenue, we intend to develop a full-fledged tax reform strategy with technical assistance from the Fund in the first PRGF program year.

12. We aim to complete the Poverty Reduction Strategy Paper (PRSP) by December 2004, drawing on the experience in implementing the I-PRSP. In doing so, we will further refine policies in terms of specific time-bound actions, and will assess more fully the budgetary implications of pro-poor measures. Assistance from the World Bank is being sought to set up an interim monitoring arrangement under the I-PRSP.

13. Addressing governance will be critical to implementing this medium-term agenda. This is essential for strengthening the performance of both revenues and the banking system. Moreover, weak governance is viewed as a key impediment to private enterprise and FDI. In light of this, many of the programmed reform measures have been designed to address economic governance problems and build stronger institutions; in this context, we recognize the importance of strengthening law and order so as to improve the investment climate. The approach supported by the PRGF arrangement is focused on improving accountability and transparency in policy—by reducing the scope for bureaucratic discretion—and in the management of public funds. The latter effort is being made with technical assistance under a donor-financed Financial Management Reform Program (FMRP), under which internal controls will be strengthened. Public procurement is also being improved with technical assistance from the World Bank, and imperfections in targeted transfer programs are being tackled. More broadly, we are finalizing a legal framework for establishing an independent Anti-Corruption Commission vested with the authority to investigate allegations of corruption.

IV. MACROECONOMIC POLICIES FOR FY03–04

14. Consistent with this medium-term strategy, real GDP growth in FY04 is targeted to rise to 5.5 percent, inflation to fall to 4.5 percent, and the external current account deficit to widen to slightly above 1 percent of GDP. Growth prospects should improve if agricultural production is at potential and export growth is more robust. These projections are subject to downside risks from higher oil prices and weaker global demand, and we will consult with Fund staff on the appropriate policy response if these risks were to materialize.

A. Fiscal Policy

15. Fiscal performance in FY03 has been positive so far, due to strong revenue collection by the National Board of Revenue (NBR), combined with a significant recovery of tax arrears. However, as a result of the lower-than-expected nontax revenues and overruns in domestic interest payments and retrenchment costs, ADP spending in FY03 will be kept at Tk 173 billion. Furthermore, every effort will be made to maintain the momentum of revenue collections, to attain the budgeted deficit target of 4.2 percent of GDP. Domestic financing will be capped at Tk 56 billion (1.9 percent of GDP), and bank financing for the budget limited to Tk 18 billion. Benchmarks for March and June 2003 have been set in line with these limits (Table 2).

16. Revenue mobilization is the central element of budget strategy for FY04. This will help balance the need to support poverty reduction with the need to contain domestic financing of the budget. It will be aimed at keeping the overall budget deficit at 4.8 percent of GDP, in accordance with the medium-term framework outlined above. Total revenue is

targeted to rise by 15 percent (0.5 percentage point of GDP)—with continued strong increases (15 percent) projected for NBR revenue—while expenditure is slated to increase by 17 percent (1.0 percentage point of GDP). To contain the cost of public debt servicing, we will limit domestic financing to 2.0 percent of GDP, and will rely more on external financing on highly concessional terms.

17. If concessional external financing turns out to be higher than the level currently projected, the overall budget deficit could be raised up to 5 percent of GDP, with additional funds to be targeted for poverty reduction and structural reform costs. On the other hand, in view of the uncertain timing of external financing, the budget will be executed prudently. Expenditure will be backloaded, particularly with respect to capital spending. The budget will be kept under review, in consultation with Fund staff. An appropriate course of action will be taken in the event of financing shortfalls. This would include rationalizing and trimming expenditure, and additional revenue measures.

18. At the heart of our medium-term fiscal strategy will be efforts to boost revenues on a sustainable basis to enable substantial progress in meeting the Millennium Development Goals. Emphasis will be given to measures to broaden the tax net and improving tax administration. Revenue measures underpinning the FY04 budget will include: (i) modernizing and expanding the coverage of the Large Taxpayer Unit for income tax; (ii) setting up, and making fully operational, the Central Intelligence Audit and Monitoring Cell for all taxes and covering 1,000 large taxpayers; (iii) revamping the bonded warehouse system (withdrawing warehouse licenses for imports for domestic consumption, and requiring bank guarantees for export-oriented imports); (iv) registering an additional 100,000 new income taxpayers, and around 200,000 new VAT taxpayers; (v) post-auditing of around 20,000 income tax files; and (vi) continued automation of customs and other modernization measures (under the CAM1 project and its integration with ASYCUDA++). These measures, when implemented on a sustained basis, could yield additional revenue of at least 1 percent of GDP per annum. However, in the short-run it would be prudent to assume additional tax revenue of around 0.5 percent of GDP. Moreover, utility prices and administrative fees and charges will be raised on a timely basis to protect nontax revenues.

19. To improve the pro-poor focus of government expenditure, we aim to increase spending for human capital development, health, and social safety nets. Such spending is targeted to rise by at least 1 percentage point of GDP in FY04, primarily reflecting higher maintenance spending for the social sectors and targeted social protection programs, in particular, micro-credit. However, we will examine all possibilities of cutting down on other expenditures, for instance on noninterest and nonwage recurrent expenditures, and will ensure strict discipline on ADP spending, drawing on recommendations of our Expenditure Commission as well as the Public Expenditure Review. Projects to be included in the ADP will be closely scrutinized to ensure best use of available funds. Moreover, within the fiscal year, no new unapproved ADP projects will be added to the program as this could undermine fiscal sustainability and compromise the overall quality of ADP projects. Adequate funding will be ensured to cover the costs of reforming the SOEs and NCBs. Tentative estimates by Fund staff suggest that the costs of reform over the medium term could be in the range of 8 percent to 12 percent of GDP, depending on loan recovery rates in the NCBs and assuming a curtailment of new NPLs and appropriate pricing for energy (see below).

20. As part of our efforts to strengthen governance, particular importance is attached to improving fiscal transparency and control, especially fiscal reporting and watchdog institutions. Recent gains in fiscal reporting will be consolidated through implementing the action plan recommended by the Fund's Fiscal Transparency Module of the Report on Observance of Standards and Codes, as well as meeting key benchmarks under the FMRP. In particular, steps will be taken by the Ministry of Finance to strengthen internal control over expenditure and the office of the Auditor General to better carry out independent audit functions.

B. Monetary and External Policies

21. Monetary policy will need to remain firm in the period ahead to check inflation and control liquidity conditions. Reserve money will be targeted to rise by 5 percent and 10 percent, respectively, in FY03 and FY04, while broad money growth is expected to slow to 12 percent. This should allow BB to rebuild NIR, while accommodating private sector credit growth. To reduce rigidities in the structure of interest rates and to enhance the effectiveness of monetary policy, we have adopted a timetable to apply a formula that links the yields on new issues of national savings certificates (NSCs) to the rates for treasury bills of comparable maturity, to be effective at the latest by December 2003. In addition, we will continue to enhance coordination between foreign exchange and liquidity management operations, drawing on Fund technical assistance.

22. We are committed to a flexible exchange rate management to strengthen the economy's resilience to external shocks and to safeguard competitiveness in a challenging global environment. Intervention in the exchange market will be undertaken only to address disorderly conditions and will be geared to help attain the programmed reserves targets. In this connection, a timetable has been adopted to phase out the existing exchange restrictions under the Fund's Article VIII. In particular, the margin requirements on the opening of letters of credit (LCs) for 55 consumable items and for sugar, rice, and wheat imports will be phased out by November 2003. In addition, by the end of the PRGF arrangement period, we expect to lift the ban on the convertibility and transferability of proceeds on current international transactions on nonresident taka accounts. In addition, we would aim to phase out export surrender requirement and export subsidies in due course.

23. External debt management policy will be prudent in order to maintain debt sustainability. To support the reform agenda, we will rely on grants and external assistance on highly concessional terms and will minimize reliance on contracting or guaranteeing new nonconcessional debt. Specifically, we intend to remain well below the program external debt ceiling, and all new nonconcessional borrowing will be limited to the power and energy, water supply and telecommunications sectors. All projects financed from nonconcessional borrowing will strictly follow guidelines issued by the government on January 15, 2002. Key criteria of these guidelines include: (i) no project will be considered unless concessional resources are not available and (ii) the project must be economically viable and financially self-sustaining. Moreover, given the weak state of the external debt management information system, we have already sought technical assistance to overcome these shortcomings and make the system operational.

V. STRUCTURAL POLICIES

24. The structural agenda facing Bangladesh is very large. Given capacity constraints, efforts under the PRGF-supported program will need to sharply focus on the areas that are particularly critical for improving growth prospects and governance, namely tax reform noted above, and NCB and SOE reforms.

A. NCB Reform

25. Recognizing that economic performance has been impeded by poor financial sector governance and the resulting high level of NPLs, we have moved to improve the institutional framework for the supervision of the financial system. Governance and BB supervision of all commercial banks will continue to be strengthened under the recently enhanced prudential framework.

26. Looking ahead, the strategy for banking reform will focus on the NCBs in view of their large NPL ratios (estimated at almost 19 percent of loans net of provisions, or 34 percent on a gross basis). The approach initially will be aimed at curbing the flow of new bad loans, and strengthening governance of NCBs, while developing detailed resolution strategies for each bank. Over the medium term, the goal is for the government to divest these banks—including through privatization in whole or in part. A comprehensive strategy to define the resolution option bank-by-bank and address the existing stock of NPLs will be adopted by April 2004. It will draw on the recommendations of the joint Bank/Fund Financial Sector Assessment Program (FSAP), follow-up technical assistance, and external audits. Implementation of the strategy will also be supported by Bank credit for banking reform to be developed in FY04.

27. In preparation for this comprehensive program, and to signal our commitment to NCB reform, the following additional steps will be taken during the first year of the PRGF-supported program:

- MoF will engage reputable local firms to conduct audits of the four NCBs, based on international auditing and accounting standards. Contracts for these audits will be finalized by August 2003 (structural benchmark).
- NCBs will be protected from outside interference and their managements made more accountable by strengthening their boards.
- New professional management will be secured for Agrani Bank by October 31, 2003 (structural benchmark), and management support for Janata and Sonali Banks will be arranged with World Bank technical assistance by December 2003 (structural benchmark). Management will be subject to performance-based criteria, and will be provided with sufficient authority to implement staffing changes at senior levels in order to strengthen bank performance and credit risk management.
- New net lending by NCBs will be restricted to at most 5 percent during FY04, through: (a) tightening prudential limits on individual loan exposure to 5 percent of

paid-up capital; (b) bank-by-bank limits on net lending to continue reducing the market share of these banks; and (c) the requirement that syndication of large loans involve meaningful participation of private banks.

- BB will develop, in consultation with Fund and Bank staff, interim MOUs with each bank to set net lending limits, including restrictions on specific loans and classes of loans, and will monitor compliance against these limits and restrictions. To ensure achievement of these limits, BB will issue guidelines on best practice in credit risk management.
- The branch structures of these banks will be further rationalized, including through merger of branches, with the aim of closing a total of 125 out of 3,000 branches by December 2003.
- Rupali Bank (6 percent of total banking system assets) will be brought to the point of sale in whole or in part by June 2004, following a transparent due diligence process and according to international best practice. An action plan will be adopted by June 2003 to attain this objective.

B. SOE Reform

28. The goals of our SOE reform strategy are to improve SOE efficiency, foster private enterprise, and reduce the fiscal burden of the SOE sector. This strategy is two-pronged:

- Substantially downsize SOEs in the manufacturing sector through a program of closures and privatization. Following the closure of 24 SOEs (mainly in the jute, textile, and paper industries) so far in FY03, an additional 11 SOEs have been slated for closure/privatization by the end of FY03. The government plans to close down or privatize another 105 units over FY04–06, with retrenchment of around 75,500 workers. The overall restructuring cost of this program has been estimated at Tk 64 billion, or 2 percent of GDP, to be absorbed in FY03–06. The Government will strive to reduce the SOE manufacturing sector to the sugar and fertilizer industries by end-FY06.
- Reforming the energy sector through appropriate pricing and a transparent regulatory framework. Decisive reform of the energy sector is critical to containing SOE losses, since such losses are heavily concentrated in this sector, and to removing impediments to investment. Recent energy price increases have already helped to reduce losses and programs have been instituted, particularly in the power sector, to reduce system losses and raise collections. In the context of the Development Support Credit of the Bank, we have adopted a new petroleum, gas, and power pricing framework to ensure efficiency and financial viability of this sector. This framework provides for a formula-based, flexible pricing mechanism that rationalizes the prices of energy products and enables cost recovery for all incurred operating, maintenance, and capital costs. In addition, an Energy Regulatory Commission Act has been passed to set up an independent body with licensing and pricing authority over the power and

gas sectors. With these steps, the efficiency of the sector is expected to improve and losses substantially curtailed.

29. The government has identified all payment arrears, mainly to utility companies, amounting to around Tk 4 billion, which will be cleared by end FY03. In return, the SOEs have committed to servicing a larger share of their debt service arrears to the government. Total SOE arrears at end 2002 amounted to about Tk 145 billion (4.8 percent of GDP). Plans to regularize these arrears will be developed in the context of the energy reform program, with possible external assistance.

C. Trade Reform

30. We are committed to further trade liberalization as a critical means for improving growth prospects. Building on initiatives under FY03, we intend to rationalize the tariff structure by moving to a four-tier tariff rate in FY04, with a maximum rate of 30 percent. The effective average tariff rate will be reduced in tandem with efforts to broaden the customs tax base in order to protect revenue. In addition, under our new five-year export/import regime, expected to be approved by Cabinet in June, the list of goods subject to control (ban, or with quantitative restrictions (QRs)) will be reduced from 134 to around 70. The objective is to keep this list to the minimum, and to confine mainly to QRs for reasons of health, culture, and religion consistent with our WTO commitments.

VI. FINANCING REQUIREMENTS AND PROGRAM MONITORING

31. The program described above has been developed with strong domestic ownership, based on the track record of the government, and has involved a broad consultative process under the I-PRSP. However, timely implementation will require broad-based support, politically and socially. For this reason, we will make every effort to forge the consensus for the needed reforms, through continued consultations with stakeholders. Moreover, we are attempting to assess the social impact of the reform measures and have put in place initial safety nets to ease the transition for the adversely affected segments of the population. This effort is starting first with the safety net measures for workers affected by SOE restructuring, privatization, and closure, with the assistance of the Bank. Well-designed safety nets will be formulated in due course to support implementation of other structural reforms.

32. Successful implementation of this structural agenda will hinge on sufficient external assistance on highly concessional terms, to complement our own efforts to mobilize domestic resources. The additional external financing need over the PRGF period (FY03–06) is estimated to total \$2 billion. We are hopeful that the gap for FY03–04 (estimated at \$800 million) could be met by the Development Support Credit (\$300 million), further Bank support in FY04, disbursements under the requested PRGF arrangement (\$200 million), and additional external support.

33. To enhance the safeguards framework for BB, we are implementing the critical recommendations of the IMF onsite safeguards assessment. In particular, the reserve management functions have been segregated between the dealing room and the back office and a separate middle office function is being developed. Additional efforts will also be

made to enhance the mechanism for reserves management, and internal audit will be strengthened with Fund technical assistance. Further, BB's financial accounts are being restated in accordance with International Accounting Standards (IAS), and an audit on International Standards on Auditing (ISA) signed off by an international partner in collaboration with a local accounting firm, will be conducted by the first PRGF review. Moreover, a timetable has been set for adoption by the BB Board of IAS as BB's accounting framework, and the ISA as the auditing standard by FY04.

34. Prior actions will be taken to put the program on a solid footing (Table 3). The program will also be monitored by quantitative, quarterly benchmarks and semi-annual performance criteria, and overall progress will be reviewed on a quarterly basis with the Fund staff. The first PRGF review will be completed by December 2003. It will focus on progress in implementing the FY04 budget and NCB reform, and on initiating tax reforms, and will reach understanding on the performance criteria and benchmarks for the remaining period of the first-year program. The second review will be completed by June 2004. Definitions of aggregates subject to program monitoring and reporting requirements are set out in the Technical Memorandum of Understanding (Annex).

35. Program implementation will be tracked by an inter-agency working group. Efforts will continue to strengthen the monthly reporting system, to ensure the quality and consistency of data used in assessing compliance with the program's quantitative targets. Furthermore, technical assistance will be requested from the Fund in the area of monetary and exchange operations, and tax reform. We will also draw on technical assistance from the World Bank and bilateral donors to strengthen financial management of the public sector and governance.

Table 1.	Key Economic Indicators, 2001/02–2007/08
Table 2.	Quantitative Performance Criteria and Indicative Benchmarks, March 2003–June 2004
Table 3.	Prior Actions and Structural Performance Criteria and Benchmarks under the First Year of the PRGF arrangement
Annex.	Technical Memorandum of Understanding

MEFP Table 1. Bangladesh: Key Economic Indicators, 2001/02–2007/08 1/

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
					Proj.		
National income and prices (percent change)							
Real GDP 2/	4.4	5.2	5.5	6.0	6.5	6.5	6.5
GDP deflator	2.7	4.8	4.0	4.0	4.0	4.0	4.0
CPI inflation (annual average)	2.4	5.2	4.5	4.0	4.0	4.0	4.0
Central government operations (percent of GDP) 3/							
Total revenue	10.2	10.4	10.9	11.4	12.0	12.2	12.3
Tax	7.7	8.3	8.7	9.3	9.8	10.0	10.1
Nontax	2.4	2.0	2.1	2.1	2.1	2.2	2.2
Total expenditure	14.8	14.5	15.7	16.1	16.5	16.5	16.4
Current expenditure	8.0	8.4	8.5	8.5	8.5	8.6	8.6
<i>Of which</i> : Interest payments	1.8	2.0	2.0	2.0	2.0	2.0	1.9
Annual Development Program	5.6	5.8	6.1	6.5	6.9	7.0	7.0
Extraordinary expenditures	0.0	0.4	0.5	0.6	0.5	0.3	0.2
Other expenditures 2/	1.2	-0.1	0.6	0.6	0.6	0.6	0.6
Overall balance (excluding grants)	-4.7	-4.2	-4.8	-4.7	-4.5	-4.2	-4.0
Primary balance	-2.9	-2.2	-2.8	-2.7	-2.5	-2.2	-2.1
Financing (net)	4.7	4.2	4.8	4.7	4.5	4.2	4.0
Domestic	2.6	1.9	2.0	1.9	1.9	1.9	1.9
External	2.1	2.3	2.8	2.8	2.6	2.3	2.1
Total central government debt (percent of GDP)	53.2	51.7	52.2	51.8	51.0	50.1	49.2
Money and credit (end of year; percent change)							
Net domestic assets	11.9	10.6	11.9	11.7	11.9	12.0	12.1
Private sector	13.9	11.4	11.3	11.5	11.8	11.9	12.1
Broad money (M2)	13.1	12.5	12.1	12.1	12.0	12.0	12.0
Money velocity	2.8	2.7	2.7	2.6	2.6	2.6	2.5
Balance of payments (in millions of U.S. dollars) 4/							
Exports, f.o.b.	5,986	6,110	6,512	7,061	7,648	8,325	9,080
(Annual percent change)	-6.7	2.1	6.6	8.4	8.3	8.9	9.1
Imports, f.o.b.	-7,697	-8,224	-9,600	-10,284	-10,920	-11,547	-12,107
(Annual percent change)	-9.1	6.8	16.7	7.1	6.2	5.7	4.8
Gross official reserves (in millions of U.S. dollars)							
In months of imports of goods and nonfactor services	1.8	2.6	2.7	3.0	3.2	3.3	3.5
Memorandum item (in billions of taka)							
Nominal GDP	2,717	2,996	3,284	3,636	4,023	4,450	4,920

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

1/ Fiscal year begins July 1.

2/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).

3/ Starting FY02, central government fiscal positions are presented on a gross basis.

4/ Balance of payments is presented on the basis of BPM5.

MEFP Table 2. Bangladesh: Quantitative Performance Criteria and Benchmarks, March 2003–June 2004 1/

(Cumulative flows, end of period) 2/

	Benchmarks Mar-03	Actual Mar-03 (est.)	Benchmarks Jun-03	Performance Criteria Sep-03	Benchmarks Dec-03	Indicative Targets Mar-04	Indicative Targets Jun-04
(In billions of taka)							
Ceiling on net domestic assets of Bangladesh Bank	-4	-18	-23	6	8	10	9
Ceiling on net domestic financing of central government	43	34	56	20	31	50	65
Ceiling on net central government bank borrowing	16	-2	18	11	13	23	30
(In millions of U.S. dollars)							
Floor on cumulative increase of net international reserves of Bangladesh Bank	221	298	557	-50	50	100	200
Contracting or guaranteeing of short-term external debt by the central government	...	0	0	0	0	0	0
Contracting or guaranteeing of nonconcessional medium- and long-term external debt by the central government	...	84	150	100	150	200	250
<i>Of which:</i> External debt with an initial maturity of over one year and up to five years	...	0	0	0	0	0	0
Accumulation of external payments arrears (continuous performance criterion during the program period)	0	0	0	0	0	0	0

1/ The aggregates are defined in the Technical Memorandum of Understanding dated May 2003.

2/ Cumulative flow since beginning of July 2002 for benchmarks through end-June 2003, and cumulative flows since the beginning of July 2003 for the subsequent benchmarks and performance criteria.

MEFP Table 3. Bangladesh: Prior Actions and Structural Performance Criteria and Benchmarks Under the First Year of the PRGF Arrangement

Measures	Timing
I. Prior Actions 1/	
1. Meeting end-March 2003 indicative benchmarks (MEFP Table 2)	
2. Adoption of a floating exchange rate regime	
3. Liberalization of treasury bill rates, and adoption of a timetable and formula for linking the rate structure of the National Savings Certificates to treasury bill rates	
4. Submission to parliament of a budget for FY04 consistent with the fiscal targets under the program	
5. Issuance by Ministry of Finance (MoF) of circulars to spending units specifying maximum quarterly expenditures that can be authorized, consistent with the program annual targets	
6. Issuance of directive by Bangladesh Bank (BB) to each nationalized commercial bank (NCB) on restrictions of new lending, in consultation with Bank and Fund staff	
7. Adoption of a timetable for the removal of margin requirements on imports	
8. Finalization by MoF of the outstanding amount of government arrears, establishment of a monitoring system to prevent accumulation of new arrears, and a timetable for the elimination of existing arrears	
9. Adoption of a timetable for Bangladesh Bank to engage a local firm affiliated with an international accounting firm and with sign off by that international accounting firm, to conduct its audit for FY03 (by the first PRGF review) in accordance with international auditing and accounting standards	
II. Structural Performance Criteria and Benchmarks	
<i>Tax reform</i>	
1. Modernize and expand the Large Taxpayer Unit to cover 1,000 income taxpayers 2/	September 30, 2003
2. Make fully operational a Central Intelligence Audit and Monitoring Cell to monitor compliance of 1,000 large taxpayers 2/	December 31, 2003
3. Complete revamping the bonded warehouse system, including requiring bank guarantees for all imports going through the system	December 31, 2003
4. Expand the audit program to cover 1,000 large taxpayers	March 31, 2004
<i>NCB reform</i>	
5. Contracts signed by MoF for audits of the four NCBs in accordance with international auditing and accounting standards	August 31, 2003
6. Contract new professional management for Agrani Bank	October 31, 2003
7. Secure management support, with Bank technical assistance, for Janata and Sonali banks	December 31, 2003
8. Adopt resolution strategies for the four NCBs (in consultation with the Bank and Fund staff) 2/	April 30, 2004
<i>Exchange and trade systems</i>	
9. Phase out margin requirements on the opening of letters of credits for imports 2/	November 30, 2003

1/ Assumes Board discussion on June 20, requiring completion of these prior actions by June 13.

2/ Indicates structural performance criteria.

BANGLADESH—TECHNICAL MEMORANDUM OF UNDERSTANDING
June 4, 2003

This memorandum sets out (i) the definitions for the proposed quantitative performance criteria and benchmarks under the first year of the PRGF-supported program (Table 3 of the Memorandum of Economic and Financial Policies (MEFP)); and (ii) related reporting requirements. The data are to be based mainly on balance sheets of BB and the banking system as compiled by BB Research Department for management.

Item 1:¹ *Net domestic assets of Bangladesh Bank (BB)* are defined as reserve money minus net international reserves (NIR) of BB valued in taka using the program exchange rates specified in Table 1 below.

Reserve money consists of currency issued by BB (excluding its own holdings) plus government currency held outside the BB plus balances of deposit money banks (DMBs) with BB (excluding foreign exchange clearing accounts) plus balances of other financial institutions with BB.)

NIR is defined in item 4 below.

Item 2: *Net domestic financing of central government* is defined as the sum of the flow of net bank credit to central government and nonbank claims on central government during the specified period.

Net bank credit to central government is defined as the sum of: (i) BB holdings of government securities and treasury bills; (ii) BB Ways and Means advances to the government; (iii) BB credit to autonomous and semi-autonomous bodies; (iv) government currency liabilities; (v) DMBs holdings of government securities and treasury bills; (vi) DMBs credit to Food Ministry; (vii) DMBs credit to other ministries, autonomous and semi-autonomous bodies; (viii) any other loans, advances and bills discounted extended to central government by the banking system, minus all bank deposits, including lending and onlending accounts, of central government.

Nonbank claims on central government is defined as the sum of: (i) all national savings certificates and related instruments held by nonbank residents, as reported by the National Savings Directorate; (ii) all outstanding U.S. Dollar Premium and Investment Bonds; (iii) all treasury bills and bonds held by nonbank residents, as reported by BB; and (iv) all loans and advances extended by nonbank residents to central government, if any.

Item 3: *Net bank borrowing of central government* is defined as the change in bank credit to central government as defined above during the specified period.

¹Item numbers refer to Table 2 of the MEFP.

Item 4: *Net international reserves of BB* are defined as gross foreign assets of BB (less BB's blocked account with the Central Bank of Iraq) minus international reserve liabilities of BB.

Gross foreign assets of BB consist of its holdings of monetary gold, exchange balances held outside Bangladesh, foreign securities (valued in market prices), foreign bills purchased and discounted, net Fund position and SDR holdings, and the net forward position, if any, of BB. Excluded from gross foreign assets will be: (i) illiquid foreign assets including real property; and (ii) any other foreign assets over which the Bangladesh Bank does not have effective control or which it cannot readily sell, including blocked accounts, pledged, collateralized or other encumbered assets. Also excluded are participation in international financial institutions, holdings of nonconvertible currencies, holdings of precious metals other than monetary gold, and claims in foreign exchange arising from derivative transactions (such as futures, forwards, swaps and options).

International reserve liabilities of BB consist of all foreign currency denominated liabilities of the BB to residents and nonresidents with outstanding maturity up to and including one year, including: (i) Asian Clearing Union debit balances; (ii) all obligations in respect of swap and outright forward transactions; and (iii) any overdue obligations of the central government with respect to foreign debt service. Liabilities also include those arising from balance of payments support borrowing by the Bangladesh Bank, irrespective of maturity, including all liabilities to the Fund.

Item 5: *Contracting or guaranteeing of short-term external debt* is defined for debt with original maturity of up to one year owed or guaranteed by central government. The term debt is defined as set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000),² but excludes normal

²The definition is as follows: "9. (a) For the purpose of this guideline, the term debt will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the

(continued)

import-related credits, forward contracts, swaps, other future market contracts, and short-term liabilities of the banking system. The definition also includes debt instruments with put options that would be triggered within one year after the contracting date.

Item 6: *Contracting or guaranteeing of medium- and long-term nonconcessional external debt* is defined as contracting or guaranteeing nonconcessional external debt by central government with an original maturity of more than one year. *Nonconcessional debt* is defined as borrowing containing a grant element of less than 35 percent. This definition includes not only debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), but also commitments contracted or guaranteed for which value has not been received. Excluded from this definition are credits extended by the Fund and Asian Development Bank, and U.S. Dollar Premium and Investment Bonds purchased by nonresidents. Debt falling within the limit shall be valued in U.S. dollars at the bilateral exchange rates prevailing at the time of the contract is entered into, or guarantee issued.

The *grant element* is to be calculated by using the currency-specific discount rates reported by the OECD as Commercial Interest Reference Rates (CIRR) as of the date of contracting or guaranteeing the debt; for maturities of less than 15 years, the grant element will be calculated based on six-month averages of the CIRR, and for maturities of 15 years or longer, the grant element will be calculated based on 10-year CIRR averages. Maturity will be determined based on the original contract.

Item 7: *External payments arrears* are the stock of overdue payments (interest and principal payments) on short-term debt in convertible currencies with an original maturity of up to and including one year (spot, money market, letters of credit, and others) and medium- and long-term debt contracted or guaranteed by the government (including BB). The limit excludes overdue payments that relate to debts which are subject to rescheduling, or that are in dispute and under discussion with creditors.

* * *

1. For program purposes, any foreign asset, liability or cash flow denominated in a currency other than U.S. dollars shall be converted into U.S. dollars by applying the appropriate end of period exchange rate for March 31, 2003, as published in the Fund's *International Financial Statistics* (Table 1).

inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.”

Table 1. Selected End-of-Period Exchange Rates, March 31, 2003

Taka per U.S. dollar	57.90	Indian rupee per U.S. dollar	47.55
SDRs per U.S. dollar	1.3738	Pakistani rupee per U.S. dollar	57.78
Australian dollars per U.S. dollar	1.6567	Swedish kroners per U.S. dollar	8.505
British pounds per U.S. dollar	0.6330	Gold price in U.S. dollars per troy ounce (London PM fixing)	334.85
Canadian dollars per U.S. dollar	1.4693		
Euros per U.S. dollar	0.9179		

Source: Fund's *International Financial Statistics*.

2. For the purposes of program monitoring, the following information, including any revisions to historical data, will be provided by BB and Ministry of Finance, or PRGF Monitoring Unit, unless specified otherwise, to the Asia and Pacific Department of the Fund, through the office of the Resident Representative in Dhaka, as set out in Table 3.

3. In accordance with the recommendations of the Safeguards Assessment, the data on the international reserves and balance sheet of BB should be reconciled with the final accounts of BB for each period. Annual data will also be reconciled with the final audited accounts when they become available.

Attachments

Table 2. Bangladesh: Concordance of Program Definitions and Data Sources

Table 3. Bangladesh: Monitoring and Reporting Requirements

Table 2. Bangladesh: Concordance Between Program Definitions and Data Sources

Item Number	Aggregate	Sources 1/	Feb-03 Value 2/
			(in billions of taka)
1	Net domestic assets of Bangladesh Bank (BB) = A - 4, converted at program US\$/taka exchange rate.		147.8
A	Reserve money		215.1
	Currency outside banks	10G: "Currency outside banks"	160.6
	Reserves	10G: "Deposit Money Banks dep."+"Deposits of cooperative banks"+"deposits of non-scheduled bks"+"priv.sect. dep. non-sched."	54.5
2	Net domestic financing of central government = flow of B plus flow of C		36.2
B	Net bank credit to central government =		189.0
	Claims on central government of banking system		262.8
	Government securities held by BB	10G: " Govt. Securities & T. Bill"+"Special Ad Hoc T. Bills"+"Other Special Ad Hoc T. Bil"+"Govt. Treasury Bond"+"Bangladesh Savings Cert."	89.8
	Government currency liabilities	10G: "Govt. Currency in Bngladsh Bk."+"Counter Entry for Govt.Cur."	3.4
	Loans and advances to central govt. by BB	10G: "Loans & Adv to Central Govt"+"Govt. Debtor Balances"	0.0
	Advances to auto and semi-autonomous bodies by BB	10G: "Auto & Semi Auto Bodies"	0.6
	Government securities held by DMBs	20G: "Claims on Government: Investment: Govt. Tresry Bills & Sec."	162.9
	Advances to ministries by DMBs	20G: "Bills: Government"+"Advances to Government"	3.1
	Advances to semi-autonomous and autonomous bodies by DMBs	20G: "Bills: Autonomous Bodies"+"Investment: Autonomous Bodies"	3.0
	<i>Minus: Deposits of central government with banking system</i>		73.7
	Government deposits with BB	10G: "Government Deposits"	0.0
	Government lending funds with BB	10G: "Government Lending Funds(1)+"Government Lending Funds(2)+"Government Lending Funds(3)"	9.1
	Government deposits with DMBs	20G: "Government Deposits"	59.0
	Government lending fund to DMBs	20G: "Borrow from Govt.On Lend"	5.6
C	Nonbank claims on central government		
	National savings certificates (NSCs) held by nonbank residents	Outstanding NSCs reported by National Savings Directorate minus 10G:"Bangladesh Saving Cert." minus 20G:"bang. sanchaya patra" minus 20G:"p.bnd/incom tax bnds"	277.2
	Treasury bills and bonds held by nonbank residents	<i>Outstanding Treasury Securities: Nonbanks</i>	3.3
3	Net bank borrowing of central government = flow of B		5.3

1/ Italicized references to sources are as follows: 10G - BB Balance Sheet (Form 10G), 20G - Consolidated Balance sheet of DMBs (Form 20G) as reported to Fund's Statistics department.

2/ Flows are from end-June, 2002.

Table 2 (cont.). Bangladesh: Concordance Between Program Definitions and Data Sources

Item Number	Aggregate	Sources 1/	Feb-03 Value 2/
			(in millions of US\$)
4	Net international reserves = D - E		1,162.6
D	Gross international reserves 3/		1,901.9
	Foreign exchange	<i>FAFL</i> : Foreign exchange holdings by currency converted into US\$ at program exchange rates	1,858.8
	SDR holdings	<i>IMF Treasurer</i> : SDR holdings converted into US\$ at program US\$/SDR rate	5.3
	Gold	<i>FAFL</i> : Gold holdings in troy ounces converted into US\$ at program gold price.	37.6
	Reserve position with the Fund	<i>IMF Treasurer</i> : reserve position converted into US\$ at program US\$/SDR rate	0.3
E	International reserve liabilities		739.3
	Use of Fund resources		54.5
	GRA	<i>IMF Treasurer</i> : GRA outstanding converted into US\$ at program US\$/SDR rate	50.6
	Loans	<i>IMF Treasurer</i> : Loans outstanding converted into US\$ at program US\$/SDR rate	3.9
	Asian Clearing Union debit balances	<i>FAFL</i> : Asian Clearing Union A/C balance in US\$	204.0
	FX clearing accounts	<i>FAFL</i> : FX clearing A/C balances in US\$	480.5
	Other liabilities	<i>FAFL</i> : Other foreign A/Cs in US\$	0.4

1/ Italicized references to sources are as follows: *FAFL*: Foreign Assets and Liabilities of BB; *IMF Treasurer*: Bangladesh's financial position with the Fund as recorded by Fund's Treasurer's Department.

2/ Flows are from end-June, 2002.

3/ Excludes Tk. 0.3 billion blocked account with CB of Iraq.

Table 3. Bangladesh: Monitoring and Reporting Requirements

Item	Reporting Requirement	Periodicity / Reporting Lag
Item 1: Net domestic assets of BB	Balance Sheet of BB (Form 10G), Consolidated Balance Sheet of DMBs (Form 20G), Monetary Survey (Form 30G)	Monthly / within six weeks of end of corresponding period.
Item 2: Net domestic financing of central government Item 3: Net bank borrowing of central government	Balance Sheet of BB (Form 10G) Consolidated Balance Sheet of DMBs (Form 20G), Monetary Survey (Form 30G) outstanding stock of national savings certificates, nonbank holdings of government securities	Monthly / within six weeks of end of corresponding period.
Item 4: Net international reserves of BB	Foreign Assets and Liabilities of BB	Monthly / within three weeks of end of corresponding period.
Item 5: Contracting of short-term external debt Item 6: Contracting or guaranteeing of new medium- and long-term nonconcessional external debt	Contracting or guaranteeing of new external debt by the public sector/government, with details on creditor, amount and terms of each loan	Monthly / within three weeks of end of corresponding period.
Item 7: External payments arrears	Level of external payments arrears during period	Monthly / within three weeks of end of corresponding period.

**Bangladesh: Three-Year Arrangement Under the
Poverty Reduction and Growth Facility**

Attached hereto is a letter from the Minister for Finance and Planning of Bangladesh dated June 4, 2003 (the "Letter"), with an attached Memorandum on Economic and Financial Policies (the "Memorandum") and Technical Memorandum of Understanding (the "TMU"), requesting from the International Monetary Fund as Trustee of the Poverty Reduction and Growth Facility Trust (the "Trustee") a three-year arrangement under the Poverty Reduction and Growth Facility, and setting forth:

- (a) the objectives and policies of the program that the authorities of Bangladesh intend to pursue during the three-year period of the arrangement;
- (b) the objectives, policies and measures that the authorities of Bangladesh intend to pursue during the first year of the arrangement; and
- (c) understandings of Bangladesh with the Trustee regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Bangladesh will pursue for the second and third years of the arrangement.

To support these objectives and policies, the Trustee grants the requested three-year arrangement in accordance with the following provisions, and subject to the provisions applying to assistance under the Poverty Reduction and Growth Facility Trust.

1. (a) For a period of three years from June 20, 2003 to June 20, 2006, Bangladesh will have the right to obtain loan disbursements from the Trustee in a total amount equivalent to SDR 347 million, subject to the availability of resources in the Poverty Reduction and Growth Facility Trust.

(b) Disbursements under this arrangement shall not exceed the equivalent of SDR 148.5 million until June 20, 2004 and the equivalent of SDR 247.5 million until June 20, 2005.

- (c) During the first year of the arrangement:
 - (i) the first disbursement, in an amount equivalent to SDR 49.5 million, will be available upon approval of the arrangement, at the request of Bangladesh; and
 - (ii) the second disbursement, in an amount equivalent to SDR 49.5 million, will be available on or after December 15, 2003, at the request of Bangladesh and subject to paragraph 2 below;
 - (iii) the third disbursement, in an amount equivalent to SDR 49.5 million, will be available on or after June 15, 2004, at the request of Bangladesh and subject to paragraph 2 below.

(d) The right of Bangladesh to request disbursements during the second and third years of this arrangement shall be subject to such phasing and conditions as shall be determined. The phasing of, and conditions for, disbursements during the second year of this arrangement shall be determined in the context of the second review contemplated in paragraph 2.I(c) of this arrangement.

2. Bangladesh will not request:

I. the second and third disbursements specified in paragraph 1(c)(ii) and 1(c)(iii), respectively:

(a) if the Managing Director of the Trustee finds that, with respect to the second disbursement, the data as of September 30, 2003, and with respect to the third disbursement, the data as of March 30, 2004, indicate that:

- (i) the ceiling on net domestic assets of the Bangladesh Bank, or
- (ii) the ceiling on net domestic financing of the central government; or
- (iii) the ceiling on net bank borrowing of the central government; or
- (iv) the floor on cumulative increase of net international reserves of the Bangladesh Bank; or
- (v) the limit on the external debt contracted or guaranteed by the central government with maturities shorter than or equal to one year; or
- (vi) the limit on the new nonconcessional external debt with maturities of over one year but less than five years contracted or guaranteed by the central government; or
- (vii) the limit on the new nonconcessional external debt with maturities over five years contracted or guaranteed by the central government

with respect to the second disbursement, as specified in Table 2 of the Memorandum and in the TMU, and with respect to the third disbursement, as specified at the time of the first review referred to in paragraph 2.I(c) of this arrangement, was not observed; or

(b) if

- (1) with respect to the second disbursement, the Managing Director of the Trustee finds that: (i) by September 30, 2003, Bangladesh has not carried out its intentions with respect to modernizing and expanding the Large Taxpayer Unit to cover 1,000 income taxpayers; or (ii) by November 30, 2003, Bangladesh has not carried out its intentions with respect to phasing out margin requirements on the opening of letters of credit for imports, as further specified in Table 3 of the Memorandum; or

(2) with respect to the third disbursement, the Managing Director of the Trustee finds that, (i) by December 31, 2003, Bangladesh has not carried out its intentions with respect to making fully operational a Central Intelligence Audit and Monitoring Cell to monitor compliance of 1,000 large taxpayers; or (ii) by April 30, 2004, Bangladesh has not carried out its intentions with respect to adopting resolution strategies for the four NCBs, as further specified in Table 3 of the Memorandum;

(c) until the Trustee has determined, with respect to the second disbursement, that the first review, and with respect to the third disbursement, that the second review of Bangladesh's program referred to in paragraph 3 of the Letter and paragraph 34 of the Memorandum has been completed;

II. any disbursement under this arrangement,

- (a) if, at any time during this arrangement, the government of Bangladesh accumulates any new external payment arrears, as specified in Table 2 of the Memorandum and in the TMU; or
- (b) if Bangladesh has:
 - (i) imposed or intensified restrictions on payments and transfers for current international transactions, or
 - (ii) introduced or modified multiple currency practices, or
 - (iii) concluded bilateral payments agreements that are inconsistent with Article VIII, or
 - (iv) imposed or intensified import restrictions for balance of payments reasons; or

When Bangladesh is prevented from requesting disbursements under this arrangement because of this paragraph 2, such disbursements will be made available only after consultation has taken place between the Trustee and Bangladesh and understandings have been reached regarding the circumstances in which Bangladesh may request the disbursements.

3. In accordance with paragraph 2 of the Letter, Bangladesh will provide the Trustee with such information as the Trustee requests in connection with the progress of Bangladesh in implementing the policies and reaching the objectives of the program supported by this arrangement.

4. In accordance with paragraph 3 of the Letter, during the period of this arrangement, Bangladesh shall consult with the Trustee on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this arrangement and while Bangladesh has outstanding financial obligations to the Trustee arising from loan

disbursements under this arrangement, Bangladesh will consult with the Trustee from time to time, at the initiative of the Government or whenever the Managing Director of the Trustee requests consultation, on Bangladesh's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to Bangladesh or of representatives of Bangladesh to the Trustee.

INTERNATIONAL MONETARY FUND

BANGLADESH

Staff Report for the 2003 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Supplementary Information

Prepared by the Asia and Pacific Department
(In consultation with other departments)

Approved by Daniel Citrin and Anthony R. Boote

June 19, 2003

I. INTRODUCTION

1. This supplement provides an update on economic developments and on the implementation of the prior actions envisaged under the proposed PRGF arrangement, based on information that has become available since the issuance of the staff report (EBS/03/76, 6/6/03). These developments do not change the thrust of the staff appraisal.

II. RECENT ECONOMIC DEVELOPMENTS

2. **The near-term economic outlook is favorable with reduced downside risks.** The pace of economic activity has been in line with the projected acceleration in real GDP growth to 5.2 percent in FY03 (ending June). Industrial production grew by 6 percent during the first three quarters of FY03, while agricultural output rebounded to 4 percent. The external position has also improved, reflecting the recovery in exports and continued strength in workers' remittances (up by 6 percent and 24 percent, respectively, in the ten months through April). Gross official reserves reached nearly \$2 billion by mid-June (two months of prospective imports), in line with the program target. Inflation remains manageable, at an underlying pace of 5 percent. The moderate upward trend in food prices observed in early 2003 was stabilized during March–April, as the impact from adjustments in utility and energy prices dissipated gradually. Financial policies remain tight and quantitative benchmarks for March 2003 were met (Table 1).

III. IMPLEMENTATION OF PRIOR ACTIONS

3. **The authorities have completed all prior actions under the proposed program** (Table 2). The key actions since the issuance of the staff report comprise:

(i) **Exchange rate.** The taka was floated on May 31, 2003, when Bangladesh Bank (BB) announced that it would no longer set any band for its spot transactions of U.S. dollars with authorized dealers. The transition to the float has gone smoothly, aided in part by a preemptive tightening of liquidity and the willingness of the authorities to allow interest rates to play their role. In addition, the recent weakness of the U.S. dollar has helped to reduce the pressure on the taka. So far, the market reaction has been favorable, despite some temporary volatility in the interbank money market during the first few days of the float as some banks tried to test the exchange market. Call money rates rose to as high as 32 percent on June 3, but have settled to below 10 percent more recently. Dollar liquidity among banks appears adequate, allowing BB to make modest foreign exchange purchases. Since the float, the interbank exchange rate has remained stable at around taka 58.5 per dollar—almost the same as the pre-float level, and the parallel market rate has settled at about taka 60 per dollar.

(ii) **FY04 budget.** The FY04 budget was submitted to Parliament on June 12. Its main targets and proposed revenue and expenditure measures are consistent with the program (Table 3). In particular:

- The overall budget deficit (4.8 percent of GDP) and its financing, and revenue and expenditure ratios (at 11.0 percent and 15.8 percent of GDP, respectively) are broadly as envisaged in the MEFP.
- The key revenue measures include, as programmed, an expansion of the VAT net to cover additional services, a broadening of the income tax net, strengthening in tax administration, and a tightening of the bonded warehouse system.
- Beyond these, the budget also proposed further revenue enhancing measures, including steps to substantially improve VAT administration and increases in the development surcharge and in supplementary duties on imports. The latter measures have resulted in higher budget estimates for import taxes than projected by the staff (by 0.2 percent of GDP). However, they would also raise the effective protection rate by $\frac{3}{4}$ percentage points (to $22\frac{3}{4}$ percent, based on the World Bank's preliminary estimates). These measures represent an unanticipated setback in trade reform and underline the importance of rationalizing tariffs (including supplementary duties) and reducing the budget's reliance on import taxes, in the context of more comprehensive tax reforms over the next two years.
- On the expenditure side, the budget's reorientation toward pro-poor and pro-growth spending is fully consistent with the proposed program. Poverty-reducing spending is

budgeted to rise to 7.5 percent of GDP in FY04 as estimated by the authorities (from 6.2 percent in FY03) with a particular focus on education. To address infrastructure bottlenecks, priority in Annual Development Program spending is also being given to the power and energy sectors. In addition, the proposed wage increase of 10 percent is as anticipated.

(iii) **Expenditure limits.** To ensure the attainment of the proposed budget targets, the Ministry of Finance (MoF) issued circulars to spending units on June 12, specifying the maximum quarterly expenditure limits that are consistent with the budget's annual targets. This entails an effective back loading of spending for both discretionary recurrent and development expenditures, as envisaged under the program, providing therefore a safeguard against potential shortfalls in revenue.

(iv) **NCB reform.** With technical assistance from the Fund and in consultation with the World Bank, BB agreed on June 9 on interim Memoranda of Understandings (MOUs) with the MoF and each of the four nationalized commercial banks (NCBs). These MOUs limit growth in lending for each bank to 5 percent in 2003, and restrict single exposures to no more than 5 percent of each bank's paid-up capital. Relative to the envisaged prior action, the MOUs are more comprehensive, by stipulating syndication requirements for any loan in excess of these limits with the participation of at least one private or foreign commercial bank, the responsibilities of each bank's Board and management for compliance with these limits, and other prudential regulations by BB. Moreover, quarterly reporting requirements have been mandated, and a medium-term resolution plan for each NCBs will be developed by March 2004.

(v) **BB audit.** An action plan has been developed by BB to engage a local auditing firm affiliated with an international partner to audit the BB's financial statements of FY03 by September 2003. This audit is expected to be signed off by the international partner. A Terms of Reference has been agreed with the World Bank who will provide the financial support for the project.

Table 1. Bangladesh: Quantitative Performance Criteria and Benchmarks, March 2003–June 2004 1/

(Cumulative flows, end of period) 2/

	Benchmarks Mar-03	Actual Mar-03	Benchmarks Jun-03	Performance Criteria Sep-03	Benchmarks Dec-03	Indicative Targets Mar-04	Indicative Targets Jun-04
(In billions of taka)							
Ceiling on net domestic assets of Bangladesh Bank	-4	-16	-23	6	8	10	9
Ceiling on net domestic financing of central government	43	34	56	20	31	50	65
Ceiling on net central government bank borrowing	16	-1	18	11	13	23	30
(In millions of U.S. dollars)							
Floor on cumulative increase of net international reserves of Bangladesh Bank	221	278	557	-50	50	100	200
Contracting or guaranteeing of short-term external debt by the central government	...	0	0	0	0	0	0
Contracting or guaranteeing of nonconcessional medium- and long-term external debt by the central government	...	84	150	100	150	200	250
<i>Of which:</i> External debt with an initial maturity of over one year and up to five years	...	0	0	0	0	0	0
Accumulation of external payments arrears (continuous performance criterion during the program period)	0	0	0	0	0	0	0

1/ The aggregates are defined in the Technical Memorandum of Understanding dated May 2003 (EBS/03/76).

2/ Cumulative flow since beginning of July 2002 for benchmarks through end-June 2003, and cumulative flows since the beginning of July 2003 for the subsequent benchmarks and performance criteria.

Table 2. Bangladesh: Status of Prior Actions for Approval of PRGF Arrangement

Prior Actions	Status
1. Meeting end-March indicative benchmarks (see Table 1)	Met
2. Adoption of a floating exchange rate regime	Adopted on May 31
3. Liberalization of treasury bill rates, and adoption of a timetable and formula for linking the rate structure of the National Savings Certificates to treasury bill rates	Completed by April 22
4. Submission to parliament of a budget for FY04 consistent with the fiscal targets under the program	Submitted on June 12
5. Issuance by Ministry of Finance (MoF) of circulars to spending units specifying maximum quarterly expenditures that can be authorized, consistent with the program annual targets	Issued on June 12
6. Issuance of directive by Bangladesh Bank (BB) to each nationalized commercial bank (NCB) on restrictions of new lending, in consultation with Bank and Fund staff	Issued on June 11
7. Adoption of a timetable for the removal of margin requirements on imports	Adopted on June 4
8. Finalization by MoF of the outstanding amount of government arrears, establishment of a monitoring system to prevent accumulation of new arrears, and a timetable for the elimination of existing arrears	Completed by April 30
9. Adoption of a timetable for Bangladesh Bank to engage a local firm affiliated with an international accounting firm, and with sign off by that international accounting firm, to conduct its audit for FY03 (by the first PRGF review) in accordance with international auditing and accounting standards	Adopted on June 11

Table 3. Bangladesh: Central Government Operations, FY01-04 1/

	2000/01	2001/02 Est.	2002/03 Rev. Proj.	2003/04	
				Staff Report	Budget
(In billions of taka)					
Total revenue	228	277	310	356	361
Tax revenue	193	210	249	286	291
NBR taxes	183	199	237	273	278
VAT, supplementary duties, excises, and other NBR taxes	101	112	131	145	148
Customs duties	50	52	59	70	76
Taxes on income and profits	32	35	48	55	54
Non-NBR taxes	10	11	12	13	13
Nontax revenue	36	66	61	70	70
Total expenditure	374	390	435	515	520
Current expenditure	194	218	248	278	278
Pay and allowances	59	69	73	81	82
Goods and services	27	33	43	48	45
Interest payments	41	49	56	66	64
Subsidies and transfers	57	58	64	65	68
Block allocations	10	8	13	20	19
Food account surplus(-)/deficit(+)	2	2	-1	4	5
Annual Development Program (ADP)	166	152	171	200	203
Non-ADP capital and net lending	12	17	10	19	19
Structural adjustment expenditures	0	0	12	15	15
Check float plus discrepancy	-16	14	-4	0	0
Overall balance (excluding grants)	-130	-127	-125	-159	-159
Primary balance (excluding grants)	-89	-78	-69	-93	-95
Net financing	130	127	125	159	159
External	50	58	68	93	93
Domestic	79	68	56	65	65
Bank	37	22	18	30	30
Nonbank	42	46	38	35	35
Privatization receipts	1	1	1	1	1
(In percent of GDP)					
Total revenue	9.0	10.2	10.4	10.9	11.0
Tax revenue	7.6	7.7	8.3	8.7	8.9
NBR taxes	7.2	7.3	7.9	8.3	8.5
Non-NBR taxes	0.4	0.4	0.4	0.4	0.4
Nontax revenue	1.4	2.4	2.0	2.1	2.1
Total expenditure	14.8	14.3	14.5	15.7	15.8
Current expenditure	7.7	8.0	8.3	8.5	8.5
Pay and allowances	2.3	2.5	2.4	2.5	2.5
Goods and services	1.1	1.2	1.4	1.5	1.4
Interest	1.6	1.8	1.9	2.0	2.0
Subsidies and transfers	2.3	2.1	2.1	2.0	2.1
Block allocations	0.4	0.3	0.4	0.6	0.6
Food account surplus(-)/deficit(+)	0.1	0.1	0.0	0.1	0.2
Annual Development Program	6.5	5.6	5.7	6.1	6.2
Non-ADP capital and net lending	0.5	0.6	0.3	0.6	0.6
Structural adjustment expenditures	0.0	0.0	0.4	0.5	0.5
Check float plus discrepancy	-0.6	0.5	-0.1	0.0	0.0
Overall balance (excluding grants)	-5.1	-4.7	-4.2	-4.8	-4.8
Primary balance (excluding grants)	-3.5	-2.9	-2.3	-2.8	-2.9
Net financing	5.1	4.7	4.2	4.8	4.8
External financing (net)	2.0	2.1	2.3	2.8	2.8
Domestic financing	3.1	2.5	1.9	2.0	2.0
Memorandum item:					
Nominal GDP (in billions of taka)	2,535	2,717	2,996	3,284	3,284

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

1/ Fiscal year ends June 30.



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 03/84
FOR IMMEDIATE RELEASE
July 11, 2003

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with Bangladesh

On June 20, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bangladesh.¹

Background

Since the last Article IV consultation, economic performance has improved and macroeconomic policy implementation has strengthened, broadly in line with the recommendations of the Board. The economy has been in a recovery, led by the agricultural and industrial sectors and aided by the strength of domestic and external demand. Real GDP growth is thus projected to accelerate to 5.2 percent for FY03 from the 4.4 percent growth rate recorded in FY02. At the same time, inflation remains manageable, although it is on a slight upward trend to around 5¼ percent, owing to rising food prices which were linked to higher utility tariffs and energy prices.

The external position has also strengthened over the past year. Following a fall in exports in FY02, due to a sharp decline in ready-made garments (RMG) prices, exports have recovered, rising by 6 percent in the ten months through April 2003. During the same period, remittances continue to be strong, growing at an annual rate of 24 percent, reflecting in part a further shift in such flows to official channels. The current account is projected to remain in a small surplus for FY03. International reserves have increased to nearly \$2 billion as of mid-June, and are projected to rise further to \$2.1 billion by end-June 2003.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Prudent macroeconomic policies have contributed to these outcomes. In particular, fiscal policy has been tightened beginning in FY02; revenue was raised by 1 percentage point of GDP, mainly in the nontax area. As a result, the central government deficit (excluding grants) fell to 4.7 percent of GDP. At the same time, the monitoring of fiscal developments was strengthened, especially with respect to Annual Development Plan (ADP) spending.

Moreover, the deficit is on course to fall further in FY03 to 4.2 percent of GDP in line with the budget as a result of significant revenue measures combined with expenditure discipline. Tax revenue in the first seven months of the year rose by 16.7 percent, compared to the same period of FY02, suggesting that tax revenue for the year is on track to improve by 0.6 percentage points of GDP. At the same time, expenditures in the first seven months fell by 0.8 percentage points of GDP, reflecting restraint in ADP spending. This result was achieved despite a marked increase in expenditure to meet reform costs of state-owned enterprises (SOEs) (0.4 percent of GDP). More recently, the ADP budget has also been revised downward, to further prune lower priority spending.

Further, the structure of financing for the deficit in FY03 has improved. Domestic financing is expected to be cut from 2.5 percent of GDP in FY02 to 1.9 percent. Moreover, based on trends so far, the share of domestic financing through costly national savings certificates (NSCs) is expected to fall. To reduce future interest burden, interest rates on NSCs were reduced by 2 percentage points and the four most costly NSC schemes were withdrawn in July 2002.

Monetary policy has been restrained since early 2002, and treasury bill rates have been allowed to rise, reflecting market conditions. In the year to March 2003, reserve money is estimated to have grown by 6 percent, as Bangladesh Bank (BB) sterilized its accumulation of international reserves with auctions of treasury bills. As a result, short-term treasury bill yields rose from 4 percent to 8 percent over the period; at the same time, commercial lending rates remained at about 12 percent. Broad money grew by 15 percent in the year to February 2003, buoyed by strong growth in credit to the private sector.

Exchange restrictions have recently been eased, and exchange rate management has been more flexible, helping to strengthen the external position. In particular, the scope of the margin requirements on letters of credit for imports has been reduced, and limits were lifted in August 2002 on travel, educational and medical expenses, and on payments for other invisibles. Nonetheless, Bangladesh continues to maintain exchange restrictions subject to Fund jurisdiction. The exchange rate for the taka remained fixed to the U.S. dollar from January 2002 until May 31, 2003, when the taka was allowed to float. With the weakening of the U.S. dollar, during the period January 2002–May 2003, the taka has depreciated by 12 percent in nominal effective terms and by an estimated 8 percent in real effective terms.

The authorities recently have limited the contracting of new nonconcessional external debt. During FY03, new loan commitments and guarantees on nonconcessional terms are projected to be at most \$150 million, down from an estimated \$350 million in FY02. External public debt at end-June 2003 is projected at \$17 billion (33 percent of GDP). In view of its concessional

nature, debt in NPV terms is about 20 percent of GDP and 101 percent of exports, while the debt service ratio remains relatively low at 6.5 percent.

Steps have been taken to renew structural reforms. With respect to manufacturing, the government has initiated a four-year program to phase out SOEs from this sector, starting with the closure/privatization of key loss-making units. In addition to Adamjee jute mills, another 24 out of a total of 150 SOEs have been closed so far in FY03. To ease this process, a severance scheme has been adopted to provide safety nets for retrenched workers. In the energy sector, the focus so far has been on tariff and pricing adjustments, to stem financial losses. Since October 2001, utility tariffs have been raised by 8 percent, and the prices of a wide range of energy products have been substantially increased. In addition, Parliament has recently passed the Energy Regulatory Commission Act, creating an independent regulator for the sector.

In the banking sector, the priority has been on improving the legal framework and upgrading prudential standards. The Bangladesh Bank Order was amended to provide greater operational autonomy to BB. The Banks (Nationalization) Act and the Banking Companies Act were also amended to strengthen BB's regulatory powers by bringing nationalized commercial banks (NCBs) within its purview and to improve capital adequacy and governance in private commercial banks. Moreover, a new Money Loans Court law was enacted that establishes specialist courts to deal with loan defaults and streamlines the recovery process.

Trade reform was given renewed impetus in the FY03 budget, when the top customs duty rate was reduced by 5 percentage points to 32.5 percent, and the number of rates reduced to five (including a zero rate). The structure of supplemental duties was also simplified by reducing the number of rates from 31 to 5. The effective average tariff rate was thus reduced to 24 percent.

Executive Board Assessment

Directors commended the authorities' prudent macroeconomic management and renewal of structural reforms, which strengthened economic performance in the past year. Economic growth is buoyant, inflation remains moderate, and international reserves have risen. The major challenge facing Bangladesh now is to put the economy on a higher growth path with faster poverty reduction. Directors noted that impediments to private sector growth, a weak banking system, limited public resources, and natural disasters have held up progress toward achieving this goal.

Directors considered Bangladesh's National Poverty Reduction Strategy (the I-PRSP), to be a coherent and comprehensive policy framework for boosting economic growth and reducing poverty. They emphasized that poverty reduction will require macroeconomic stability and an improvement in the investment climate. For this, the authorities will need to accelerate structural reforms, ease bottlenecks in physical infrastructure, further invest in human capital, and strengthen governance. Directors encouraged the authorities to more sharply prioritize pro-poor policies and programs in framing the full PRSP, to ensure a full costing of these programs within a medium-term expenditure framework, and to broaden further the participatory process,

particularly to include parliamentarians, to enhance political support for the reform agenda. Furthermore, monitoring mechanisms should be established to gauge the progress in reducing poverty and, in this context, additional work should be undertaken to better define final outcome indicators.

Directors endorsed the macroeconomic framework and the emphasis of the proposed Poverty Reduction and Growth Facility (PRGF)-supported program on fiscal reforms, restructuring and privatization of the nationalized commercial banks (NCBs) and state-owned enterprises (SOEs), more liberal exchange and trade regimes, and improved economic governance. They stressed that for the structural reforms to be successfully implemented, the underlying economic governance issues will need to be decisively tackled. In this context, improved accountability in public resource management, judicial reform, and the proposed establishment of an anti-corruption commission would be especially helpful.

On fiscal reform, Directors welcomed the reduction of the fiscal deficit in fiscal year 2002/03 and the budget framework for fiscal year 2003/04, which is consistent with a pro-poor growth strategy. Directors noted the low revenue effort, and underscored the importance of action to boost revenue, particularly in view of intended trade liberalization. They endorsed the extension of the coverage of the VAT and income tax and the strengthening of tax administration. On the expenditure side, Directors welcomed the planned shift in budget allocations toward financing of structural reforms, poverty reduction and the social sectors (especially education), and the critical energy and power sectors. To achieve the targeted allocation, it will be important to improve development project selection and implementation, as well as transparency and accountability in expenditure management, drawing on the recommendations of the fiscal ROSC.

Directors stressed that continued fiscal reform over the medium term will be vital, and should center on a sustained revenue effort and a shift in spending toward investments in infrastructure and human capital to better support growth and the Millennium Development Goals. However, while they welcomed the increased budgetary allocation to education, they stressed that the effectiveness of social spending is at least as important, and encouraged the authorities to draw upon the findings and recommendations of last year's public expenditure review in guiding the projected increase in spending. To support poverty reduction, it will be important to promote the development of the rural sector, including through a better functioning of land markets and through sound microfinance policies. For public debt sustainability, Directors called on the authorities to curtail domestic financing for the budget, to exercise prudence in external debt management, and to refrain from non-concessional borrowing. Moreover, public debt management should be strengthened, starting with an improved debt information system.

Directors welcomed the recent tightening of monetary policy and the greater flexibility in interest rate policy, which contributed to the successful float of the exchange rate. They stressed that monetary policy would need to remain firm in the period ahead in order to contain inflationary pressures, support orderly conditions in the foreign exchange market, and facilitate a further rebuilding of international reserves. Over time, the authorities would need to address some of the recommendations in the Financial System Stability Assessment (FSSA) report regarding

monetary policy instruments. The completion of the safeguards assessment of the central bank was welcomed, and the authorities were urged to address the critical weaknesses quickly.

Directors endorsed the authorities' SOE reform plan for the manufacturing sector, noting the orderly divestment of key loss-making units so far aided by the safety nets for retrenched workers. They encouraged the authorities to maintain the momentum of this reform, so as to substantially withdraw SOEs from this sector within three years as planned and make room for the private sector.

Directors stressed that the serious problems of SOEs in the energy sector would also need to be decisively addressed, in order to contain fiscal risks and ease critical infrastructure bottlenecks. They welcomed recent pricing actions, which have helped stem the financial losses of the sector, but stressed that the effect of price increases on the poor should be mitigated through a well-targeted social safety net. Directors encouraged the authorities to make further progress, in consultation with the World Bank, by moving in a timely way to implement an automatic pricing framework for energy, starting with adoption in the near term of an interim pricing formula. An effective regulatory body should also be installed soon, now that the legal framework is in place. In addition, Directors attached importance to resolving the inter-enterprise arrears of SOEs in this sector in the context of an appropriate restructuring, and to defining the next phase of reforms so as to permit a higher level of investment in this sector. Plans to improve the pricing and regulatory framework were considered an important first step, but the goal should be eventual privatization of the key enterprises. A few Directors noted the delay in the corporatization of the Telephone and Telegraph Board, and urged timely implementation of the process.

Directors welcomed the recent upgrading of the legal framework for banking regulation and loan recovery, as well as the strengthening of Bangladesh Bank's operational autonomy and supervision over the NCBs. They considered the proposed approach to NCB reform to be a cautious but meaningful start to addressing the weaknesses in this area and in the financial sector more generally. The planned audits of these banks should help in defining a resolution strategy for each bank by April 2004, drawing also on the findings of the FSSA. Some Directors strongly concurred with the recommendations of the FSSA that all NCBs should be sold off, and suggested that privatization be included in the resolution strategies. Directors emphasized the need in the interim to strengthen oversight of NCBs and bank management, to restrict NCB lending, and to forcefully address the problems of directed lending and outside interference in the management of these banks. Directors also called on the authorities to strengthen anti-money laundering legislation to address terrorism financing issues and clarify the powers of the financial intelligence unit, and to upgrade capacity for enforcing the legislation.

Directors welcomed the recent move to a floating exchange rate regime, which will offer greater flexibility in macroeconomic policy management, better protect competitiveness, and enhance Bangladesh's resilience to shocks. Directors stressed that more will need to be done over the next two years to rationalize import taxes, reduce the effective rate of protection, and remove the anti-export bias, especially in order to diversify exports and reduce external vulnerability.

Noting that the authorities have proposed timetables for eliminating the restrictions with respect to the margin requirements for imports and the nonresident taka accounts, Directors approved these restrictions on a temporary basis. However, a few Directors were concerned that these timetables had slipped relative to the previous undertakings. The authorities were urged to set a timetable for eliminating the remaining restriction on advance payments for imports.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2003 Article IV Consultation with Bangladesh is also available.

Bangladesh: Selected Economic Indicators, FY00-04 1/

	1999/00	2000/01	2001/02	2002/03	2003/04
				Proj.	
National income and prices (percent change)					
Real GDP 2/	5.9	5.3	4.4	5.2	5.5
GDP deflator	1.9	1.6	2.7	4.8	4.0
CPI inflation (annual average)	3.4	1.6	2.4	5.2	4.5
Central government operations (percent of GDP) 3/					
Total revenue	8.4	9.0	10.2	10.4	11.0
Tax	6.7	7.6	7.7	8.3	8.9
Nontax	1.7	1.4	2.4	2.0	2.1
Total expenditure	13.5	14.1	14.8	14.5	15.8
Current expenditure	7.5	7.7	8.0	8.4	8.5
<i>Of which: Interest payments</i>	1.6	1.6	1.8	2.0	2.0
Annual Development Program	5.4	6.5	5.6	5.8	6.2
Extraordinary expenditures	...	...	...	0.4	0.5
Other expenditures 2/	0.6	-0.2	1.2	-0.1	0.6
Overall balance (excluding grants)	-5.1	-5.1	-4.7	-4.2	-4.8
Primary balance	-3.6	-3.5	-2.9	-2.2	-2.8
Financing (net)	5.1	5.1	4.7	4.2	4.8
Domestic	2.7	3.1	2.6	1.9	2.0
External	2.4	2.0	2.1	2.3	2.8
Total central government debt (percent of GDP)	47.9	50.8	53.2	51.7	52.2
Money and credit (end of year; percent change)					
Net domestic assets	13.6	20.2	11.9	10.6	11.9
Private sector	10.5	16.3	13.9	11.4	11.3
Broad money (M2)	18.6	16.6	13.1	12.5	12.1
Money velocity	3.2	2.9	2.8	2.7	2.7
Balance of payments (US\$ millions) 4/					
Exports, f.o.b.	5,701	6,419	5,986	6,110	6,512
(Annual percent change)	7.9	12.6	-6.7	2.1	6.6
Imports, f.o.b.	-7,566	-8,430	-7,697	-8,224	-9,600
(Annual percent change)	4.8	11.4	-8.7	6.8	16.7
Gross official reserves (US\$ millions)					
In months of imports of goods and nonfactor services	1.9	1.7	1.8	2.6	2.7
Memorandum item:					
Nominal GDP (in billions of taka)	2,371	2,535	2,717	2,996	3,284

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

1/ Fiscal year begins July 1.

2/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).

3/ Starting FY02, central government fiscal positions are presented on a gross basis.

4/ Balance of payments is presented on the basis of BPM5.



Press Release No. 03/92
FOR IMMEDIATE RELEASE
June 20, 2003
Corrected: June 23, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US\$490 Million Three-Year PRGF Arrangement for Bangladesh

The Executive Board of the International Monetary Fund (IMF) today approved a three-year, SDR 347 million (about US\$490 million) arrangement under the Poverty Reduction and Growth Facility (PRGF) for Bangladesh, which will support the government's economic reform program for 2003-06. The decision will make available immediately to Bangladesh the first disbursement in an amount equivalent to SDR 49.5 million (about US\$70 million).

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

In commenting on the Executive Board's decision, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chair, stated:

“Over the past year, Bangladesh’s economic performance has strengthened as a result of the authorities’ prudent macroeconomic management and renewal of structural reform. The challenges facing Bangladesh now are to build on this record of policy implementation and to put the economy on a path of higher growth with faster poverty reduction.

“Bangladesh’s National Strategy for Economic Growth, Poverty Reduction, and Social Development (the I-PRSP) has been prepared under a broad consultative process and provides a coherent and comprehensive policy framework for halving poverty by 2015. Within this strategy, the authorities have adopted a three-year PRGF-supported program designed to maintain macroeconomic stability, accelerate structural reforms that are critical for poverty reduction and growth, and improve the investment climate.

“The principal structural elements of the program comprise fiscal reform, reforms of the nationalized commercial banks (NCBs) and state-owned enterprises (SOEs), more liberal exchange and trade regimes, and improved economic governance. Fiscal reform is centered on a

sustained revenue effort and a shift in spending toward investments in infrastructure and human capital, to better support growth and achieve the Millennium Development Goals. The budget for fiscal year 2003/04 is in line with this strategy, providing for significant revenue measures and giving priority to the education, power, and energy sectors. Determined implementation of revenue measures and improved development project selection will be critical, as will be additional steps to improve transparency and accountability in expenditure management.

“The authorities’ approach to NCB reform is cautious but represents a meaningful start to addressing the weaknesses in this area. The envisaged audits of these banks should help in defining a resolution strategy for each bank by April 2004. In the interim, attention will need to be placed on strengthening oversight of NCBs and bank management, and restricting NCB lending, to curb the flow of new nonperforming loans.

“The ongoing momentum in reforming SOEs in the manufacturing sector should be reinforced, to substantially withdraw SOEs from this sector. Furthermore, reform of SOEs in the energy sector will be needed to contain fiscal risks and ease critical infrastructure bottlenecks. Recent pricing actions have provided a start, but the authorities will need to make further progress, in consultation with the World Bank, notably by implementing an automatic pricing framework for energy and installing an effective regulatory body.

“For these structural reforms to be successfully implemented, the underlying economic governance issues will need to be decisively tackled. More broadly, institutional changes to improve public resource management will be important,” Mr. Sugisaki stated.

ANNEX

Recent Economic Developments

The economy of Bangladesh is undergoing recovery. Over the first half of 2003, industrial production and exports have rebounded by 5 percent. Real GDP growth is thus expected to recover to an estimated 5.2 percent for FY03, driven by agricultural production and strong domestic demand. Meanwhile, inflation remains manageable, at an underlying pace of 5 percent, as the moderate upward trend in food prices observed in early 2003 was stabilized during March-April, and the impact from adjustments in utility and energy prices dissipated gradually. Gross international reserves have been rebuilt to around US\$2 billion (or two months of prospective imports) at mid-June, from the low of US\$1 billion reached in November 2001.

Prudent macroeconomic policies have contributed to these results. In particular, fiscal policy has been tightened beginning in FY02; revenue was raised by 1 percentage point of GDP, mainly in the nontax area. As a result, the central government budget deficit fell to 4.7 percent of GDP (from 5.1 percent of GDP in FY01), and is on course to fall further to 4.2 percent of GDP in FY03 as budgeted, on account of both revenue measures and expenditure discipline. Monetary policy has also been restrained since early 2002, and excess bank reserves have been reduced

substantially. Reserve money remained flat over 2002, through sales of treasury securities by Bangladesh Bank.

Significant steps have also been taken to renew the momentum of structural reforms. In particular, Bangladesh Bank has gained greater autonomy and expanded authority to supervise the nationalized commercial banks, key loss-making state-owned enterprises have been closed, and adjustments made to utility tariffs and energy prices.

Program Summary

The proposed PRGF-supported program builds on this record of policy implementation, and is focused on the structural reforms critical for putting the economy onto a higher growth path to achieve faster poverty reduction. Attaining a sustainable and rapid growth necessary for halving poverty by 2015—a goal in the Interim Poverty Reduction Strategy Paper (I-PRSP)—will require not only maintenance of macroeconomic stability but also a major improvement in the investment climate. For this, the authorities will need to accelerate structural reforms that are central to addressing the high cost of borrowing, bottlenecks in physical infrastructure, inadequate investment in human capital, and poor economic governance, all of which have been identified as key impediments to growth and poverty reduction efforts.

Under the program, real GDP growth is targeted to rise to 6.5 percent by FY06, to be met largely by external assistance on concessional terms, and official reserves would be built to over three months of imports by end-FY06. To achieve these goals, the key elements in the program are:

- fiscal reform, involving a sustained revenue effort and a shift in spending toward infrastructure and human capital to support growth and the Millennium Development Goals, while keeping public debt sustainable;
- reforms of nationalized commercial banks, including defining bank-by-bank resolution strategies, and in the interim, steps to strengthen bank management and restrain lending to help stem the flow of new bad loans;
- state-owned enterprise reforms, particularly closing/privatizing state-owned enterprises in manufacturing, and reforming state-owned enterprises in the energy sector
- more liberal exchange and trade regimes, by moving to a floating exchange rate regime and continued trade reform, to reduce external vulnerability.

For structural reforms to be successfully implemented, the underlying economic governance issues will need to be decisively tackled. More broadly, institutional changes to improve public resource management will be needed. In this context, the envisaged creation of an anti-corruption commission is key.

Table 1. Bangladesh: Key Economic Indicators, FY00–04 1/

	1999/00	2000/01	2001/02	2002/03	2003/04
				Proj.	
National income and prices (percent change)					
Real GDP 2/	5.9	5.3	4.4	5.2	5.5
GDP deflator	1.9	1.6	2.7	4.8	4.0
CPI inflation (annual average)	3.4	1.6	2.4	5.2	4.5
Central government operations (percent of GDP)					
3/					
Total revenue	8.4	9.0	10.2	10.4	11.0
Tax	6.7	7.6	7.7	8.3	8.9
Nontax	1.7	1.4	2.4	2.0	2.1
Total expenditure	13.5	14.1	14.8	14.5	15.8
Current expenditure	7.5	7.7	8.0	8.4	8.5
<i>Of which:</i> Interest payments	1.6	1.6	1.8	2.0	2.0
Annual Development Program	5.4	6.5	5.6	5.8	6.2
Extraordinary expenditures	...	...	...	0.4	0.5
Other expenditures 2/	0.6	-0.2	1.2	-0.1	0.6
Overall balance (excluding grants)	-5.1	-5.1	-4.7	-4.2	-4.8
Primary balance	-3.6	-3.5	-2.9	-2.2	-2.8
Financing (net)	5.1	5.1	4.7	4.2	4.8
Domestic	2.7	3.1	2.6	1.9	2.0
External	2.4	2.0	2.1	2.3	2.8
Total central government debt (percent of GDP)	47.9	50.8	53.2	51.7	52.2
Money and credit (end of year; percent change)					
Net domestic assets	13.6	20.2	11.9	10.6	11.9
Private sector	10.5	16.3	13.9	11.4	11.3
Broad money (M2)	18.6	16.6	13.1	12.5	12.1
Money velocity	3.2	2.9	2.8	2.7	2.7
Balance of payments (in millions of U.S. dollars)					
4/					
Exports, f.o.b.	5,701	6,419	5,986	6,110	6,512
(Annual percent change)	7.9	12.6	-6.7	2.1	6.6
Imports, f.o.b.	-7,566	-8,430	-7,697	-8,224	-9,600
(Annual percent change)	4.8	11.4	-8.7	6.8	16.7
Gross official reserves (in millions of U.S. dollars)	1,596	1,306	1,582	2,100	2,566
In months of imports of goods and nonfactor services	1.9	1.7	1.8	2.6	2.7
Memorandum item:					
Nominal GDP (in billions of taka)	2,371	2,535	2,717	2,996	3,284

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

1/ Fiscal year begins July 1.

2/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).

3/ Starting FY02, central government fiscal positions are presented on a gross basis.

4/ Balance of payments is presented on the basis of BPM5.

**Statement by Yaga V. Reddy, Executive Director for Bangladesh
June 20, 2003**

I. INTRODUCTION

My authorities wish to thank the staff for their perceptive report on Bangladesh. This Report, while laying out a demanding reform program as part of the proposed PRGF arrangement, provides a broad overview of improvements made in the macroeconomic management while delineating the current status of the economy and the future challenges facing it. We also commend staff for their insightful Joint Staff Assessment of the I-PRSP; the FSSA report, the Fiscal Transparency Module of the ROSC as well as the useful Statistical Appendix. This set of five documents, read with the Three Year National Strategy for Economic Growth, Poverty Reduction and Social Development (NSEGPRSD- being the IPRSP of the Government of Bangladesh); offers a comprehensive account of the recent developments in the economy, the policy challenges facing my Bangladeshi authorities and the reform steps they propose to take with support from the IMF and other aid agencies. As has been indicated by my authorities in the MEFP and LOI, they are in agreement with the staff report including on the pace, direction and calibration of the reform program. On behalf of my Bangladesh authorities, I would therefore like to take this opportunity to offer more comprehensive discussion on a few important issues.

II. RECENT MACROECONOMIC DEVELOPMENTS

My authorities have over the past year, taken a number of credible steps to enhance macroeconomic stability and improve fiscal discipline. These steps consistent with the advice of the Executive Board during the 2002 consultations, resulted in containing the fiscal deficit at 4.7 percent of GDP in FY02. The fiscal deficit for the current fiscal year FY 2003 will remain within 4.2 percent of GDP.

Despite the uncertain external environment, my authorities have been able to maintain macroeconomic stability and steer the economy to a sustainable growth path. Last year GDP growth rate was 4.4 percent, in the current year growth is expected to go up by almost one percentage point, reaching 5.2 percent. Agriculture is projected to grow at 4 percent and industry at 6.6 percent. My authorities have been pursuing a sound monetary policy to keep inflation stable, boost private investment and to enhance reserves. The fiscal deficit for the current fiscal year will remain within 4.2 percent of GDP. The Revenue-GDP ratio at around 10.4 percent as well as the Expenditure-GDP ratio at around 15 percent are among the lowest in the world. My authorities recognize the need for providing additional headroom to enable substantial increase in social and poverty reduction expenditure and are therefore committed to increase the Revenue-GDP ratio by at least 0.5 percentage points a year from its present value of 10.4 percent over the next three years. While the present revenue GDP ratio is low, it must also be recognized that the expenditure GDP ratio at 15 percent is also very low.

Overcoming the negative growth recorded last year , exports have grown by 7.75 percent up to April 2003. Foreign exchange remittances during the same period rose by 24 percent- reflecting increased confidence in the economy. Gross foreign exchange reserves in the month of June, 2003 rose near to US\$ 2 billion double the level of October, 2001.

The effectiveness of monetary policy has been strengthened through the introduction and development of repo and reverse repo instruments, while a link is being established between small savings instruments and treasury bill rates. A flexible exchange rate system has been introduced. The structural reform program has advanced considerably: through enhanced autonomy to the Bangladesh Bank, sale of large loss making SOEs, and embarking on trade liberalization.

My authorities have already met the nine prior actions set for the first year of the PRGF arrangement. These are - (1) they met the end-March indicative benchmarks, (2) adopted floating exchange rate regime, (3) agreed to liberalize treasury bill rates, and adopt a timetable and formula for linking the rate structure of the National Savings Certificates to treasury bill rates, (4) submitted to parliament a budget for FY04 consistent with the fiscal targets under the program, (5) issued circulars to spending units specifying maximum quarterly expenditures that can be authorized, consistent with the program annual targets, (6) issued directive by Bangladesh Bank (BB) to each nationalized commercial bank (NCB) on restriction of new lending, in consultation with Bank and Fund staff, (7) adopted a timetable for the removal of margin requirements on imports, (8) agreed on the outstanding amount of government arrears, establishing a monitoring system to prevent accumulation of new arrears, and a timetable for the elimination of existing arrears, and (9) adopted a timetable for Bangladesh Bank to engage a local affiliated firm with sign off by an international accounting firm, to conduct its audit for FY03 (by the first PRGF review) in accordance with international auditing and accounting standards. These strong steps mirror the determination of my authorities to proceed aggressively on the path of reform, for which they are now seeking Fund support in the form of PRGF support.

III. THREE YEAR NATIONAL STRATEGY OF ECONOMIC GROWTH, POVERTY REDUCTION AND SOCIAL DEVELOPMENT (NSEGPRSD /I-PRSP)

At 5.0 percent, the average growth rate of Bangladesh during the last decade was remarkable by any international standard. Despite this, my Bangladeshi authorities recognize and accept that this growth rate is not enough if it has to meet the goals it has set for itself in the I-PRSP. These goals, to be reached by 2015, go beyond the Millennium Development Goals and therefore require an accelerated development strategy. Such a strategy, which has been framed in their I-PRSP, was finalized after extensive consultations over a period of more than one year. During this period, my authorities undertook extensive consultations with a wide range of stakeholders across the country starting from the grass-root level upwards and including different arms of government, nongovernmental organizations, members of civil society and Bangladesh's development partners. These consultations were extremely useful in building up ownership, creating a consensus for reform while incorporating a strong degree of pragmatism in the projections.

The I-PRSP envisages pro-poor economic growth focusing on systematic reduction of both income and human poverty, reduction of the gender gap, promotion of women's advancement, provision of social security to the poor, strengthening the participatory process and ensuring governance. My authorities believe that the targets set forth in the I-PRSP including the projected growth rate of 6.5 percent by the terminal year of the program period are achievable.

My authorities accept the need for further work while developing the full PRSP including on the lines suggested in the JSA. They recognize that areas of further work include - prioritization of near-term policies, costing of strategies and programs, selection of indicators and baselines for improvement in monitoring implementation of the program and initiating PSIA of the reform strategy.

The approach supported by the I-PRSP/PRGF is focused on improving accountability and transparency in policy making - through reforming institutions, reducing the scope for bureaucratic discretion and improving public expenditure management. A number of legal enactments, such as The Energy Regulatory Commission Act 2002, Bangladesh Telecommunication Act 2001 as well as , amendments to Bangladesh Bank Order 1972 are aimed at achieving these objectives. A donor-financed technical assistance project titled 'Financial Management Reform Program' (FMRP) is designed to strengthen internal controls, and carry out poverty tracking studies and PSIA. Public procurement is also being improved with technical assistance from the World Bank, and imperfections in targeted transfer programs are being addressed. More broadly, my authorities are finalizing a legal framework for establishing an independent Anti-Corruption Commission vested with the authority to investigate allegations of corruption.

Good governance will be critical to implementing this medium-term agenda. My authorities acknowledge that this will be essential for strengthening the performance of public administration, revenue mobilization system and the banking system. My authorities recognize that weak governance is viewed as a key impediment to growth of private enterprise and FDI. In light of this, many of the programmed reform measures have been designed to improve economic governance and build stronger institutions; in this context, we recognize the importance of strengthening law and order so as to improve the investment climate. My authorities are committed to continuing consultation with a broad spectrum of stakeholders to develop the full PRSP by December, 2004 and also to institute an appropriate poverty monitoring and tracking mechanism to regularly evaluate the impact of the Program on poverty reduction.

IV. FISCAL POLICY

My authorities have taken a major initiative to raise revenue by 1.5 percent of GDP over the program period. These efforts will consolidate as well as build upon the ongoing initiatives wherein the revenue-GDP ratio has been increased from 8.4 percent in FY 2000 to 10.4 percent in FY 2003. This challenging revenue growth of about 15 percent year on year will be achieved mainly through improving tax administration and broadening the tax base. My authorities are confident that , given the tax potential, it would be possible to achieve the

revenue target through appropriate reforms in both direct as well as indirect taxes as reflected in the MEFP. My authorities also believe that the parallel trade reform initiatives will complement these revenue enhancement efforts by reducing leakages. As of April, 2003, despite a reduction of supplementary duties and the top tariff rate by 5 percentage points and with only a moderate import growth, trade related revenue has increased by 21 percent.

My authorities are committed to the fundamentals of the agreed medium-term macro-economic framework as well as the quarterly performance and structural criteria, and would make necessary adjustments in expenditure depending upon inflow of revenue resources and availability of concessional financing. Poverty reducing spending in FY04 budget will rise by over 1 percent of GDP. The projected World Bank Supported Development Support Credit to be available within the program period would be spent on structural adjustments in the SOE sector and in poverty reducing programs. My authorities remain committed to contain fiscal deficits within the projections of the MTEF.

V. MONETARY POLICY

Market-based exchange rate of Taka has been introduced by my authorities from 31st May 2003 to allow the exchange rate to adjust spontaneously to changing market realities. As the change of regime took place in an environment of balanced and sound macroeconomic fundamentals, the Taka has remained stable after the float. The transition has turned out to be smooth. The dealers in the market adjusted to the new realities quickly.

My authorities are cognizant of the importance of strengthening the safeguards framework of the Bangladesh Bank (BB) and they have taken a number of steps towards this direction. They are implementing all the critical recommendations of the safeguards assessment including separating the reserve management functions from the dealing room and back office, developing a separate middle office function, and restating BB's financial accounts in accordance with International Accounting Standards. In this connection, they wish to thank the IMF for the technical assistance provided. In addition, the World Bank is providing support to BB through the Central Bank Strengthening Project. The aim of this project is to support the overall strengthening of the BB to enable it to play its due role as country's monetary authority and bank regulator and supervisor. The project includes components to strengthen the legal framework, reorganization and modernization of BB including through putting in place IT systems, and capacity building of BB staff.

The Bangladesh Bank Order has been amended to strengthen BB's operational autonomy. The Banking Companies Act and Bank's (Nationalization) Act were amended to bring Nationalized Commercial Banks (NCBs) and Development Financial Institutions (DFIs) under greater supervision of BB. My authorities would get NCBs as well as Bangladesh Bank audited according to International Standards of Auditing, with the FY03 audit of Bangladesh Bank to be signed off by an internationally experienced external audit firm.

My authorities remain committed to take all possible steps to prevent money laundering and combat financing of terrorism. The Money Laundering Prevention Act has been passed aimed at preventing illegal transactions. To enhance effectiveness of this important initiative, parallel steps are being taken under the WB project to train BB staff in the effective implementation of AML/CFT provisions, as well as install systems in BB to capture and share data on ML/FT. Banks and non-bank financial institutions are already under reporting requirements of the Money Laundering Prevention Act. These reporting requirements and surveillance would next be extended to cover other financial intermediaries like insurance companies, stock-brokers and money-changers.

My authorities have taken due note of the FSAP recommendations and are actively pursuing necessary reforms. Restructuring of the nationalized commercial banks has been taken up. Of the four NCBs, arrangements have been initiated for immediate privatization of one, appointment of new management team in another, and appointment of management - support teams in the other two. The new management team/ management support teams will work out the best resolution strategy for each bank, based on comprehensive evaluation by external auditors. As an interim measure, to stem the growth of bad loans, lending growth of the NCBs is being restricted to 5 percent through (1) tightening single borrower exposure to 5 percent of paid up capital, (2) bank-by-bank limits on net lending to continue reducing the market share of these banks and (3) the requirement that syndication of large loans involve meaningful participation of private banks. Prudential measures for private sector banks have also been shored up. Minimum capital requirement has been raised from the previous 400 million Taka and eight percent of risk weighted assets to 1 billion Taka and nine percent of risk weighted assets. Lending discipline has been tightened with stricter guidelines on loan rescheduling and lower limits for single borrower exposure. Corporate governance practices in banks have received special attention. Fit and proper tests have been introduced for directors and chief executives; continuous tenure of board directors has been limited to six years. Audit committees of bank boards have been made mandatory, to be comprised of non-executive members, with clear roles and responsibilities in internal control and risk management. Provision has been made for nomination by Bangladesh Bank of up to two directors from amongst depositors in the board of a bank, and the maximum number of directors (including the depositor nominees) has been limited to fifteen.

On the issue of restrictions in place, my authorities remain committed to phase out entirely by November 03 the margin requirements on imports. They also expect to lift the restrictions, by the end of the PRGF period, on the convertibility and transferability of proceeds of current international transactions in non-resident Taka accounts.

VI. STRUCTURAL REFORMS

My authorities have taken bold steps to reduce losses of State Owned Enterprises (SOEs) through efficiency improvements as well as privatization. As a result, overall losses have been reduced by 17 percent and losses of manufacturing SOEs have been reduced by 41 percent and it is expected that loss in this sector would be further reduced to 0.4 percent of GDP from 1 percent in FY 1999-2000. The claims of the employees of SOEs which were

privatized or closed down have been paid as appropriate. Adequate provision has also been made in the budget for FY04 for payment of claims of employees of SOEs which are likely to be privatized or closed in future. My authorities are committed to impose hard budget constraints on SOEs and implement closure/privatization program of SOEs as reflected in the MEFP.

The Government has undertaken a series of reform measures in the energy and power sector in order to create an appropriate enabling environment for improved public sector performance, attract multi-lateral and private investment, rationalize tariff rates and improve tariff collections, and give 'value for money' to the consumers. In order to promote efficient energy use, the government has adopted a new electricity, gas and petroleum pricing framework to ensure efficiency and financial viability of this sector. This framework will provide for a formula-based, flexible pricing mechanism that rationalizes the prices of energy products and enables cost recovery for all operating, maintenance, and capital costs.

Reforming the energy sector through appropriate pricing and transparent regulatory framework has been given due importance. Decisive reform of the energy sector is critical to containing SOE losses, since such losses are heavily concentrated in this sector. Recent energy price increases have already helped to reduce losses and raise collections. In addition, setting up of an independent Energy Regulatory Commission, it is expected, would enhance efficiency and substantially curtail losses.

To generate greater dynamism in the export sector , my authorities are putting in place a new 5-year Export Policy. In order to reduce excessive dependence on a limited number of export products, the new export policy emphasises diversification of exports by exploring possibility of increased export of ICT software products, agriculture and agro-based products, light engineering (including auto parts and bicycles), leather products and high-end RMG. My authorities are seeking the help of the WB in formulating a suitable strategy to meet the challenges consequent to the phase out of the MFA in 2005.

VII. IMPROVING GOVERNANCE, TRANSPARENCY AND ACCOUNTABILITY

The IRPSP rightly recognizes the need to enhance governance as part of the initiative to reduce poverty, and my authorities remain committed to this goal. A number of steps have been taken by them as part of this initiative. First, the Cabinet has recently approved a draft legislation for establishing an Anti Corruption Commission to be placed before the parliament for approval. This Commission will report annually to parliament and will be vested with appropriate independence and authority . Second, the Government is continuing with the process of strengthening the judiciary through provision of financial autonomy, security of tenure for judges as well as relinquishing control over the disciplinary and promotion processes of judges to the Supreme Court. The process of separation of the judiciary from the executive is also firmly underway. Third, my authorities are implementing a Financial Management Reform Program (FMRP) aimed at enhancing financial accountability in the government, while reducing the scope for the use of discretion by public officials. The institution of the Comptroller and Auditor General is being strengthened, and

steps are being taken to improve the quality of audits as well as reconciliation of accounts. Fourth, my authorities are heightening the integrity of the procurement process through reforming rules, mandating the usage of standard bidding documents, introducing mechanisms to ensure transparency in the award processes as well as enhancing capacity of officials. Fifth, they are aware of the urgency to reform public administration and are taking steps in this direction including allowing lateral recruitments of qualified personnel, introducing performance based incentives, and not filling up lower level vacant posts.

Bangladesh is a vibrant democracy with an independent press and both these institutions bolster the efforts of my authorities to enhance governance. My authorities firmly believe that the process of expression of views in the polity through the democratic institutions and press will enhance rather than hinder the national consensus which has been developed as part of the PRSP process.

The enhanced transparency policies adopted by my authorities also provide strong incentives to good governance. This is demonstrated by the wide consultative procedure adopted for preparing the IPRSP as well as their decision to publish IMF and World Bank related documents including the Staff report. In parallel, the government has taken firm steps to improve the transparency of its internal operations. Extensive websites are being maintained by various departments of the Government of Bangladesh including the Finance Division, the Bangladesh Bank, the National Board of Revenue and the Economic Relations Division which provide upto date data on operations as well as regulations in place. These sites are also being improved constantly. The I-PRSP, from its inception to final form, is posted in Economic Relation Division's Website. The Monthly Fiscal Report capturing expenditure, revenue, and budget deficit has recently been added to Finance division's website.

VIII. STATISTICAL ISSUES

My Bangladesh authorities broadly agree with the analysis and the recommendations of the fiscal transparency module of the Report on Observation of Standards and Codes (ROSC). A large number of the measures laid out in the action plan for improving fiscal transparency have been implemented already. For example, the budget for FY 2003-04 has been formulated based on a Three Year Medium-Term Macro Economic Framework. The on-going reforms in financial management will enable my authorities to effectively address the recommendations of the Fiscal ROSC .

IX. RISKS

While my Bangladeshi authorities recognize the risks and challenges involved in the implementation of this program, they wish to point out that they have already demonstrated both the capacity as well as the commitment to effectively manage such risks, take politically bold decisions and combat vested interests. They have successfully implemented bold reforms in the financial, SOE and the energy sectors. The launching of a special program to

recover illegal arms, curb terrorism, and enactment and implementation of Speedy Trial Act are strong steps to improve the law and order situation. They have also effectively improved financial discipline and enhanced macroeconomic stability within a very short time. My authorities have successfully built a strong foundation for further reforms within the program period. They will continue to capitalize on the gains resulting from the reforms already implemented and put in their best efforts to forge a wide ranging consensus through continuing dialogue with stakeholders for effective and smooth implementation of the Program. In addition, my authorities will strengthen internal capacity and skills to manage the program with technical assistance from development partners.

X. CONCLUSION

My authorities would like to place on record their deep appreciation of the valuable assistance provided to them by Fund staff - both in terms of policy advice as well as technical assistance. They have benefited substantially from these inputs and with the PRGF in place, they look forward to continued support from and enhanced cooperation with the Fund.