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Bangladesh: Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility (PRGF) and Requests for Waiver of Performance Criteria, Activation of the Trade Integration Mechanism (TIM), and Augmentation of the Access Under the PRGF Arrangement in Accordance with the TIM—Staff Report; Staff Supplement; and Press Release on the Executive Board Discussion

In the context of the second review under the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) and requests for waiver of performance criteria, activation of the Trade Integration Mechanism (TIM), and augmentation of the access under the PRGF Arrangement in accordance with the TIM with Bangladesh, the following documents have been released and are included in this package:

- the staff report for the second review under the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) and requests for waiver of performance criteria, activation of the Trade Integration Mechanism (TIM), and augmentation of the access under the PRGF Arrangement in accordance with the TIM prepared by a staff team of the IMF, following discussions that ended on **May 7, 2004,** 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 July 13, 2004**. 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 23, 2004** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its July 28, 2004 discussion** of the staff report that completed the review.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bangladesh*
Memorandum of Economic and Financial Policies by the authorities of Bangladesh*
*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

Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility (PRGF) and Requests for Waiver of Performance Criteria, Activation of the Trade Integration Mechanism (TIM), and Augmentation of the Access Under the PRGF Arrangement in Accordance with the TIM

Prepared by the Asia and Pacific Department

(In consultation with other departments)

Approved by Steven Dunaway and Anthony Boote

July 13, 2004

- Discussions on the second review under a three-year PRGF arrangement were held in Dhaka during April 26–May 7, 2004. The staff team comprised Mr. Weerasinghe (Head), Mmes. Puckahtikom and Liu, and Mr. Berezin (all APD), Mr. Akitoby (FAD), Mr. Mlachila (PDR), and Ms. Tan (APD assistant). The mission was assisted by Mr. Verhoeven, the Resident Representative, and worked closely with the World Bank resident mission and an overlapping MFD technical assistance mission. Mr. Gauba (OED) participated in the policy discussions.

- The mission met with Finance and Planning Minister Rahman, Finance Secretary Khan, Bangladesh Bank Governor Ahmed, other senior officials, and civil society and donors.

- The PRGF arrangement, for SDR 347 million (65 percent of quota), was approved on June 20, 2003. The PRGF-supported program is centered on four structural areas: fiscal reform, reform of the nationalized commercial banks, reform of the state-owned enterprises, and exchange and trade reform. Addressing economic governance was considered key to this agenda. The first review under the PRGF was concluded in January 2004.

- In order to facilitate the adjustment to the lifting of quotas under the Multi-Fiber Agreement, the authorities have requested augmentation of PRGF access of SDR 53.33 million (10 percent of quota) in accordance with the TIM.

- The authorities intend to publish the staff report, LOI, and MEFP.

- The principal authors of this report are Mr. Weerasinghe and Ms. Liu, with inputs from other team members.

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Executive Summary

Over the past year, Bangladesh achieved steady economic growth with manageable inflation, but the political climate for reform has become more difficult. Nonetheless, the government (with its two-thirds parliamentary majority) remains committed to reform, though it is sensitive to the political and social impact of reforms. Substantial risks also derive from the lifting of quotas under the Multi-Fiber Agreement (MFA).

Macroeconomic policies have been prudent, and the December 2003 quantitative targets and March 2004 performance criteria were met. The budget deficit for FY04 would be contained to 3.8 percent of GDP, well below program. With rebounding exports and buoyant remittances, the current account deficit is much lower than programmed.

Progress on structural reforms has been mixed due to delays in implementation, with slippages in meeting most of the structural performance criteria and benchmarks. However, remedial actions have been taken, with respect to both tax administration and the process of strengthening bank management and adopting bank-by-bank resolution strategies.

To continue the reform agenda under the PRGF arrangement, while coping with the forthcoming MFA impact, the government's priorities over the second year are:

- Maintaining cautious macroeconomic policies to support growth. The FY05 budget targets an additional revenue effort of ½ percent of GDP, while ensuring sufficient resources are allocated to infrastructure and social sectors. Monetary policy will continue to remain cautious but adequately supportive of the private sector.

- Stepping up efforts to reform tax administration and to broaden the revenue base. The system of the Large Taxpayer Unit will be expanded to cover VAT and withholding tax, with measures to modernize the National Board of Revenue.

- Determined implementation of nationalized commercial bank reforms. In particular, measures to strengthen bank management and implementing the resolution strategies for each bank.

- A timely trade reform effort, to improve competitiveness and reduce anti-export bias.

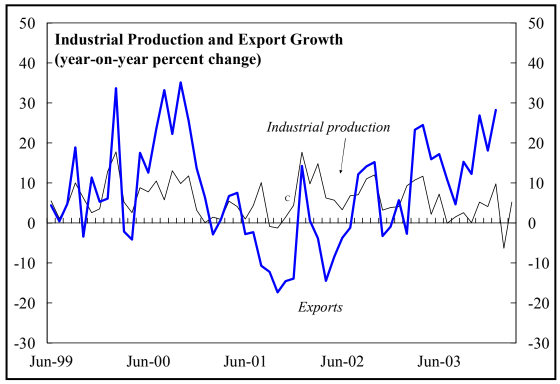
- Tackling governance through the above structural measures and the implementation of anti-corruption measures.

The key risks to the program derive from the MFA quota phase-out and the structural areas. The latter is prone to risks due to a confrontational political environment, weak governance, and capacity constraints. Continued technical assistance remains essential.

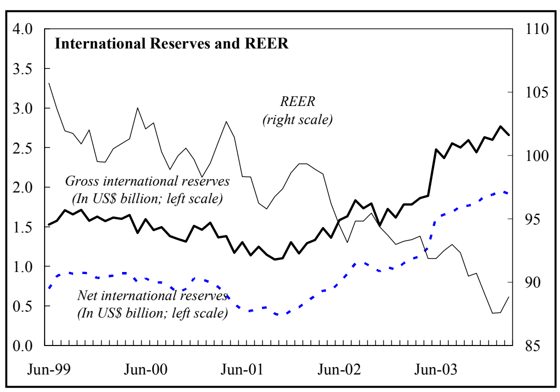
I. Performance Under the First-Year Program

1. **In the attached letter dated July 8, 2004 and the Memorandum of Economic and Financial Policies** (MEFP) (Attachment I), the government of Bangladesh outlines the progress that has been made under the program, requests completion of the second review under the PRGF arrangement and waivers for the nonobservance of structural performance criteria (MEFP ¶4, 18, and 27–28), and requests augmentation of PRGF access in accordance with the Trade Integration Mechanism (TIM).

2. **Economic performance has been broadly on course.** The projected real GDP growth of 5½ percent for FY04 is within reach (Tables 1 and 2, and Figure 1). Activity in the agricultural sector has been strong, aided by good harvests, while industrial production has also rebounded, supported by a strong recovery in exports. However, the inflation target of 4½ percent for the year is no longer attainable due primarily to higher imported food prices, and has been revised up to 6 percent (year-on-year) based on the current trend. All quantitative targets for end-December were met and all end-March quantitative performance criteria have been observed (MEFP Table 2).

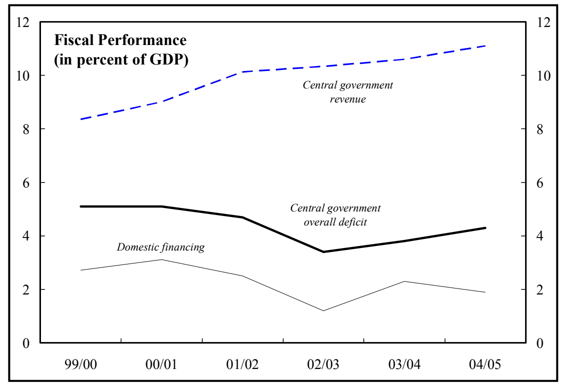


3. **The external sector has gained strength.** Exports have rebounded by 15½ percent during the first ten months of this fiscal year, driven by ready-made garments (RMG) and frozen food (Table 3 and Figure 2). This has been supported in part by improved external competitiveness as the effective exchange rate has depreciated by 1.6 percent and 5.6 percent in real and nominal terms, respectively, during the period May 2003–May 2004. Strong nominal depreciation against the euro was a key factor in improving growth and raising the share of RMG exports to the European Union (EU), which now accounts for nearly two-thirds of Bangladeshi garment exports. Import growth, mainly for the RMG sector, was also buoyant. Together with strong remittances, the external current account deficit is expected to narrow to 0.2 percent of GDP by end-June 2004 (compared with a programmed deficit of 1.2 percent of GDP). Aid inflows and program loan disbursements are much lower than expected under the program, in part due to the delay of the World Bank's Development Support Credit II (DSC II) and education sector loan to July, and consequently recent reserve accumulation has slowed down. At end-June, official reserves stood at $2.7 billion (2.7 months of imports). External debt management has been prudent and the government contracted only $8 million of nonconcessional debt through end-May.



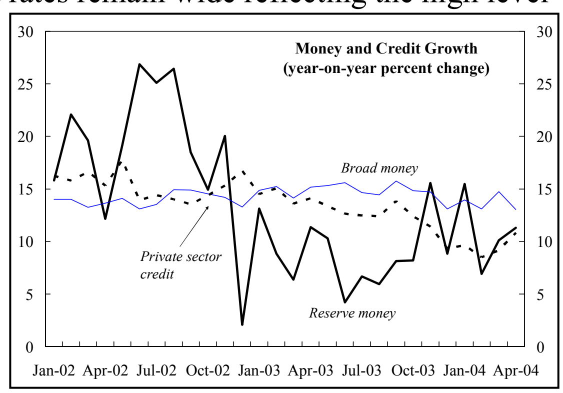
4. **The overall budget deficit will be contained to an estimated 3.8 percent of GDP in FY04, well below program** (Table 4 and Figure 3). Total spending is now projected to be about 1.2 percent of GDP lower than programmed, on account of slower implementation of the Annual Development Program (ADP) as well as lower current spending. Interest

payments and retrenchment costs were lower than projected, while transfers to enhance social safety nets and school teachers' compensation were higher. However, tax revenue collections by the National Board of Revenue (NBR) are projected to be 0.2 percent of GDP lower than programmed. Reflecting the delays in implementation of the tax administrative reforms (see below), collections from income taxes, customs, and supplementary duties were lower than targeted.



5. **Monetary policy has been cautious while remaining supportive of growth.** In the twelve months to April, reserve money grew by 11½ percent and broad money by 13 percent (Tables 5 and 6, and Figure 4). In light of stronger-than-programmed inflow of remittances, Bangladesh Bank (BB) has mopped up excess liquidity through sales of treasury securities, keeping excess bank reserves within the target range. Private sector credit growth has moderated to 11 percent (year-on-year), reflecting accelerated loan write-offs by the nationalized commercial banks (NCBs).

6. **Interest rates have come down across-the-board, but lending rates are still high due to structural factors.** During FY04, interest rates on treasury securities have declined by 3 percentage points, National Savings Certificate (NSC) interest rates by 1½ percentage points, deposit rates by 1 percentage point, and lending rates by 1½ percentage points. Meanwhile, spreads between lending and deposit rates remain wide reflecting the high level of nonperforming loans in the banking system, and some disparities in the structure of interest rates (e.g., treasury bill rates lower than deposit rates, and administered lending rates to some sectors) still remain due to rigidities. Recent MFD technical assistance has highlighted the need to improve the interbank market and secondary market for treasury securities. At the same time, determined banking sector reforms are needed to reduce the wide spreads.



7. **Progress on the structural reform agenda has been mixed, with slippages in meeting the structural performance criteria and the benchmarks in tax administration and NCB reform** (MEFP Table 3). In particular:

- **On tax administration:** The newly expanded Large Taxpayer Unit (LTU) for income tax has started operations and the bonded warehouse system has been revamped, broadly as envisaged. In addition, limited progress has recently been made in expanding the external audit program, but because of capacity constraints the original target of 1,000 new cases proved to be unrealistic. Although the target for making the Central Intelligence Cell (CIC) fully operational was missed (an end-December 2003 structural performance criterion), it is now functional and the monitoring of large taxpayers has begun (MEFP ¶4). In this regard, a new information base has been set up to detect large tax evaders for follow-up enforcement.

- **On NCB reform:** The Memoranda of Understanding (MOUs) for the four NCBs have been implemented satisfactorily, but delays have emerged in the strengthening of bank management. The selection of a sales adviser for Rupali has been slow, and the appointment of a new management team for Agrani (an end-January benchmark) was delayed. Similarly, the process for selecting management support teams for Sonali and Janata has been protracted. In addition, adoption of bank-by-bank resolution strategies (a structural performance criterion for end-April) has also been delayed.

8. **Due to stiff opposition by vested interests, state-owned enterprise (SOE) reform has stalled.** Closure or privatization of manufacturing SOEs has been halted, following protests by trade unions notwithstanding the availability of generous severance payments. Now, loss-making SOEs have been encouraged to downsize with a freeze on hiring and with no recourse to the budget or bank borrowing. Only five manufacturing SOEs have been closed during FY04 with around 16,000 workers retrenched.

9. **In response to higher world oil prices, domestic energy prices were adjusted under the pricing formula agreed with the World Bank.** The price of jet fuel was raised by 8 percent in April, the price of kerosene by 17 percent in May, and the price of fuel oil by 50 percent in June. These increases, while significant, fell short of full pass-through of changes in import parity prices for some items given the backlog in price adjustments. With these price adjustments, financial losses of Bangladesh Petroleum Corporation (BPC) have been reduced, though they remain significant (0.3 percent of GDP in FY04). Furthermore, the financial performance of energy sector SOEs continues to be a serious concern, especially in the case of Dhaka Electricity Supply Authority (DESA)—its stock of arrears to other SOEs rose by 40 percent to 2 percent of GDP during the last 18 months.

II. Report on the Discussions

A. Outlook and Risks

10. **The political climate for reform has become more difficult.** At the midpoint of its five-year term, the government has been facing increasing confrontation with the opposition party. In the first half of 2004, the opposition staged several nationwide strikes (hartals). The government, with a two-thirds majority in parliament, is regarded as likely to complete its five-year mandate. Nonetheless, it is sensitive to the political and social impact of its proposed reforms, and some key measures have been delayed.

11. **Significant risks derive from the lifting of quotas under the Multi-Fiber Agreement (MFA) at the beginning of 2005, given Bangladesh's heavy dependence on RMG exports**. On the upside, RMG exports have been recovering faster than expected, and there are indications of fresh investment in the sector despite post-MFA threats. Also, Bangladesh should be able to retain some of its competitive edge in the EU and Canadian markets, given its duty-free access. In addition, Bangladesh is expected to be able to compete in the high-volume, low-margin segment of the world garment market, particularly as RMG buyers are expected to diversify their sources to avoid overdependence on a few major exporters such as China and India. On the downside, however, with intensified competition, Bangladesh is likely to face pricing pressure and lose significant market share in the United States, and continue to face funding and implementation constraints in upgrading infrastructure, crucial for competitiveness.

12. **While the impact of the MFA quota phase-out on the balance of payments is subject to substantial uncertainties, the mission worked with the authorities to revise the macroeconomic framework** (Box 1)**.** The original medium-term framework has been scaled back, and real growth has been revised down to 5.5 percent in FY05 and to 6 percent in FY06, with inflation falling to below 5 percent. At the same time, in light of the slower-than-anticipated recovery in external project disbursements, external financing has also been somewhat scaled back. Preliminary assessment suggests a possible deterioration in the trade balance of $1.4 billion during FY05–06 (or an average of 1.0 percent of GDP per year) and an additional financing gap of $1.2 billion—with no policy adjustment—with the effect starting in the second half of 2004 (Table 7). To mitigate this impact, a policy adjustment framework was formulated that would, together with a drawdown in reserves, result in a reduced financing gap of about $300 million during FY05–06. These projections also indicate that the ratios of external debt to GDP should remain within a comfortable zone in the medium term, below 35 percent.

13. **Noting the positive developments so far under the program, despite a difficult political environment, the authorities reaffirmed their commitment to macroeconomic prudence and steadfast efforts in structural reform,** as set out in their three-year PRGF strategy (IMF Country Report No. 03/205). Against the background of the slippages in the implementation of some of the structural reforms, they also undertook to implement a critical mass of reforms as prior actions for the second review (MEFP Table 4). At the same time, the authorities pointed to the need to give due consideration to socio-political factors in the sequencing and timing of sensitive measures and the pace of reform. In this context, they view continued financial support from the World Bank and the Fund as vital, and welcome the introduction of the TIM by the Fund.

B. Fiscal Policy and Reforms

14. **The medium-term fiscal strategy remains centered on boosting revenue performance and reorienting expenditure to better support growth and the Millennium Development Goals (MDGs), while, at the same time, protecting fiscal sustainability** (Table 8). To this end, the authorities are committed to addressing the key structural fiscal issues over the medium term (Box 2). Sustained efforts in both tax administration and policy will be required to achieve the program target of raising revenue an additional ½ percentage of GDP a year. This is needed to support pro-growth spending (e.g., for structural reforms and maintenance of infrastructure), and for meeting the MDGs (e.g., greater access of the poor to education, health, and nutrition). To preserve fiscal sustainability, the overall central government deficit is targeted to stabilize at 4.0 percent of GDP, consistent with the medium-term objective to contain public debt to under 60 percent of GDP, inclusive of potential costs of NCB and SOE reforms.

15. **The budget for FY05 has been formulated consistent with the medium-term fiscal strategy.** It targets an overall deficit of 4.3 percent of GDP, compared with 4.7 percent initially projected, with domestic financing capped at 1.9 percent of GDP to help achieve the inflation target. The FY05 budget targets a strong revenue effort, together with a stepped-up implementation of the ADP financed by higher concessional external assistance.

16. **Achieving the FY05 budget revenue target will require strengthened tax administration and policy efforts equivalent to an additional effort of 0.5 percent of GDP** (MEFP ¶18–19). On tax administration, particular attention should be given to ensuring continued effectiveness of measures already in place. In addition, concrete steps are needed

for expanding the LTU to cover the VAT and withholding taxes (a performance criterion proposed for end-September 2004). The authorities agreed to have the LTU coverage of the VAT be set at a minimum of 50 percent of total VAT collection by NBR, covering at least the 100 largest VAT filers. Given the need to strengthen implementation capacity in NBR, further technical assistance from DFID and the World Bank will be critical.

17. **On tax policy**, **the authorities have taken steps in the FY05 budget to reduce and rationalize trade taxes.** In the context of the authorities' trade reform efforts (see Section E below), a three-tier tariff structure has been introduced, with a maximum rate of 25 percent, together with a significant reduction in supplementary duties. Preliminary estimates by the World Bank suggest that the overall revenue impact of these tariff reforms would be neutral. Nonetheless, the authorities have taken steps in the FY05 budget to protect revenue through: (i) allowing the existing tax holiday facility to lapse at end-June 2005; (ii) expanding the VAT net to cover more services; and (iii) bringing additional taxpayers into the tax net.

18. **With the aim of improving the quality of expenditure, the authorities continue to reorder priorities to favor pro-growth and pro-poor spending** (MEFP ¶20). Accordingly, the FY05 budget aims at providing adequate spending for the MDG-related social sectors and for the maintenance of physical infrastructure. Poverty reducing spending—including in health, primary education, physical infrastructure, and rural development—is targeted to rise by 0.8 percentage points of GDP to 7.4 percent of GDP in FY05. The budget provides for a substantial increase in ADP spending, which will require stepped-up efforts with project selection and execution. In addition, efforts are being made to better manage ADP spending, by streamlining the decision process and introducing new procurement guidelines to enhance its quality and poverty impact. Progress is also being made in implementing some of the recommendations of the ROSC, particularly in establishing reliable fiscal reporting and an effective basis for medium-term budgeting, to strengthen public expenditure management.

19. **Concerted efforts are needed to facilitate domestic nonbank financing.** Following administrative changes on the sale of NSCs, especially the elimination of a hefty 100 basis points fee on gross sales that accrued to banks, the volume of NSC sales since February has declined sharply. Given the declining sales, the authorities need to balance the objective of reducing NSC interest rates to align them with comparable market instruments with the budgetary need for recourse to nonbank financing. Accordingly, on balance, interest rates on all NSC instruments will be reduced by another 0.5 percentage point (lower than the one percentage point implied by the agreed formula), which is a prior action for the completion of the review. The authorities are also contemplating a special window for limited access by pensioners and widows to NSCs at above-market interest rates as a form of social safety net. The staff emphasized that such a mechanism is not an optimal form of social safety net and will need to be carefully designed to minimize the scope for abuse.

C. Monetary and Exchange Rate Policies

20. **The monetary stance continues to be aimed at balancing the support for economic growth while containing inflation.** While the uptick in inflation in late 2003 stemmed mainly from external factors, a cautious monetary stance is warranted. In view of the slower-than-anticipated growth in private sector credit and lower deficit financing from the banking system, BB tightened policy for FY04 relative to the program by reducing the June targets for broad money and private sector credit. However, due to the delay in disbursement of the World Bank adjustment loans (DSC II and education loans amounting to $300 million) from the fourth quarter of FY04 to July, the program has allowed for bridge

financing through a higher level of banking system credit to government at end-June and a correspondingly lower level of international reserves. This financing, necessary to maintain the government's budget in the face of delays in World Bank disbursements, will be fully unwound by end-July. For FY05, the monetary program limits the growth in M2 to 12½ percent, allowing for a rise of 13 percent in credit to the private sector, while further building up external reserves.

21. **The authorities recognize the need to improve monetary operations through better functioning interbank and treasury securities markets.** Strengthening and deepening the primary dealer system will help banks manage their liquidity more effectively on market-based interest rates and facilitate the development of a secondary market for treasury securities. Early action by BB to build the nonbank treasury bill market, which is very small at present, is also important to meet the domestic nonbank financing needs of the budget (see ¶19). To facilitate market development, the withholding tax on income from securities and bonds was reduced and unified at 20 percent, from a range of 25–45 percent, in the FY05 budget. The authorities have requested MFD technical assistance (a resident expert) with practical knowledge on developing and implementing interbank and treasury securities markets.

22. **Since the floating of the taka in May 2003, the exchange rate has been managed flexibly.** The key objective of the authorities has been to build up reserves, especially against the background of the pending phase-out of MFA quotas. They succeeded in doing this with little movement of the taka/U.S. dollar exchange rate in the first half of FY04, as the balance of payments position strengthened considerably. External competitiveness was facilitated by the depreciation of the dollar against most major currencies, especially the euro. In the second half of FY04, the taka depreciated by about 4 percent against the U.S. dollar. On balance, the authorities have confined their interventions to building reserves to a more comfortable level and to countering disorderly market conditions. A deepening of the interbank market is required, particularly to make it more competitive between net foreign exchange sellers (mainly NCBs) and net buyers (private banks).

23. **The authorities remain committed to the floating exchange rate regime, and will use it as a first line of defense against the potential impact from the lifting of MFA quotas.** The authorities will continue to confine interventions to countering disorderly conditions and building reserves to a more comfortable level. They recognize that a market-based depreciation of the taka during FY04–05 will be consistent with the need to maintain external competitiveness. Following technical assistance from LEG and MFD, the authorities are planning to remove the remaining exchange restrictions subject to Fund jurisdiction (restrictions on advance payments for imports and transfer of funds from nonresident taka accounts). They intend to remove the advance payments for imports by end-December 2004, and review the restriction on the nonresident taka accounts by end-June 2005 paying due attention to having adequate regulatory safeguards to prevent illegal transactions and limit the scope for capital outflows.

D. Reforming the Nationalized Commercial Banks

24. **The NCB reform strategy is aimed at containing the core macroeconomic risks** by stemming the flow of nonperforming loans (NPLs), strengthening bank management, and developing and implementing bank-by-bank strategies to resolve the long-standing problems of these banks. Accordingly, MOUs have been signed that restrict net lending, prohibit large unsyndicated loans, and oblige the banks to expedite loan write-offs. Management teams are

also being arranged or strengthened. Technical assistance and funding are being provided under the World Bank Enterprise Growth and Bank Modernization Project (EGBMP).

25. **The discussions centered on concrete steps to advance the process of strengthening bank management as prior actions for the completion of the review.** In particular, the MOUs will be extended through end-2004 and will be strengthened to include explicit targets for cash recoveries for the 20 largest defaulters of each NCB; targets on reduction of operating expenses; and implementation of BB's core risk management guidelines to the NCBs. The authorities are also taking steps to redress the slippages that have occurred in the process of strengthening NCB management, with the following key steps to be taken as prior actions for the review: the signing of the final contract for Rupali's sales advisor; signing of the final contract for the new management team for Agrani; signing of the final management support contract for Sonali; and holding of a pre-bid conference for interested bidders for the Janata management support contract.

26. **Bank-by-bank resolution strategies have been formulated in consultation with World Bank and Fund staffs and adopted by the government** (MEFP Annex I). Under these strategies, three NCBs (Rupali, Agrani, and Janata, accounting for market share of 25 percent) will be brought to the point of divestment in full or in part in sequence over the period 2004–06. Safeguarding the integrity of the divestment process is an overriding concern given the governance issues in the NCBs and their poor financial condition as evidenced in the special audits (Box 3).

27. **With respect to Sonali (the largest NCB with 17 percent market share), the authorities consider privatizing to be politically untenable, although partial divestment over the medium term has not been ruled out.** In particular, they have pointed to the need to move cautiously while gaining experience with NCB privatization and to the central role that Sonali plays in providing the government with treasury functions and essential banking services for the rural sector. Against this background, an alternative restructuring strategy was developed for Sonali that should contain its problems in the near term and put it on a path toward partial divestment over the medium term. This strategy entails restricting its commercial lending operations and stepping up NPL recoveries in the context of an enhanced MOU; bringing in a management support team and appointing a new CEO with a reputable record in banking; reconstitution of its board of directors to meet BB's fit and proper test; and leveling the playing field by ensuring free entry into areas where Sonali has a dominant position. Based on their efforts to address the slippages and strengthened efforts to move forward the NCB reform process, the authorities are requesting a waiver of the end-April structural performance criterion relating to the adoption of NCB resolution strategies.

E. Trade and SOE Reforms

28. **Timely efforts are being made on trade reform in order to improve competitiveness and reduce anti-export bias** (MEFP ¶24). Starting in FY05, tariff incidence has been reduced by 3½ percentage points, from an estimated 24.5 percent, through a significant reduction in the level and dispersion of customs and supplementary duties. For customs tariffs, the FY05 budget introduces a streamlined three-tier structure (7.5, 15, and 25 percent), with the maximum rate reduced from 30 to 25 percent. For supplementary duties, the number of rates have been reduced from seven to three (15, 25, and 30 percent), together with a sharp reduction in the maximum rate from 75 to 30 percent. Moreover, with effect from April 2004, the number of products subject to quantitative restrictions was significantly reduced from 122 to 63. In consultation with the World Bank, the authorities intend to

continue with their trade reform efforts, including a streamlining of import licensing requirements.

29. **The momentum for reforming SOEs in manufacturing will need to be regained as soon as practicable.** Given the difficult labor issues, the current approach of partial closure of loss-making SOEs is second best. Under this approach, the SOE concerned (or its loss-making sub-unit) will not be granted budgetary support and no new hiring will be allowed. Funding for severance payments under the EGBMP loan will be made only when these conditions are met. In the meantime, operations of these SOEs will need to be scaled down significantly to prepare them for their full closure in FY07 as committed under the EGBMP.

30. **Regarding the energy sector SOEs, the reform effort needs to be stepped up,** in consultation with the World Bank. Domestic prices for energy products need to be kept under close review, with timely adjustments. In addition, actions to turn around the energy sector SOEs, particularly DESA, are critical. Further efforts are needed, in coordination with assistance from the World Bank and ADB, to define a reform plan to address the serious infrastructure bottlenecks and stem arrears in this sector. For DESA, effective measures to reduce system losses, improve bill collection, and resolution of its arrears remain the key components of the agenda.

F. Request for Fund Support in Accordance with the TIM

31. **In order to assist Bangladesh's orderly adjustment to the MFA quota phase-out, the authorities are seeking Fund assistance in accordance with the TIM** through an augmentation of access under the PRGF of SDR 53.33 million (10 percent of quota), to be disbursed in three equal tranches (Table 9). For FY05, the program would be fully financed, notably with large assistance from the World Bank (of which $300 million delayed from FY04) and assuming assistance in accordance with the TIM is granted. For FY06, additional financing would be needed, which is expected to be forthcoming from the World Bank and ADB. As these projections are subject to major uncertainties, the authorities intend to request additional assistance in accordance with the TIM if the balance of payments impact of the MFA quota phase-out turns out to be significantly worse than anticipated.

32. **The authorities are committed to strengthening the reform elements already under the PRGF, notably the flexible exchange rate, the reduction in anti-export bias, and improvements in the investment climate, and they are prepared to tighten financial policies as necessary to help contain pressures** (MEFP ¶22–24). In addition, the authorities are planning to implement additional sector specific measures to improve competitiveness, in consultation with the World Bank. An inter-ministerial committee has also been set up to define a comprehensive Post-MFA Action Program to assist in the transition to a quota-free era. Key components of these efforts include enhancing the business climate through trade reform, improvements to the FDI regime in the RMG sector, and addressing infrastructural bottlenecks, as well as training and marketing programs, and alternative skill development for displaced workers.

33. **Bangladesh should be able to continue its debt service to the Fund without difficulty** (Table 11). Even including possible augmentation of access in accordance with the TIM, the total debt outstanding to the Fund is expected to peak at less than 1 percent of GDP and total debt service to the Fund as a proportion of exports of goods and services is expected to be small and peak at less than 1½ percent in FY12 when repayments fall due to the Fund.

G. Other Issues

34. **Addressing the safeguards issues will enhance the credibility of the central bank.** In this regard, a local auditor with an affiliation to an international firm has now been selected, and BB's financial statements for FY04 will be audited in accordance with international standards and the results will be signed off by the affiliated international firm. The authorities intend to publish the full audit opinions together with the corresponding financial statements in the latter part of 2004, ahead of the third review. The reconciliation of monetary data reported to the Fund against BB's financial statements will be reviewed by the auditor as part of this annual audit. In addition, reconciliation of the interbranch accounts is being completed for the first nine months of FY04, and full-year accounts will be completed by end-August 2004. As part of its effort to build capacity with MFD technical assistance, BB will implement a plan for strengthening internal audit functions, upgrade accounting skills and standards, and establish appropriate reporting lines.

35. **Faster progress with governance is crucial for improving the investment climate.** Reform measures in NCBs, tax administration, and trade reform, in particular, bear directly on economic governance and they will need to be implemented firmly to have a lasting impact. In addition, the government is taking steps to reduce the scope for corruption by improving budgetary processes and providing a more enabling and transparent environment for public service delivery. The new public procurement guidelines introduced in 2003 are an important step in this direction and should be strictly implemented. Beyond these, concerted actions to develop an anti-corruption strategy and improve the law and order situation will be important. Following the passage of the Anti-Corruption Commission (IACC) Act by parliament in February, the authorities announced in May a selection committee and chairman, with the intention of having a three-member IACC selected soon thereafter. Early adoption of an action plan to make the IACC functional and effective would help enhance credibility. Technical assistance in these area is being provided by the ADB.

36. **Progress is being made toward finalization of the full PRSP by end-2004.** Activities undertaken to date include establishing an institutional framework for the preparation of the full PRSP; setting up thematic groups to facilitate a broad range of consultations with all concerned parties and stakeholders at all levels; and identifying main pillars of the poverty reduction strategy for the final PRSP. A detailed assessment has been made by the staffs of the World Bank and the Fund of the PRSP preparation status report, which has been concurrently circulated to the Board (www.imf.org). While noting that the progress to date has been satisfactory in the preparation of the full PRSP, the staff assessment points out that the status report does not pay adequate attention to the need for a more comprehensive approach to tackle governance issues and law and order problems, and underscored the need for strengthened efforts in public expenditure management and in promoting the role of the private sector.

37. **On program monitoring,** understandings have been reached on the quantitative performance criteria for end-September 2004 and the quantitative targets for end-December 2004, and on indicative targets for the remainder of FY05. Furthermore, structural conditionality to cover the first half of FY05 has been agreed, centering on fiscal and NCB reforms (MEFP Table 3). The third and fourth reviews are proposed to be completed by December 2004 and June 2005, respectively. Technical assistance, coordinated closely with the World Bank, DFID, and MFD will remain essential to help build capacity, especially in tax administration and NCB reform.

III. Staff Appraisal

38. **Over the past year, the authorities' policies have succeeded in strengthening economic performance under the program.** The economic recovery has continued, inflation has been kept in check, and the external sector has strengthened. Macroeconomic management has remained on course and all quantitative targets and performance criteria were observed. On the structural front, despite a difficult political environment, the authorities have continued with the reform agenda. However, progress has been mixed, with slippages in meeting the structural performance criteria and benchmarks in tax administration and NCB reform. These slippages have now been redressed.

39. **Strengthened implementation of structural reforms will be crucial for building on this progress and putting the economy on a sustainable and higher growth path to achieve a lasting reduction in poverty.** The authorities' policy program for the second year of the PRGF is designed to meet these challenges and prepare the economy to better cope with the impending MFA quota phase-out. While maintaining a macroeconomic stance supportive of growth, the authorities are pushing forward structural reforms in tax administration, NCBs, and the trade sector. A critical mass of policy actions have been implemented at the outset of the second-year program, which will give the reform process the needed momentum.

40. **Steadfast implementation of these policies, together with credible action to strengthen governance, will be needed to improve the investment climate and underpin growth.** Effective execution of the program measures to strengthen tax administration, trade reform, and NCB reform, and the new public procurement guidelines will directly address core issues of economic governance. In addition, concerted actions to develop and implement an anti-corruption strategy and improve the law and order situation will be crucial to help improve investor sentiment. In this regard, the early and effective functioning of the IACC will be important to enhance credibility.

41. **In line with the objective of better supporting growth and the MDGs, the targeted increase in the FY05 budget for infrastructure and pro-poor social spending is appropriate.** This would remain consistent with fiscal sustainability given the prospective external support on concessional terms. However, the stepped-up ADP spending in the FY05 budget will require improved project selection and execution, better public expenditure management with improved fiscal transparency and accountability, and timely decisions on meeting policy conditions for project financing.

42. **Achieving the FY05 budget revenue target will require much strengthened tax administration efforts, with appropriate political backing.** Particular attention should be given to ensuring the continued effectiveness of the tax administration measures already in place. In addition, decisive and timely steps are needed to expand the LTU to cover the VAT and withholding taxes, with the coverage extending to at least the 100 largest VAT filers. Given the need to strengthen the implementation capacity of the NBR, further technical assistance from DFID, the World Bank, and the Fund will also be critical.

43. **Improving monetary operations through the development of the interbank and treasury securities markets should be a priority for BB.** Timely action to build the nonbank treasury bill market is also necessary to meet the nonbank financing needs of the budget. The staff supports the authorities' request for MFD technical assistance in this area. Meanwhile, staff has reservations about the merits of plans for a special window for

pensioners and widows to NSCs at above market interest rates as a form of social safety net, given the potential for abuse of such a system.

44. **The floating exchange rate regime has worked well for Bangladesh.** The authorities are encouraged to continue to confine their interventions in the exchange market to countering disorderly conditions and building international reserves to a more comfortable level. Moreover, the floating exchange rate should be allowed to act as a first line of defense against the potential impact from the lifting of the MFA quotas. A market-based depreciation of the taka will be consistent with the need to maintain external competitiveness.

45. **The reform agenda for the NCBs is appropriately ambitious, and its implementation will require strong political will and technical assistance support.** The poor financial condition of the NCBs as evidenced in the special audits underscores the urgency for decisive actions in this area. Close monitoring is needed to ensure adherence to the strengthened and extended MOUs between the NCBs and BB. The authorities also need to boldly build on the first steps recently implemented in strengthening bank management and persevere with the implementation of the bank-by-bank resolution strategies that have been formulated.

46. **Against the background of the MFA quota phase-out, the authorities' concerted trade reform effort in the FY05 budget is well timed.** The reduction and rationalization of the trade taxes in FY05 will enhance competitiveness and reduce anti-export bias, and the determination of the authorities to move forward in this area will help bolster confidence in the export sector of Bangladesh in the post-MFA era. While the tariff reforms are estimated to be revenue neutral, the authorities are encouraged to protect revenue through the rigorous implementation of the additional revenue measures introduced in the FY05 budget. In addition, the authorities should move urgently in further defining and implementing their post-MFA action program, together with efforts to improve the business climate.

47. **Stepping up the reform of the energy sector will be important to address infrastructure bottlenecks to growth and improve financial performance in this sector.** The authorities are encouraged to work closely with the World Bank and the ADB to define a framework for turning around the financial and operational performance of the energy sector SOEs, particularly DESA. In addition, domestic energy prices need to be kept under close review, with adjustments made on a timely basis. With regard to manufacturing SOEs, the momentum for reform in this sector needs to be regained as soon as practicable.

48. **Progress is being made toward finalization of the full PRSP by end-2004, although much work is still ahead.** In the joint staff assessment of the PRSP preparation status report, the staffs of the Bank and Fund consider that the progress to date has been satisfactory, but point out that the status report does not pay sufficient attention to the need for a more comprehensive approach to tackle governance issues and law and order problems, and for a strengthened effort in public expenditure management. The authorities are encouraged to pay due attention to these shortcomings in the full PRSP.

49. **Risks to program implementation have heightened in a difficult political environment, but remain within manageable bounds in view of the continued commitment of the government to the overall reform process.** In particular, program implementation risks remain considerable in the structural areas deriving from resistance of vested interests and weak administrative capacity. And the phasing out of the MFA quotas

pose a key external risk. To mitigate these risks, the authorities should be vigilant on policies, while close monitoring and technical assistance should be continued.

50. **In order to assist Bangladesh's orderly adjustment to the MFA quota phase-out, the authorities are seeking Fund assistance in accordance with the TIM** through an augmentation of access under the PRGF of SDR 53.33 million (10 percent of quota), in three equal tranches. Given the authorities' commitment to strengthening the reforms under the PRGF arrangement, the staff recommends Board approval of the authorities' request for Fund assistance in accordance with the TIM. Including possible augmentation of access in accordance with the TIM, the total debt service to the Fund remains small and Bangladesh should have no difficulty in servicing its obligations to the Fund.

51. **Bangladesh's overall record under the program so far has been satisfactory and going forward, the MEFP sets out a credible and ambitious agenda.** The authorities have reaffirmed their commitment to persevere with the reform agenda, and they are making efforts to garner domestic support for reform. Given the strength of the program, and given that the delays in making the CIC fully operational and in adopting bank-by-bank resolution strategies have now been redressed, the staff recommends approval of the requested waivers for the nonobservance of these structural performance criteria and completion of the review.

Box 1. Bangladesh: Potential Impact of the Removal of MFA Quotas

The impact of the removal of MFA quotas at the end of 2004 for Bangladesh is expected to be substantial. More than three-fourths of Bangladesh's exports are ready-made garments (RMG), and the RMG and related sectors account for about half of industrial sector and a substantial proportion of services sector employment. RMG employment is estimated at 1.8 million, of which 80 percent are women. The population that is directly or indirectly dependent on RMG is estimated to be at least 10 million.

The medium-term macroeconomic framework for the first PRGF review only partially factored in this potential impact. This was manifested in a projected slowing of RMG export growth from a historical average of 23 percent over the 1990s, to 5 percent during FY05–FY06, when the potential impact is expected to peak (Table 7).

This framework has been updated to reflect analysis by the staff based on more recent and detailed information.[1] Detailed data have become available on Bangladesh's export performance in FY02 and FY03 relative to competitors in individual product categories, classified by MFA quotas and by key markets. An analysis of this information points, in particular, to a major erosion of Bangladesh's market shares in those specific segments where MFA quotas were lifted in 2002. Simulations suggest possible cumulative declines over two years in RMG exports in the range of 7 percent to 30 percent depending on structural assumptions.

Without policy adjustment, the staff's current projections are for RMG exports to fall by nearly 20 percent during FY05-FY06—the midpoint of the above range. This implies a possible net (direct) impact on the trade balance of $1.4 billion (or 1.0 percentage point of GDP on an annual average basis), creating an additional external financing gap of $1.2 billion.

With timely and adequate policy response, the impact could be mitigated, notably through a downward exchange rate movement, a more rapid reduction in anti-export bias, and a more concerted effort to improve the investment climate and upgrade infrastructure. However, given the time needed for some of these measures to bring results, RMG exports could still fall, to virtually no growth in FY05 and a decline of 5.7 percent in FY06.

These projections are subject to a large margin of uncertainty and are based on two main assumptions:

- **A repetition of Bangladesh's negative experience through September 2003 following the lifting of a portion of MFA quotas** in January 2002. Global RMG demand during this period rose, but this was largely captured by China, India, and Pakistan. In the U.S. market, Bangladesh experienced a 44 percent plunge in its exports of products whose quotas were removed; overall exports to the U.S. fell by 15 percent. In the EU market, Bangladesh's exports of products subject to quota removal also fell by 41 percent, but total exports to Europe rose by 12 percent, due to the impact of the All But Arms Initiative introduced in March 2001.

- **Continued preferential access to the EU and Canadian markets**. Although Bangladesh's preferential access to the EU market will also diminish in relative terms, with duty-free access to the EU and Canadian markets (65 percent of total RMG exports at end-2003 compared to 55 percent at end-FY02), Bangladesh will be somewhat sheltered from the full effects of competition. Its key competitors will continue to face import duties in these markets on the order of 12 percent and 22 percent, respectively, although MFN tariffs might eventually fall as a result of a Doha Round tariff agreement.

On this basis, exports could fall sharply in the U.S. market during FY05–06, but to a lesser extent in the EU and Canadian markets. As a consequence, GDP growth could be up to one percentage point lower in FY06, and RMG employment could fall by 10–15 percent.

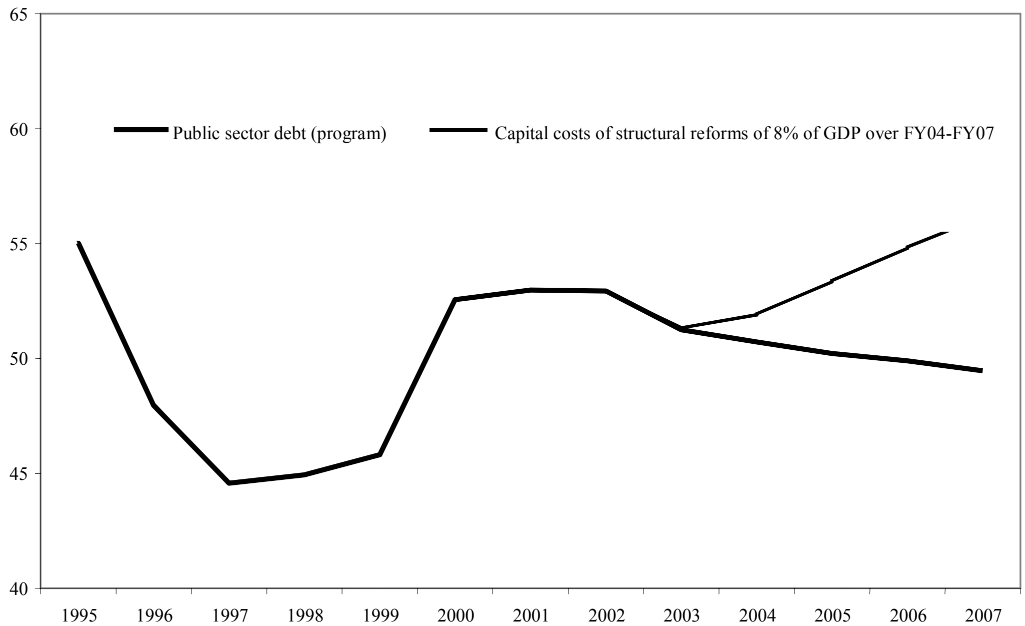
Relative to the projections made under the first PRGF review, the trade balance impact of the removal of MFA quotas after policy adjustment is projected at $0.6 billion during FY05–FY06 (0.4 percentage point of GDP on average). This implies a total external financing gap of $1.5 billion, or $0.3 billion (equivalent to nearly 40 percent of quota) above the original program (Tables 7 and 9).

[1]See Mlachila and Yang, 2004, "The End of Textiles Quotas: A Case Study of the Impact on Bangladesh," IMF Working Paper, WP/04/108.

Box 2. Bangladesh: Key Medium-Term Fiscal Issues

Public sector debt sustainability. The medium-term fiscal path is judged sustainable over the medium term, based on a sensitivity analysis on the profile of public debt relative to the program scenario. The program scenario projects a gradual decline in debt, from about 53 percent of GDP in FY02 to about 49 percent of GDP in FY07, reflecting mainly the reduction in the budget deficit and the decline in the average interest rate on public debt. After factoring in the potential capital costs of SOE and NCB reforms (tentatively estimated at up to 8 percent of GDP during FY04–07), the public debt ratio would increase to 57 percent of GDP by FY07. This level of debt is manageable because over half is external on highly concessional terms. However, the major source of risk is underestimation of quasi-fiscal costs associated with NCB and SOE reforms.

Bangladesh: Public Debt Sustainability



Tax administration and policy. A good start has been made to address major weaknesses in tax administration. Moreover, the authorities are working on a medium-term strategy to modernize the National Board of Revenue (NBR), with World Bank assistance. On tax policy, the priorities should be to rationalize the complex tax system and expand the tax base**.** Steps are being taken in the FY05 budget to start addressing these key priorities. FAD technical assistance would be critical in this area.

Public expenditure policy and management. On public expenditure policy, the focus should be on achieving a better balance between recurrent and capital spending, to ensure adequate maintenance spending for physical infrastructure and for the MDG-related social sectors. On expenditure management, the recently completed Expenditure Review Commission's report identified significant weaknesses in the areas of the Annual Development Program (ADP) and budget design and preparation. The report also proposed steps to reform the public expenditure management through: (i) strengthening the project selection and approval procedures for the ADP; (ii) integrating the Revenue and Development Budgets; (iii) introducing program budgeting, underpinned by a medium-term expenditure framework.

Fiscal transparency. Progress has been made in the basic areas of fiscal transparency, but the ROSC has identified significant weaknesses in other areas of the fiscal transparency code. Major concerns include: (i) weak coordination, monitoring, and reporting of foreign-financed projects; (ii) lack of medium-term expenditure framework; (iii) weak parliamentary mechanisms for oversight of public finances; (iv) weak internal audit mechanisms; and (v) lack of estimates of contingent liabilities and costs of quasi-fiscal activities in the budget documents and/or in other annual fiscal accounts.

Box 3. Bangladesh: Resolution Strategies for the Nationalized Commercial Banks

The special audits of the NCBs for 2002 (the last year for which audited financial statements are available) have recently been concluded. These audits revealed severe problems in all four banks, larger than previous estimates:

- High levels of NPLs, stemming from a legacy of imprudent (and often politicized) lending, poor loan monitoring, and ineffectual loan recovery.
- Large and growing capital shortfalls.
- Operational inefficiencies due to overstaffing, vast and unprofitable branch networks, lack of strategic planning, and the absence of computerized systems for transaction processing and record keeping.

Key Results of the Special Audits
(As of end-2002)

	Rupali	Agrani	Janata	Sonali	All NCBs
Gross NPLs as percent of total loans and advances	50.8	41.6	37.4	45.0	43.0
Capital shortfall relative to CAR					
In billions of taka	-11	-20	-31	-91	-152
In percent of GDP	-0.4	-0.7	-1.1	-3.3	-5.6
Memorandum items:					
Total loans and advances					
In billions of taka	40	84	90	147	361
In percent of GDP	1.5	3.1	3.3	5.4	13.2
Share of NCB loans and advances	11.1	23.2	25.0	40.7	100
Share of banking system loans and advances	4.7	9.8	10.6	17.2	42.3

To resolve these problems, the government is committed to divesting Rupali, Agrani, and Janata over the medium term (Annex I, MEFP). Timelines for bringing these banks to the point of sale over the three years (2004-06) in a phased manner have been set. The main modalities of the bank-by-bank resolution strategies that have been agreed include:

- Transferring full management control and a substantial share of equity to a strategic private investor. A limited public issuance of shares could be entertained in due course, in order to stimulate capital markets and create market discipline.

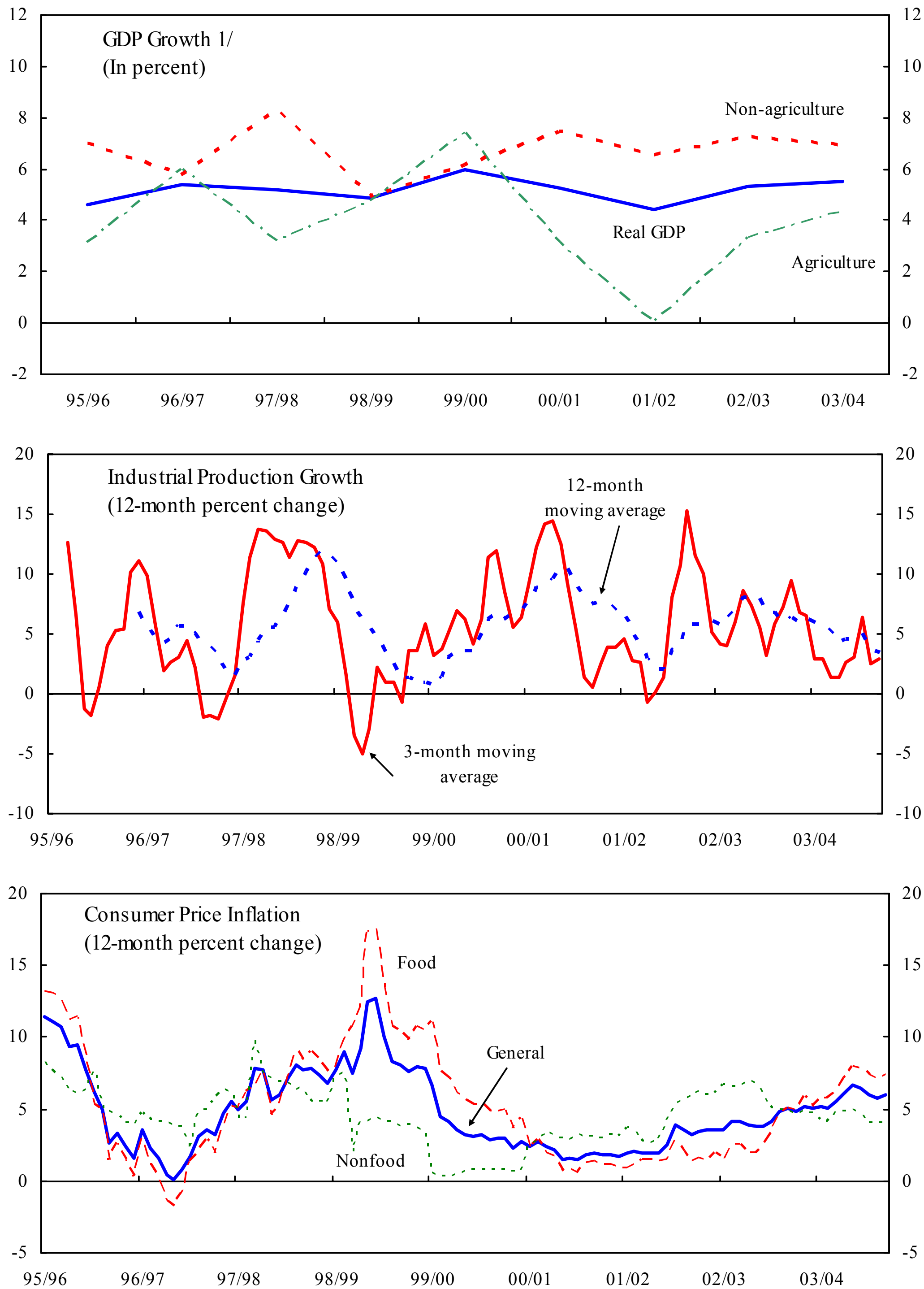
- Giving important consideration to finding fit and proper buyers to allay governance concerns.

- Government eliminating the negative capital position only at the signature of the final sales contract, and only after the buyer has agreed to inject enough capital to meet the minimum capital asset ratio (9 percent).

- Immediately starting restructuring of bank operations, placing no restrictions on staff retrenchment, pay scales, and branch closure.

The government has stressed the unique role of Sonali in the economy, which includes operating a check clearing facility for other banks, and performing various treasury functions and payment services, such as selling National Savings Certificates, processing government salaries, tax payments, pensions, scholarships, and utility bills. Additionally, Sonali maintains the largest rural network (almost 4,000 branches) in the country, and an overseas network for collecting most of the remittances for workers abroad. Consequently, there is concern that if a majority equity stake in Sonali were divested in the near-term, it may no longer perform all of these functions and banking services to vulnerable groups in rural areas may be impaired. If Sonali were to continue providing these functions, it should do so on a commercial basis, so as to improve its operating performance.

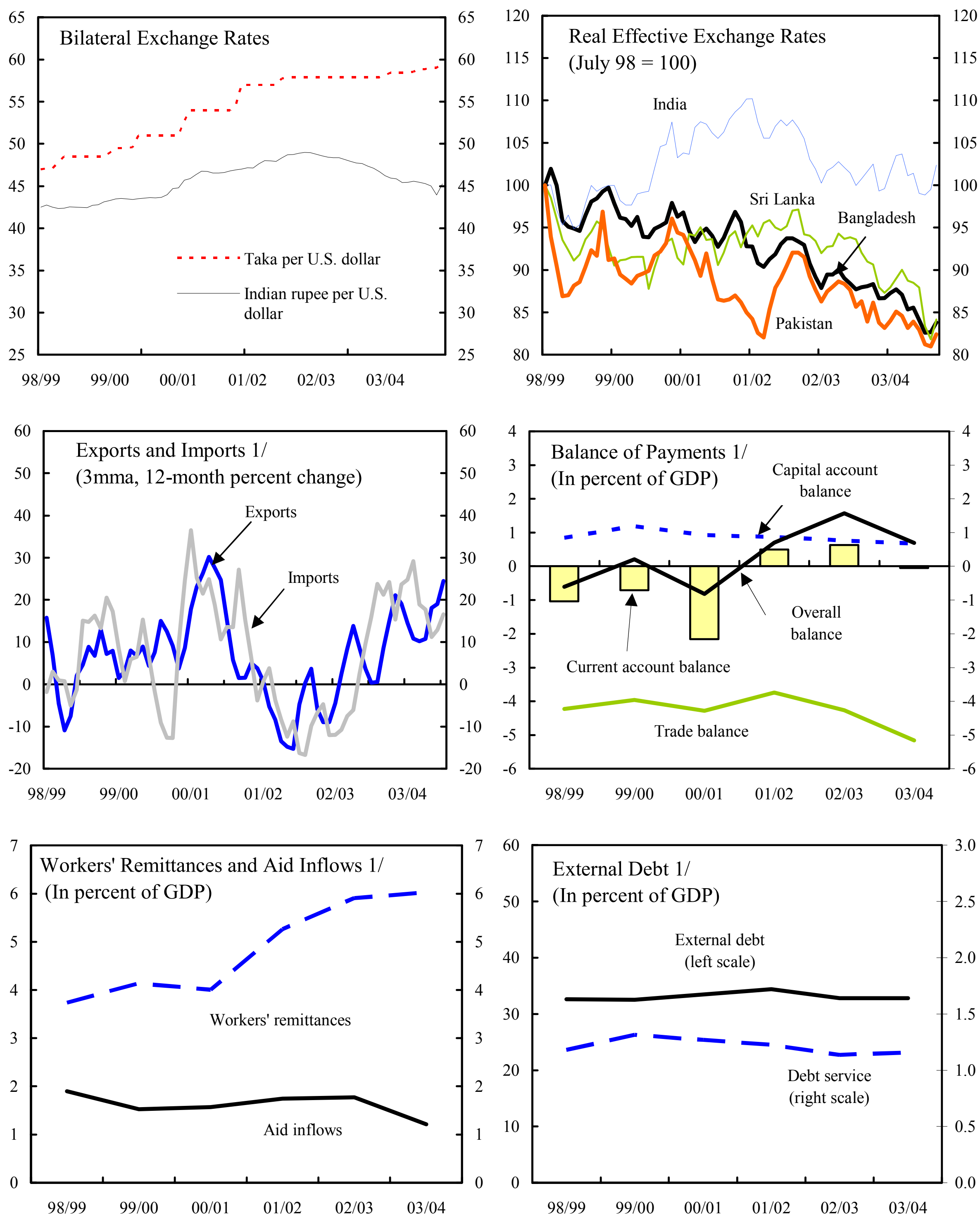
Figure 1. Bangladesh: Real Sector Indicators, FY96-04



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

1/ Estimates for 2003/04.

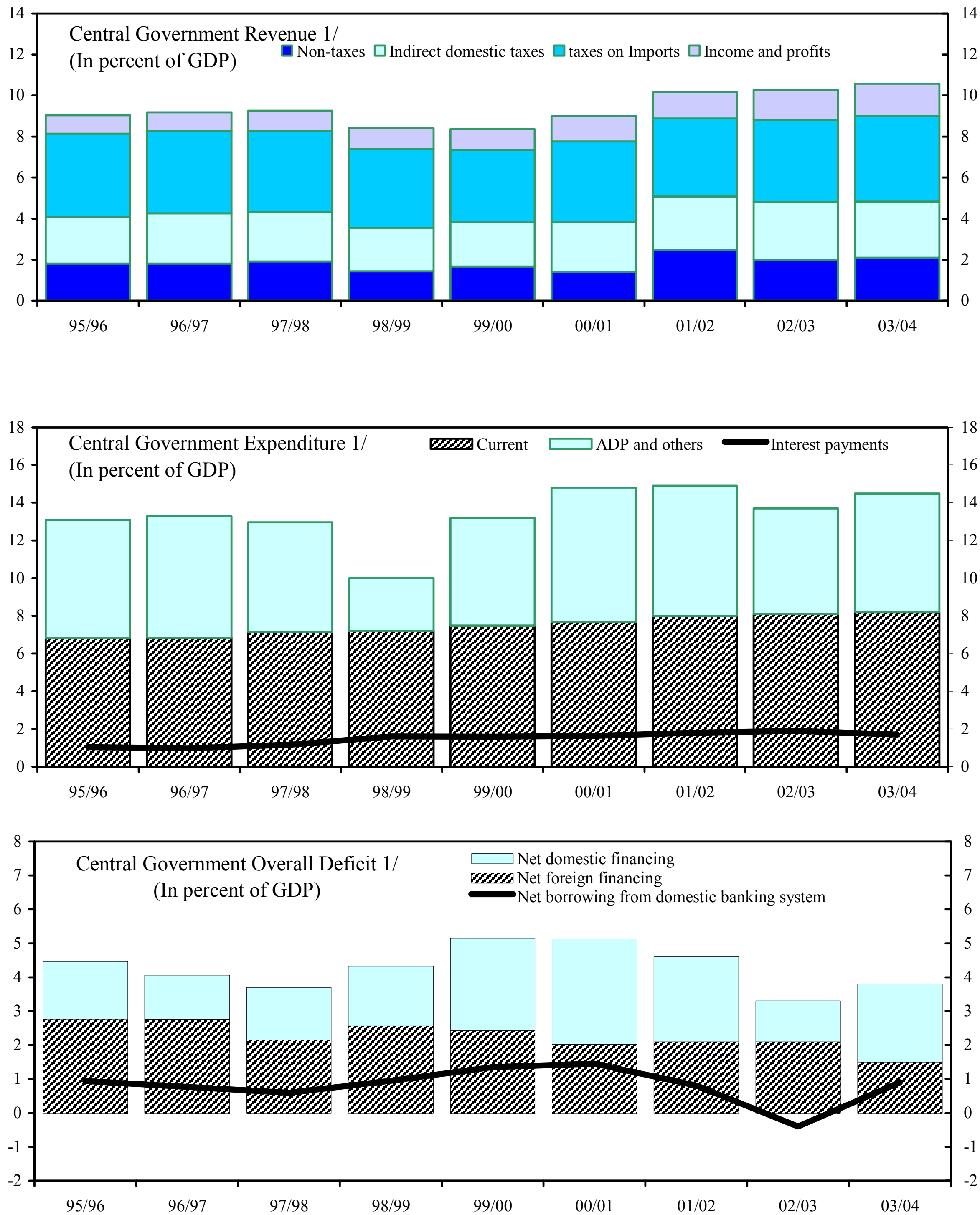
Figure 2. Bangladesh: External Sector Indicators, FY98-04



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

1/ Estimates for 2003/04.

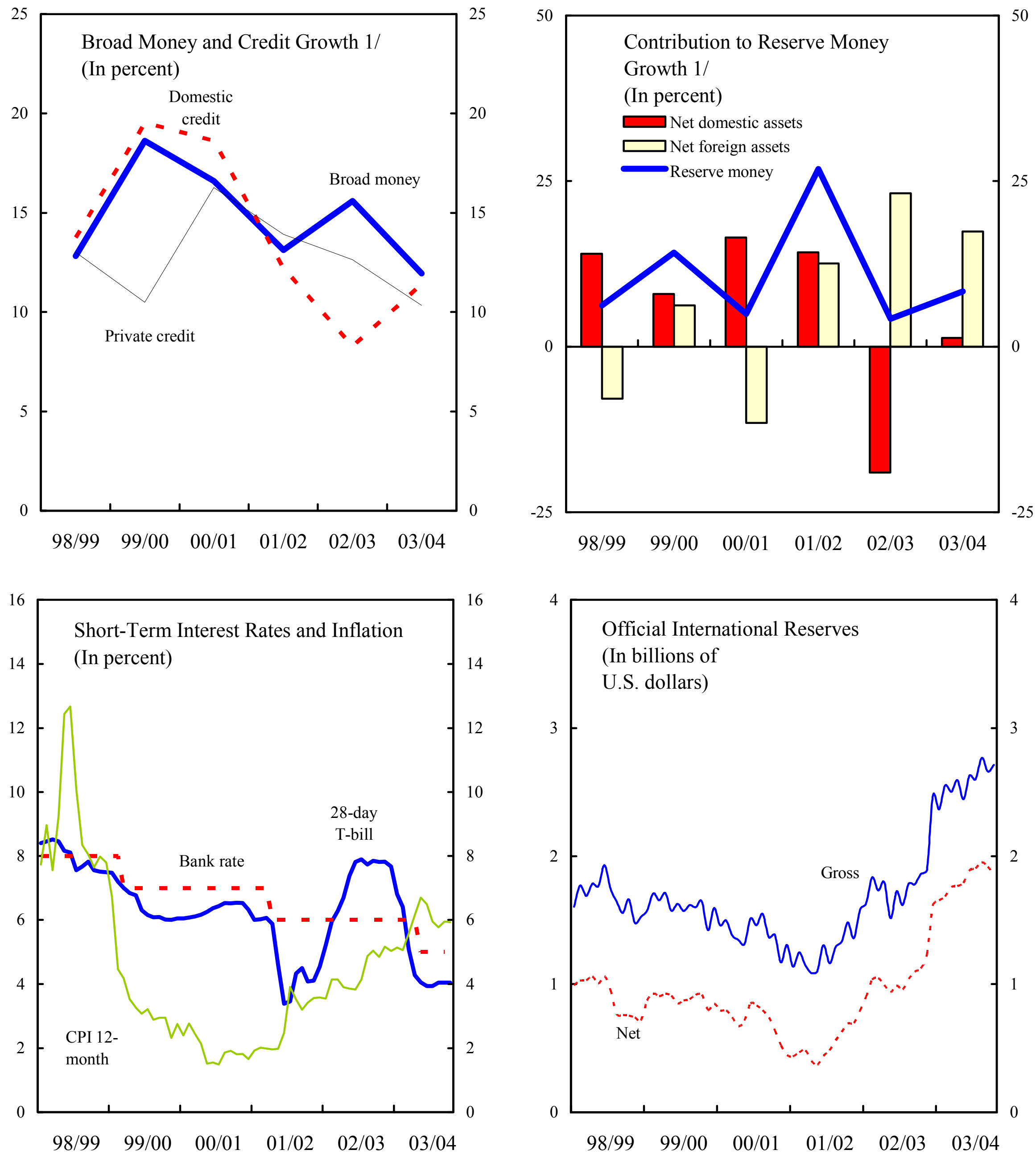
Figure 3. Bangladesh: Fiscal Sector Indicators, FY96-04



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

1/ Estimates for 2003/04.

Figure 4. Bangladesh: Monetary Sector Indicators, FY99-04



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

1/ Estimates for 2003/04.

Table 1. Bangladesh: Key Social Indicators, 1970–01

	1970–75	1980–85	1995–01 1/	Low-Income 2/
Population				
Total population, midyear (millions)	75.6	97.1	133.3	2,505.9
Growth rate (percent annual average for period)	2.6	2.6	1.7	1.9
Urban population (percent of population)	9.9	17.5	25.6	30.8
Total fertility rate (births per woman)	6.6	5.3	3.0	3.5
Poverty (percent of population)				
National headcount index	...	...	33.7	...
Urban	...	...	19.1	...
Rural	...	...	37.4	...
Income				
GNI per capita (in U.S. dollars)	200	200	360	430
Income/consumption distribution				
Gini index (percent of income or consumption)	...	25.9	31.8	...
Lowest quintile	...	9.7	9.0	...
Highest quintile	...	35.8	41.3	...
Social indicators				
Public expenditure (percent of GDP)				
Health	...	...	1.4	1.1
Education	0.8	1.4	2.5	2.8
Net primary school enrollment rate (percent of age group) 3/				
Total	50	56	89	...
Male	66	65	88	...
Female	33	47	90	...
Access to an improved water source (percent of population)				
Total	...	...	97	76
Urban	...	...	99	90
Rural	...	...	97	70
Immunization rate (percent under 12 months)				
Measles	...	1	76	60
DPT	...	2	83	61
Child malnutrition (percent under 5 years)	...	68	48	...
Life expectancy at birth (years)				
Total	46	52	62	59
Male	47	52	61	58
Female	45	51	62	60
Mortality				
Infant (per 1,000 live births)	137	113	51	80
Under 5 (per 1,000 live births)	222	175	77	121
Adult (15–59) (per 1,000 population)				
Male	473	383	262	312
Female	486	388	252	256
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, FY02-08 1/

	2001/02	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08
			Prog.	Proj.		Proj.		
National income and prices (percent change)								
Real GDP	4.4	5.3	5.5	5.5	5.5	6.0	6.0	6.0
GDP deflator	2.7	4.4	4.0	5.5	5.0	4.7	4.1	3.8
CPI inflation (annual average) 2/	2.8	4.4	4.5	5.9	5.5	5.0	4.5	4.0
Central government operations (percent of GDP)								
Total revenue	10.2	10.3	10.8	10.6	11.1	11.6	11.8	12.0
Tax	7.7	8.3	8.7	8.5	9.0	9.5	9.7	9.9
Nontax	2.4	2.0	2.1	2.1	2.1	2.1	2.1	2.1
Total expenditure	14.9	13.7	15.6	14.4	15.5	15.8	15.9	16.0
Current expenditure	8.0	8.1	8.4	8.2	8.4	8.5	8.6	8.6
Of which : Interest payments	1.8	1.9	2.0	1.7	1.8	1.8	1.8	1.8
Annual Development Program	5.6	5.4	6.1	5.4	5.9	6.1	6.2	6.3
Other expenditures 3/	1.3	0.2	1.2	0.8	1.1	1.2	1.1	1.1
Overall balance (excluding grants)	-4.7	-3.4	-4.8	-3.8	-4.3	-4.2	-4.1	-4.0
Primary balance	-2.9	-1.5	-2.8	-2.1	-2.5	-2.4	-2.3	-2.2
Financing (net)	4.7	3.4	4.8	3.8	4.3	4.2	4.1	4.0
Domestic	2.6	1.3	2.0	2.3	1.9	1.9	1.9	1.9
External	2.1	2.1	2.8	1.5	2.4	2.3	2.2	2.1
Total central government debt (percent of GDP)	52.7	53.2	52.2	50.3	49.0	48.3	47.9	47.5
Money and credit (end of year; percent change)								
Net domestic assets	11.9	12.2	14.2	11.8	11.8	12.8	14.1	14.3
Private sector	13.9	12.6	15.6	10.3	13.3	14.0	14.5	14.7
Broad money (M2)	13.1	15.6	14.1	11.9	12.6	11.0	13.0	13.5
Balance of payments (in billions of U.S. dollars) 4/								
Exports, f.o.b.	5.9	6.5	7.0	7.4	7.6	7.4	7.8	8.2
(Annual percent change)	-7.6	9.5	7.2	13.3	2.9	-1.8	4.8	5.2
Imports, f.o.b.	7.7	8.7	10.1	10.1	10.7	11.0	11.5	12.0
(Annual percent change)	-8.7	13.0	15.7	15.8	6.1	3.2	3.9	4.4
Gross official reserves (in billions of U.S. dollars)	1.6	2.5	2.8	2.6	3.0	3.0	3.1	3.2
In months of imports of goods and nonfactor services	2.1	2.9	2.9	2.6	2.9	2.7	2.7	2.7
Memorandum item								
Nominal GDP (in billions of taka)	2,732	3,005	3,294	3,345	3,705	4,109	4,534	4,989

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

1/ Fiscal year begins July 1.

2/ CPI has recently been rebased using FY96 weights.

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

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

Table 3. 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
		Prel.	Prog.	Proj.		Proj.		
Trade balance	-1,768	-2,207	-3,109	-2,718	-3,124	-3,598	-3,675	-3,773
Exports (f.o.b)	5,929	6,492	6,959	7,353	7,566	7,429	7,786	8,188
Of which : RMG sector	4,582	4,912	5,222	5,600	5,628	5,313	5,384	5,605
Imports (f.o.b)	-7,697	-8,699	-10,068	-10,071	-10,690	-11,027	-11,461	-11,962
Services	-500	-688	-981	-845	-1,079	-1,092	-1,125	-1,165
Income	-321	-195	-230	-230	-311	-327	-340	-355
Transfers	2,826	3,418	3,677	3,696	3,889	4,083	4,281	4,481
Official current transfers 2/	69	60	85	60	53	54	55	56
Private transfers	2,757	3,358	3,592	3,636	3,836	4,029	4,226	4,425
Of which: Workers' remittances	2,501	3,062	3,292	3,371	3,523	3,700	3,880	4,063
Current account balance	237	328	-643	-97	-625	-933	-860	-812
Capital and financial account balance	446	577	913	479	104	106	95	106
Capital account	410	392	405	350	349	356	363	369
Financial account	36	185	508	129	-245	-250	-268	-263
Foreign direct investment	65	92	60	95	52	55	58	60
Portfolio investment	-6	2	2	2	0	0	0	0
Net aid flows	541	634	1,171	251	300	228	215	201
Other long-term loans (net)	-42	-20	-25	-25	0	0	0	0
Other short-term loans (net)	20	143	0	124	0	0	0	0
Other assets (net)	-52	-81	-107	-75	-99	-96	-92	-95
Trade credits (net)	-482	-656	-544	-343	-448	-388	-398	-379
Commercial banks (net)	-9	71	-50	100	-50	-50	-50	-50
Errors and omissions	-354	-94	0	-161	0	0	0	0
Overall balance	329	811	270	221	-521	-828	-765	-706
Financing items	-329	-811	-270	-221	-350	190	-89	-114
Bangladesh Bank	-329	-811	-270	-221	-350	190	-89	-114
Financing gap	0	0	0	0	870	637	854	820
Exceptional Financing (identified)	...	...	...	...	815	525	445	445
Residual financing gap	...	...	...	...	55	112	409	375
Memorandum items:								
Current account balance (percent of GDP)	0.5	0.6	-1.2	-0.2	-1.0	-1.4	-1.2	-1.0
Export growth rate (percent)	-7.6	9.5	7.2	13.3	2.9	-1.8	4.8	5.2
Import growth rate (percent)	-8.7	13.0	15.7	15.8	6.1	3.1	3.9	4.4
Gross official reserves (US$ million) 3/	1,582	2,471	2,848	2,600	3,042	2,952	3,049	3,176
(In months of imports of goods and services)	2.1	2.9	2.9	2.6	2.9	2.7	2.7	2.7
Net international reserves (US$ million)	792	1,604	1,874	1,825	2,175	1,984	2,073	2,187
Medium and long-term external public debt (US$ million)	16,276	16,519	18,164	16,770	17,940	18,806	19,874	20,895
(In percent of GDP)	34.4	31.9	32.9	29.9	29.1	27.7	26.9	26.0
Amortization after debt relief 4/	...	...	...	-366	-365	-451	-473	-495
Debt-service ratio 5/	6.1	5.5	5.7	5.4	5.8	6.5	6.4	6.3
Nominal GDP (US$ million)	47,303	51,744	55,287	56,136	61,614	67,866	73,919	80,286

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/ Gross foreign reserves of Bangladesh Bank, including resident foreign currency deposits.
4/ Starting in FY04, Japan is expected to give debt relief upfront, instead of grants to compensate for debt service on certain loans.
5/ In percent of current earnings defined as the sum of exports of goods, nonfactor services, and private transfers.

Table 4. Bangladesh: Central Government Operations, FY02–08 1/

	2001/02	2002/03	2003/04			2004/05	2005/06	2006/07	2007/08
			Prog.	Rev. Bud.	Proj.	Budget		Proj.	
	(In billions of taka)								
Total revenue	276.8	309.7	356.9	354.0	354.0	412.3	476.8	535.1	597.6
Tax revenue	210.3	248.2	286.6	283.0	283.0	335.7	389.8	438.9	491.6
NBR taxes	199.2	237.6	273.4	270.5	270.5	321.2	373.2	420.7	471.0
Non-NBR taxes	11.1	10.7	13.2	12.5	12.5	14.5	16.6	18.3	20.6
Nontax revenue	66.5	61.5	70.3	71.0	71.0	76.6	87.0	96.2	106.0
Total expenditure	403.7	423.6	515.4	493.7	481.2	572.5	649.8	720.8	799.5
Current expenditure	218.2	244.5	278.3	272.6	272.6	310.7	348.7	390.7	428.6
Pay and allowances	68.8	71.2	80.7	79.1	79.1	84.2	93.4	103.1	112.4
Goods and services	33.2	42.5	47.8	48.8	48.8	51.7	60.2	73.5	83.5
Interest payments	49.3	56.6	65.6	58.4	58.4	65.3	75.4	82.0	90.7
Subsidies and transfers	58.4	70.2	64.7	81.9	81.9	94.8	107.6	118.7	127.1
Subsidies	6.8	13.5	11.6	13.4	13.4	15.0	16.6	18.4	19.2
Transfers	51.6	56.7	53.1	68.5	68.5	79.8	90.9	100.3	107.9
Block allocations	8.4	4.0	19.5	4.4	4.4	14.7	12.2	13.5	14.8
Food account surplus(-)/deficit(+)	2.1	-2.7	3.5	5.1	5.1	2.2	3.5	3.5	3.5
Annual Development Program (ADP)	152.3	163.0	200.0	190.0	180.0	220.0	251.0	280.3	316.5
Non-ADP capital and net lending	17.2	6.6	18.7	16.0	13.5	30.1	33.1	34.9	37.4
Extraordinary expenditures	0.0	12.3	14.9	10.0	10.0	9.6	13.4	11.4	13.5
Check float plus discrepancy	13.8	-12.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-126.9	-101.0	-158.5	-139.7	-127.2	-160.2	-173.0	-185.7	-201.9
Primary balance (excluding grants)	-77.6	-44.4	-92.9	-81.2	-68.8	-94.9	-97.6	-103.7	-111.2
Net financing	126.9	101.0	158.5	139.7	127.2	160.2	173.0	185.7	201.9
External	58.1	63.5	92.5	79.9	51.5	89.2	93.7	97.9	105.1
Domestic	68.1	37.5	65.0	59.8	75.7	71.0	79.3	87.8	96.8
Bank	21.7	-10.7	20.0	15.0	30.7	26.0	30.0	32.0	36.0
Nonbank	46.4	48.2	45.0	44.7	45.0	45.0	49.3	55.9	60.7
Privatization receipts	0.6	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of GDP)								
Total revenue	10.2	10.3	10.8	10.6	10.6	11.1	11.6	11.8	12.0
Tax revenue	7.7	8.3	8.7	8.5	8.5	9.1	9.5	9.7	9.9
NBR taxes	7.3	7.9	8.3	8.1	8.1	8.7	9.1	9.3	9.5
Non-NBR taxes	0.4	0.4	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	2.1	2.1	2.1	2.1
Total expenditure	14.9	13.7	15.6	14.8	14.4	15.5	15.8	15.9	16.0
Current expenditure	8.0	8.1	8.4	8.2	8.2	8.4	8.5	8.6	8.6
Pay and allowances	2.5	2.4	2.4	2.4	2.4	2.3	2.3	2.3	2.3
Goods and services	1.2	1.4	1.5	1.5	1.5	1.4	1.5	1.6	1.7
Interest	1.8	1.9	2.0	1.7	1.7	1.8	1.8	1.8	1.8
Subsidies and transfers	2.1	2.3	2.0	2.4	2.4	2.6	2.6	2.6	2.6
Subsidies	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Transfers	1.9	1.9	1.6	2.0	2.0	2.2	2.2	2.2	2.2
Block allocations	0.3	0.1	0.6	0.1	0.1	0.4	0.3	0.3	0.3
ADP	5.6	5.4	6.1	5.7	5.4	5.9	6.1	6.2	6.4
Non-ADP capital and net lending	0.6	0.2	0.6	0.5	0.4	0.8	0.8	0.8	0.8
Other expenditures	0.1	0.3	0.6	0.5	0.5	0.3	0.4	0.3	0.3
Check float plus discrepancy	0.5	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-4.7	-3.4	-4.8	-4.2	-3.8	-4.3	-4.2	-4.1	-4.1
Primary balance (excluding grants)	-2.9	-1.5	-2.8	-2.4	-2.1	-2.6	-2.4	-2.3	-2.2
Net financing	4.7	3.4	4.8	4.2	3.8	4.3	4.2	4.1	4.1
External financing (net)	2.1	2.1	2.8	2.4	1.5	2.4	2.3	2.2	2.1
Domestic financing	2.5	1.2	2.0	1.8	2.3	1.9	1.9	1.9	1.9
Banks	0.8	-0.4	0.6	0.4	0.9	0.7	0.7	0.7	0.7
Nonbank	1.7	1.6	1.4	1.3	1.3	1.2	1.2	1.2	1.2
Memorandum item									
Nominal GDP (in billions of taka)	2,732	3,005	3,294	3,345	3,345	3,701	4,105	4,530	4,983

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

1/ Fiscal year ends June 30.

Table 5. Bangladesh: Central Bank Balance Sheet, June 2003-June 2005

	Jun-03		Sep-03		Dec-03		Mar-04		Jun-04	Sep-04	Dec-04	Mar-05	Jun-05
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Rev. Prog.	Revised program for FY05			
	(End of period; in billions of taka)												
Net international reserves 1/	78	94	75	103	104	111	112	113	110	123	127	131	135
Net international reserves 2/	80	89	75	96	98	98	98	98	96	...	...	...	...
Net international reserves 3/	...	...	...	...	...	...	...	...	110	122	125	128	131
Net domestic assets 1/	136	121	143	110	120	110	115	114	122	114	117	118	121
Net domestic assets 2/	135	125	143	116	126	124	129	129	137	...	...	...	...
Net domestic assets 3/	...	...	...	...	...	...	...	...	122	115	119	121	125
Net credit to central government	69	62	72	36	54	45	57	53	53	41	44	47	50
Credit to other nonfinancial public sector	1	1	1	1	1	1	1	1	1	1	1	1	1
Credit to deposit money banks	48	48	48	50	48	48	48	54	53	53	53	53	53
Other items, net 1/	19	9	22	23	17	16	8	6	15	19	18	17	16
Reserve money	215	214	218	212	224	221	226	227	232	237	244	249	256
Currency	158	153	160	152	161	158	163	166	167	170	175	179	183
Reserves	57	61	58	60	63	63	63	61	66	67	69	71	73
	(Change since start of fiscal year; in billions of taka)												
Net international reserves 1/	32	48	-3	9	10	17	18	19	17	13	17	21	25
Net domestic assets 1/	-23	-39	6	-11	0	-10	-6	-7	1	-8	-5	-4	-1
Net domestic assets 2/	-23	-33	6	-9	1	-1	4	4	12	...	...	...	...
Net domestic assets 3/	...	...	...	...	...	...	...	...	...	-7	-3	-1	3
Net credit to central government	-39	-46	3	-27	-8	-17	-5	-9	-10	-12	-8	-6	-2
Credit to other nonfinancial public sector	0	0	0	0	0	0	0	0	0	0	0	0	0
Credit to deposit money banks	1	1	0	2	0	0	0	6	5	0	0	0	0
Other items, net	16	6	3	14	8	7	-1	-3	6	4	3	2	1
Reserve money	9	9	4	-2	10	7	12	13	18	5	11	17	23
Currency	19	15	2	14	8	5	10	13	13	4	8	12	16
Reserves	-10	-6	1	-1	2	2	2	0	5	1	3	5	7
Memorandum items:													
Reserve money (year-on-year percent change)	4.3	4.2	11.1	8.1	10.2	8.8	9.8	10.1	8.4	11.7	8.8	10.1	10.1
Net international reserves (in millions of U.S. dollars) 1/	1,349	1,604	1,299	1,756	1,774	1,922	1,896	1,917	1,825	2,025	2,075	2,125	2,173
Flow since start of fiscal year (in millions of U.S. dollars) 1/	336	812	-50	138	170	270	292	299	221	200	250	300	348
Net international reserves (in millions of U.S. dollars) 2/	1,380	1,545	1,299	1,657	1,671	1,688	1,688	1,688	1,650	...	...	...	...
Flow since start of fiscal year (in millions of U.S. dollars) 2/	557	722	-50	112	126	143	143	143	105	...	...	...	...
Net international reserves (in millions of U.S. dollars) 3/	...	...	...	...	...	...	...	1,917	1,871	2,071	2,121	2,171	2,219
Flow since start of fiscal year (in millions of U.S. dollars) 3/	...	...	...	...	...	...	...	...	...	200	250	300	348
Required domestic cash reserves (in millions of taka)	41	41	42	44	44	45	44	44	46	47	49	50	52
Excess domestic cash reserves (in millions of taka)	16	20	16	16	19	18	19	16	20	20	20	21	21

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

1/ Calculated from monetary data using end of period exchange rates.
2/ Calculated using program exchange rates (rates for FY04 as of end-March 2003).
3/ Calculated using program exchange rates (rates for FY05 as of end-March 2004).

Table 6. Bangladesh: Monetary Program, June 2003-June 2005

	Jun-03		Sep-03		Dec-03		Mar-04		Jun-04	Sep-04	Dec-04	Mar-05	Jun-05
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Rev. Prog.	Revised program for FY05			
	(End of period; in billions of taka)												
Net foreign assets	124	140	123	149	151	156	156	157	158	172	177	182	187
Net domestic assets	985	1,000	1,013	1,027	1,072	1,053	1,074	1,067	1,118	1,139	1,177	1,211	1,249
Domestic credit	1,059	1,034	1,089	1,055	1,111	1,081	1,096	1,099	1,152	1,176	1,217	1,255	1,294
Net credit to central government	202	173	213	172	176	167	177	174	204	199	217	222	230
Credit to other nonfinancial public sector	61	55	62	55	55	61	59	63	59	59	58	58	57
Credit to private sector	797	806	814	828	880	852	860	863	889	919	942	975	1,007
Other items, net 1/	-74	-34	-76	-28	-39	-28	-22	-32	-34	-37	-40	-44	-45
Broad money (M2)	1,110	1,140	1,135	1,176	1,223	1,209	1,230	1,223	1,276	1,311	1,354	1,393	1,436
	(Change since start of fiscal year; in billions of taka)												
Net foreign assets	29	45	-1	9	11	16	16	16	18	14	19	24	29
Net domestic assets	95	109	27	27	73	53	75	67	118	22	59	93	131
Domestic credit	102	76	29	21	77	47	62	65	118	25	65	103	142
Net credit to central government	18	-11	11	-1	3	-6	4	1	31	-5	13	18	26
Credit to other nonfinancial public sector	2	-3	1	0	0	6	4	8	4	-1	-1	-2	-2
Credit to private sector	82	90	17	22	74	47	54	57	83	30	53	87	118
Other items, net	-7	33	-2	6	-5	6	12	2	0	-3	-6	-10	-11
Broad money (M2)	124	154	26	36	83	69	91	84	136	35	78	117	160
	(Year-on-year percent change)												
Net foreign assets	30.2	46.8	12.1	35.9	48.7	54.0	46.0	46.3	13.0	15.5	13.5	16.4	18.3
Net domestic assets	10.6	12.2	11.7	13.3	10.8	8.8	12.0	11.2	11.8	11.0	11.8	13.5	11.8
Domestic credit	10.6	8.0	12.7	9.2	7.8	4.8	6.4	6.7	11.4	11.5	12.6	14.1	12.4
Net credit to central government	9.7	-5.8	15.5	-6.6	-6.8	-11.4	-3.2	-5.1	17.7	15.6	29.6	27.7	12.8
Credit to other nonfinancial public sector	4.2	-5.7	13.6	0.5	-11.9	-2.2	4.2	10.7	6.9	6.6	-5.3	-8.6	-3.4
Credit to private sector	11.4	12.6	11.9	13.9	12.9	9.3	8.8	9.2	10.3	11.0	10.5	13.1	13.3
Other items, net	10.6	-48.8	26.9	-52.7	-38.8	-55.8	-69.0	-54.2	-0.5	30.8	42.4	35.6	32.3
Broad money (M2)	12.5	15.6	11.8	15.7	14.4	13.1	15.4	14.8	11.9	11.6	12.0	13.9	12.6
	(In billions of taka, unless otherwise noted)												
Memorandum items													
Broad money multiplier	5.17	5.32	5.21	5.54	5.46	5.46	5.44	5.39	5.49	5.53	5.56	5.59	5.61
Broad money velocity	2.70	2.64	2.70	2.63	2.57	2.62	2.65	2.66	2.62	2.61	2.59	2.58	2.57
Net domestic financing of central government (since beginning of FY)	56	38	20	15	31	24	41	39	76	4	33	53	71
Bank	18	-11	11	-1	3	-6	4	1	31	-5	13	18	26
Nonbanks	38	48	9	16	28	30	37	39	45	9	20	35	45

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

1/ The large change in other items, net in June 2003 was due in part to writeoffs by commercial banks of longstanding nonperforming loans, in response to changes in regulatory guidelines by Bangladesh Bank.

Table 7. Bangladesh: Projected Balance of Payments Impact of the Removal of MFA Quotas, FY04-06 1/
(In millions of U.S. dollars)

	2003/04	2004/05	2005/06	2006/07	FY05-06
			Projections		
Projections under the First PRGF review 2/					
Trade balance	-3,109	-3,082	-3,107	-3,088	-6,189
Exports	6,959	7,389	7,940	8,600	15,329
(in percent change)	7.2	6.2	7.5	8.3	6.8
Of which : RMG exports	5,379	5,675	5,987	6,316	11,662
(in percent change)	9.5	5.5	5.5	5.5	5.5
Net RMG exports	3,335	3,473	3,686	3,867	7,159
Imports (fob)	10,068	10,471	11,047	11,688	21,518
Of which: RMG-related imports	2,044	2,202	2,301	2,449	4,503
Services (net)	-1,211	-1,356	-1,388	-1,479	-2,744
Overall balance	270	-307	-272	-328	-579
NIR accumulation	270	300	310	254	610
Financing gap	0	607	582	582	1,189
Post MFA, without policy adjustment					
Trade balance	-2,718	-3,422	-4,131	-4,165	-7,553
Exports	7,353	7,110	6,706	6,937	13,817
(In percent change)	13.3	-3.3	-5.7	3.4	-4.5
Of which : RMG exports	5,600	5,081	4,502	4,813	9,583
(In percent change)	14.0	-9.3	-11.4	6.9	-10.3
Net RMG exports	3,472	3,109	2,772	2,947	5,881
Imports (fob)	10,071	10,532	10,838	11,101	21,370
Of which: RMG-related imports	2,128	1,972	1,730	1,866	3,702
Services (net)	-1,075	-1,391	-1,376	-1,398	-2,766
Overall balance	221	-872	-1,480	-1,530	-2,352
NIR accumulation 3/	221	103	-102	62	1
Financing gap	0	975	1,379	1,592	2,353
Post MFA, with policy adjustment, under the second PRGF review					
Trade balance	-2,718	-3,124	-3,598	-3,675	-6,722
Exports	7,353	7,566	7,429	7,786	14,995
(In percent change)	13.3	2.9	-1.8	4.8	0.5
Of which : RMG exports	5,600	5,628	5,313	5,384	10,940
(In percent change)	14.0	0.5	-5.6	1.3	-2.6
Net RMG exports	3,472	3,444	3,271	3,296	6,916
Imports (fob)	10,071	10,690	11,027	11,461	21,717
Of which: RMG-related imports	2,128	2,184	2,042	2,088	4,312
Services (net)	-1,075	-1,390	-1,419	-1,465	-2,809
Overall balance	221	-521	-828	-765	-1,348
NIR accumulation	221	350	-190	89	159
Financing gap	0	870	637	854	1,507
Impact of MFA Quota Removal					
Before policy adjustment					
Trade balance	391	-340	-1,024	-1,077	-1,364
(In percent of GDP)	0.7	-0.6	-1.5	-1.5	-1.0
Net RMG exports	137	-363	-915	-920	-1,278
Services (net)	136	-35	12	81	-22
Overall balance	-49	-565	-1,208	-1,202	-1,773
NIR accumulation	-49	-197	-412	-192	-609
Additional financing gap	0	368	797	1,010	1,164
With policy adjustment					
Trade balance	391	-42	-491	-587	-533
(In percent of GDP)	0.7	-0.1	-0.7	-0.8	-0.4
Net RMG exports	137	-29	-415	-571	-444
Services (net)	136	-34	-31	14	-65
Overall balance	-49	-214	-556	-437	-769
NIR accumulation	-49	50	-500	-165	-451
Additional financing gap	0	263	55	273	318
Memorandum items					
Nominal GDP (in millions of U.S. dollars)	56,136	61,614	67,866	73,919	...
Quotas (in millions of SDR)	533	533	533	533	533

Source: Bangladesh Bank, and staff estimates and projections.

1/ The removal of quotas is not expected to materially affect balance of payments entries not explicitly included in the table.

2/ These projections incorporate very preliminary estimates of the potential MFA impact, based on partial data.

3/ For maintaining about 3 months of import cover.

Table 8. Bangladesh: Millennium Development Goals

	1990	1995	2001	2002	2015 Target
Goal 1. Eradicate extreme poverty and hunger					
Target 1: Halve 1990 US$1 a day poverty and malnutrition rates					
1. Population below US$1 a day (percent)	...	...	36.0	...	...
2. Poverty gap at US$1 a day (percent)	...	...	8.1	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	9.0	...	...
Target 2:					
4. Prevalence of child malnutrition (percent of children under 5)	65.8	57.4	47.7	...	...
5. Population below minimum level of dietary energy consumption (percent)	35.0	38.0	32.0	...	...
Goal 2. Achieve universal primary education					
Target 3: Net enrollment to 100					
6. Net primary enrollment ratio (percent of relevant age group)	64.0	...	86.6	...	100.0
7. Percentage of cohort reaching grade 5 (percent)	...	...	65.5	...	...
8. Youth literacy rate (percent of ages 15-24)	42.0	45.1	49.1	49.7	...
Goal 3. Promote gender equality					
Target 4: Education ratio to 100					
9. Ratio of girls to boys in primary and secondary education (percent)	76.1	...	104.7	...	100.0
10. Ratio of young literate females to males (percent of ages 15-24)	65.5	67.7	70.6	71.1	...
11. Share of women employed in the nonagricultural sector (percent)	17.6	23.3	22.9	...	...
12. Proportion of seats held by women in national parliament (percent)	...	11.0	...	...	...
Goal 4. Reduce child morality					
Target 5: Reduce 1990 under 5 mortality by two-thirds					
13. Under 5 mortality rate (per 1,000)	144.0	116.0	82.0	73.0	48.0
14. Infant mortality rate (per 1,000 live births)	96.0	75.0	54.0	48.0	...
15. Immunization, measles (percent of children under 12 months)	65.0	79.0	76.0	77.0	...
Goal 5. Improve maternal health					
Target 6: Reduce 1990 maternal mortality by three-fourths					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	380	...	...
17. Births attended by skilled health staff (percent of total)	...	9.5	11.6	...	...
Goal 6. Combat HIV/AIDS, malaria, and other diseases					
Target 7: Halt, and begin to reverse, AIDS, etc.					
18. Prevalence of HIV, female (percent of ages 15-24)	...	...	0.0	...	...
19. Contraceptive prevalence rate (percent of women ages 15-49)	39.9	44.9	53.8	...	...
20. Number of children orphaned by HIV/AIDS	...	...	2,100.0	...	...
Target 8: Halt, and begin to reverse, AIDS, etc.					
21. Incidence of tuberculosis (per 100,000 people)	...	...	233.0	221.0	...
22. Tuberculosis cases detected under DOTS (percent)	...	7.0	26.0	32.0	...
Goal 7. Ensure environmental sustainability					
Target 9: Various (see notes)					
23. Forest area (percent of total land area)	9.0	...	10.2	...	...
24. Nationally protected areas (percent of total land area)	...	0.8	0.8	0.8	...
25. GDP per unit of energy use (PPP $ per kg oil equivalent)	8.1	9.0	10.8	...	...
26. CO2 emissions (metric tons per capita)	0.1	0.2	0.2	...	...

Table 8. Bangladesh: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2015 Target
Target 10: Various (see notes)					
27. Access to an improved water source (percent of population)	94.0	...	97.0	...	...
Target 11: Various (see notes)					
28. Access to improved sanitation (percent of population)	41.0	...	48.0	...	...
29. Access to secure tenure (percent of population)	...	...	...	...	...
Goal 8. Develop a global partnership for development					
Target 12: Various (see notes)					
30. Youth unemployment rate (percent of total labor force ages 15-24)	2.5	7.0	10.7	...	...
31. Fixed line and mobile telephones (per 1,000 people)	2.0	2.4	8.3	13.2	...
32. Personal computers (per 1,000 people)	...	0.2	1.9	3.4	...
General indicators					
33. Population	110	120.1	133.3	135.7	...
34. Gross national income (in billions of U.S. dollars)	31	39.2	50.7	51.1	...
35. GNI per capita (in U.S. dollars)	280	330	380	380	...
36. Adult literacy rate (percent of people ages 15 and over)	34.2	37.1	40.6	41.1	...
37. Total fertility rate (births per woman)	4.1	3.4	3.1	3	...
38. Life expectancy at birth (years)	54.8	58.3	61.2	62.1	...
39. Aid (percent of GNI)	6.8	3.3	2.1	1.8	...
40. External debt (percent of GNI)	40.4	40.7	31.3	34.2	...
41. Investment (percent of GDP)	17.1	19.1	23.1	23.1	...
42. Trade (percent of GDP)	19.7	28.2	36.9	33.3	...

Sources: World Bank; and Fund staff estimates.

Note: In some cases the data are for earlier or later years than those stated.

Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than US$1 a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

Goal 8 targets: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system. Address the special needs of the least developed countries. Address the special needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Table 9. Bangladesh: Proposed Schedule of Disbursements Under the PRGF Arrangement and Augmentation of PRGF Access in Accordance with the Trade Integration Mechanism (TIM)

Original Amount	Augumentation	Total	Available Date	Conditions for Disbursement
SDR 49.5 million (9.3 percent of quota)		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)		SDR 49.5.0 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)		SDR 49.5 million (9.3 percent of quota)	July 30, 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)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 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)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 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)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 percent of quota)	December 15, 2005	Observance of the end‑September 2005 performance criteria and completion of the fifth review.
SDR 50.0 million (9.4 percent of quota)		SDR 50.0 million (9.4 percent of quota)	June 15, 2006	Observance of the end‑March 2006 performance criteria and completion of the sixth review.
Total SDR 347.0 million (65 percent of quota)	SDR 53.33 million (10 percent of quota)	SDR 400.33 million (75 percent of quota)		

Table 10. Bangladesh: External Financing Requirements, FY 2003-07

(in millions of U.S. dollars)

	2002/03	2003/04		2004/05	2005/06	2006/07
		Prog.	Proj.		Proj.	
Total financing requirements	1,627	2,134	1,264	2,071	1,864	2,105
Gross financing requirements	738	1,741	1,135	1,877	1,954	2,009
Current account deficit	-328	643	97	625	933	860
MLT debt amortization	436	496	496	500	588	617
Trade credits (net)	656	544	343	448	388	398
UFR (abstracting from expected Fund financing)	35	25	25	0	0	0
Other Bangladesh Bank liabilities (net)	-42	-148	137	155	-101	-8
Other long term loans (net)	20	25	25	0	0	0
Other short-term loans and assets (net)	-62	107	-49	99	96	92
DMBs foreign exchange assets (net)	-71	50	-100	50	50	50
Errors and omissions	94	0	161	0	0	0
Build up in gross reserves (+, increase in assets)	889	394	129	194	-90	97
Resources	1,256	1,614	1,024	1,201	1,227	1,252
Aid disbursements	1,162	1,552	927	1,149	1,172	1,194
Foreign direct and portfolio investment	94	62	97	52	55	58
Financing gap						
With PRGF financing	300	520	240	870	637	854
Identified program financing	300	520	240	815	525	445
Loans	300	450	170	795	505	445
World Bank	300	400	70	695	405	345
ADB	0	50	100	100	100	100
Grants	0	70	70	20	20	0
UK	0	20	20	20	20	0
Others	0	50	50	0	0	0
Residual financing gap 1/	0	0	0	55	112	409
Memorandum items						
PRGF financing under existing arrangement	71	69	69	219	146	0

Source: Bangladesh Bank; and Fund staff estimates and projections.

1/ Excluding possible augmentation of PRGF access in accordance with the Trade Integration Mechanism.

Table 11. Bangladesh: Projected Fund Transactions Under the PRGF, 2002/03-2007/08 1/

(In millions of SDRs)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Total use of Fund (UFR) resources outstanding	74.0	99.0	247.5	346.5	346.5	346.5
SBA	24.5	0.0	0.0	0.0	0.0	0.0
PRGF	49.5	99.0	247.5	346.5	346.5	346.5
Proposed PRGF						
Disbursements	49.5	49.5	148.5	99.0	0.0	0.0
Debt service	0.0	0.5	1.0	1.6	2.0	2.0
Repayments	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	18.6	46.4	65.0	65.0	65.0
Total UFR as a percentage of GDP	0.2	0.3	0.6	0.8	0.7	0.6
Debt service to the Fund as a percent of exports of goods and services	1.2	0.5	0.0	0.0	0.0	0.0

1/ Excluding possible augmentation of PRGF access in accordance with the Trade Integration Mechanism.

Bangladesh: Fund Relations
(As of May 31, 2004)

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	533.30	99.97
Reserve position in Fund	0.19	0.03

III. **SDR Department:**	SDR million	Percent Allocation
Net cumulative allocation	47.12	100.00
Holdings	1.80	3.83

IV. **Outstanding Purchases and Loans:**	SDR million	Percent Quota
PRGF arrangements	99.00	18.56

V. **Financial Arrangements:**

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	6/20/03	6/19/06	347.00	99.00
ESAF	8/10/90	9/13/93	345.00	330.00
SAF	2/06/87	2/05/90	201.25	201.25

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

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	0.00	0.00	0.00	0.00	4.95
Charges/interest	0.87	1.28	1.28	1.28	1.28
Total	0.87	1.28	1.28	1.28	6.23

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 statements 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 arrangement 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. BB has since made progress in addressing those weaknesses. IAS has been adopted as its accounting framework, its FY03 accounts were audited by a local auditing firm and signed off by an international accounting firm, and reserve management functions have been separated into front and back offices.

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 on three occasions during 2000–02, when the trading band for BB's transactions was correspondingly widened or raised. 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 the period to January 2003, the scope and level of margin requirements were adjusted on four occasions. In October 2003, the margin requirements on 55 items were reduced from 100 percent to 50 percent and all margin requirements were removed effective December 2, 2003.

In August 2002, limits on the availability of foreign exchange for travel, medical, and educational expenses, as well as other services, were removed.

At the last Article IV consultation (June 2003), the Executive Board approved the maintenance by Bangladesh of margin requirements for the opening of letters of credit for the import of goods until November 30, 2003, and also approved the maintenance of restrictions for advance payments for imports and on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts until the conclusion of the second review under the PRGF arrangement or June 30, 2004, whichever is sooner.

IX. Article IV Consultation

The next Article IV consultation will be held subject to the provisions of the decision on consultation cycles approved on July 15, 2002. The last Article IV consultation was held over two missions in January and April 2003, and was concluded on June 20, 2003 (IMF Country Report NO. 03/205).

X. Technical Assistance During 2002–04

2002

January:	MFD/LEG mission advised on operational steps to facilitate the adoption of a more flexible exchange rate regime.
February:	An external legal expert advised on amendments to the Bangladesh Bank Order to strengthen the independence of BB.
April:	MFD consultant provided recommendations for the establishment of a repo market.
May:	A pre-FSAP mission advised on banking sector reform, followed by a full FSAP mission in October.
May–November:	MFD peripatetic adviser assisted in foreign exchange operations and liquidity management.
August:	FAD team conducted a fiscal ROSC, and STA conducted a multisector technical assistance mission.
October:	MFD mission provided assistance in implementing the Safeguards recommendations.

2003

January and May:	MFD missions advised on preparations for moving to a flexible exchange rate regime.
March–September:	MFD resident adviser assisted BB with liquidity forecasting and monetary and exchange operations.
May:	MFD mission assisted BB with nationalized commercial bank (NCB) reforms; a peripatetic adviser assisted BB with producing its FY03 accounts in accordance with IAS.
August:	MFD mission provided recommendations for reducing interest rates.
August–September:	FAD mission provided recommendations on tax administration.
November:	MFD mission provided recommendations for the resolution of NCBs and on the functioning of treasury bill markets. An STA mission on monetary and financial statistics and a joint LEG/MFD mission on revising Bangladesh’s foreign exchange regulations were conducted.

2004

January-February:	STA mission to follow up on the recommendations of the 2002 Multisector Report.
February-May:	An MFD expert assisted the Fund mission in monitoring and expanding memoranda of understanding for the nationalized commercial banks. A peripatetic adviser assisted BB with improving accounting standards in accordance with IAS.

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 Bank[1]

The World Bank has an expanding assistance program in Bangladesh including investment and policy-based lending, analytical and advisory services, and lending and non-lending technical assistance. The Bank also maintains policy dialogue on a broad range of macroeconomic and sectoral issues. This Annex, however, focuses on Bank activities that are complementary to those of the Fund.

World Bank-Bangladesh Relations and Policy Dialogue

Since taking office two years ago, the government has made progress on critical areas such as budgetary management, state-owned enterprises (SOEs), central and commercial banking, energy, telecommunications, public procurement, separation of public accounts and audit and other areas of economic governance. The Bank has been regularly interacting with key Government officials and has been providing inputs into the design and sequencing of reforms, as requested by the authorities.

To obtain inputs for the preparation of the country's Poverty Reduction Strategy, the government organized a series of national consultation workshops, including various government and nongovernmental organizations, members of civil society, and development partners. The Joint Staff Assessment, prepared by the Bank and the Fund and presented to their Boards on June 2003, concluded that the Interim PRSP constitutes an adequate framework for enhancing growth and poverty reduction. The government plans to complete the full PRSP by December 2004.

As part of its nonlending services, the Bank has completed key reports. These include, inter alia, the Public Expenditure Review and the Poverty Assessment – prepared jointly with the Asian Development Bank - which provided inputs for the I-PRSP. In addition, an Investment Climate Assessment (jointly with the Bangladesh Enterprise Institute) and a report on Private Provision of Infrastructure in Bangladesh have been completed and disseminated. More recently, the Bank has completed the Development Policy Review, a review of trade policies in South Asia and the Bangladesh Development Forum Economic Update. A Report on the Observance of Standards and Codes (ROSC) in accounting and auditing has been completed and made available to the public.

Restructuring SOEs. 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" (May 2003) was discussed widely. In response to a request from the authorities, the Bank 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

[1]Prepared by World Bank staff.

in areas relating to pricing policy and the regulatory regime for energy and other utilities. As part of a wide reform program of rolling back state ownership and control within the economy, the recently approved *Enterprise Growth and Bank Modernization* project will provide restructuring support of financial and non-financial SOEs, aiming to trigger employment through private sector enterprise growth and urgently needed reforms within the SOEs.

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 comanaged the Financial Sector Assessment Program report that was prepared in October 2002. With IDA financing, the government is implementing a program to strengthen the Bangladesh Bank. The *Enterprise Growth and Bank Modernization* project will also help Bangladesh achieve a competitive private banking system through restructuring and eventual divestment of most of the nationalized commercial banks.

Trade Liberalization. In response to requests from the authorities, the Bank has been regularly providing 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 within the Tariff Commission for tariff analysis and WTO-related negotiations. In addition, the Bank has regularly provided brief trade-related policy notes to the government as inputs into the annual budget preparation process. The ongoing *Bangladesh Export Competitiveness Study* is examining key macro- and microeconomic factors affecting Bangladesh's competitiveness. Accordingly, the study will provide specific recommendations on priority policy and institutional actions to support the Bank's policy dialogue and help implement the country's PRSP.

Infrastructure Development. Infrastructure development is needed in the country for economic growth in general, and private sector development in particular. In this context, the Bank is helping to prepare a power sector strategy, and has recently approved a Power Sector Development TA which includes a project preparation facility.

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 FY01–FY03 country assistance strategy (CAS) for Bangladesh identified four main thrusts: (i) helping to build stronger institutions and governance across sectors; (ii) consolidating gains in human development; (iii) implementing an integrated approach to rural development; and (iv) accelerating and broadening private sector-led growth.

A CAS Progress Report was discussed by the Board on June 19, 2003. The Bank is in the process of developing a new results-based CAS for the FY05-08 period, in order to ensure an adequate alignment of Bank assistance with the PRSP. Details of the program for FY2004 and FY2005 are provided below.

The World Bank's Assistance Program

The Bank has been assisting Bangladesh since FY1973. As of May 31, 2004, the World Bank Group has approved $10.7 billion for 197 projects (including one IBRD loan) to Bangladesh. Total net commitments totaled $2.2 billion, and undisbursed funds totaled US$1.5 billion. During FY2003, new commitments totaled $554.2 million and disbursements totaled $560.3 million (including $300 million of adjustment lending). As of May 31, 2004 total new commitments were $150 million and disbursements $185 million.. The Bank is currently supporting 25 projects in key sectors, including social and human development, rural development, energy and infrastructure, private sector development, finance, and environment. These operations emphasize policy and institutional reforms in line with the CAS and CASPR objectives.

In FY2003 the Bank approved five IDA Credits. These included four investment projects, namely Social Investment Program ($18.24 million); Rural Transport Improvement ($190 million); BD Telecommunications TA ($9.12 million); and Central Banking Strengthening ($37 million); and one adjustment operation, the Development Support Credit I ($300 million). The latter marks a shift toward programmatic lending, and complements a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) approved by the IMF Board on June 20, 2003.

During FY2004, 6 projects are scheduled to go to the Board and commitments are projected to reach US$526.5 million. Of these projects, three have already been approved, including Second Primary Education Development Project ($150 million); Power Sector Development TA ($15.5 million); and Enterprise Growth and Bank Modernization ($250 million). The remaining three projects, which will be approved before the end of June, include Rural Water Supply ($40 million); Reaching Out of School Children ($51 million); and Economic Management TA ($20 million).

The projects[2] currently planned for FY2005 include two adjustment credits, Development Support Credit II ($200 million) and Education Sector Development Support Credit (US$100 million); and three investment operations, Health, Nutrition and Population Sector Program II ($150 million); Private Sector Development (US$25 million); and Water Management Improvement (US$84.6 million). Bank financing is also under consideration for a possible Poverty Reduction Support Credit (PRSC) ($200 million) and a power sector investment project.

[2]IDA Credit amounts are indicative.

As of April 2004, IFC's held portfolio was $152.2 million in 11 projects, of which $117.7 million was on IFC's own account and $34.5 million was in B-loans. Projects span sectors such as power, telecommunications, cement, gas, and financial markets. During FY2004, IFC committed $5 million in a leasing company, ULC, as well as $40 million to an oil and gas company, Cairn Energy, to support its expenditure needs in Bangladesh and India. In addition, IFC has a second investment in GrameenPhone ($30 million) pending commitment, as well as a small investment of $3 million in a local commercial bank, BRAC Bank, focusing on SMEs. In FY2003, IFC committed $12 million in a ceramic tile manufacturer and syndicated a $21 million loan for Khulna Power under its B-loan program. In mid-2002, with the support of several 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, tax policy and administration, 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. The Bank has also collaborated with the Fund in several areas related to the Report on Observance of Standards and Codes (ROSC) and safeguards assessment.

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 I 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 loan to Bangladesh stood at $7.20 billion, $5.00 billion, and $4.37 billion, respectively, on December 31, 2003. 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 2004 is about $378 million ($200 million Ordinary Capital Resources (OCR) and $178 million Asian Development Fund (ADF)) for the following projects: Teaching Quality Improvement for Secondary Education ($68.9 million), SME Sector Development Program ($50.0 million), Chittagong Port Trade Facilitation Project ($20.0 million), Railway Development Project ($180.0 million), and Secondary Town Integrated Flood Protection II ($59.1 million).

2005–06 Program

The lending program of the AsDB for 2005–06 includes 12 projects amounting to $990 million ($550 million OCR and $440 million ADF) and covering several sectors.

Technical assistance

As of December 31, 2003, the AsDB had provided 285 technical assistance (TA) grants for project preparatory and advisory services amounting to $152.17 million. The 2004 TA program includes six advisory TAs and five project preparatory TAs, for a total amount of about $4.7 million. The TA program for 2005–06 includes total grants of $5 million per annum.

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 and its update 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, the finance, industry and trade sectors, and Dhaka-Chittagong economic corridor development.

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 2002 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 2002 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 June 22, 2004)

	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 2/	GDP/GNP	External debt
Date of latest observation	June 22, 2004	June 22, 2004	June 20, 2004	June 20, 2004	April, 2004	June 20, 2004	April, 2004	April/Feb., 2004	February, 2004	April, 2004	2002/03	March, 2004
Date received	June 22, 2004	June 22, 2004	June 22, 2004	June 22, 2004	May 20, 2004	June 22, 2004	May 5, 2004	June 10, 2004	May 4, 2004	June 1, 2004	June 3, 2004	June 10, 2004
Frequency of data 3/	D	D	W	W/M	M	W	M	M	M	M	A	A
Frequency of reporting 4/	D	D	W	W/M	M	W	M	M	M	M	A	A/M
Source of data 5/	A	A	A	A	A	A	A	N	A	A	A/N	A/N
Mode of reporting 6/	M	M/T	M	M	M/V	M	M	M	M	M	M/V	M/V
Confiden-tiality 7/	C	A	D	D	D	C	C	C	D	B	C/D	C/D
Frequency 3/ of Publication	D	D	M	M	M	W	M	M	M	O	A	A

1/ Interest rates at weekly auctions of Treasury bills.
2/ Based on financing data.
3/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, or O-other.
4/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, V-irregularly in conjunction with staff visits, or O-other irregular basis.
5/ 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.
6/ E-electronic data transfer, C-cable or facsimile, T-telephone, M-mail, V-staff visits, O-other.
7/ 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
July 8, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C., U.S.A.

Dear Mr. de Rato:

The Government of Bangladesh is committed to implementing the reform strategy set out in our Interim Poverty Reduction Strategy Paper (I-PRSP), endorsed by the IMF Executive Board together with the approval of the arrangement under the Poverty Reduction and Growth Facility (PRGF) in June 2003. This strategy is aimed at moving the economy onto a path of higher sustainable growth with job creation, and faster poverty reduction. It will be further defined in the Poverty Reduction Strategy Paper (PRSP) that is to be completed by end-2004.

Based on discussions for the second review under the PRGF arrangement with the Fund staff in February and May 2004, the attached Memorandum of Economic and Financial Policies (MEFP) assesses economic and policy performance through May 2004 under the arrangement, updates the macroeconomic framework, and discusses the financial policies and structural reform program through June 2005. It supersedes the MEFP dated June 4, 2003.

In view of newly available data, and drawing on a recent study by IMF staff on the potential impact of the impending expiry of the WTO Agreement on Textiles and Clothing at the end of 2004, the outlook for our balance of payments has considerably worsened entailing additional financing need. While the Government has strengthened policies to mitigate this adverse impact, additional financial assistance is still required and therefore, we hereby request the activation of the Fund's Trade Integration Mechanism (TIM) and an augmentation of access under the PRGF arrangement by 10 percent of quota or the equivalent of SDR 53.33 million, in accordance with the TIM. We would then, by the activation of the TIM, be able to request a further augmentation of access under the PRGF arrangement in accordance with the TIM, if the actual balance of payments effect is larger than anticipated under the revised baseline.

All quantitative performance criteria for end-March 2004 were observed. Although the structural performance criteria on the Central Intelligence Cell (CIC) and relating to bank-by-bank resolution strategies for the nationalized commercial banks (NCBs) were missed, corrective actions have now been taken. The CIU is now fully functioning, and bank resolution strategies are being adopted by the Government at the latest before the completion of the second review. On this basis, and in view of the policies set out in the attached memorandum, including the strengthening of tax administration and stepped up reform of the

NCBs, the Government requests waivers for the nonobservance of these structural performance criteria and the completion of the second review.

The Government of Bangladesh will provide the Fund with such information as the Fund may request in connection with progress in implementing the economic and financial policies, and achieving the objectives of the program. The Government believes that the policies set out in the attached MEFP are adequate to achieve the objectives of the program, but it will take any further measures that may become appropriate for this purpose. The Government of Bangladesh will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

Sincerely yours,

/s/

M. Saifur Rahman
Minister for Finance and Planning
Ministry of Finance

Attachment

BANGLADESH

Memorandum of Economic and Financial Policies for Fiscal Year 2005

July 8, 2004

I. INTRODUCTION

1. The BNP-led government adopted in June 2003 a reform strategy to move Bangladesh to a higher growth path and faster poverty reduction, as spelled out in its Interim Poverty Reduction Strategy Paper (I-PRSP). This strategy is being supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). This memorandum assesses economic performance under the first year of the arrangement, updates the medium-term policy framework, and lays out the objectives and policies that the government intends to pursue in FY05.

II. PERFORMANCE UNDER THE FIRST-YEAR PROGRAM

2. The economic recovery that began in FY03 strengthened further in FY04, although inflation has picked up. Driven by both domestic and external demand, real GDP growth is likely to accelerate to 5.5 percent, from 5.3 percent in FY03 (MEFP Table 1). Activity in the industrial and services sectors and exports have all rebounded. However, due mainly to higher imported food prices, inflation rose in late 2003 but has leveled off more recently to about 6 percent; nonfood inflation remains moderate. The inflation target for the year has therefore been raised to 6 percent.

3. Macroeconomic management remains cautious and all quantitative targets for end-December and performance criteria for end-March were met (MEFP Table 2). On the fiscal side, in response to somewhat weaker-than-targeted revenue performance in the first half of FY04, we have stepped up efforts to meet the programmed revenue target, and have trimmed ADP spending relative to the budget. We have revised the FY04 budget to trim the overall deficit to 4.2 percent of GDP, from 4.8 percent programmed.

4. The original revenue target (an effort for the year of Tk 45 billion) has been underpinned by a more vigorous implementation of tax administration measures. We also recognize that revenue performance hinges on improved capacity in the NBR. Intensified efforts are being made to collect VAT in the retail sector, and to ensure steadfast functioning of the new Large Taxpayer Unit (LTU) for income tax; some 80 selected LTU cases have been audited and additional collection has begun. Furthermore, although the target for making the Central Intelligence Cell (CIC) fully operational (an end-December 2003 structural performance criterion) was missed, corrective actions have been taken. The organization chart has now been approved, budget allocation and staffing have been arranged, and the identification of potential evaders and monitoring of 35 large taxpayers has begun. In addition, a new information base has been set up to detect large taxpayers that have escaped the tax net for follow up enforcement.

5. On the expenditure side, current spending has been broadly in line with the budget, with lower interest payments offset by higher transfers to enhance school teacher compensation and social safety net. Given the slow pace of Annual Development Program (ADP) spending in the first half of the year, efforts have been stepped up following issuance of instructions to operationalize the procurement guidelines. At the same time, ADP spending in lower priority areas has been reduced by 0.4 percentage point of GDP relative to the program to safeguard the quality of spending.

6. Monetary policy remains prudent. Even though the uptick in inflation appears to have stemmed mainly from external factors, we believe a cautious monetary stance is warranted. Thus, following the staff advice in February, and in view of the slower-than-anticipated growth in private sector credit, for FY04 Bangladesh Bank (BB) has tightened policy relative to the program by reducing the June targets for broad money and private sector credit. The limit for banking system credit to the government has also been scaled back, in line with the lower revised budget deficit. With continued remittance inflow, BB's open-market operations have been active, keeping excess reserves and reserve money growth within the target range. Furthermore, the primary dealer system for government securities was launched in December and the functioning of the interbank market has been strengthened.

7. Meanwhile, the external sector is recovering, and external debt management has been cautious. Exports grew by 15½ percent during the first ten months of this fiscal year, led by ready-made garments (RMG) and frozen food. Import growth, mainly for the RMG sector, was also buoyant, while remittances remain strong. In addition, the contracting of new nonconcessional debt has been kept well below the program limits. Overall, as a result of slower-than-anticipated aid disbursements, especially some temporary delays in the disbursement of program loans from the World Bank, and the pickup in imports, the foreign exchange market has tightened in recent months, leading to a slowdown in the accumulation of reserves. Overall, the level of reserves reached $2.7 billion by end-June 2004 (2.7 months of import cover). Finally, external competitiveness has been boosted as the effective exchange rate has depreciated by 3 and 6 percent, respectively, in real and nominal terms since the taka was floated in May 2003.

8. Good headway has been made on the structural agenda, but slippages in some areas subject to the program's structural performance criteria and benchmarks have been unavoidable, in part due to capacity constraints (MEFP Table 3). On tax administration in particular, as noted above, both the newly expanded LTU for income tax and the CIC have been in operation after initial delays, although teething problems continue. The bonded warehouse system has been revamped, broadly as envisaged, although the bank guarantee requirements for imports for domestic consumption have been stayed by the High Court. In addition, progress has recently been made in expanding the audit program to cover 80 cases (a benchmark for March 2004), but because of capacity constraints, the original target of 1,000 new cases now appears highly unrealistic.

9. With respect to the Nationalized Commercial Banks (NCBs), their performance under Memoranda of Understanding (MOUs) with BB has been satisfactory. However, the final stages for strengthening bank management proved protracted. While the selection of a sales adviser for Rupali was broadly on track, the appointment of a new management team for

Agrani (an end-January benchmark) was delayed. Similarly, the process for selecting management support teams for Sonali and Janata (an end-May benchmark) is going forward, albeit with some delays. Finally, adoption of bank-by-bank resolution strategies (a structural performance criterion for end-April) had been delayed.

10. Following substantial efforts last fiscal year, closure of state-owned enterprises (SOEs) in manufacturing has essentially stalled due to stiff opposition of vested interests and in spite of the availability of severance payments to affected workers. Nonetheless, loss-making SOEs have been encouraged to downsize. Moreover, kerosene price was raised by 17 percent in May, in response to higher world oil prices in line with the automatic pricing formula agreed with the World Bank and to bring it in line with diesel prices to curb adulteration of diesel. With this adjustment, losses of Bangladesh Petroleum Corporation (BPC) have been reduced, although they remain significant (0.3 percent of GDP for FY04) in view of the high world oil prices. However, for SOEs in the energy sector, their financial performance has been a concern, especially in the case of Dhaka Electricity Supply Authority (DESA)—its stock of arrears to other SOEs rose by 40 percent to 2 percent of GDP during the last 18 months.

III. Medium-Term Outlook

11. Notwithstanding the difficult political environment, the government remains committed to the reform strategy for a private sector-led growth and poverty reduction, as outlined in our I-PRSP. Preparations for a full PRSP have begun, and we aim to complete this by end-2004 on target. A National Steering Committee has been formed to lead this effort, and twelve interministerial working groups are to produce inputs for the PRSP by June. In addition, consultations at the regional and national levels and with donors have been held. We intend to strengthen the consultative process to ensure a genuine national ownership. In addition, attention will be given to costing and incorporating pro-poor policies into a medium-term expenditure framework.

12. We have updated the medium-term macroeconomic framework to factor in risks in the external outlook. Inflation risk has risen with the edging up of world commodity prices, but the key risk stems from the lifting of MFA quotas at end-2004. RMG exports have been buoyant due to strengthened competitiveness, especially in the duty-free EU market, and fresh investment has been made in the sector. However, Bangladesh is vulnerable due to its heavy dependence on RMG exports and on quota preferences. Without a decisive policy response, the possible adverse BOP impact of the lifting of MFA quotas on Bangladesh could be on the order of $1.4 billion during FY05–06 (or an average of 1 percent of GDP per year), in line with Fund staff estimates. To mitigate this impact, reform elements under the PRGF to reduce the cost of doing business and to enhance competitiveness will be critical, as described below. Of particular importance will be maintenance of a flexible exchange rate, significant reduction in anti-export bias through trade reform, concerted efforts to improve the investment climate, and prudent financial policies.

13. To complement this strategy and to strengthen the economy's competitiveness and resilience, a high-level National Coordination Council under the Prime Minister's office has now been set up to define an action plan for the export sector. In particular, we intend to

reduce the cost of doing business by streamlining administrative procedures and licensing requirements, open up the RMG sector to foreign direct investment, further liberalize the import regime, and adopt other measures to assist the RMG sector in the post-MFA era. The latter measures include: (i) a skill development program for workers and managers in the RMG sector; (ii) retraining programs for displaced workers; and (iii) a capacity-building program for SMEs who are most at risk, especially in technology and marketing.

14. Particular care will be taken to avoid picking winners and to keep the cost to the budget to a very minimum. To support overall policy adjustment and to meet the impact of the MFA quota phase-out on the balance of payments and the budget, we are seeking additional external assistance, including through the Fund's Trade Integration Mechanism and complementary assistance from the World Bank and ADB in particular.

15. The original medium-term macroeconomic framework under the PRGF has been adjusted to incorporate the policy response to post-MFA challenges. Real growth has been revised to 5.5 percent in FY05 and to 6 percent in FY06, with inflation falling to 5 percent. The external current account deficit is projected to widen to 1.4 percent of GDP by FY06, and gross official reserves kept at close to three months of import cover.

A. Fiscal Policy and Reform

16. Our fiscal strategy remains to protect fiscal sustainability while supporting growth and poverty reduction. To this end, we are making strong revenue efforts by expanding the tax base, reducing and rationalizing trade taxes, and improving tax administration. Expenditure management is also being strengthened to ensure increased spending on high-quality projects for infrastructure and the priority social sectors. We intend to address the key structural fiscal problems, so as to contain public debt to under 60 percent of GDP, inclusive of the potential cost of SOE/NCB reforms, which is the key risk factor. This debt ratio is judged manageable as half of debt is external on highly concessional terms.

17. For FY05, the budget will be set consistent with this medium-term fiscal strategy. The overall deficit will be contained to 4.3 percent of GDP, and domestic financing capped at Tk 71 billion (1.9 percent of GDP). A further revenue effort of 0.5 percentage point of GDP is being targeted, and the implementation of ADP projects is to be stepped up. Measures to strengthen both tax administration and policy will be required. These measures will draw on the recommendations of FAD technical assistance, more recent work by the World Bank staff on a medium-term strategy to modernize the NBR, and DFID technical assistance under its RIRA project.

18. Strengthening tax administration will remain a top priority. For FY05, we will give particular attention to ensuring continued effectiveness of those measures that have been introduced so far this fiscal year. In addition, we will ensure adequate preparations so as to put in place on schedule an expanded LTU system covering the VAT and withholding income tax (a performance criterion for end-September 2004). In particular, the LTU coverage of the VAT will be set at a minimum of 50 percent of total VAT collections by NBR, covering at least the 100 largest VAT filers. In addition, enforcement will be enhanced, including by setting up a commissioneriate for enforcement and by stiffening penalties for

noncompliance. Furthermore, nationwide inspections in the retail sector to enforce compliance with VAT have been launched, and legislative amendments will be made to strengthen enforcement and self-assessment. We will seek further technical assistance in tax administration.

19. On tax policy, the key priorities are to expand the tax base, simplify the tax system, make it more efficient, and improve compliance. Most important, in the context of the FY05 budget, trade taxes have been rationalized and reduced (see ¶ 24 below). Such rationalization should strengthen compliance, reduce the scope for leakage, and improve collections. Nonetheless, we have taken steps to protect revenue by taking compensating measures. These include reducing the scope of tax holidays and bringing additional taxpayers into the tax net. In particular, the existing tax holiday facility will be allowed to lapse at end-June 2005 and will be replaced by a more rational system for investment incentives in consultation with the Fund in the context of the FY06 budget. Drawing on the recommendations of the Revenue Commission, the VAT net has been expanded to include more services and VAT enforcement for products at import and domestic level has been strengthened. We will refrain from inter-year changes in tax rates. Looking beyond FY05, we will seek assistance of an FAD tax policy mission to follow up on reform priorities in line with the medium-term tax policy strategy.

20. On the expenditure side, the budget will incorporate a further reordering of priorities to favor pro-growth and pro-poor spending. Accordingly, it will aim 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. Subsidies relative to GDP will be contained at current levels, but pro-poor spending is estimated to increase further by 0.8 percentage point of GDP to reach 7.4 percent of GDP. Close tracking of priority spending will be continued. Nonetheless, ADP spending needs to be better managed so as to enhance its quality and poverty impact. In this regard, we will draw on the recommendations of the ROSC for Bangladesh in order to strengthen the management of foreign-financed projects, while fostering fiscal transparency and accountability, and will seek further FAD technical assistance on expenditure management.

21. We will make best effort to promote domestic nonbank financing, while aligning interest rates on National Savings Certificates (NSCs) with comparable market instruments. In particular, we will take steps to ensure ready availability of NSCs, and will seek MFD technical assistance to actively build the nonbank treasury bill market. Moreover, the recent reduction in NSC interest rates has been extended to postal savings certificates, and the next phase of rate reductions on all NSC instruments will be implemented effective July 16, 2004, prior to the completion of the second review. Finally, we are contemplating a special window for limited access by pensioners and widows to NSCs at above-market interest rates as a form of social safety net. This mechanism will be designed to minimize the scope for abuse, by requiring registration and proof of identity, and by providing for modest transaction limits and restricted sale outlets.

B. Monetary and External Sector Policies

22. The monetary stance will continue to be aimed at balancing the support for economic growth while containing inflation. For FY05, the monetary program is aimed at limiting growth in banking system credit and M2 to 12½ percent, while further building up reserves. With MFD technical assistance, further steps are envisaged to improve the functioning of the interbank and treasury bill markets to help reduce interest rate spreads and improve intermediation. In particular, the primary dealer system will be strengthened by rationalizing the tax treatment of interest income and improving the incentives for dealer participation in order to facilitate the development of a secondary market for treasury bills.

23. We are committed to the floating exchange rate regime, which will be the first line of defense against the potential shock from the lifting of MFA quotas. Interventions will be confined to countering disorderly conditions and building reserves to the programmed level. Following technical assistance from LEG and MFD, we have examined the possible removal of the remaining exchange restrictions subject to Fund jurisdiction (transfer of funds from nonresident taka accounts and restrictions on advance payments for imports). Regulatory safeguards are being developed to prevent illegal transactions and limit the scope for capital outflows. We intend to remove the restriction to the advance import payments by end-December 2004, and the restriction with respect to the nonresident taka account will be reviewed by end-June 2005.

24. More concerted efforts are being taken to reform the trade system in order to improve competitiveness and reduce anti-export bias. Starting in FY05, tariff incidence will be reduced by 3½ percentage points, from an estimated 24.5 percent in FY04, through a significant reduction in the level and dispersion of customs and supplementary duties. For customs duties, the FY05 budget has provided for a three-tier structure, with a maximum rate of 25 percent. For supplementary duties, the number of rates has been reduced from seven to three, and the maximum rate reduced to 30 percent; higher rates will be maintained for luxuries and special items (automobiles, and arms and ammunition). With effect from April 2004, we have significantly reduced the number of products subject to quantitative restrictions from 122 to 63. We intend to further phase out quantitative restrictions for reasons other than environmental, security, religious, except for poultry, fishing net, and salt, and replace them with appropriate tariff duties. At the same time, import licensing requirements will be streamlined to improve the investment climate. In order to make the RMG sector resilient, we intend to significantly reduce restrictions to the import of textiles outside of the back-to-back LC regime.

C. Reforming the Nationalized Commercial Banks

25. The NCB reform strategy is aimed at containing the core macroeconomic risks and is two-pronged: stemming the flow of nonperforming loans through a strengthening of bank management, and developing and implementing bank-by-bank strategies to resolve the longstanding problems of these banks. Accordingly, MOUs have been signed that restrict net lending, prohibit large unsyndicated loans, and oblige the banks to expedite loan recoveries.

26. We are taking steps to advance the process of strengthening bank management to redress the slippages so far. In particular, the sales adviser for Rupali has now been appointed and the final contract signed, and the retendering for the management support team for Janata is proceeding on course. Moreover, the contract for management support for Sonali has been signed, and the contract for the new management team for Agrani is expected to be signed by end-July. Furthermore, the MOUs have been extended to end-2004 and strengthened to include explicit targets for cash recoveries from the 20 largest defaulters of each NCB, targets on reductions of operating expenses, and implementation of Bangladesh Bank's core risk management guidelines by end-June 2004.

27. Bank-by-bank resolution strategies have been finalized in consultation with Bank and Fund staff (attachment), and have been adopted by the Government. Under these strategies, three NCBs (Rupali, Agrani, and Janata, for a combined market share of 25 percent) will be brought to the point of divestment in full or in part in sequence over the period 2004–06. Safeguarding the integrity of the divestment process is an overriding concern given the governance issues in the NCBs.

28. On Sonali, the largest NCB (17 percent market share), a restructuring strategy is being pursued, aimed at putting this bank on a commercial footing and on a path to partial divestment over the medium term. We believe an early partial divestment is not advisable given Sonali's central role in the provision of Treasury functions and essential banking services for the rural sector. The strategy for Sonali is thus designed to effectively contain its problems through strengthening management, revamping the board of directors, and, in the context of an enhanced MOU, further containing its commercial lending operations and stepping up NPL recoveries.

29. BB's supervision of banks, both state-owned and privately owned, will be strengthened. Off-site inspections are being intensified to ensure compliance with prudential regulations. We are also moving toward adopting international standards on loan classification and restructuring and the treatment of contingent liabilities and accrued interest, in line with recommendations made by the FSAP.

D. SOE Reform

30. We recognize the need to regain the momentum for reforming SOEs in manufacturing as soon as practicable. Accordingly, we are in the process of closing an additional five SOEs and we aim to significantly downsize loss-making SOEs. Budgetary support to them will not be extended nor will new bank credit for capital spending. Retrenched workers will receive severance packages, and to prevent the "revolving door" problem, no new hiring will be allowed. In addition, lending from NCBs to loss-making SOEs will be tracked more closely by requiring MOF approval of all new loans and regular reporting to BB.

31. In consultation with the World Bank, domestic prices for petroleum products, in particular diesel, will be kept under very close review and adjusted in July 2004, taking account of international oil prices and the need to reduce the losses of BPC. In addition, an Energy Regulatory Commission is expected to be created to provide a framework for reforming the energy sector SOEs. We intend to define a reform plan with assistance from

the World Bank, to address the serious infrastructure bottlenecks and to stem arrears in this sector. For DESA, effective measures to reduce system losses, improve bill collection, and resolution of its arrears will be the key components of the agenda.

E. Other Issues

32. Further progress will be made in addressing the critical recommendations under the Fund's safeguards assessment. In particular, BB's financial statements for FY04 will reflect additional progress in implementing international financial reporting standards, and will be audited in accordance with international auditing standards by a local firm affiliated with an international firm and signed off by the latter. We will publish the 2004 and all future audit opinions together with the corresponding financial statements. Monetary data reported to the Fund will also be reconciled against BB's audited financial statements and reviewed by the external auditors as part of this annual audit. Furthermore, as part of its medium-term effort to build capacity and with MFD technical assistance, BB will strengthen its foreign reserves management control framework, adopt and implement a plan for strengthening internal audit functions, upgrade accounting skills and standards, and establish appropriate reporting lines.

33. Faster progress with economic governance is crucial for improving the investment climate. Reform measures in NCBs and tax administration, in particular, bear directly on governance and when firmly implemented they should have a lasting impact. Beyond these, actions to reform the energy sector and the police will be important. Furthermore, the Anti-Corruption Commission (IACC) Act was passed by parliament in February and the chairman has been appointed. We are developing an anti-corruption strategy and we plan to soon draw up an action plan to make the IACC functional and effective. Technical assistance in this area is being provided by the World Bank, the Asian Development Bank, and USAID.

34. With regard to program monitoring, quantitative performance criteria have been set for end-September 2004, targets for end-December 2004, and indicative targets for the remainder of FY05. Key benchmarks and structural performance criteria for the remainder of FY05 center on fiscal and NCB reforms, are in MEFP Table 3 and prior actions are in MEFP Table 4. The third and fourth PRGF reviews are proposed to be completed by December 2004 and June 2005. Quarterly visits by the staff will continue. In addition, technical assistance, coordinated closely with the World Bank, will remain essential to help build capacity, especially in tax administration and NCB reform.

Attachments

MEFP Table 1. Bangladesh: Key Economic Indicators, FY02-08 1/

	2001/02	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08
			Prog.	Proj.	Proj.			
National income and prices (percentage change)								
Real GDP	4.4	5.3	5.5	5.5	5.5	6.0	6.0	6.0
GDP deflator	2.7	4.4	4.0	5.5	5.0	4.7	4.1	3.8
CPI inflation (annual average) 2/	2.8	4.4	4.5	5.9	5.5	5.0	4.5	4.0
Central government operations (percent of GDP) 3/								
Total revenue	10.2	10.3	10.8	10.6	11.1	11.6	11.8	12.0
Tax	7.7	8.3	8.7	8.5	9.0	9.5	9.7	9.9
Nontax	2.4	2.0	2.1	2.1	2.1	2.1	2.1	2.1
Total expenditure	14.9	13.7	15.6	14.4	15.5	15.8	15.9	16.0
Current expenditure	8.0	8.1	8.4	8.2	8.4	8.5	8.6	8.6
Of which : Interest payments	1.8	1.9	2.0	1.7	1.8	1.8	1.8	1.8
Annual Development Program	5.6	5.4	6.1	5.4	5.9	6.1	6.2	6.3
Other expenditures 4/	1.3	0.2	1.2	0.8	1.1	1.2	1.1	1.1
Overall balance (excluding grants)	-4.7	-3.4	-4.8	-3.8	-4.3	-4.2	-4.1	-4.0
Primary balance	-2.9	-1.5	-2.8	-2.1	-2.5	-2.4	-2.3	-2.2
Financing (net)	4.7	3.4	4.8	3.8	4.3	4.2	4.1	4.0
Domestic	2.6	1.3	2.0	2.3	1.9	1.9	1.9	1.9
External	2.1	2.1	2.8	1.5	2.4	2.3	2.2	2.1
Total central government debt (percent of GDP)	52.7	53.2	52.2	50.3	49.0	48.3	47.9	47.5
Money and credit (end of year; percentage change)								
Net domestic assets	11.9	12.2	14.2	11.8	11.8	12.8	14.1	14.3
Private sector	13.9	12.6	15.6	10.3	13.3	14.0	14.5	14.7
Broad money (M2)	13.1	15.6	14.1	11.9	12.6	11.0	13.0	13.5
Balance of payments (in billions of U.S. dollars) 5/								
Exports, f.o.b.	5.9	6.5	7.0	7.4	7.6	7.4	7.8	8.2
(Annual percent change)	-7.6	9.5	7.2	13.3	2.9	-1.8	4.8	5.2
Imports, f.o.b.	7.7	8.7	10.1	10.1	10.7	11.0	11.5	12.0
(Annual percent change)	-8.7	13.0	15.7	15.8	6.1	3.2	3.9	4.4
Gross official reserves (in billions of U.S. dollars)	1.6	2.5	2.8	2.6	3.0	3.0	3.1	3.2
In months of imports of goods and nonfactor services	2.1	2.9	2.9	2.6	2.9	2.7	2.7	2.7
Memorandum item								
Nominal GDP (in billions of taka)	2,732	3,005	3,294	3,345	3,705	4,109	4,534	4,989

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

1/ Fiscal year begins July 1.
2/ CPI has recently been rebased using FY96 weights.
3/ Starting FY02, central government fiscal positions are presented on a gross basis.
4/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).
5/ Balance of payments is presented on the basis of BPM5.

MEFP Table 2. Bangladesh: Quantitative Targets and Performance Criteria Under the PRGF, December 2003-June 2005 1/

(Cumulative flows, end of period) 2/

	Dec-03	Mar-04		Jun-04		Sep-04	Proposed Targets for FY05		
							Dec-04	Mar-05	Jun-05
	Actual	Performance Criteria		Indicative Targets		Performance	Indicative Target		
		Target	Actual	Orig.	Revised	Criteria			
(In billions of taka)									
Ceiling on net domestic assets of Bangladesh Bank 4/	-1	6	4	9	12 3/	-7	-3	-1	3
Ceiling on net domestic financing of central government 4/	21	50	39	65	76 3/	4	33	53	71
Ceiling on net central government bank borrowing 4/	-6	13	1	20	31 3/	-5	13	18	26
(In millions of U.S. dollars)									
Floor on cumulative increase of net international reserves of Bangladesh Bank 4/	143	125	143	225	105 3/	200	250	300	348
Contracting or guaranteeing of short term external debt by the central government 5/	0	0	0	0	0	0	0	0	0
Contracting or guaranteeing of nonconcessional medium- and long-term debt by the central government 4/	0	200	8	250	250	100	150	200	250
Of which: External debt with an initial maturity of over one year and up to five years 5/	0	0	0	0	0	0	0	0	0
Accumulation of external payments arrears 5/	0	0	0	0	0	0	0	0	0

1/ The aggregates are defined in the Technical Memorandum of Understanding dated May 2003 (IMF Country Report No. 03/205).
2/ Cumulative flow since start of financial year beginning July 1.
3/ Including the bridge financing of Tk 16 billion for delay of the World Bank's DSCII and education loans (US$300 million) into July 2004. This amount will be unwound following receipt of such loans.
4/ Performance criteria assessed on a quarterly basis under the program period.
5/ Performance criteria assessed on a continuous basis under the program period.

MEFP Table 3. Bangladesh: Structural Performance Criteria and Benchmarks Under the PRGF, 2004

Measures	Timing	Status
I. Performance Criteria and Benchmarks for the Second Review		
1. Make fully operational a CIC to monitor compliance of 1,000 large taxpayers 1/	December 31, 2003	Not observed 2/
2. Complete revamping the bonded warehouse system, including requiring bank guarantees for all imports going through the system	December 31, 2003	Observed
3. Contract new professional management for Agrani	January 31, 2004	Not observed 3/
4. Expand the audit program to cover 1,000 large taxpayers	March 31, 2004	Not observed
5. Adopt resolution strategies for the four NCBs (in consultation with the World Bank and Fund staff) 1/	April 30, 2004	Not observed 4/
6. Secure management support for Janata and Sonali	May 31, 2004	Not observed 5/
II. Performance Criteria and Benchmarks for the Third Review		
1. Expand the LTU system to cover withholding income tax and VAT, with a minimum coverage of 50 percent of total VAT collection by NBR, covering at least the 100 largest VAT filers 1/ 6/	September 30, 2004	
2. Agree on action plans with the managements of Sonali, Janata, and Agrani covering the period to June 2006, to operationalize the resolution strategies for each bank, with key benchmarks as specified in the TMU 1/	November 30, 2004	
3. Bring Rupali to point of sale by issuing an information memorandum to the public	December 31, 2004	

1/ Indicates structural performance criteria.
2/ Progress toward meeting this criterion is described in paragraph 4 of the MEFP.
3/ Expected to be observed by end-July 2004.
4/ Expected to be observed by mid-July 2004.
5/ Progress toward meeting these criteria are described in paragraph 26 of the MEFP
6/ The key elements of this criterion are described in detail in paragraph 18 of the MEFP.

MEFP Table 4. Bangladesh: Prior Actions for the Second Review

Nationalized Commercial Banks

1. Signature of the final contract for Rupali's sales advisor.

2. Signature between bidder and government of final management support contract for Sonali.

3. Signature between bidder and government of final contract to secure new management team for Agrani.

4. Hold pre-bid conference for short-listed firms for the Janata management contract.

5. Adoption by Government of bank-by-bank resolution strategies.

6. Bangladesh Bank to extend MOUs with each NCB for 2004, including lending limits, and targets for cash recovery from the 20 largest defaulters of each bank.

Fiscal

7. Submit to parliament a FY05 budget consistent with the fiscal targets under the program.

8. Align interest rates on all NSC instruments, including postal savings instruments.

9. Adopt in the FY05 budget a three-tier customs duties structure with a maximum rate of 25 percent.

NCB RESOLUTION STRATEGIES

1. End-game strategies

The government is committed to divesting in whole or in part all four Nationalized Commercial Banks (NCBs) over the medium term. Accordingly, we intend to implement the following end-game strategies:

(i) Rupali: Financial advisor (FA) to be appointed and the bank is to be brought to the point of divestment by end-2004 based on the options recommended by the FA by end-2004.

(ii) Agrani: Corporatize and by end-2005 bring it to the point of divestment where it can attract a strategic partner to bid for substantial shareholding with full management control.

(iii) Janata: Corporatize and by end-2006 bring it to the point of divestment where it can attract a strategic partner to bid for substantial shareholding with full management control.

(iv) Sonali: Corporatize and bring it to the point where a minority shareholding can be divested over the medium term, the extent and pace of which will be worked out by the government with the help of the management advisor and is acceptable to IDA and the Fund.

2. Containing flow problems and improving bank financial performance

In the interim, the government intends to contain the problems of the NCBs and improve bank financial performance, by strict monitoring of the following key measures:

Strengthening bank management

Rupali: The sales advisor has been in place since June 24, 2004.

Agrani: The new management team has been selected through an international tender process to manage the bank. The final contract for the new team is expected to be signed by end-July 2004, and the new team, led by a Bangladeshi CEO approved by government, will be in place by end-August.

Janata: The retendering of a management support contract is under way, with the support team expected to be in place by mid-November. The pre-bid conference for short-listed firms for the management support contract was held on June 19, 2004.

Sonali: IBTC has been selected to field the management support team. The final management contract was signed on July 8, 2004, and the team in place by mid-August.

Revamping the boards of directors

The boards of directors of all the NCBs will be reconstituted to comprise only directors qualified as "fit and proper" under Bangladesh Bank (BB) guidelines. In the reconstitution process, Ministry of Finance (MOF) and BB will ensure that at least two board members have recognized financial/bank experience.

Extending and enhancing Memoranda of Understanding

To facilitate the rehabilitation of the NCBs, the government in 2002 signed Memoranda of Understanding (MOUs) with all four banks, which among other things, capped net credit growth to 5 percent, barred the sanctioning of loans to saturated sectors, as well as loans to a single client or group that were more than 5 percent of the bank's paid up capital. BB has extended the MOUs until end-2004, and stands ready if necessary to extend them beyond that date. The MOUs will be expanded to include:

- Targets for cash recoveries from the top 20 defaulters of each bank;
- Targets on reduction of operation expenses; and
- Implementation of BB's core risk management guidelines by end-June 2004.

3. **Guiding principles for bank reform and divestment**

The government will be guided by the following principles:

No restrictions on human resource policies will be imposed: To ensure that the government realizes maximum benefit from the reform program it is essential that the NCBs are given greater autonomy in the area of human resource policy. To achieve this, policies on branch rationalization and HR policies relating to hiring, promotion, firing, staff compensation, and instituting voluntary retirement schemes (VRS) will need to be reviewed and maximum decision making autonomy will have to be allowed to the NCBs.

Quality, rather than price alone, should be the key selection factor: Fit and proper criteria will be used to determine the new private owners of these banks. The strategic investor will need to have significant banking expertise, management capabilities, a credible track record, and is prepared to put forward a significant amount of its own capital as a condition of sale. Government will not entertain any bid that requires regulatory forbearance for minimum capital adequacy.

Recapitalization by government up to zero level and only at signature of the final sales contract: This critical safeguard will preserve the integrity of the divestment process. NPLs from SOEs with government guarantees will be settled only by the government at that point.

Share offering to strategic investors and required holding period: Strategic investors will be preferred to investors in the form of equity funds and will be required to hold their shares for a specified minimum period.

Restrictions on foreign ownership would be eased: The government intends to permit qualified foreign investors to own shares in a privatized bank in excess of the statutory ceiling of 10 percent on a case by case basis to encourage foreign participation in the competitive bidding process.

Public relations exercise: The government will initiate intensive measures to inform the public about the need for banking reforms, focusing on the importance of a sound and healthy financial sector for overall economic development in the country.

4. **Containing and strengthening Sonali's operations**

The government is cognizant of the need to contain ongoing problems at Sonali. To achieve this, the following measures, in addition to those described above for the other NCBs, will be taken:

- Starting with MOUs from end-June 2004, Sonali's lending growth will be restricted to 5 percent, inclusive of loan write-offs, so as to reduce its market share.
- A new CEO meeting the fit and proper test with a proven track record in banking will be appointed by end-July 2004. Continued management support team will be ensured as long as necessary.
- The board of directors will be reconstituted by end-September 2004 to meet BB's fit and proper test for board membership.
- To level the playing field and introduce competition, the government will ensure free entry into areas where Sonali has a dominant position.

Addendum to the Technical Memorandum of Understanding

The Technical Memorandum of Understanding dated June 4, 2003 (IMF Country Report No. 03/205) will be modified as follows:

- Para. 1, page 80 will be replaced by:

1. For program purposes, any foreign asset, liability, or cash flow denominated in a currency other than the U.S. dollar shall be converted into U.S. dollars by applying the appropriate end-of-period exchange rate for March 31, 2004, as published in the Fund's *International Financial Statistics* (Table 1).

Table 1. Selected End-of-Period Exchange Rates

Taka per U.S. dollar	58.9791	Indian rupee per U.S. dollar	43.3900
SDR per U.S. dollar	1.4805	Pakistani rupee per U.S. dollar	57.5110
Australian dollar per U.S. dollar	1.3177	Swedish kroner per U.S. dollar	7.5737
British pound per U.S. dollar	0.5451	Japanese yen per U.S. dollar	104.3000
Canadian dollar per U.S. dollar	1.3105	Gold price in U.S. dollars per troy ounce (London PM fixed)	428.3000
Euro per U.S. dollar	0.8181		

Source: Fund's *International Financial Statistics.*

- The following additional paragraphs will be added at the end of page 81:

2. The end-November 2004 structural performance criterion with respect to the action plan to operationalize bank-by-bank resolution strategies for the NCBs will include:

- Targets and timetables for cash recoveries from the top 20 defaulters of each bank;
- Timelines for necessary legal changes to eliminate restrictions over human resource policies and limits on foreign ownership in the banking sector;
- Timelines to bring the banks to the point of divestment;
- Remedial actions that will be taken if any of the banks breach their respective MOUs.

3. A bridge financing of Tk 16 billion will be required by June 2004 to cover delay of the World Bank's DSCII and educational loans ($300 million) into the first six weeks of FY05. This will be unwound following receipt of such loans.

INTERNATIONAL MONETARY FUND

BANGLADESH

Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Performance Criteria, Activation of the Trade Integration Mechanism (TIM), and Augmentation of the Access Under the PRGF Arrangement in Accordance with the TIM

Supplementary Information

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

Approved by Steven Dunaway and Anthony R. Boote

July 23, 2004

1. Based on information that has become available since the issuance of the Staff Report 2004, this supplement provides an update on the status of prior actions for completion of the second review under the PRGF arrangement and recent developments. The thrust of the staff appraisal remains unchanged.

I. Implementation of Prior Actions

2. All prior actions for the second review under the PRGF arrangement have been completed, except the signing of the final contract to secure a new management team for Agrani (Table 1). The sales advisor for Rupali has assumed duty on June 24 in accordance with the terms of reference to bring the bank to the point of sale by end-December 2004. The final contract for management support for Sonali was signed on July 8, and the team is expected to assume duty in August. The pre-bid conference for the Janata management contract (with six short-listed firms) was successfully held on June 19. As for Agrani, the signing of final contract for a new management team was not completed as envisaged, but the contract is expected to be signed soon, once an outstanding procurement issue is resolved between the World Bank (who finances the contract) and PriceWaterhouseCoopers. Bank-by-bank resolution strategies for the nationalized commercial banks (NCBs) were approved by the Prime Minister and adopted by the government in early July after extensive discussions among the members of the Economic Affairs Committee. Finally, all four NCBs signed MOUs with Bangladesh Bank, that set new limits for their lending, targets for cash recovery from NPLs, and benchmarks for cutting operational costs.

3. In the fiscal area, a FY05 budget consistent with the fiscal target under the program was passed by parliament in early July with the adoption of all proposed policies, including a new three-tier customs duties structure with a maximum rate of 25 percent, as discussed in

the Staff Report 2004. Effective on July 17, 2004, the interest rates for the National Savings Certificates (NSCs) have been adjusted in line with the undertakings for the second review under the PRGF arrangement (¶19 and MEFP ¶21). Rates on new issues of NSCs were reduced by ½ percentage points to 10½ percent and 10 percent, respectively, for the 5-year savings certificate and the 3-year bonus certificate. The interest rates on postal saving deposits were reduced by 1 percentage points to 7½ percent (one-year) and 9½ percent (three-year). As a form of social protection, a special window was introduced for limited access by pensioners to the 5-year NSCs at a fixed rate of 11 percent. The denominations of the NSCs for this scheme range from Tk 50,000 ($850) to Tk 1 million ($16,950), with a ceiling on total purchases by an individual of Tk 2 million.

4. The authorities have informed staff that up to this date the final contract between the bidder (PriceWaterhouseCoopers) and the government to secure a new management team for Agrani Bank has not been signed. Notwithstanding the nonimplementation of this prior action, staff recommends the completion of the second review by the Executive Board based on the fact that the government has undertaken all the necessary actions within its direct control in trying to reach understandings for the signature of the final contract, and that the authorities have committed that as soon as the negotiations for the final contract are completed, the contract would be signed, probably by mid-August.

II. Recent Developments

5. All quantitative targets for end-June are likely to be observed, except for the indicative ceiling on the NDA of Bangladesh Bank (BB). BB has now contributed Tk 6 billion to the Tk 16 billion of financing from the banking system to bridge the delay in disbursement of a World Bank program loan (¶20, Staff Report 2004), a Tk 3 billion increase over the previous estimates. While the 12-month reserve money growth was moderately higher at end-June (estimated at 12 percent, y-o-y), growth in broad money is expected to remain as programmed with a recovery in private sector credit.

6. Preliminary partial data indicate that tax revenues in FY04 are likely to be lower than estimated at the time of the preparation of the FY05 budget, owing to weaker-than-anticipated income tax and VAT collections. However, expenditures including those under the Annual Development Program, are also running lower than estimated so that the overall budget deficit is expected to remain as programmed.

7. Despite the delays in program loan disbursements, gross official reserves stood at $2.6 billion in mid-July, reflecting continuing buoyancy in exports and remittances.

8. The government recently adopted a restructuring plan for Dhaka Electricity Supply Authorities (DESA) as part of the energy reform program supported by the ADB. Under this program, DESA is envisaged to undertake operational restructuring through measures including removal of corrupt officials, instituting accountability, and reducing system losses. The program is aimed at eventually converting DESA into a holding company. In addition, new policies to allow private investment in infrastructure projects are also being considered.

Table 1. Bangladesh: Status of Prior Actions for the Second Review[1]

	Prior Actions	Status
Nationalized Commercial Banks		
1.	Signature of the final contract for Rupali's sales advisor.	Done
2.	Signature between bidder and government of final management support contract for Sonali.	Done
3.	Signature between bidder and government of final contract to secure new management team for Agrani.	Pending
4.	Hold pre-bid conference for short-listed firms for the Janata management contract.	Done
5.	Adoption by Government of bank-by-bank resolution strategies.	Done
6.	Bangladesh Bank to extend MOUs with each NCB for 2004, including lending limits, and targets for cash recovery from the 20 largest defaulters of each bank.	Done
Fiscal		
7.	Submit to parliament a FY05 budget consistent with the fiscal targets under the program.	Done
8.	Align interest rates on all NSC instruments, including postal savings instruments.	Done
9.	Adopt in the FY05 budget a three-tier customs duties structure with a maximum rate of 25 percent.	Done

[1]Update to MEFP Table 4 (Staff Report 2004).

Press Release No. 04/161
FOR IMMEDIATE RELEASE
July 29, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review Under Bangladesh's PRGF Arrangement and Approves Activation of the Trade Integration Mechanism

The Executive Board of the International Monetary Fund (IMF) has completed the second review of Bangladesh's economic performance under its three-year Poverty Reduction and Growth Facility (PRGF) arrangement. In doing so, the Executive Board approved Bangladesh's request for a waiver on the nonobservance of structural performance criteria on making fully operational a Central Intelligence Cell (CIC) by the end of December 2003 and on adopting resolution strategies for the four nationalized commercial banks by the end of April 2004.

The decision enables Bangladesh to draw an amount equivalent to SDR 49.5 million (about US$72 million) under the arrangement, and would bring total disbursements under the program to SDR 148.5 million (about US$216 million). The IMF's Executive Board approved Bangladesh's three-year PRGF arrangement on June 20, 2003 (see Press Release No. 03/92) for an amount equivalent to SDR 347 million (about US$505 million).

The Executive Board also approved Bangladesh's request for activation of the Trade Integration Mechanism (TIM) together with an augmentation of the PRGF amounting to SDR 53.33 (about US$78 million) in accordance with the newly created TIM (see Press Release No. 04/73). As a result, the PRGF amounts to SDR 400.33 million (about US$583 million).

The TIM is designed to address existing or anticipated balance of payments difficulties related to the implementation of trade liberalization measures by other members. Under the TIM's "baseline feature," the current activation of the TIM and augmentation under the arrangement is intended to help Bangladesh cope with balance of payments pressures stemming from the lifting of Multifiber Arrangement (MFA) quotas by the end of 2004. Should these balance of payments pressures prove stronger than anticipated the Board noted the authorities' intention to request at a later stage an augmentation of PRGF access under TIM's "deviation feature," and stated its willingness to consider such a request.

This is the first activation of the TIM since the Executive Board approved the new mechanism on April 2, 2004.

Following the Executive Board's discussion of Bangladesh on July 28, 2004, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

“Bangladesh’s economic recovery has continued in the first year of the PRGF-supported program, bolstered by the authorities’ sound macroeconomic management. Growth remains robust, inflation has been kept in check, and the external sector has strengthened. The program is on course, with achievement of the key macroeconomic targets. Despite a difficult political environment, the authorities have continued with the reform agenda. After some slippages, key reform measures in tax administration and in the nationalized commercial banks are being0020implemented. The recent catastrophic flooding has had a devastating impact, and the government intends to seek the assistance of the international community for rehabilitation and reconstruction.

“The authorities’ policies for the second year of the PRGF arrangement are designed to turn the initial progress into faster and lasting growth, with a view to reducing poverty and preparing the economy to better cope with the Multifiber Agreement quota phase-out by end-2004. Meeting these challenges will require steadfast implementation of policies, especially in tax administration, trade reform, and NCB reform, together with credible actions to strengthen governance.

“The budget targets for FY 2005 include increases in infrastructure and pro-poor social spending, supported in part by the prospective external support on concessional terms. However, the stepped-up spending, particularly through the Annual Development Program (ADP) will require improved project selection and execution, better public expenditure management with improved fiscal transparency and accountability, and timely decisions on meeting policy conditions for project financing. Achieving the revenue target will also require much strengthened tax administration, and timely actions to expand the Large Taxpayers Unit to cover the value-added and withholding taxes. Fundamental reforms in the National Board of Revenue will also be critical to underpin the programmed revenue targets for attaining the Millennium Development Goals.

“Monetary policy continues to be prudent in supporting growth, with a downward trend in inflation. To further improve monetary operations, the Bangladesh Bank will need to take steps to strengthen the operations of the interbank and treasury securities markets. The floating exchange rate regime has worked well for Bangladesh, and should help mitigate the potential impact from the lifting of the MFA quotas and is consistent with the need to maintain external competitiveness.

“Structural reform measures will need to be decisively implemented to help improve the prospects for investment and to maintain fiscal sustainability. In particular, the implementation of the reform agenda for the NCBs will require strong political support, technical assistance, and close monitoring. It will also be important to further build on recent steps to strengthen bank management and to persevere with the implementation of the bank-by-bank resolution strategies that have been adopted.

“The authorities’ concerted trade reform effort is well timed, particularly in view of the pending MFA quota removal. The determination to move forward in this area will help bolster confidence in the export sector in Bangladesh in the post-MFA era.

"Assistance under the Trade Integration Mechanism should help to smooth the economic adjustment process related to the phase-out of MFA quotas, but strong efforts on the part of the authorities will also be needed urgently in further defining and implementing the post-MFA action program.

"Stepping up the reform of the energy sector will be important to address infrastructure bottlenecks and improve growth prospects. Restructuring plans, particularly for the Dhaka Electricity Supply Authorities, will be critical for turning around the financial and operational performance of the energy sector SOEs. In addition, further efforts will be needed to divest manufacturing SOEs as soon as practicable. Domestic energy prices will also need to be kept under close review with timely adjustment when needed.

"Progress is being made toward the finalization of the full PRSP by end-2004, but further attention will be needed to develop a more comprehensive approach to tackle governance issues as well as law and order problems, and to strengthen public expenditure management," Mr. Kato said.

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 5½-year grace period on principal payments.