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Role of Central Bank in a Developing Economy: A Study on Bangladesh Bank

Choudhury, Riad

University of Rajshahi

ROLE OF CENTRAL BANK IN A DEVELOPING ECONOMY: A STUDY ON BANGLADESH BANK

Ph.D. Dissertation

Researcher

Riad Choudhury
Ph. D. Research Fellow
Institute of Bangladesh Studies
Rajshahi University, Rajshahi

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Institute of Bangladesh Studies
Rajshahi University, Rajshahi

Supervisor

M. Zainul Abedin, Ph.D.
Professor of Economics
Institute of Bangladesh Studies
Rajshahi University, Rajshahi

Institute of Bangladesh Studies
Rajshahi University, Rajshahi, Bangladesh

June 2013

Dedicated To

My Father
Late Moqbul Ahmed Chowdhury
and
My Elder Brother
Late Md. Reffat Chowdhury

Certificate

I have the pleasure to certify that, the dissertation titled "**Role of Central Bank in a Developing Economy: A Study on Bangladesh Bank**" is an original work of Riad Choudhury. He has completed the research work under my direct guidance and supervision. As far as I know, this is the researcher's own achievement and this dissertation has not been previously submitted to any university/ institute for any kind of degree or diploma.

I also certify that I have gone through the draft and final version of the dissertation and found it satisfactory for submission to the Institute of Bangladesh Studies (IBS), Rajshahi University for the degree of Doctor of Philosophy in Economics.

(M. Zainul Abedin, Ph.D.)
Professor of Economics
Institute of Bangladesh Studies (IBS)
Rajshahi University
Rajshahi, Bangladesh
&
Supervisor

June, 2013
Rajshahi

Declaration

I do hereby declare that the dissertation titled "**Role of Central Bank in a Developing Economy: A Study on Bangladesh Bank**" submitted to the Institute of Bangladesh Studies (IBS), Rajshahi University for the degree of Doctor of Philosophy in Economics is exclusively my own and is an original research work carried out under the direct supervision and guidance of my learned supervisor Dr. M. Zainul Abedin, Professor of Economics, Institute of Bangladesh Studies (IBS), Rajshahi University, Rajahahi. No part of the dissertation in any form has been submitted to any university/ institute for any degree or diploma or for other similar purposes.

June, 2013
Rajshahi

(Riad Choudhury)
Ph D. Research Fellow
Session: 2005-2006
Institute of Bangladesh Studies (IBS)
Rajshahi University
Rajshahi, Bangladesh

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Riad Choudhury
Ph.D. Research Fellow
(Session: 2005-2006)
IBS, Rajshahi University

ABSTRACT

The Central Bank is the apex institution in the financial system of every economy. Unlike the developed countries, in most of the developing economies, Central Banks shoulder a larger array of responsibilities. Bangladesh Bank being the Central Bank of Bangladesh has been entrusted with functions with a view to stabilizing domestic and external monetary value and promoting and maintaining a high level of production, employment and real income in the country. To achieve these objectives, Bangladesh Bank anchored on multi-dimensional functions. It incorporated a wide range of reform measures and adopted a host of development activities also. The study aims at critically evaluating the role of Bangladesh Bank in a developing economy like Bangladesh.

It is strongly argued that the Central Banks of the developing countries should undertake promotional functions along with the traditional functions. The specific rationales of the promotional role and the prospective avenues through which the Bank can proceed with development initiatives have been explored in this dissertation. Attempts have been made here to trace the structure, functions and growth trends of Bangladesh Bank. Formulation and implementation of Monetary Policy is one of the key functions of Bangladesh Bank like any other Central Bank of the world. The Monetary Policy of the Bank has been analyzed in this thesis in terms of the policy targets, intermediate targets and the employed instruments. The evolving role of Bangladesh Bank as a banker of the banks has been analyzed categorically. Attempts have been made to unearth the role, Bangladesh Bank plays towards the Government. The reforms, which the Bank embarked upon at times, have been critically evaluated in the dissertation. Attempts have also been made to examine the promotional functions of Bangladesh Bank. For the above mentioned analysis, time series data have been used under a blend of methods consisting of content analysis, historical and story telling, etc. in the framework of a case study. The analysis is primarily quantitative, though qualitative method has also been applied. In this research, growth rates like Simple Growth Rate (SGR) and different ratios have frequently been used as measuring indicators. Except these rates and ratios, percentage share of some variables in relation to some measure of National Income or in respect to some other variables have commonly been used throughout the research.

The rationales of the Central Bank's promotional role, identified in this study are basically and mostly the characteristics of the developing country's backward financial system, where the unique position of the Central Bank assume the added responsibility of developmental role. Among the characteristics of the developing economies the generally existing dualism of traditional and modern sector, undue concentration of banking business risks, the narrowness of the long-term capital market, inadequate commercial bank financing in some vital but apparently not credit-worthy sectors are significant. The study organized the promotional functions in seven areas like fostering the growth of the banking system and institution building, acting as a bank for the general public, ensuring supply of long-term capital to different sectors, financing the under served sectors, pursuing selective credit policy to channel credit to a particular real market, widening the functional scope of the commercial banking system and playing catalytic and innovative role in the reorientation of goals and objectives of financial institutions towards socially responsible lending practices along with providing guidelines for the planners, publishing financial sector information, promoting research and providing training for the bank officials.

A nine member Board of Directors Chaired by the Governor directs the affairs and business of Bangladesh Bank. All of the members of the Board are nominated by the government. The traditional functions of Bangladesh Bank are akin to those of any other Central Bank of the world. Starting from the Bangladesh Bank Order 1972 to the Bangladesh Bank (Amendment) Act 2003 and thereafter the functions were made broader-based. Growth trends of the balance sheets of the banking department and the issue department have been analyzed in this dissertatiion.

Monetary Policy in Bangladesh is formulated around price stability and economic growth rates as the basic policy targets. Bangladesh Bank pursues the Policy within a framework of monetary targeting where levels and growth paths of reserve money and broad money are projected and monitored as operating target and intermediate target respectively. The instruments in the Monetary Policy include Bank Rate, Repurchase Agreement *(Repo)* and *reverse repo* interest rates of Bangladesh Bank, the Cash Reserve Requirement (CRR), Statutory Liquidity Ratio (SLR), credit control and credit rationing.

The growth of broad money in Bangladesh has been found erratic. In FY2011, broad money growth rate was 21.34 percent which was lower than the 22.44 percent growth rate recorded in Fiscal Year 2010, but higher than the growth rate of 19.17 percent in Fiscal Year 2009. Without a few exceptions, the actual growth rate of broad money was higher than its projected growth rate. In the composition of reserve money 'Net Foreign Assets (NFA)' always held a big share. As NFA remains practically outside the control of Bangladesh Bank, the large share of NFA in the reserve money composition implies substantially limited control of Bangladesh Bank over broad money. The second largest source of reserve money 'Net Credit to Government' derives mainly from Government budget deficits and thus manifests fiscal dominance.

It was found that, during the period of 1970s, Bangladesh Bank pursued an easy Monetary Policy to support the nationalized corporations and to reconstruct and rehabilitate the war-torn infrastructure. Prior to 1990, the Policy was based on a method of direct control over various instruments. Since the adoption of Financial Sector Reform Program in 1989-90, the policy stance has been gradually shifted towards indirect control. Until the earlier months of FY2005, Bangladesh Bank continued with the growth supportive accommodative monetary stance. Inflationary pressure caused by supply shocks in the world market and depreciation of Taka against major currencies and an adverse trend in the current account balance drove the Bangladesh Bank to switch from the accommodative to a tightened Monetary Policy stance from the third quarter of FY05. Bangladesh entered into a floating exchange rate regime effective from May 31, 2003. The transition to floating exchange rate regime proved smooth in Bangladesh. The study found unorganized money market, narrow security market, external factors, lack of central bank independence, etc. are posing limitations to the efficacy of Monetary Policy of Bangladesh Bank.

As a banker of the banks, Bangladesh Bank was found to address all the major aspects of the financial system of the economy. It formulated many regulations, policies, guidelines and adopted different measures. These were also revised occasionally to upgrade to international standard and to meet the changing need of time. The functions of Bangladesh Bank towards the banks have been included into nine groups in the present study.

Bangladesh Bank undertakes various functions on behalf of the Government obligated by the Bangladesh Bank Order 1972. The most important one among the functions is debt management. The Bank has a separate department namely Debt Management Department at its head office. There is a high profile Cash and Debt Management Committee (CDMC) for this purpose. The Bank provides advances to the Government mainly to meet budget deficits. It provides 'ways and means' loan to the Government, undertakes sale and purchase of various Treasury Bills, NSD certificates and various bonds and collects revenue on behalf of the Government. Bangladesh Bank performs the Government's treasury functions. It provides advices to the Government on financial and economic issues whenever called upon to do so.

The reforms undertaken in the banking sector of Bangladesh have multi-dimensional background weaved by economic, historic and conditionality factors. Broadly the reform measures include interest rate deregulation, implementation of new system of loan classification and provisioning, new capital adequacy requirement, new supervision, operational and management tools, and lastly, reforms in the legal framework. It was revealed from the analysis of the reform measures that, the objectives of the initiatives remained largely unfulfilled and in some cases the situation deteriorated instead of improving. Price competition situation was deteriorated in the post-reform period. The reform measures could not generate better efficiency in resource allocation to productive sectors. It is found that, quality of loan portfolio was not enhanced significantly. Comparing to the neighboring countries, the percentage ratio of NPLs to total loans was found to be the highest with huge margin in Bangladesh. The banks were found continuously failing to maintain the required level of provisions against their classified loans. It was also found that, loan classification norms of Bangladesh are not up to the international standard in terms of length of overdue. But the requirement for provisioning fixed by Bangladesh Bank is consistent with international standard. The indicators employed under the CAMELS framework indicate overall institutional inefficiency specially for the NCBs and the DFIs.

Flaws in the reform design and sequencing, ineffective and weak legal framework, supervisory and regulatory forbearance of Bangladesh Bank, ownership conflict of the reform programme, lack of commitment on the part of the Government, even in some cases Government-led distortions were found to be the main causes for the poor outcome.

To attain developmental objectives, Bangladesh Bank adopts mainly a financial inclusion approach. It has been found playing development role in the areas of agriculture, industry, Small and Medium Enterprises (SME) and women entrepreneurship, export, customer interest protection, automation of the banking system, green banking, etc.

From FY 2011-2012, Bangladesh Bank obligated the banks to set annual agricultural/rural credit disbursement target at 2.5% of their total loans and advances. In FY 2010-11, disbursement of refinance facility in agriculture was TK. 1.86 billion and the outstanding amount of refinance in the same year was TK. 56.03 billion. The Bank launched refinance scheme for the sharecroppers, extended agricultural credit at concessional four percent interest rate to encourage domestic production of pulse, spices, lentils and oilseeds, and promoted crop diversification. It facilitated establishment of agro product-processing industries in the country. The Bank introduced opening of a bank account by a farmer by keeping only ten taka as initial deposit. As a result, financial inclusion as percentage of adult population increased from 65.33 percent in 2004 to 87.23 percent in 2010.

Bangladesh Bank is trying to encourage investments in the risky but prospective agro-based/food processing and IT sector projects and to provide term finance for infrastructure and other investment projects and to promote private sector entrepreneurs in the development of capital projects. To promote Small and Medium Enterprises (SME) a new department namely 'SME and Special Programmes Department' has been established in Bangladesh Bank. In 2010 the Bank formulated the "SME Credit Policy and Programs, 2010". At present the Bank with the help of Government and different development partners, is implementing five refinance schemes. Till 30 September 2012, Taka 25.72 billion has been refinanced against 32,018 SMEs.

For women entrepreneurship development, Bangladesh Bank directed the banks and financial institutions to put highest priority in receiving loan application from small and medium women entrepreneurs and settle the loan disbursement process within very reasonable time. Bangladesh Bank allocated at least 15 percent of total Bangladesh Bank refinance fund for women entrepreneurs at a reduced rate of ten percent. In FY 2011, SME loan facilities of TK. 20.48 billion have been extended to women entrepreneurs.

At present Bangladesh Bank is implementing Export Development Fund (EDF) to enhance export through facilitating access to financing in foreign exchange for input procurements by manufacturer-exporters. The Bank raised the fund to USD 400 million. The Bank introduced Deposit Insurance Scheme and created a Deposit Insurance Trust Fund (DITF) to protect the interest of the customers of the banking sector. The Bank established 'Customers' Interest Protection Centre' (CIPC) at its head office and at the branch offices and advised the banks to set up a "Complaint Cell" in each bank. Upto September 2012, 79 percent of the complaints received through CIPC have been resolved. Recently Bangladesh Bank has established a new department namely 'Financial Integrity and Customer Services Department' at its head office for dealing with complaints of the customers of the banks and financial institutions more easily and quickly.

Bangladesh Bank launched some initiatives to make the banking system modern technology based, efficient and secure. The Bank initiated green banking practices in the financial sector of Bangladesh. As of October 2012, Taka 838.4 million has been refinanced to environment friendly green projects.

In the financial inclusion approach the Bank facilitated opening bank accounts for hardcore poor, unemployed youth, freedom fighters, beneficiaries under social security program, distressed people, small life insurance policy holder and *aila* affected people by depositing small amount of money ranging from Taka ten to one hundred only. The Bank also took steps to make the banking services easily accessible to the physically handicapped people. The inclusive approach followed by the Bank is a very timely one. But the measures so far taken are yet to be fully able to address the demand side problems of the financially excluded sections of the population.

It seemed that, Bangladesh Bank is over burdened with numerous objectives and functions to carry on satisfactorily with the existing capacity. The functions and objectives may be curtailed to reasonable level. The Bank should try to address the demand side problems of the financially excluded sections of the population. It should follow a comprehensive and well-coordinated development agenda to be more effective. A central authority for collecting and publishing banking sector related data should be raised. A well articulated co-ordination between Monetary Policy and Fiscal Policy is warranted. Substantial independence is a pre-condition for Bangladesh Bank to perform its expected role effectively.

ABBREVIATIONS

ACH	:	Automated Clearing House
ATM	:	Automated Teller Machine
BACH	:	Bangladesh Automated Clearing House
BACPS	:	Bangladesh Automated Cheque Processing System
BAFEDA	:	Bangladesh Foreign Exchange Dealers Association
BB	:	Bangladesh Bank
BCA	:	Bank Companies Act
BEFTN	:	Bangladesh Electronic Funds Transfer Network
BPRD	:	Banking Regulation and Policy Department
BRC	:	Banking Reform Committee
BWIs	:	Brettonwoods Institutions
CAMEL	:	Capital, Asset Quality, Management Capability, Earning and Liquidity Level
CAMELS	:	Capital, Asset Quality, Management Capability, Earning, Liquidity Level and Sensitivity to Market Risk
CAR	:	Capital Adequacy Ratio
CBRP	:	Commercial Bank Restructuring Project
CEO	:	Chief Executive Officer
CGR	:	Compound Growth Rate
CIB	:	Credit Information Bureau
CIPC	:	Customers' Interest Protection Centre
CPE	:	Center for Payment Expertise
CPI	:	Consumer Price Index
CRG	:	Credit Risk Grading
CRR	:	Cash Reserve Ratio
CSR	:	Corporate Social Responsibility
DCA	:	Debtor-Creditor Agreement

DFI	:	Development Financial Institution
DFID	:	Department of International Development
DIS	:	Deposit Insurance Scheme
DITF	:	Deposit Insurance Trust Fund
DMB	:	Deposit Money Bank
EDF	:	Export Development Fund
EDW	:	Enterprise Data Warehouse
EEF	:	Extended Fund Facility
EPZ	:	Export Processing Zone
ERM	:	Environmental Risk Management
ERP	:	Enterprise Resource Planning
ESAF	:	Enhanced Structural Adjustment Facility
ETP	:	Effluent Treatment Plant
EWS	:	Early Warning System
FCB	:	Foreign Commercial Bank
FRTMD	:	Exchange Reserve and Treasury Management Department
FSAC	:	Financial Sector Adjustment Credit
FSRP	:	Financial Sector Reform Project
FSRP-TA	:	Financial Sector Reform Project- Technical Assistance
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
GoB	:	Government of Bangladesh
HHK	:	Hybrid Hoffman Kiln
IADI	:	International Association of Deposit Insurers
IBS	:	Institute of Bangladesh Studies
ICA	:	Inter-Creditor Agreement
IDA	:	International Development Agency
IMF	:	International Monetary Fund

IPO	:	Initial Public Offering
KPIs	:	Key Performance Indicators
LDCs	:	Least Developed Countries
LLRC	:	Large Loan Review Cell
LLRS	:	Large Loan Restructuring Scheme
LRA	:	Lending Risk Analysis
MFS	:	Mobile Financial Services
MFA	:	Multi-Fibre Arrangement
MFI	:	Micro Finance Institution
MIC	:	Middle Income Country
MICR	:	Magnetic Ink Character Recognition
MIS	:	Management Information System
MLC	:	Money Loan Court
MoF	:	Ministry of Finance
MoU	:	Memorandum of Understanding
MPS	:	Monetary Policy Statement
MTMF	:	Medium Term Macroeconomic Framework
NCB	:	Nationalized Commercial Bank
NCMBC	:	National Commission on Money, Banking and Credit
NII	:	Net Interest Income
NIM	:	Net Interest Margin
NLL	:	New Loan Ledger
NPL	:	Non Performing Loan
NSAPR	:	National Strategy for Accelerated Poverty Reduction
OMO	:	Open Market Operation
PAD	:	Public Accounts Department
PCB	:	Private Commercial Bank
PFP	:	Policy Framework Paper

PMR	:	Provision Maintenance Ratio
POS	:	Point of Sale
PPS	:	Performance Planning System
RM	:	Reserve Money
ROA	:	Return on Assets
ROE	:	Return on Equity
RWA	:	Risk Weighted Assets
Repo	:	Repurchase Agreement
SAF	:	Structural Adjustment Facility
SAL	:	Structural Adjustment Loan
SAP	:	Structural Adjustment Program
SBs	:	Speialised Banks
SEM	:	Secondary Exchange Market
SGR	:	Simple Growth Rate
SLR	:	Statutory Liquidity Ratio
SMA	:	Special Mention Account
SME	:	Small and Medium Enterprise
SOE	:	State Owed Enterprise
TGR	:	Trend Growth Rate
USAID	:	United States Agency for International Development Agency
WES	:	Wage Earners' Scheme
XPL	:	Export Performance Licensing Scheme

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CHAPTER I

INTRODUCTION

1.1 Prelude

The Central Bank, being the apex of the financial system of an economy, undertakes the major financial operations of the Government. By the conduct of these operations it influences the behavior of financial institutions so as to support the economic policy of the Government. Fundamental decisions relating to economic development do not belong to the domain of the Central Bank. But money and finance have crucially important role to play in economic development; and here the Central Bank has very significant role to play.[1] It is truer for the developing economies.

In the context of Central Banking, styles and objectives of monetary management differ to varying degrees across countries due to differences in socio-economic, technological-institutional environment. In most of the developed economies Central Banks are vested only with the conduct of Monetary Policy, mainly with a single objective of maintaining price stability. On the contrary, in most of the developing economies Central Banks besides Monetary Policy, also shoulder many other responsibilities, like regulation and supervision of banks and financial institutions and giving advices to the Government.

Bangladesh Bank, as the Central Bank of our country has been entrusted with functions and responsibilities with a view to stabilizing domestic and external monetary value and promoting and maintaining a high level of production, employment and real income in the country.[2] To achieve these objectives, Bangladesh Bank pursued Monetary Policy of varying nature, from accommodative in the past to tight at present. It incorporated a wide range of

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[1] A.K.N. Ahmed, *Of Deregulation and Central Bank Autonomy: Essays on Economic Issues in Bangladesh* (Dhaka: The University Press Limited, 1997), p.56.

[2] M. Sadiqunnabi Choudhury, "Monetary Policy in Bangladesh-should we Go for Inflation Targeting?", *Journal of the Institute of Bankers, Bangladesh,* vol. 51, No. 2 (July-December, 2004), pp.113-33.

reform measures also. These functions and assertions of Bangladesh Bank have significant bearing on the economy of Bangladesh.

It is of earnest importance to evaluate the role, played by Bangladesh Bank over the last 40 years from independence. But no comprehensive study has so far been done in this regard. The present research is an attempt to reduce this gap.

1.2 Statement of the Problem

There had been no clearly defined concept of Central Banking prior to the twentieth century. In many countries one bank came to the position of Central Bank due mainly to the special privilege of the monopoly of issuing note in certain areas and acting as the Government's banker and agent.[3] These banks were expected to make additional loans to the Government when the Government was having particular difficulties in financing a deficit, notably at times of war or civil strife.[4] They were not called Central Banks, but were known as banks of issue or as national banks. Gradually such banks of issue acquired other functions and powers and in course of time the term 'Central Bank' came to be generally used.[5]

Considering the time of establishment, the Riksbank of Sweden is the oldest Central Bank in the world, which was initially founded as a private institution in 1656 and was re-organised under the authority and supervision of the parliament in 1668. But the Bank of England, established in 1694, was the first bank of issue to assume the position of Central Bank and to develop the fundamentals of the art of central banking. By the end of the nineteenth century, almost every country in Europe, along with Japan, Java and Persia in the East, and Egypt and Algeria in Africa had established a bank of issue with special privileges and powers. These banks in different ways or in varying degrees assumed the essential functions of Central Banks.[6] At present every country of the world has a Central Bank of its own. Bangladesh Bank is the Central Bank of

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[3] M.H. de Kock, *Central Banking* (4th ed.; New Delhi: Universal Book Stall, 1995), p.1.

[4] C.A.E. Goodhart, *The Central Bank and the Financial System* (London: MacMillan Press Ltd., 1995), p.205.

[5] Kock, *Central Banking*, *op.cit.,* p.1.

[6] *Ibid.,* pp. 2-12.

Bangladesh. It came into existence on the 31st October 1972 under the Bangladesh Bank Order 1972, which took effect on the 16th December 1971.[7]

There are significant differences between the role of Central Banks in developed and developing countries. Central Banks in developing economies have several objectives, and distinct trade-offs as compared to those of developed countries, which usually pursue a single objective of price stability. The most striking feature of Central Banking in the developing countries pertains to their critical role in development of real sector of the economy. In regard to choice of instruments, given the level of market development, and multiple objectives, developing countries cannot entirely rely on single instrument such as interest rates. Rather, Central Banks in developing economies prefer a judicious mix of interest rates, cash reserves, and other instruments. While pursuing multiple objectives, and managing complex trade-offs, Central Banks in developing economies assume the responsibility of looking after the interests of several agents including depositors, intermediaries, government, business, and external trade. Unlike developed countries, developing countries are to concentrate not only on growth, but also on building up the potential for future growth.[8]

Bangladesh Bank performs a wide range of functions to support the economic activities and achieve macroeconomic goals of Bangladesh. Being at the top of the financial system of Bangladesh, it is the guardian of the country's financial institutions and thus it generates great influence over the economy of Bangladesh. As of June 2011, 47 scheduled banks which include state-owned commercial and specialised banks, local private commercial banks and foreign commercial banks, are operating in Bangladesh through a network of 7,712 branches. Among these branches as many as 3,414 belong to state-owned commercial banks, 2,847 branches to local private banks, 63 branches to foreign banks and 1,388 branches to specialised banks. Moreover, one National Co-operative Bank, one *Ansar VDP* Bank, one *Karmasangsthan* Bank and one *Grameen* Bank are operating as the non-scheduled banks. Besides, a bank

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[7]*Banglapedia,* Vol. 1, ed. by Sirajul Islam (Dhaka: Asiatic Society of Bangladesh, 2003), s.v. "Bangladesh Bank" by S M Mahfuzur Rahman, p. 468.

[8] C. R. Basu, *Central Banking in a Planned Economy: The Indian Experiment* (2nd ed.; New Delhi: Tata McGraw Hill Publishing Co. Ltd, 1978), p. 4.

named *Probashi Kalayan* Bank (Expatriate Welfare Bank) has started its operation since April 2011.[9]

Formulation of Monetary Policy, issue of bank notes, development of money market, promotion of the best interest of economy, utilization of the productive resources of the country and stabilization of internal and external value of the local currency (Taka) are the principal functions of the Bank. It is also the banker's bank and banker to the Government. Purchases, sales and rediscounts of bills of exchange and promissory notes drawn on and payable in Bangladesh are also included in the functions of the Bank. Bangladesh Bank manages the public debt and is the sole custodian of foreign exchange.[10] It also has a host of development initiatives based mainly on the principle of financial inclusion. The Financial Sector Reform Project (FSRP) launched in 1990 and later Financial Sector Reform Program-Technical Assistance (FSRP-TA) introduced many modern reform measures including new management and operational tools in the operational arena of Bangladesh Bank. All these reforms gave a changed shape to the conduct of present business of Bangladesh Bank.

There are varying opinions regarding the role played by Bangladesh Bank in the above-mentioned respects**.** The Bank in its reports and statements claims to be considerably successful in this part. On the other hand, economists and analysts like former Bangladesh Bank Governor A.K.N. Ahmed are much skeptic about it. According to A.K.N. Ahmed;

> It is unfortunate that our Central Bank is proving itself unable to play its role either as a referee, umpire, traffic police or judge. It must equip itself to come to the centre of the stage and be able to guide, direct, counsel and where necessary restrain and discipline our financial institutions by judiciously using its wide powers before it is too late.[11]

The economists have questioned the supply of money and credit. The time lag of Monetary Policy, paucity of data, built in deficiencies of CPI and the evolving nature of the economy supposedly pose hindrances before Bangladesh Bank. Fiscal dominance undermines the ability of Bangladesh Bank to achieve

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[9] GOB, *Bangladesh Economic Review 2011* (Dhaka: Economic Advisory Wing, Finance Division, Ministry of Planning, 2007), p. 57.

[10] Wasim Md. Mazbahul Haque, "Financial Development in Bangladesh", unpublished Ph.D. Thesis (Rajshahi: Institute of Bangladesh Studies, Rajshahi University, 2004), p. 80.

[11] Ahmed, *Of Deregulation*, *op.cit.,* p.51.

the inflation target. Large scale deficit in the annual budget can generate persistent high inflation.[12]

The 'Bank Shangoskar Committee' (Bank Reform Committee), formed in 1996 and reorganized in 1997, mentions in its report that, the lack of autonomy of Bangladesh Bank is a major limiting factor to the performance of Bangladesh Bank.[13] In this regard, the committee, citing the "Core Principles of Bank Supervision" of the Basle Committee, recommends that the amendments of the Bangladesh Bank Order 1972 and the Banking Company Act 1991 are necessary. It also recommends that administrative reforms of Bangladesh Bank and transparency and accountability of Bangladesh Bank should be ensured for achieving its objectives.

Obviously there arise some questions: what are the usual functions of a Central Bank in a developing economy? What functions does Bangladesh Bank perform as the Central Bank of Bangladesh? How has Bangladesh Bank grown since its establishment? What role Bangladesh Bank is playing while pursuing Monetary Policy? Is Bangladesh Bank capable of playing the role of the banker of the banks and as a banker to the Government? How the reforms already undertaken have worked, and are any more reform necessary?

1.3 Objectives

The study is designed to achieve the following objectives:

(i) Broad Objective: The broad objective of the study is to critically evaluate the role of Bangladesh Bank as a Central Bank in a developing economy like Bangladesh.

(ii) Specific Objectives: The specific objectives of the study are as follows:

(1) to trace the structure and growth trend of Bangladesh Bank;

(2) to examine the Monetary Policy pursued by Bangladesh Bank;

(3) to investigate into the policies and actions undertaken by Bangladesh Bank as a banker of the scheduled banks;

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[12] Choudhury, "Inflation Targeting?", *op.cit.,* p. 125.

[13] GoB, *Bank* Sanskar *Committeer Protibedon* [Report of the Bank Reconstruction Committee] (Dhaka: GoB, 1999), p.9.

(4) to examine the role of Bangladesh Bank as a banker to the Government;

(5) to make a critical analysis of the reforms undertaken by Bangladesh Bank.

(6) to explore the developmental role played by Bangladesh Bank as the Central Bank of the country.

1.4 Review of Literature

The researcher has studied a number of official and unofficial books, articles, reports, manuscripts and other publications on Central Banking and related topics. It has been found that, literature with specific focus on the role of Central Bank in developing economies and particularly that of Bangladesh Bank in Bangladesh is not sufficient. However, a brief review of literature is given below.

1.4.1 Basu (1978)[14]

The author in his book titled *Central Banking in a Planned Economy: The Indian Experiment* analyzes the role of 'Reserve Bank of India' in the development process of India in the context of planned development programme of the country. He discusses a good number of issues like effectiveness of Monetary Policy, nature of growth and price situation in the Plan period. India, being a developing economy and a neighboring one of Bangladesh, is very much relevant to the present study; and as the book provides a thorough and critical exposition of Central Banking in India, is very useful for the present research.

1.4.2 Ghatak (1981)[15]

The author in his book titled *Monetary Economics in Developing Countries* discussed the important issues confronting the LDCs in the use of monetary theory and policy. The focus of attention of the author has been the theoretical contributions to the literature by different economists. Empirical relevance of these theories and models to the LDCs has also been analyzed in the book. The

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[14] C. R. Basu, *Central Banking in a Planned Economy: The Indian Experiment* (2nd ed.; New Delhi: Tata McGraw Hill Publishing Co. Ltd, 1978).

[15] Subrata Ghatak, *Monetary Economics in Developing Countries* (London: The MacMillan Press Ltd, 1981).

author points out that despite some limitations of Monetary Policy, Central Bank has a major role to play in the process of economic growth and stability. However, the process as to how Central Bank plays the mentioned role is not elaborated in this book.

1.4.3 National Commission on Money, Banking and Credit (1986)[16]

In the backdrop of severe crisis in the financial sector of Bangladesh, reform measures were initiated in this sector at the beginning of the 1980s. To define the scope and modalities of the early phases of the reform, the Government constituted a National Commission on Money, Banking and Credit with the famous economist A. F. A. Husain as its Chairman. The Commission completed the study and submitted its findings and recommendations in this *Report of the National Commission on Money, Banking and Credit* to the Government in 1986.

The Commission examined various issues of the banking sector in detail, such as bank rate and refinancing policy of Bangladesh Bank, overdue loans of the Nationalised Commercial Banks (NCBs) and the Development Financial Institutions (DFIs), supply of adequate loan to rural and agriculture sector. The report suggests for the increase of independence of Bangladesh Bank.

1.4.4 Dow and Saville (1988)[17]

The authors in their book titled *A Critique of Monetary Policy: Theory and British Experience* examine how Monetary Policy has worked, or failed to work, in the United Kingdom in the 1970s and 1980s. The authors, both of whom are ex-officials of Bank of England, at first in Part I, tried to provide an account of the behavior of the financial system in the absence of monetary control, and then in Part II, as a second stage, to superimpose the effects of monetary control. In Part III, which is the final Part of the book, the authors evaluate the limitations and role of Monetary Policy in British economy. The book proved very useful in understanding the working of Monetary Policy in a developed economy.

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[16] *Report of the National Commission on Money, Banking and Credit*, A. F. A. Husain, Chairman (Dhaka: Government of Bangladesh, June 1986).

[17] J.C.R. Dow and I.D. Saville, *Monetary Policy: Theory and British Experience* (New York: Oxfod University,1988).

1.4.5 Ligeti (1993)[18]

The article titled "Selective Credit Control in the Developing Countries" written by S. Ligeti is a very long one having three sections. There is a sub-section namely" The Role of Central Banks in the Developing Countries" in the article. Here the author expresses that, in developing countries, where the credit system is underdeveloped, the primary task of the Central Bank is not so much to regulate the monetary situation as to promote growth. The main focus of the article is different aspects of selective credit control and the author discusses it elaborately analyzing many evidences and views of a good number of scholars and many evidences. Analysis of the role of Central Bank in developing countries is very brief and not specific in the article.

1.4.6 Abedin (1995)[19]

The author in the article titled “Impact of Monetary and Fiscal Policy Reforms on Macro Economic Performance: Recent Trends in Bangladesh” first traced the historical background of adopting monetary and fiscal reforms in Bangladesh. Then, using time series data attempts were made to verify to what extent the goals of the reforms had been achieved by the end of June 1993. The study reveals that, the monetary and fiscal reforms could not raise per capita GDP, private investment and exports to the expected levels. However, the package of reform policies was successful in bringing down the rate of inflation, raising the real rate of interest and reducing fiscal deficit in the period under consideration. But, the author defies the reliance of the reform programmes on the real rate of interest for raising savings and showed that, income rather than the real interest rate determines the rate of savings in a low-income country like Bangladesh. The author questioned the apparent success of the reform measures in reducing the export-import gap, arguing that the said gap had been brought down at the cost of imports of capital machineries, which hinders capital formation and technology transfers. The author suggested for the nation to act on specified short term,

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[18] S. Ligeti, “Selective Credit Policy in the Developing Countries”, *Monetary Economics,* ed. by C S Nagpal, and A C Mittal(New Delhi : Anmol Publications Pvt. Ltd. 1993), pp. 234-310.

[19] M. Zainul Abedin, “Impact of Monetary and Fiscal Reforms on Macro Economic Performance: Recent Trends in Bangladesh”, *Bangladesh Journal of Political Economy*, vol. XIII, no. 2 (July 1995), pp. 48-61.

medium term and long term goals. He stressed on boosting up income to raise the low rate of savings, political and economic stability, continuity of economic policies, removal of illiteracy and maintenance of a congenial production and business environment for attaining progress and prosperity.

1.4.7 Hassan (1995)[20]

The author in his article titled "An Inquiry into the Autonomy and Independence of Central Bank and Macroeconomic Performance" examined recent evidence on the relationship between measures of macroeconomic performance and measures of Central Bank independence. The article is divided into eight sections, where issues of cost of inflation and optimal Monetary Policy, relationship of Central Bank independence and Monetary Policy, empirical evidence on the relationship between central bank independence and economic performance, objectives of Bangladesh Bank and proposed specific areas for Bangladesh Bank autonomy and independence are analyzed. The author with the analysis of some scholarly studies and empirical evidences comes to the conclusion that, Bangladesh Bank, as a more independent and autonomous institution, may be able to contribute more to long run economic growth rate and can control inflation rate. The article confines to only a single issue i.e. autonomy of Central Bank. Role of Central Bank and other aspects of Central Bank performances are not discussed in this article.

1.4.8 Fry, Goodhart and Almeida (1996)[21]

The authors in their book titled *Central Banking in Developing Countries: Objectives, Activities & Independence* have examined the current state of central banking in 44 developing countries of Africa, Asia, the Middle East, Europe, Latin America and the Carribbean. The authors analysed the banks' achievement in their primary objective of price stability and at the same time discuss the reasons behind the general lack of success. The analyses by the authors are based on macroeconomic data from IMF and World Bank sources, as well as detailed

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[20] M. Kabir Hassan, "An Inquiry into the Autonomy and Independence of Central Bank and Macroeconomic Performance", *Banking and Finance in Bangladesh: a Collection of Essays*, ed. by Kabir Hassan (Dhaka: Academic Publishers, 1995), pp.103 -123.

[21] Maxwell J. Fry, Charles A.E Goodhart and Alvaro Almeida, *Central Banking in Developing Countries: Objectives, Activities & Independence* (London: Routledge,1996).

questionnaire responses from the mentioned countries. The book covers government financing, foreign exchange systems and the domestic banking system. Role of Central Bank did not get much attention in this book.

1.4.9 Ahmed (1997)[22]

The writer in his book titled *Of Deregulation and Central Bank Autonomy: Essays on Economic Issues in Bangladesh* discussed the role of Central Bank in economic development and different aspects of Central Bank autonomy among some other economic issues, explicitly in two essays out of thirteen, compiled in the book. The writer, a former governor of Bangladesh Bank, with more than thirty years of Central Banking experience employs a suggestive approach while discussing major development functions of Central Bank, viz., savings mobilization, institution building, credit management, exchange rate control, Monetary Policy formulation etc. He points out that the maintenance of price stability, which is a *sine qua non* of sustainable economic growth and development, is the principal purpose of Central Bank autonomy. The book proved very much helpful for the present research for the experience-based views expressed herein, though it lacks evaluation of the role of Central Bank.

1.4.10 Bank Shangoskar Committee (Bank Reform Committee) (1999)[23]

In 1996, after the expiry of Financial Sector Reform Programme (FSRP), the Government of Bangladesh (GoB) formed a six member Bank Shangoskar Committee [Bank Reform Committee] (BRC) to recommend necessary measures to enhance the efficiency of the commercial banks operating in Bangladesh. In 1997, professor Wahiduddin Mahmud, who was already acting as a member of the committee, was elevated to the position of Chairman of the committee replacing the initial Chairman Kazi Fazlur Rahman. The committee placed 11 interim reports before the Government and submitted its final report titled *Bank Shangoskar Committeer Protibedan* [Report of the Bank Reform Committee] in December 1999.

[22] A.K.N. Ahmed, *Of Deregulation and Central Bank Autonomy: Essays on Economic Issues in Bangladesh* (Dhaka: The University Press Limited, 1997).

[23] *Bank Shangoskar Committeer Protibedon* [Report of the Bank Reform Committee], Wahiduddin Mahmud, Chairman (Dhaka: Government of Bangladesh, June 1986).

The report contains nine chapters where two chapters are dedicated exclusively to Bangladesh Bank, though the Central Bank has been dissected through out the whole report, specially in the *Introduction* and *Recommendations* chapters. In the second chapter of the report titled *Bangladesh Bank*, the BRC examined the autonomy of the Central Bank and put forward some vital recommendations to ensure the autonomy. The committee questioned the appointment procedure of the Governor and Deputy Governors of the Bank and opined that the functions of Bangladesh Bank were not truly reflected in the Bangladesh Bank Order 1972. It also emphasized on the institutional reforms of Bangladesh Bank.

In the third chapter named *Rationalisation of the Supervision Programme,* the BRC mentions that, weak supervision system of Bangladesh Bank is largely responsible for the existing grief situation in the banking sector of Bangladesh. It called for reorganisation of the supervision system of Bangladesh Bank.

In fourth to seventh chapters, different aspects of the Nationalised Commercial Banks (NCBs), private banks, Bank Company Act 1991 and Money Loan Court Act have been analyzed respectively.

Miscellaneous topics like Deposit Insurance Scheme, classified, over due and default loans, reporting system of the banks, different definitional ambiguities, etc. are covered in the eighth chapter named *Miscellaneous*. The last chapter is *The Recommendations,* where a summary of the recommendations rendered in the previous chapters have been compiled. The committee gave the highest priority on restructuring of the supervisory and regulatory set up for ensuring strong system of supervision over the banks. It asked for strengthening of legal framework and effective restructuring of the NCBs. It proposed to set a well defined guideline for deficit financing of the Government and not to interfere anyway with the affairs of Bangladesh Bank Board. The BRC suggested that, the Directors of the NCBs should not be Member of the Parliament or an office bearer of a political party or a loan defaulter.

The report was very much helpful for the present research, specially to understand the rationale for, elements and directions of the reforms in the financial sector, which determined the present shape of the financial sector of Bangladesh.

1.4.11 Ahmed (2002)[24]

The author in the article titled "Macro Management of the Economy and Monetary Policy" analyses macro economic management and the part played by Monetary Policy therein. According to him, in the face of surging tide of globalisation, the challenges confronted by the monetary authorities are becoming harder than ever. He opines that, the basic thrust of Fiscal and Monetary Policies should not be just containing the fiscal deficit, but to alter the composition of fiscal deficit to ensure macroeconomic stability. He places emphasis on ensuring more equitable distribution of resources, side by side of introducing long and medium term growth of the economy. Mentioning that the central bankers can only pull the economy through restrictive Monetary Policy and the Fiscal Policy as a counter-cyclical tool can push the economy in the downturn, the author stresses the necessity of liberal policy measures. According to the author, the process of meshing Fiscal and Monetary Policies involves a lot of tightrope walking by the Central Bank Governor, which brings up the relationship between the Central Bank and the Government. The author expresses that, there cannot be absolute autonomy for the Central Bank and the Central Bank Governors have to learn to live with politicians in order to be effective. The author places some suggestions regarding autonomy of Bangladesh Bank which include being clear-eyed about the purpose of autonomy, upgrading the Central Bank's in-house skill and competence, initiating certain hard steps in monetary and fiscal fields, establishing Bangladesh Bank's integrity and credibility to the financial world and adopting home-grown remedy for the home-grown problems instead of depending too much on outside agencies.

1.4.12 Choudhury and Adhikary (2002)[25]

The authors in the article titled "Loan Classification, Provisioning Requirement and Recovery Strategy: A Comparative Study on Bangladesh and India" makes an inter-country comparison of non-performing loans between Bangladesh and India in terms of non-performing loan status, classification and provisioning standard and recovery strategy in each of the country. The authors observe that,

[24] A. K. N. Ahmed, "Macro Management of the Economy and monetary Policy", *Bank Parikrama*, vol. XXVIII, no. 4 (December 2002), pp. 57 - 69.

[25] Toufic Ahmad Choudhury & Bishnu Kumar Adhikary, "Loan Classification, Provisioning Requirement and Recovery Strategy: A Comparative Study on Bangladesh and India", *Bank Parikrama*, vol. XXVII, nos. 2 & 3 (June & September 2002), pp. 134-75.

both Bangladesh and India adopted prudential norms for loan classification almost at the same time in 1990's with the same level of non-performing loan. Subsequently, India experienced a substantial reduction of non-performing loans, while Bangladesh could not breakthrough the non-performing menace. The study reveals that, Bangladesh has proceeded very quickly (as compared to India) towards achieving international standard of loan classification; the provisioning measures also, are more stringent in Bangladesh than in India. It is also observed that, India has adopted a wide variety of recovery measures for reducing non-performing loans, which might contribute towards better recovery of non-performing loans in India. On the other hand, Bangladesh has concentrated on legal measures, that too according to the authors has been found to be ineffective and time-consuming. The authors conclude with the recommendation that, the strategy of attacking non-performing loan problem in Bangladesh should be concerned with how to arrest fresh non-performing loans as well as to recover existing non-performing loans.

1.4.13 Khan (2002)[26]

The author in his article titled "An Evaluation of Monetary Policy before and after Financial Sector Reforms in Bangladesh" evaluated Monetary Policy pursued before and after Financial Sector Reforms Program (FSRP) in Bangladesh. He traced the changes taken place in Monetary Policy from the time of independence to 2001 pointing out the causes as well. The author analyzed the impact of reform measures initiated under FSRP on Monetary Policy. He discussed mainly the instruments and the intermediate targets of Monetary Policy in the analysis. The role played by Bangladesh Bank through implementation of Monetary Policy has not been evaluated in this article.

1.4.14 Choudhury (2004)[27]

The author in his article titled "Monetary Policy in Bangladesh: Should We Go for Inflation Targeting?" examines the issue of choice of appropriate Monetary Policy framework and justifies whether Bangladesh should continue monetary targeting

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[26] Syed Ahmed Khan, "An Evaluation of Monetary Policy before and after Financial Sector Reforms in Bangladesh", *Journal of the Institute of Bankers Bangladesh*, vol. 48, (Jan 2001-June 2002), pp. 48 -70.

[27] M. Sadiqunnabi Choudhury, "Monetary Policy in Bangladesh- Should We Go for Inflation Targeting?", *Journal of the Institute of Bankers, Bangladesh,* vol. 51, No. 2 (July-December, 2004), pp.113-33.

framework or go for adopting inflation targeting regime. He recommends some policy implications for designing institutional setup for potential optimal Monetary Policy choice. The author brings forward the issue of inflation targeting; but did not make an overall assessment of Monetary Policy.

1.4.15 Haque (2004)[28]

The author in his dissertation titled "Financial Development in Bangladesh" assesses the overall development of financial sector including Bangladesh Bank from 1972 to 2000 in Bangladesh. The author devotes one whole chapter out of eight to Bangladesh Bank. Moreover, different policies of Bangladesh Bank along with some other important aspects like autonomy of Bangladesh Bank are discussed in two more chapters. The method of analysis of this research is primarily quantitative in nature, but qualitative method has also been applied. The author mainly analyzed the growth trend of Balance Sheet of Banking and Issue departments of Bangladesh Bank. Role of Bangladesh Bank was not evaluated in this study.

1.4.16 Islam and Begum (2004)[29]

The authors in the article titled "High lending Rates in Bangladesh: An Analytical Review" explores the causes of high lending rates in Bangladesh. The authors reveal that, high interest rate prevails in Bangladesh due to its less competitive, distorted, fragmented and oligopolistic financial system under deregulated interest rate regime. The other factor affecting high interest rate spread are high non-performing loan, high expenditure-income ratio, lack of operational efficiency of the Nationalised Commercial Banks (NCBs), uneven competition among the banks and high interest spread of the Private Commercial Banks (PCBs) and Foreign Commercial Banks (FCBs). According to the authors, though Bangladesh Bank wants to reduce lending rates at desirable level, gradually reduced bank rate and Statutory Liquidity Ratio (SLR), commercial banks did not respond

[28] Wasim Md. Mazbahul Haque, "Financial Development in Bangladesh", unpublished Ph.D. thesis, (Rajshahi: Institute of Bangladesh Studies, Rajshahi University, 2004).

[29] Md. Ezazul Islam and Mst. Nurnaher Begum, "High Lending Rates in Bangladesh: An Analytical Review", *Bank Parikrama*, vols. XXVIII & XXIX, (June 2003 – December 2004), pp. 100 - 119.

quickly. The authors conclude that, financial sector reforms must be strengthened in order to reduce the cost of financial intermediation and to reduce wastage of resource through lowering the amount of bad loan.

1.4.17 Khan (2004)[30]

The author in his article titled “Central Bank Autonomy – An Analysis in the Context of Bangladesh” examined the autonomy of Bangladesh Bank in some areas like Central Bank objectives, appointment of the Governor, Deputy Governors and Board of Directors, use of Monetary Policy instruments, Government borrowing, Central Bank supervision, exchange rate policy and transparency of Bangladesh Bank. The author observes that, the process of appointment and dismissal of the Governor, Deputy Governor and the Board of Directors of Bangladesh Bank, salary and terms and conditions of their services, required prior approval of the Government in many key regulations keep the autonomy of Bangladesh Bank at the minimum in respect of financial independence. In Monetary Policy, some steps, mainly sparked by the Government intervention such as practice of directed lending to priority sectors, use of various subsidies, easy refinance facilities to many sectors etc. became limiting factors for Monetary Policy in Bangladesh as well as for autonomy of Bangladesh Bank. Though Bangladesh Bank enjoys full autonomy in terms of pricing and volume of treasury bills issued through weekly tender, the autonomy of Bangladesh Bank and achievement of Monetary Policy target like price stability are hampered by the unlimited borrowing power of the Government from the Bangladesh Bank. The author observes that, following the Financial Sector Reform Programme, the supervisory role of Bangladesh Bank has been increased along with regulatory functions that have contributed towards better supervision and at the same time enhanced the degree of autonomy of Bangladesh Bank. According to the author, Bangladesh Bank enjoys autonomy to some extent in respect of policy decisions on foreign exchange reserve management, exchange rate policy and intervention policy in the foreign exchange market. The author is convinced that, at present Bangladesh Bank is more transparent and accountable than before fulfilling an important precondition

[30] Syed Ahmed Khan, “Central Bank Autonomy- An Analysis in the Context of Bangladesh**”,** *Bank Parikrama*, vols. XXVIII & XXIX, (June 2003 – December 2004), pp. 77-99.

of Central Bank autonomy. The article concludes with some recommendations, where imposition of some legal constraints on the amount of Government borrowing from Bangladesh Bank and involvement of the parliament in the appointment of Governor, Deputy Governor and the Board of Directors are important ones.

1.4.18 Khan (2005)[31]

The Author in his article titled "Management of Non-performing Loans: An Analysis in the Context of Bangladesh" discussed the causes of growth of non-performing loans in the banking sector of Bangladesh. The author pointed out a good number of causes of non-performing loans in Bangladesh like recessionary demand situation faced by Bangladeshi industrial product due to influx of foreign products making industrial loans in turn non-performing, antiquated legislation and delay in obtaining decrees from courts, social banking under the directives of the Government and Bangladesh Bank, where profit generation is foregone by the banks in many cases, external influences on the banks directing the sanction of loans, directed loans to priority sectors and state owned enterprises. In addition to these causes, the author also mentioned about some natural factors like flood, drought and cyclone, some economic factors like recession and inflation, some human factors like changes in Government policies, human skill deficiencies in credit delivery system and the inadequacies in different areas to face the increasing competitive market pressure coming through globalisation as contributing elements to the step rise in non-performing loans in the country. The author discussed in brief the non-performing loans management guidelines like provisioning, capital adequacy requirement, legal measures and CAMEL rating, employed by Bangladesh Bank. The article ends with a set of recommendations to reduce non-performing loans. The title of the article suggests a systematic analysis of the role of concerned authorities to arrest non-performing loans in Bangladesh. But no such significant analysis was found in the article.

The review of literature suggests that, there exists knowledge-gap in the field of present research. No comprehensive research was conducted so far in Bangladesh to evaluate the role of Bangladesh Bank and to quarry analytically, if there is any gap between the aspirations and the assertions.

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[31] Tanvir Ahmed Khan, "Management of Non-performing Loans: An Analysis in the Context of Bangladesh", *Bank Parikrama*, vol. XXX, no. 2 (June 2005), pp. 51-65.

1.5 Justifications

The existing knowledge-gap in the field of role evaluation of Bangladesh Bank makes the main justification for undertaking this research.

As the research attempted a comprehensive study on the role, played by Bangladesh Bank, this reveals the actual state of the mentioned role and the loopholes in the performance as well. While conducting the present research, the other aspects of role and functions have also been studied. So, the research is very much useful to the policy makers of monetary sector in Bangladesh.

The research will be useful to the academicians and researchers. The findings will open new avenues of research on Central Banking and can also be used as secondary source data by the researchers of relevant fields.

Almost all of the developing countries have more or less similar experiences as of Bangladesh regarding the role of Central Bank. The research has the prospect to be helpful to those developing countries also.

1.6 Scope and Limitations of the Study

The scope and the limitations of the present study are as follows:

1.6.1 Scope of the Study

The study analyses the role played by Central Bank in developing economies, particularly that of Bangladesh Bank in Bangladesh. The impact of the functions of any Central Bank in the respective economy is huge and multi-dimensional. It has cross-border and international facets also. The present study examines the role of Bangladesh Bank in five specific areas viz., formulating and implementing Monetary Policy, acting as the banker of the banks, the position of Bangladesh Bank as a banker to the Government, implementing the reform measures in the banking sector of Bangladesh and lastly the development role of Bangladesh Bank.

At the beginning, the study traces the evolution of Central Banking from the beginning to modern days. The significant differences between the role of Central Banks in developed and developing countries have been delineated in the study. After discussing the origin, structure and functions of Bangladesh Bank in brief, the study examines the growth of Bangladesh Bank with the help of growth trend of asset and liability sides of the Issue Department and Banking Department. Analysis of Monetary Policy of Bangladesh Bank starts with the Monetary Policy framework of the Bank. The targets fixed and the instruments employed by the Bank have been delineated here. The study examines the changing stance of Monetary Policy of Bangladesh Bank and the Exchange Rate Policy. The study discusses the conventional and modern functions of Bangladesh Bank as a banker of the banks. The significant functions under this category and covered here are lender of the last resort, keeping deposits of the banks, clearing, settling and transferring functions, licensing of banking companies, ensuring capital adequacy of banks, quality of loan portfolio, management and supervision, governance in bank management and customer protection. Analysis of the role of Bangladesh Bank as a banker of the Government covers the functions of Bangladesh Bank like keeping deposits of the Government, making advances to the Government, managing the public debt, selling Government treasury bills and bonds, transferring Government funds and rendering advices to the Government. The study critically analyses the reforms undertaken by Bangladesh Bank to achieve its goals and objectives. For this purpose, at first the background of the reforms, the reform measures and their implementation has been discussed. Then the outcomes of these measures and the causes of such outcomes have been critically analyzed in the study. The development initiatives, undertaken by the Bank have been examined in the study. Finally, the study offers some policy recommendations.

1.6.2 Limitations

The study has some limitations, which are mentioned below.

(i) It is difficult and sometimes impossible to isolate the effects due absolutely to the Bangladesh Bank's initiatives on the economy since there are many other factors (among whom natural condition, Government's Fiscal Policy and external factors are very influencing ones) contributing to the outcomes. So it was not possible to calculate the exact values regarding the role of Bangladesh Bank in some areas under examination.

(ii) Though Capital Market, especially the stock exchange market is controlled by Securities Exchange Commission (SEC), Bangladesh Bank asserts significant influence over it. But due to paucity of time, the study does not investigate into the role of Bangladesh Bank in the Capital Market of Bangladesh.

(iii) The study analyses the reform measures undertaken by Bangladesh Bank in the banking sector of Bangladesh. Doing so, all the reforms have been analyzed critically, but though the measures taken in the legal framework have been mentioned in the dissertation, detail analysis of the outcomes of the measures of this category have not been done, as this analysis calls for adequate law-based knowledge, time and space, which fall beyond the scope of the present study.

(iv) Data of the early years of Bangladesh are sometime not available due to the liberation war and other reasons. So, in many cases our analysis starts from a later period instead of 1972.

1.7 Methodology

1.7.1 Definition

The word 'method' is derived from two Greek words viz. *'meta'* and *'hodos'* meaning a way, a way of doing something. A method is a planned, systematic and well-articulated approach of investigation. It involves a process where the stages or steps of collecting data are explained and analytical techniques are also defined.[32] Methodology is a set of methods, which are used in a particular area of activity. It is the systematic study of the principles, which guide scientific investigation.[33]

1.7.2 Selection of Method

Research is a systematic search for knowledge and a critical examination into a subject to discover new facts. It is also considered as a formal, systematic and

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[32] M. Zainul Abedin, *A Hand Book of Research* (2nd rev. ed., Dhaka: Book Syndicate, 2005), p.51.

[33] *Ibid.*

intensive process of carrying on the scientific method of analysis. Research generally requires a systematic structure of investigation resulting in some sort of formal record of procedures.[34]

This is a case study on Bangladesh Bank in its present life context. But past history and future prospects are also discussed here. It also evaluates past and present performance. Multiple methods have been used in conducting the present study, where content or documentary analysis was the principal method. Justification of adopting documentary analysis method is that, it is appropriately applicable in finding out what has happened in course of time and correlating the events. It is capable of accepting relatively unstructured data and of analyzing unobserved phenomenon.[35] Besides content analysis method, historical analysis, story telling,[36] etc. have been used here. The analysis of the present research is primarily quantitative in nature, although to realize the objectives of the study, qualitative interpretations have also been made. The researcher has exploited the data of the last 40 years (1972-2011) of the relevant sections of Bangladesh Bank, banking sector and the economy of Bangladesh. The researcher has undertaken an opinion survey on purposively selected persons from among the bankers, monetary sector experts and policy makers.

1.7.3 Sources of Data

Both primary and secondary data were used in the study. As content analysis method was followed as the principal method for the research, so most of the data were extracted from the secondary sources. The primary sources include story telling, unpublished documents of Bangladesh Bank, newspapers, reports, theses, dissertations, manuscripts, etc. The secondary sources comprised of published official statistics, annual reports, reviews, reports, documents, books, articles, periodicals of different domestic and international agencies, laws, ordinances, etc. Internet has been browsed heavily to reach many sources of data. The most extensively used sources of data are as follows.

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[34] *Ibid.,* p. 11 & 12.

[35] *Ibid.,* p.54.

[36] The list of the story tellers have been placed in Appendix Table-1.

- Annual Report,
  Department of Public Relations and Publications, Bangladesh Bank.
- Economic Trends,
  Statistics Department, Bangladesh Bank.
- Bangladesh Bank Bulletin,
  Department of Public Relations and Publications, Bangladesh Bank.
- Monetary Policy Review,
  Policy Analysis Unit, Research Department, Bangladesh Bank.
- Financial Sector Review,
  Policy Analysis Unit, Research Department, Bangladesh Bank.
- Working Papers,
  Department of Public Relations and Publications, Bangladesh Bank.
- Policy Notes,
  Department of Public Relations and Publications, Bangladesh Bank.
- Economic Review,
  Ministry of Finance, People's Republic of Bangladesh.
- Statistical Yearbook of Bangladesh,
  Bangladesh Bureau of Statistics,
  Statistics Division, Ministry of Planning, Government of the Peoples Republic of Bangladesh

- Web sites of Bangladesh Bank, Ministry of Finance, People's Republic of Bangladesh, The World Bank, International Monetary Fund (IMF), Reserve Bank of India (RBI) and some other Central Banks have been extensively visited.

1.7.4 Measuring Indicators

In this research, growth rates like Simple Growth Rate (SGR) and different ratios have frequently been used as measuring indicators. In most cases, the growth rates and the ratios are expressed in percentage forms. Except these rates and ratios, percentage share of some variables in relation to some measure of National Income (GNP or GDP) or in respect to some other variables have commonly been used throughout the research. Some formulas have also been used in this study.

A brief sketch of the indicators, ratios and formulas, used in this study has been given below.

(1) Relationship between Lending Interest Rate and Deposit Interest Rate

$i_l = \{ 1 / (1 - k) \} \times i_d$;[37]

Where,

i_l = Interest Rate on Lending

i_d = Interest Rate on Deposit

k = Required Reserve Ratio

This formula was first used by Jackline Wahba and Mahmoud Moheildin to show the ideal relationship between the lending interest rate and deposit interest rate in a competitive market. From the above formula the ideal and desirable interest rate spread of the financial market can be derived as:

$i_l - i_d = \{ k / (1 - k) \} \times i_d$;

The right hand side of the above equation suggests the desirable interest rate spread. The more the actual spread is away from the desirable spread, the more the market deviates from competition and tends to be oligopolistic.

The formula and the expression have been used to assess the policy reforms of Bangladesh Bank to achieve price competition within the banking sector of Bangladesh.

(2) Advance Deposit Ratio (ADR)

ADR = Advance / Deposit;

Advance deposit ratio (ADR) is the ratio of advances given by the Deposit Money Banks (DMBs) to the deposit of the DMBs.

[37] Jackline Wahba and Mahmoud Mohieldin, "Liberalizing Trade in Financial Services: The Uruguay Round and the Arab Countries", *World Development*, vol. 26, no (issue). 7 (July 1998), pp. 1348, cited in Islam and Begum, "High Lending Rates in Bangladesh", p. 110.

This ratio has been used as an indicator following international practice to indicate the extent of utilization of the deposited money, in other words, the extent of resource utilization in the economy through the banking system. The higher value of the ratio indicates higher resource utilization and *vice versa*.

(3) Percentage Share of Borrowing from Different Sources in Total Borrowing of DMBs

Share of Source_i= (Borrowing from Source_i /Total DMB Borrowing) x 100

Percentage share of borrowing from any source in total borrowing of DMBs is derived from the product of the ratio of borrowing from source to total DMB borrowing and 100.

This expression has been used to calculate the percentage shares of the different sources like Bangladesh Bank, Government, banks and other financial institutions in total borrowing by the DMBs. Relative contribution of these sources in DMB borrowing can be found and ranking in this regard can be made by using this formula.

(4) Percentage Share of Different Sectors in Total DMB Advances

Percentage Share of Sector in DMB Advances

= (DMB Advance to Sector / Total DMB Advances) x 100;

Percentage share of any sector in total DMB advances is derived from the product of the ratio of DMB advance to sector to total DMB advances to all the sectors and 100.

This expression has been used to calculate the percentage shares of the three broad sectors (agriculture, industry and service) in total DMB advances, which compared to the percentage share of the three sectors to GDP acts as an indicator of the efficiency of resource allocation by the DMBs.

(5) Percentage Share of Different Sectors to Total GDP

Share of Sector_i = (Contribution of Sector_i in Total GDP/ Total GDP) x 100

Percentage share of any sector in Gross Domestic Product (GDP) is derived from the product of the ratio of contribution of that sector in GDP to total GDP and 100.

This expression has been used to calculate the percentage shares of the three broad sectors (agriculture, industry and service) in the GDP of Bangladesh. Relative contribution of these three sectors in GDP of Bangladesh can be found and ranking in this regard can be made by using this formula.

(6) Credit Allocation Index

$I_{ti} = A_{it} / Q_{it;}$

Where,

I_{ti} = Credit allocation index for i-th sector for year t

A_{it} = Share of the i-th sector in advances by all DMBs for year t

Q_{it} = Share of the i-th sector in GDP for year t

Practically I_{ti} is a ratio of ratios as both A_{it} and Q_{it} are two ratios. This is an effective indicator to assess efficiency in resource allocation. It is specially useful in indicating sectoral disparity regarding resource allocation. I_{ti} may either be proportional to, or greater than or less than one. When it is proportional to one for a sector that implies resource is allocated to that sector proportional to its contribution to GDP, indicating no bias. If it is greater than one for a sector, resource is allocated in favour of that sector; and if it is less than one for a sector, then resource allocation is adverse for that sector.

(7) Ratio of Total Classified Loans to Total Loans (in percent)

= (Total Classified Loans of the Banks / Total Loans Given by the Banks) x 100

This ratio has been used to judge the quality of the loan portfolio of the banking industry. There is an inverse relation between the value of the ratio and the quality of the loan portfolio, i.e., a higher value of the ratio indicates decline in the said quality and *vice versa.*

The ratio was measured twice. At first it was measured for the whole banking industry and then the ratios for the different clusters of banks like NCBs, PCBs, FCBs and DFIs were measured.

Three more similar ratios were measured for the same purpose. These are: (a) Percentage Ratio of Sub-standard Loans to Total Classified Loans; (b) Percentage Ratio of Doubtful Loans to Total Classified Loans; and (c) Percentage Ratio of Bad Loans to Total Classified Loans. These three ratios placed together show a comparative picture of the categories of the classified loans of the banking industry.

(8) Provision Maintenance Ratio (PMR)

PMR = (Maintained Provision / Required Provision) x 100;

This ratio has been used to show the state of provisioning against classified loans by the banks in Bangladesh. A higher PMR indicates more compliance of the provisioning related regulations by the banks and *vice versa*.

This ratio also was measured twice. At first it was measured for the whole banking industry and then the ratios for the different clusters of banks like NCBs, PCBs, FCBs and DFIs were measured to determine the comparative position of provision adequacy by different clusters of banks operating in Bangladesh.

(9) Expenditure-Income Ratio (E-I Ratio)

EI Ratio = Expenditure / Income;

EI ratio judges the operating efficiency of the banks. A high and increasing EI ratio reveals operating inefficiency and flaws in the bank management and *vice versa*. This ratio has been measured to judge management soundness of the banks under the CAMELS framework, employed by Bangladesh Bank.

(10) Return on Assets (ROA)

ROA = Net after-tax Profit / Bank Asset;

ROA measures income per unit of assets employed in a bank for a given year. A high ROA indicates a better managed bank and *vice versa*. It is a widely used indicator of banking efficiency. It has been used to reflect the efficiency of the management of a bank’s assets to assess the earning and profitability of banks under the CAMELS framework.

(11) Return on Equity (ROE)

ROE = Net after-tax Profit / Bank's Equity Capital;

ROE is the rate of return, which management earns on the equity capital provided by the owners of a bank. A high ROE indicates managerial efficiency and *vice versa*. ROE has been used to reflect managerial efficiency of the banks operating in Bangladesh. This also has been done to assess the earning and profitability of banks under the CAMELS framework.

1.7.5 Techniques of Data Analysis

The study employed time series analysis. Besides, charts, graphs, tabular presentation, etc. have been used extensively in this study.

1.8 Operational Definitions

1.8.1 Central Bank

The definition of Central Bank is derived to a considerable extent from its functions. According to R.S. Sayers the business of a Central Bank, as distinguished from a commercial bank, is to control the commercial bank in such a way as to promote the general Monetary Policy of the state[38]. M.H. de Kock defines Central Bank including most of the important functions of a Central Bank[39]. We can define a Central Bank as that central monetary institution which is charged with performing the duties of banker's bank and managing the monetary system of the country.

1.8.2 Developing Economy

Developing Economy refers to the economically backward country which lags behind substantial manufacturing and service capability with backward technologies in agriculture and raw material extraction, but achieved some progress in economic activities. This description of the poorer nations of the world

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[38] S. K. Srivastava, *Monetary Economics: An Analysis of Money and Banking with Special Reference to India* (3rd rev. ed., Delhi: Atma Ram & Sons, 1972), p.287.

[39] de Kock, *Central Banking*, pp. 14-15.

came into current usage in the 1960s and started to replace the less complimentary expressions 'underdeveloped' or 'backward'[40].

1.8.3 Monetary Policy

Although the term Monetary Policy has been used with increasing frequency by experts and laity, few have attempted a precise definition of it. According to Paul A. Samuelson, Monetary Policy represents the central bank's action to control the supply of high-powered money and thereby the economy's supply of money and credit.[41] Paul Einzig defined an ideal Monetary Policy as the effort to reduce to the minimum the disadvantages and increase the advantages, resulting from the existence and operation of a monetary system.[42] However, we can define Monetary Policy as a policy employing the central banks control on the supply of money for achieving the objectives of general economic policy.

The organization responsible for the conduct of a country's Monetary Policy is the Central Bank of that country.[43] Bangladesh Bank conducts Monetary Policy in Bangladesh.

1.8.4 Inflation

The broad definition of inflation is that, inflation is a rising price level. According to Crowther, inflation is a state, in which the value of money is falling, *i.e.*, prices are rising. Recognizing the inherent ambiguities, inflation may be defined as a sustained and sizeable rise in the general price level in the economy[44].

Out of the different measures of Inflation, Consumer Price Index (CPI) inflation, expressed as the rate of change of CPI is used in Bangladesh for measuring price stability. The CPI is designed to reflect changes over time in the prices paid by the ultimate consumers of a specified basket of goods and

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[40] C.S. Nagpal, *Dictionary of Economics* (2nd ed.; New Delhi: Anmol Publications Pvt Ltd., 1994).

[41] Khan, "Monetary Policy".

[42] M.C. Vaish, *Monetary Theory* (6th ed.; Delhi: Vikas Publishing House Pvt. Ltd., 1973), p. 273.

[43] Frederic S. Mishkin, *The Economics of Money, Banking and Financial Markets* (New York: Harper Collins Publishers, n.d.), p. 13.

[44] Vaish, *Monetary Theory*, p.200.

services[45]. Each of the goods and services in the basket is weighted according to its importance in consumer's budget.

1.8.5 Economic Growth

Economic growth can be defined as the increase in the economy's output over time. The best measure of the economy's output is Gross National Product (GNP) in constant price *i.e.,* real GNP. Growth is considered as the expansion of the economy's output[46].

The Economic growth rate can be computed by using the following compound interest formula,

$$GNP_t = GNP_b (1+r)^n ;$$

Where, *t* designates the terminal year, *b* the beginning year of the period, *n* the number of years in the period, and *r* the average annual rate to be determined.

1.8.6 Broad Money

Broad Money is a measure to calculate money supply in an economy. It is defined as the sum of narrow money and time deposit. Usually Broad Money is denoted by M_2. It is expressed as

$$M_2 = M_1 + TD;$$

Where,

M_2 = Broad Money

M_1 = Narrow Money; and

TD = Time deposit

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[45] S.P. Gupta and M.P. Gupta, *Business Statistics* (11th ed.;New Delhi: Sultan Chand & Sons, 1996), p.346.

[46] Edward Shapiro, *Macroeconomic Analysis* (5th ed,; New Delhi: Galgotia Publications pvt. Ltd., 1988), p.429.

Narrow money (M_1) is the sum of currency outside banks, demand deposits and deposits with Bangladesh Bank other than Deposit Money Bank (DMB).

Bangladesh Bank uses Broad Money as intermediate target in its Monetary Policy Framework to achieve the policy targets.

1.8.7 *Repo*

"Repo" is a Latin word which stands for repurchase agreement. In banking practice, *repo* is a facility provided by the Central Bank to the banks in temporary crises of fund to use financial securities as collateral for short term borrowing from the Central Bank with the agreement that, after a short duration they will get back the securities on repayment of the borrowed amount including the agreed interest amount. The *Repo* auction enables the banks to place bids for funds collateralized by treasury bills. The Central Bank accepts the bids to the extent needed to maintain the intended level of liquidity. The purpose of *repo* on the Central Bank's part is to ensure liquidity of the banks and to minimize volatility in the country's money market.

Bangladesh Bank introduced *repo* facility in Bangladesh in July 2002 and uses it as an indirect tool of its Monetary Policy. The duration of *repo* is determined mutually, which usually extends from one to seven days. The interest rate is also settled mutually. Bangladesh Bank's bank rate or the call market rate has influence on *repo* interest rate.

1.8.8 *Reverse Repo*

Reverse Repo is the counter part of *Repo*. In *Reverse Repo* auction the banks submit offers of their excess funds. The Bangladesh Bank accepts the offers to the extent needed to maintain the intended level of liquidity

1.8.9 Capital Adequacy

Capital adequacy, alternatively called capital base adequacy is a regulatory requirement, to be maintained by the banks; the requirements imposed by the respective Central Banks now are fixed in line with the Basel accords. It is a certain minimum of capital to be held by the banks against their risk weighted assets. The central Banks implement the regulation in their own countries and the Basel Committee on Bank Supervision, a coordinating body within the Bank for International Settlement (BIS) supervises the administration of capital reserves for Central Banks around the world.

The concept of capital adequacy emerged with a view to preserve the confidence among the depositors to stay with the bank and make the bank less likely to suffer a run on its deposits, at the same time on the bank's part to enjoy the confidence of other banks- both contributing to minimizing financial system instability. If most of the banks in an economy are under-capitalized in terms of capital adequacy, it may cause systemic risk, particularly during economic downturn or any other extraordinary business shock.

Bangladesh Bank administers capital adequacy in Bangladesh and brings necessary changes in the regulations time to time. The current regulation in force requires all scheduled banks to maintain at least 10% of total Risk Weighted Assets (RWA) or the amount determined by Bangladesh Bank from time to time as capital. Moreover, banks have to maintain at least 50% of required capital as Tier 1 capital to fulfill the requirements of Basel II accord.

1.8.10 Loan Classification

Loan classification means assigning by the banks each and every loan case a particular status through verification of the borrower's repayment performance on a particular date. There are two broad groups in which the loans may be classified, namely classified and unclassified. Classified loans are grouped in three classes viz., sub-standard, doubtful and bad/loss. For the purpose of classification, loans are first categorized into four categories namely continuous loan, demand loan, term loan and short-term agricultural credit/ micro credit. Then both objective and qualitative judgment criteria are used by the banks to deem a loan classified or unclassified. Length of overdue is followed as objective criteria while if any uncertainty or doubt arises in respect of recovery of any loan, the loan is to be classified on the basis of qualitative judgment, be it classifiable or not on the basis of objective criteria.

Loan classification is implemented in order to curb financial distress and arrest the growth of default loan in any banking system. Bangladesh Bank introduced loan classification in November 1989 in Bangladesh and since then modified the policy of loan classification occasionally to make it an effective one.

1.8.11 Categories of Loans

For the purpose of classification, all loans and advances of the banks are brought into four categories, namely (a) continuous loan (b) demand loan (c) fixed term loan and (d) short-term agricultural and micro credit. The categories are defined below:[47]

1.8.11.1 Continuous Loan

The loan accounts in which transactions may be made within certain limit and have an expiry date for full adjustment will be treated as continuous loans.

1.8.11.2 Demand Loan

The loans that become repayable on demand by the bank will be treated as demand loans. If any contingent or any other liabilities are turned to forced loans those too will be treated as demand loans.

1.8.11.3 Fixed Term Loan

The loans, which are repayable within a specific time period under a specific repayment schedule, will be treated as fixed term loans.

1.8.11.4 Short-term Agricultural Credit

This category includes the short-term credits as listed under the annual credit programme issued by the Agricultural Credit Department of Bangladesh Bank. Credits in the agricultural sector repayable within less than 12 months are also included herein. Short-term Micro-credits will include any micro-credits for less than Tk. 25,000.00 and repayable within less than 12 months.

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[47] Bangladesh Bank, BRPD Circular No.05, dated June 05, 2006.

1.8.12 Loan Loss Provision

Loan loss provision is an internationally practiced system followed by the banks to set aside a percentage of their income as an expense when calculating their pre-tax incomes mainly to account for future losses on potential loan defaults. The other reasons for provisioning include potential loss on the investment account due to market volatility of securities, required payment of different types of advances to different parties such as legal fees to the lawyers, etc. Banks are required to maintain provision as risk premium during loan pricing. Provisioning can be used as an indicator of the performance of the banking industry. If the maintained provision as a percentage of required provision declines over time, it can be argued that, their performance has improved and *vice versa*

If banks do not keep provision against the potential losses and the unadjusted entries, their income as well as their assets may be inflated and may not depict the actual financial position accurately. So, the Central Banks around the globe impose regulatory obligations on the banks to maintain certain percentage of income as provision. All the scheduled banks in Bangladesh are required to maintain minimum amount of provision as per regulatory standard set by the Bangladesh Bank.

1.8.13 Loan Write off

Write-off is a process of removing bad debt or uncollectible loans from the balance sheet of the banks. Banks may write-off bad debts under specific write-off policies formulated by respective central Banks. Bangladesh Bank issued a uniform write-off policy for the first time in Bangladesh in January 2003, which is still in effect. According to this policy, banks operating in Bangladesh may at any time write-off loans that have been classified as “bad/loss”. Loans which have already passed five years as “bad/loss” and for which 100 percent provisions have been kept, should be written-off immediately.

1.8.14 CAMELS[48]

CAMELS is a rating system used to evaluate the performance of the banks in the banking sector. Bangladesh Bank developed CAMELS under Financial Sector Reform Programme (FSRP). Under CAMELS framework, six crucial dimensions

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[48] CAMELS stands for Capital, Asset Quality, Management Capability, Earning, Liquidity Level and Sensitivity to Market Risk

of banking operations are analyzed and evaluated. The indicators used in the rating system are (i) capital adequacy, (ii) asset quality, (ii) management soundness, (iv) earnings, (v) liquidity, and (vi) sensitivity to market risk. The banks, based on their performance in respect of the above indicators, are rated between 1-5 grades in ascending order, where rating 1 stands for the best performance and 5 for the worst.

1.8.15 Basle Accord

Basel Accord is a set of agreements set by the Basel Committee on Bank Supervision (BCBS) of Bank for International Settlements (BIS), situated in Basel of Switzerland. The Basel Committee on Bank Supervision (BCBS) provides recommendations on banking regulations in regards to three types of risks, viz., capital risk, market risk and operational risk. The purpose of the accords is to ensue that, financial institutions maintain enough capital to meet obligations and absorb unexpected losses. BCBS has formulated two sets of accords so far known as Basel I and Basel II.

The first Basel Accord (Basel I) was issued in 1988 and focuses on the capital adequacy of financial institutions. According to Basel I, the assets of financial institutions are categorized into five risk categories (0%, 10%, 20%, 50%, and 100%). This policy requires the banks to maintain a ratio of capital to Risk-Weighted Assets (RWA) of not less than eight per cent with at least four per cent in core capital.

The second Basel Accord (Basel II) focuses on three main areas, including minimum capital requirements, supervisory review and market discipline, which became famous as three pillars. Basel II is to be fully implemented by 2015.

1.8.16 Interest Rate Spread

Interest rate spread is simply the difference between the lending interest rate charged by the banks on advances and the deposit interest rate offered on the deposits by the banks. Usually this spread is calculated between weighted average interest rates on advances and deposits. In the banking industry interest rate spread is used to measure the price competition within the industry.

1.8.17 Non-performing Loan (NPL)

A non-performing loan (NPL) is a default loan in the banking system, which ceases to perform or generate income for the lender bank. When a borrower cannot repay interest and/or installment on a loan after it has become due, then it is termed as non-performing loan. It is a zero-yield asset when applied to loans and advances and hence safety of such loan is endangered. Non-performing loan is a multi-class concept. Such loans can be classified into different groups based on the length of overdue of the said loan. The international standard classification terminologies applicable for non-performing loans are “sub-standard”, “doubtful” and “bad/loss” loans.

1.9 Time Reference

The study encompasses the time span of 40 years from Fiscal Year 1971-72 to FY 2010-11. Where available, data of more recent years have been used.

1.10 Plan of the Dissertation

The findings of the present research are presented here in the form of a dissertation. A brief structure of the dissertation reflecting the plan of the research is given below.

Chapter I: Introduction

It contains the prelude, statement of the problem, objectives of the research, review of literature, justifications of the study, scope and limitations and methodology followed by operational definitions.

Chapter 2: Role of Central Bank in a Developing Economy

In this Chapter at first the traditional functions of a Central Bank in a developing economy have been mentioned. This has been followed by a discussion on the rationale of developmental role of Central Banks in developing economies. Then the promotional functions of the Central Banks have been delineated. At last, the challenges to the development role of Central Banks have been identified.

Chapter 3: Origin, Structure, Functions and Growth Trend of Bangladesh Bank

Four aspects of Bangladesh Bank have been discussed in this chapter. First of all, origin of Bangladesh Bank, then its structure including the departments and branches all over the country, then the functions of Bangladesh Bank in brief has been delineated. At last, growth of Bangladesh Bank with the help of growth trend of asset and liability sides of the Issue Department and growth trend of asset and liability sides of the Banking Department have been discussed in this chapter.

Chapter 4: Monetary Policy of Bangladesh Bank

In this chapter the Monetary Policy, pursued by Bangladesh Bank has been analysed. The analysis starts with the Monetary Policy Framework of Bangladesh Bank. Then the targets of Monetary Policy and the instruments, employed by Bangladesh Bank to achieve the stated targets have been discussed. Changing stance of Monetary Policy has been delineated here. The chapter also contains an analysis on exchange rate policy pursued by Bangladesh Bank.

Chapter 5: Role of Bangladesh Bank as a Banker of the Scheduled Banks

The functions performed by Bangladesh Bank as a banker of the scheduled banks have been discussed in this Chapter. In the early part of the Chapter, the conventional functions like lender of the last resort, keeping deposits of the banks, clearing, settling and transferring functions, licensing of banking companies have been discussed. In the later part, the modern functions, most of whom originated from modern day necessity and many of whom were devised under FSRP have been discussed in five broad categories viz., capital adequacy of banks, quality of loan portfolio, management and supervision, governance in bank management and customer protection.

Chapter 6: Role of Bangladesh Bank as a Banker to the Government

In this chapter such functions of Bangladesh Bank have been discussed, which the Bank performs as a banker of the Government. The deposit keeping, making advances to the Government, managing the public debt, selling Government treasury bills and bonds, transferring Government funds from one place to another and rendering advices to the Government are the principal functions, discussed in this chapter.

Chapter 7: A Critical Analysis of the Reforms Undertaken by Bangladesh Bank

The reform measures, undertaken by Bangladesh Bank in the financial sector of Bangladesh have been critically analyzed in this chapter. The analyses have been done mainly in five steps. First of all, the background of the reforms has been discussed. Next, the objectives of the reforms followed by the implementation of the reforms have been delineated. Then the outcomes of all these measures, except that of legal framework have been categorically analyzed. Analysis of the outcomes reveals very unsatisfactory performance of the reform measures. So, this analysis has been followed by another analysis of the causes of the failure, which is the fifth step.

Chapter 8: Bangladesh Bank's Role in Development

The development initiatives of Bangladesh Bank have been discussed in this chapter. The chapter starts with the mode of the development role of Bangladesh Bank in the economy. Then the promotional activities of the Bank in different sectors and areas have been traced. The sectors and areas are agriculture, Small and Medium Enterprises (SMEs) and women entrepreneurship, customer interest protection, automation of the banking industry and green banking.

Chapter 9: Summary, Recommendations and Conclusions

In this chapter, all the preceding chapters have been summarized sequentially to present a compact but brief substance of the dissertation. The recommendations are placed in this concluding chapter. It also contains suggestions for further research.

CHAPTER II

ROLE OF CENTRAL BANK IN A DEVELOPING ECONOMY

2.1 Prelude

There are significant differences between the role of a Central Bank in a developed country and that in a developing country. These differences arise from their different stages of development.[1] The Central Banks were set up in the developed countries when the monetary and financial systems were already well-developed. So, in such countries the regulatory role of the Central Bank is emphasized.[2] But the scenario is different in case of developing countries. The developing world consists of a large number of heterogeneous countries, differing significantly from one another in such important aspects as area, population, resource endowment, stage of development, per capita income, as well as in social and political institutions.[3] These characteristics of the developing economies are by no means identical and are far too numerous to be examined, even in broad outline, in the limited space of this Chapter. But there are some more or less common characteristics, imperfections and needs regarding financial condition through out the developing economies which warrant Central Bank intervention with development objective. Here it may be mentioned that, the reason behind setting up Central Banks in the developing countries was not essentially economic; rather it was political in nature- especially in the colonial territories. These countries having attained political independence set up Central Banks expressing thereby their political independence.[4] According to Sayers,

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[1] V. V. Bhatt, 'Some Aspects of Financial Policies and Central Banking in Developing Countries", *World Development*, Vol. 2, No. 10-12, (October-December 1974), pp. 59-67.

[2] John Hicks, *Critical Essays in Monetary Policy* (London: Oxford University Press, 1967), pp. 158-59.

[3] Eprime Eshag, *Fiscal and Monetary Policies and Problems in Developing Countries* (New York: Press Syndicate of the University of Cambridge, 1983), p. xv.

[4] S. Ligeti, "Selective Credit Policy in the Developing Countries", *Monetary Economics,* ed. by C S Nagpal and A C Mittal (New Delhi: Anmol Publications Pvt. Ltd.,1993), p. 279.

> Colonial territories seeking some measure of political independence have tended to regard a Central Bank as an outward and visible sign of independence, and lack of one as signifying continued subjection. [5]

In most cases, these Central Banks replaced the Currency Boards which had their origin in the colonial past and in many respects they are similar to those of their colonial powers. But in course of time, these Banks assumed greater importance in the respective economies.

At present, Central Bank objectives may be broadly classified into: (a) the tactical objectives of monetary stabilization; (b) the promotional objectives including distributive and welfare objectives. [6] The tactical objectives are spelt out in all the Central Bank statutes, whereas the promotional and developmental objectives are stated explicitly usually in the case of developing countries and exceptionally in developed countries. In the USA, the Federal Reserve Act in its Section 2A.1 enjoins the Board of Governors and the Federal Open Market Committee to maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable price and moderate long run interest rates. Though the other Central Banks in the developed countries do not have any promotional objectives spelt distinctly in their statutes, they use Monetary Policies to implement basic national economic goals along with fulfilling the monetary stabilization objectives. Central Banks in Italy, Japan, the Netherlands, Sweden and West Germany used various techniques such as asset reserve requirements and government borrowing and relending to preferred sectors such as housing, agriculture, exports, small business and underdeveloped regions. Similarly, Bank of England took initiatives in establishing specialised institutions like the Industrial and Commercial Finance Corporation, the Finance Corporation for industry, the Security Management Trust and the Banker's Industrial Development Company. [7]

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[5] R. S. Sayers, "Central Banking in Underdeveloped Countries", (Commemoration Lectures, National Bank of Egypt, Cairo, April 1956), *Central Banking after Bagehot* (London: Oxford University Press, 1957), p. 114.

[6] Anand G. Chandavarkar, "Promotional Role of Central Banks in Developing Countries", *IMF Working Paper,* no. WP/87/20 (IMF, Treasurer's Department, March 27, 1987), p. 2.

[7] *Ibid.*, pp. 2 & 3.

In the developing countries also, the development aspects of the functions of the Central Bank performed along with the traditional part are becoming more dominant. Accordingly the roles of a Central Bank in a developing economy have been discussed as functions in two broad areas, viz., traditional functions and promotional functions. Here, emphasis has been given on the promotional aspect of the role played by the Central Bank.

2.2 Traditional Functions of the Central Bank in a Developing Economy

The traditional functions of the Central Bank in a developing economy can be listed as follows.

2.2.1 Monopoly of Note Issue

Like the Central Banks of the developed countries, the Central Banks of the developing countries also have the monopoly of note issue. This monopoly power of issuing notes by the Central Bank is important to maintain confidence in the value of the legal currency of the country. It is also important to promote acceptability of the currency among the members of the public.[8]

2.2.2 Banker to the Banks

A fundamental and universally acknowledged duty of the Central Bank is to serve as the banker's bank. As the banker of the banks, the Central Bank performs a set of functions such as acting as lender of last resort, regulating and supervising the financial institutions, ensuring clearance, settlement and transfer, ensuring quality of loan portfolio, at the same time protecting the customers. A very important role of the Central Bank as a banker to the banks in a developing economy is to encourage the growth of sound institutions and check the appearance of the weaklings, because in the financial sector a weak institution can weaken the other and better institutions.[9]

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[8] Subrata Ghatak, *Monetary Economics in Developing Countries* (London: The Macmillan Press Ltd, 1981), p. 38.

[9] Sayers, "Central Banking in Underdeveloped Countries", *op. cit.,* p. 121.

2.2.3 Pursue Monetary Policy

Pursuing Monetary Policy is one of the key functions of the Central Banks in the developing countries. Usually Monetary Policy in such countries is implemented with some basic policy targets like price stability and economic growth rates. Central Banks employ a judicious mix of instruments to achieve the targets.

2.2.4 Banker to the Government

The Central Bank in a developing country acts as the banker to the Government. As part of this role, it makes advances to the Government and maintains the cash balances of the Government. The Bank receives and makes payments for the Government. It also renders financial and economic advices to the Government.

2.3 Rationale of Developmental Role of Central Banks in Developing Economies

Existing literatures suggest that the role of Central Bank in a developing economy has to be conceived in the context of evolving a sound financial infrastructure conducive to rapid development.[10] Some literature even advocate for direct financing for sectoral development by the Central Bank.[11] The main rationales of the developmental or promotional role of the Central Bank in a developing economy are as follows:

2.3.1 Position of the Central Bank

The overriding accent of the developing countries has been on achieving rapid economic development. Economic development is not only facilitated but also quickened by the appropriate development of the financial system, structure of financial institutions and instruments.[12] The Central Bank, being the apex of the financial system of an economy influences the behavior of financial institutions so as to support the economic policy of the Government. More than the statutes and

[10] Bhatt, 'Some Aspects of Financial Policies", *op. cit.,* p. 64.

[11] For detail, see Henry Christopher Wallich, *Monetary Problems of an Export Economy- The Cuban Experience, 1914-1947* (Cambridge: Harvard University Press, 1950).

[12] See Raymond W. Goldsmith, *Financial Structure and Development* (New Haven: Yale University Press, 1969).

formal powers, it is the Central Banks' status, expertise and influence in relation to the Government, development agencies and the financial community, which defines the promotional opportunity-set of the Bank as a regulator, innovator, participant and catalyst of financial development.[13] Therefore, the Central Banks in developing countries have to have a distinct developmental orientation. The role of the Central Bank in the developing countries is emphasized not only as regulator of sound integrated financial systems but also as promoter.[14] These two functions are interrelated. The functions of a Central Bank as a regulator are in fact reinforced by its functions as a promoter.[15]

2.3.2 Dualism of Traditional and Modern Sector

The money economy of the developing countries is evidently characterized among others by `dualism`, where the traditional sector and the modern sector exist side by side. The traditional sector is characterized by subsistence and remains fully or partly outside the scope of money economy. A considerable part of agricultural production takes place within this sector and agriculture accounts for a rather larger share. This implies that, a considerable part of the country's production serves self-sufficiency to the consumer more or less within the framework of a moneyless barter. The implication of this dualism is that, in the course of the developing country's growth, when the share of the traditional sector is decreasing, not just the capital requirement of the modern sector appears on the money and capital market, but the monetization of the traditional sector means a money requirement.[16] Central Banks of developing countries have very important role to play in this regard.

2.3.3 Slow Pace of Development of Commercial Banking System

General banking is generally regarded as the business of the commercial banks. The Central Bank should strive by every means consistent with reasonable security to encourage these banks. But undue concentration of business risks is

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[13] Chandavarkar, "Promotional Role of Central Banks", *op. cit.,* p. 4.

[14] C. R. Basu, *Central Banking in a Planned Economy: the Indian Experiment* (2nd ed., New Delhi: Tata McGraw-Hill Publishing Co. Ltd., 1976), p. 145.

[15] John Hicks, *Capital and Growth* (Oxford: Oxford University Press, 1965), p. 292.

[16] Ligeti, "Selective Credit Policy", *op. cit.,* pp. 267 & 268.

very likely to occur in the developing countries. The commercial banks also face huge difficulty in attracting and holding sufficient capital and managerial ability. Consequently, in these economies after making all allowances for the result of an encouraging atmosphere, the development of the commercial banks may not be fast enough to make adequate provision for the country's economic potentialities.[17] Thus, a gap is likely to exist. It is the responsibility of the Central Bank to fill this gap. Sayers mentions, "It (Central Bank) should think solely of filling the gaps unfilled by others."[18] A wider geographic and functional penetration of the banking system is also required in this context. Central Bank is to take the lead in this initiative.[19]

2.3.4 Narrow or Non-existent Long Term Capital Market

The existence of a flexible long-term capital market catering to the needs of all classes of entrepreneurs is a precondition for the Central Bank to confine itself to only the regulatory role. Such a capital market influences and in its turn is influenced by the short-term money market. Optimism and pessimism emanating from the long-term market may upset the equilibrium of the short-term market and defective organization of the one is bound to affect the working of the other market.[20] Therefore, though the Central Bank is linked to the short-term market, it is not possible for the Bank to function adequately if it ignores the working of the long-term market resulting hindrances to the development process. The long-term capital market is practically very narrow and in many cases absent in the developing countries. So, the Central Bank in a developing economy is to occasionally step into the long-term market, especially if the market is in a diseased or disorganized condition.

2.3.5 Lack or Absence of Institutional Credit to the Under-served Sectors

Sustainable development of the economy requires among others, harmonious gradual development of all the sectors of the economy. So, adequate institutional

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[17] Sayers, "Central Banking in Underdeveloped Countries", *op. cit.,* pp. 116-118.

[18] *Ibid.,* p. 118.

[19] *Ibid.,* pp. 114 & 115 and Bhatt, 'Some Aspects of Financial Policies", *op. cit.,* p. 64.

[20] S. N. Sen, *Central Banking in Undeveloped Money Markets* (4th ed.; Calcutta: Bookland Private Limited, 1967), p. 231.

credit flow to these sectors is imperative for the sake of development. But in the developing countries only a few sectors are blessed with institutional credit from the commercial banking system. In these countries, commercial bank financing is very low in sectors like agriculture and small and medium enterprises. But these countries possess comparatively large agricultural section, which contribute a substantial percentage of the national income. Generally the development of commercial banking is inadequate in the developing countries. Again, the banks find the rural people with scarcely any tangible resources to pledge as security manifesting them not credit-worthy.[21] Almost similar problem is faced by the small scale producers. There is practically no organization for the supply of finance, both short-term and long-term, to such producers, who are actually responsible for the production of a large share of the domestic output in the economy. This is true even for some developed countries like Australia, New Zealand and South Africa.[22]

2.4 Promotional Functions of the Central Bank in a Developing Economy

It has been mentioned earlier in this chapter that, Central Banks in developing countries have a twin role to perform, that of a regulator as well as promoter. These roles are necessarily concurrent rather than sequential.[23] The monetary instruments employed by the Central Bank can have multiple targets and there is no necessary one-to-one relationship between a monetary instrument and a target in the developing countries.[24]

2.4.1 Foster the Growth of the Banking System and Institution Building

In a developing country the channels of trade and growth of capital in both industry and agriculture have to be encouraged. To facilitate these developments the Central Bank should foster the process of widening and deepening of the geographical penetration of the banking system as quickly as possible through creation of a nation-wide network of bank branches.[25] Sayers considers the encouragement of the growth of sound commercial banking throughout the

[21] *Ibid*., pp.233-34.

[22] *Ibid.,* p. 234.

[23] Chandavarkar, “Promotional Role of Central Banks”, *op. cit.,* p. iii.

[24] *Ibid.,* p.4.

[25] Sayers, “Central Banking in Underdeveloped Countries”, *op. cit.,* p. 117.

economy as the first priority on the agenda of a new Central Bank.[26] Central Banks in developing countries should also build institutions with multifarious objectives. The Bank may take initiatives in organizing subsidiaries for the purpose of facilitating the supply of capital of different terms for the sectors in need.

2.4.2 Banker to the General Public

In the developing economies, the Central Bank can be a bank for the general public. Though usually the economists especially of the nineteen-twenties did not approve the general banking business by the Central Bank, there are economists like R. S. Sayers, who vehemently advocated for this function of the Central Bank. According to Sayers,

> The banking business to be cultivated falls into three parts: the central bank can be a bank for the general public, it can be the government's banker, and it can be the banker's bank. More than 'can be': the central bank in an undeveloped financial system should busy itself in all three directions.[27]

The main justification for the role of Central Bank as the bank for the general public lies in the slow pace of development of sound commercial banking system in the developing countries. This slow pace opens gaps which have been mentioned earlier in this Chapter. In such a situation, to make adequate provision for the country's economic potentialities the Central Bank should undertake banking activities for the general public.[28] If there are no such gaps, the Central Bank is not required to engage itself in banking for the public.

2.4.3 Measures for the Supply of Long-Term Capital

The Central Bank can follow two methods in extending its activities regarding supply of long-term capital. The first one is, it can start separate department and the second one is, it can co-operate and participate in setting up separate institutions for the supply of long-term finance.[29]

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[26] *Ibid*., pp.132-33.

[27] *Ibid.*, p.116.

[28] *Ibid.*, p.118.

[29] Sen, *Central Banking, op. cit.,* p. 244.

The first method was adopted in Australia. The Royal Commission on the Monetary and Banking Systems in Australia of 1937 stressed in its report the need for establishing such department for providing mortgage credit. Accordingly, two departments of the Commonwealth Bank, the Mortgage Bank Department and the Industrial Finance Department were established in 1943 and 1946 respectively. Such departments are expected to finance the development of agriculture and industry, especially small business for which financial accommodation is not readily available through ordinary banking or other channels. These may grant overdrafts or fixed loans, or may subscribe to the share capital of a company, or underwrite an issue of shares. These may also finance hire purchase of capital goods both to the dealer and the ultimate user. Such a department may have a Cost Accountant as in Australia, who can provide free of cost, expert advice on costing, budgeting and day-to-day problems of the borrowers.[30]

But these activities spark two questions. The first one is, should a Central Bank invest its funds in long-term investments? The second one is, Should the Central Bank itself grant long-term loans and advances? The orthodox opinion is that, the Central Bank should never invest in long term. But Central Banks everywhere are authorised to invest in long-term government securities. And this does not indicate a locking up of funds in long-term investments. Moreover, in many countries Central Banks have invested their funds in purchasing shares of institutions established for the purpose of supplying long-term finance. For example, the Bank of England is a shareholder of the Agricultural Mortgage Credit Corporation set up in 1929. The Netherlands Bank participated in the capital stock of the company for the Financing of National Reconstruction of September, 1945.[31] However, the great weight of tradition is against the Central Bank's undertaking of any such long-term financing. A really important objection arises on the grounds of discrimination and political controversy. If the Central Bank undertakes the function of financing industrial development, it renders itself open to charges of discrimination and favouritism, and may become involved in political controversies.

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[30] *Ibid.,* pp. 245 & 246.

[31] *Ibid.,* pp. 246 & 247.

The second method of setting up separate institutions for meeting the needs of long-term finance goes with the tradition. According to this method, separate institutions are established with the participation of the Central Bank, commercial banks and other financial organisations. The Central Bank purchases some shares and nominates a number of directors of the institutions. This method has some certain advantages. As the Central Bank is required to invest a small portion of its assets in these concerns, so this participation does not threaten to render its position illiquid at any time. At the same time, the knowledge that the Central Bank and other banks are behind this organisation is likely to strengthen its position and make its bonds and debentures more attractive to the public. Again, as the funds to be invested in industrial finance would be raised from the market, instead of through the creation of Central Bank credit, so this method avoids the danger of inflation to a large extent.[32]

This method has been adopted by United Kingdom, Canada, India, South Africa, etc.[33]

2.4.4 Measures for the Under-Served Sectors

In the developing countries, the under-served sectors, especially agriculture, considering its contribution in the economy needs institutional financing. As these sectors are generally not proved to be credit-worthy to the commercial banks, cautious intervention of the Central Bank in financing in these sectors is imperative. The developed countries like USA, Australia and New Zealand recognised this necessity much earlier.

The Federal Reserve Act contained two special provisions for rural financing. The first one was that, it authorised the Federal Reserve Banks to rediscount agricultural bills with a maturity of six months (later raised to nine months), while the maximum maturity for the ordinary trade bills was only three months. The extra period of maturity was provided recognising the farmer's need for working capital usually for a longer period than in the case of ordinary commercial transactions. The second provision was to enable the Federal Reserve Banks to rediscount or grant loans against warehouse receipts

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[32] *Ibid.,* pp. 249 & 250.

[33] *Ibid.*

evidencing the storage of durable agricultural commodities with a maturity of nine months. This was done in favour of the orderly marketing of agricultural products, to enable the Federal Reserve System (FRS) to meet the extraordinary demands for the marketing of crops. Moreover, through this provision, the FRS would be able to establish a link between itself and the machinery of agricultural credit without the intermediary of the commercial banks.[34] In some countries including India, Central Banks have sought to aid rural credit by charging a lower rate for rediscounting of agricultural paper than the fixed rate for the ordinary rediscounts.[35]

But the effectiveness of these methods in carrying the flow of Central Bank credit into the channels of agriculture depends on two vital factors. The first one is, the extent of usage of agricultural finance in the form of rediscountable bills and the second one is, the efficiency of the organisation of ware-housing in the respective country. Financing through bills of exchange is practically non-existent in the developing countries with a few exceptions. At the same time, while a system of warehouses exist in some countries, most of them lack such an organisation. In the developing countries in general the sectors are not properly organised and integrated into the money market structure. So, in these countries, the methods of financing the under-served sectors depending on bills of exchange are less likely to be effective. The Indian experience is a good testimony in this regard. In January 1938, the Reserve Bank of India, to finance agriculture framed a scheme offering rediscount facility at concessional rates through the scheduled banks the bills of approved moneylenders who were the most important agency for the supply of credit to the agriculturists. The Reserve Bank put the conditions that these bills should be drawn for making advances to the farmers against the security of produce, and that the benefits of the concessional rates should be passed on to the farmers. But the scheme failed on account of the fact that, in India, the ordinary farmers did not borrow against the security of their produce. They used to borrow more for meeting the expenses of production than for the marketing of crops. In the subsequent years, the Reserve

[34] E. S. Sparks, *History and Theory of Agricultural Credit in the United States* (New York: Thomas Y. Crowell Company, 1932), pp. 318-324.

[35] Sen, *Central Banking, op. cit.,* p. 236.

Bank adopted a number of similar schemes. But to all these schemes the response was very poor.[36]

In Australia, the Central Bank intervention in financing agriculture has been proved successful. In 1925, the commonwealth Bank set up a separate Rural Credits Department to finance agriculture directly. The department is an agency for the grant of loans, on special terms, to co-operative associations and marketing bodies. The Rural Credits Department grants loans only upon the security of primary produce placed under the legal control of the Bank, and upon such other security associated with the production or marketing of primary produce as the Bank thinks fit. The rates of interest charged in this department have been lower than those operative in the General Banking Division of the Bank. The loans are essentially short-term in nature and are granted to enable the mentioned organizations to pay the primary producers for commodities as they are delivered, and to provide for the orderly marketing of produce.[37]

This sort of intervention raises one basic question- is it desirable for a Central Bank to grant direct loans to agriculture or any other sector? In the defence, it has been argued that, the Central Bank may conduct ordinary banking business if that becomes necessary for maintaining contact with the money market. It has also been suggested that, such ordinary banking business might be done through either a separate department or a separate institution.[38] So, granting direct loans to agriculture or other under-served sectors is justified as an instrument of contact, information and control in the respective fields. But at the same time, the limits to such operations should be carefully maintained. The Central Bank can grant direct loans only if the sector under consideration is organised on a large scale and is in a position to provide good credit-worthy borrowers. Where the sector is not so organised, there should exist proper organisations for marketing or other purposes to which the Central Bank can extend credit with safety.[39]

[36] *Ibid.,* pp. 238-39.

[37] *Ibid.,* pp. 240-42.

[38] *Ibid.,* pp. 242-43.

[39] *Ibid.,* p. 243.

2.4.5 Selective Credit Policy

Theoretically selective credit policy refers to one of the following two acts:[40]

(a) the attempt to influence general credit conditions by a policy tool other than changes in the magnitude of claim against the Central Bank;

(b) the use of a policy tool to channel credit to a particular financial market, hence (although, not necessarily) to a particular real market.

We take the second one for our analysis.

In an economy all the sectors are not equally important for the realization of national economic objectives and all the sectors are not in equal need of credit. Considering this reality, some sectors are declared as 'priority sectors' by the state and these sectors are treated discriminatorily in favour of them. A Central Bank may pursue selective credit policy to finance the priority sectors, identified for the respective economy. This policy serves restriction or facilitation of granting credits by the commercial banks or other financial institutions.

The Central Bank may adopt various methods for selective credit policy. The Bank may establish different required reserve ratios for different types of banks and other financial mediators. The basis of selection here is the character of the financial institutions. A second method is the use of differentiated discount rates and other refinancing conditions. The main theme of this method is to apply preferential discount rates (for the sake of simplicity all sorts of refinancing are treated under this term) for the securities of the targeted sectors, while there is a generally used discount rate, applicable to the other sectors. The third method is to impose loan quotas. According to this method, the activity of certain types of financial institution is restricted by the establishment of quotas, while for other financial institutions no such quotas are established. As the fourth method, the Central Bank can give directives to the commercial banks and other financial institutions. Practically, these are instructions from the Central Bank to the banks and furthermore are agreements of voluntary and informative nature.[41]

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[40] William L. Silber, " Selective Credit Policies, A Survey", *Banca Nazionale del Lavora Quarterly Review,* 1973, pp. 328-351, cited in Ligeti, "Selective Credit Policy", *op. cit.,* pp. 234-310.

[41] Ligeti, "Selective Credit Policy", *op. cit.,* pp. 234-310.

2.4.6 Catalyst and Innovator

It is very important for the Central Banks of the developing economies to play the role of catalyst and innovator with development objectives. The Bank can perform this role in many areas in versatile ways.

2.4.6.1 Stimulate Financial Saving

To stimulate financial saving, the Central Bank can adopt several institutional and policy measures. These measures are discussed below in brief.

2.4.6.1.1 Widen Functional Scope of the Commercial Banking System

Along with extending banking services, the Central Bank can work on widening the functional scope of the commercial banking system. The Central Bank can induce the commercial banks not to confine themselves only to purveying credit and deposit mobilization, but also to provide entrepreneurial and managing guidance to the underserved areas like agriculture and small industry.[42]

2.4.6.1.2 Devise Attractive Financial Instrument

To stimulate financial saving, it is imperative to make the deposit schemes attractive to the potential savers. The Central Bank should pay attention in devising such deposit schemes which are linked to the basic motives to save. Experience has revealed that, savers are likely to prefer financial instruments which are simple, convenient and easily intelligible; at the same time which do not involve transaction costs and can be easily and without loss converted into money. Apart from this link of deposit schemes with saving motives, some schemes should also be linked with certain services desired by the savers. Thus, the real return on deposits- other than interest would be sufficiently attractive to induce savers to prefer this form of financial asset to private lending or other physical assets like gold, real estate, commodity inventories etc.[43]

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[42] For more see, V. V. Bhatt, *Structure of Financial Institutions* (Bombay: Vora & Co., 1972).

[43] Bhatt, 'Some Aspects of Financial Policies", *op. cit.,* p. 63.

2.4.6.1.3 Expand the Coverage of Existing Schemes and Policies

Some schemes and policies have already been proved attractive in the developing countries. Compulsory provident fund is one such scheme which is quite popular in countries like Malaysia, India and Bangladesh. The Central Bank may introduce such schemes to cover wage and salary earners in all the possible sectors. Social security deposits have been proved preferred asset in both developed and developing countries. The Central Bank may explore possible ways to exploit the full potential of such deposits.[44] Savers also prefer insurance policies. Life insurance facilities may be expanded. For farmers, crop insurance instead of life insurance is apprehended to be more preferred. Compulsory crop insurance schemes- that are attractive to the farmers may be introduced. Further, some bank deposit schemes can be linked with life insurance as well as crop insurance.[45]

Some favourable policy decisions of the Government may make the initiatives of the Central Bank more effective. In a number of countries including Bangladesh, provident fund subscriptions and insurance premiums are deductible for the purpose of income tax calculation. The Government can widen the scope of deduction by including all financial savings other than that in the form of currency and gold.[46]

2.4.6.1.4 Generate Confidence in the Financial Sector

It is the responsibility of the Central Bank to ensure that the evolving banking system is viable and its practices are sound. For this purpose, the Central Bank should perform its regulatory and supervisory functions properly, carry on regular off-site and on-site inspections. It should also ensure that the core principles are maintained by the commercial banks and other financial institutions satisfactorily.

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[44] *Ibid.*

[45] *Ibid.*

[46] Joseph A. Schumpeter, *Capitalism, Socialism and Democracy,* (3rd ed.; New York: Harper Torchbooks, 1962), pp. 423-24.

2.4.6.2 Financial Inclusion and Reorientation of Goals of Financial Institutions

Central Banks can play catalytic and innovative role in the reorientation of goals and objectives of financial institutions towards socially responsible lending practices ensuring adequate credit flows to small businesses and other underserved or financially excluded economic sectors and population segments.[47] Deepening and widening of financial inclusion create opportunities for upholding domestic output and demand, raising real wage and employment. Central Banks are in a position, capable of guiding the financial sector towards socially and environmentally responsible financing by sensitizing banks and financial institutions about their Corporate Social Responsibilities (CSR). This can be done by moral suasion and/ or issuing and implementing necessary circulars for mainstreaming of CSR obligations in the corporate goals and objectives of the banks and financial institutions. Central Banks may keep campaigning on financial inclusion offering basic financial services at the doorstep of all people and channeling adequate credit flows to the productive pursuits, prospective for the respective economy.[48]

2.4.7 Other Promotional Functions

Besides the above listed functions, the Central Bank of a developing country can perform some other promotional functions which have significant bearing on the economy. These functions include: (a) provide guidelines to be followed by the planners about some definite patterns of economic and investment policies; (b) publish information regarding the state of the economy; (c) promote research in money and banking; (d) provide training for the bank officials; etc.

2.5 Challenges

The Central Banks face a good deal of challenges and obstacles in playing their promotional role in the developing economies. These challenges origin from the inherent characteristics of the developing countries and substantially reduce the efficacy of the instruments employed by the Banks.

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[47] Atiur Rahman, "Poverty and Grassroots Entrepreneurship", Bangladesh Bank Governor's lecture delivered as special guest at IGC South Asia Growth Conference on 15 July 2012, held at Dhaka, Bangladesh.

[48] *Ibid.*

Monetary Policy pursued by the Central Bank in the developing economies has some basic limitations. It is evident from experience that, the monetary structure of a country often limits the chance of the Central Bank to exercise any real power over the economy.[49] Two basic instruments in the disposal of the Central Bank, the bank rate and open market operations become practically prohibitive due to many reasons.[50]

Monetary Policy becomes effective where the government has, by and large, balanced budgets and exchange rate stability is the primary concern of the policy, which now no longer exist.[51] Moreover, with the other domestic objectives like full employment and development becoming dominant, governments have become aware of the monetary implications of Fiscal Policy. Monetary Policies thus have become secondary to Fiscal Policies in the developing world.[52]

Real limitations on Central Bank arise as a result of:[53]

(a) excessive reliance of the Government on Central Bank credit; and

(b) lack of integration of money and capital markets.

While the second limitation can be overcome with the geographical and functional extension of the banking system, the first one is beyond the control of the Central Banks in the developing countries.

This expected role of a Central Bank to be performed in a developing economy requires a stable and liberal monetary system and climate.[54] There are many pre-requisites among which substantial if not full autonomy of the Bank is a vital one. History of the developed countries suggests that these requirements take a long time to be fulfilled and substantial power and influence come only very slowly. The Bank of England itself took long two hundred years to grow up.[55] At present, virtually no Central Bank of the developing world enjoys full autonomy.

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[49] Sayers, "Central Banking in Underdeveloped Countries", *op. cit.,* p. 113.

[50] These reasons have been discussed in detail in Chapter IV of this dissertation.

[51] Bhatt, 'Some Aspects of Financial Policies", *op. cit.,* p. 66.

[52] *Ibid.*

[53] *Ibid.,* p. 65.

[54] Chandavarkar, "Promotional Role of Central Banks", *op. cit.,* p.iii.

[55] Sayers, "Central Banking in Underdeveloped Countries", *op. cit.,* p. 115.

2.6 Conclusion

Generally the Central Bank's primary concern is conceived to be the regulation of the money market. But central banking has to be thought of quite differently in the developing countries where the financial system has yet to evolve to a stage, reached in the developed countries. In these countries, Central Banks are obliged to assume some responsibilities for encouraging and even undertaking the financing of the development of the resources of the country. They are to extend their activities into other sectors of the money market, besides the commercial banks, into sectors which are inadequately developed. Even incursions into the domain of long-term finance, which is traditionally regarded as lying outside the legitimate interests of Central Banks, are also necessary. Thus in the developing countries the role of the Central Banks has to be changed from an agency of regulation to one of development. At the same time, Central Banks should be aware of the potential problem of harmonization between the regulatory and developmental objectives as the two objectives may conflict. Although in course of business a Central Bank generates profit, it cannot be regarded as a profit centre concerned with the maximization of profit.

There must be patience while expecting the desired role from the Central Bank in a developing economy. Allowance should be given to the Central Bank to be venturesome in the kind of business it is willing to handle, even at the cost of making some mistakes.[56]

The next chapter deals with the origin, structure, functions and growth trend of Bangladesh Bank.

[56] *Ibid.*

CHAPTER III

ORIGIN, STRUCTURE, FUNCTIONS AND GROWTH TREND OF BANGLADESH BANK

3.1 Origin of Bangladesh Bank

The history of banking in the South Asian region dates back to the early eighteenth century. The major landmark was the establishment of the Hindustan Bank in 1770 in Kolkata. In 1846 Dhaka Bank started operation. During the British period, a number of banks were established in this region. These include Kurigram Bank in 1887, Kumarkhali Bank in 1896, Mahalaxmi Bank and Chittagong Bank in 1910 Comilla Union Bank in 1922.[1] Another bank established during this period was Presidency Bank in 1876, later renamed as Imperial Bank in 1921. This bank performed the functions of a Central Bank, besides, doing commercial banking. By that time many new Central Banks were being established in the world elsewhere. In many cases these new Central Banks came out of some sort of crisis to resolve. In 1882 the Bank of Japan was set up to restore order out of the chaos caused by the excessive issue of notes by the several national banks. The financial panic of 1907 laid down the foundation of the Federal Reserve System (FRS) in the USA in 1914.[2]

The Federal Reserve System soon succeeded in working its way into the financial system of the USA and proved to be of great benefit and assistance to the Government and the banks during the war and post-war period. The success of the FRS played an important part in focusing attention on the desirability of having a central banking system in any country. Moreover, the International Financial Conference, held at Brussels in 1920, passed a resolution implying that, all countries which had not yet established a Central Bank should proceed to do so as soon as possible.[3] In this line of development, Reserve Bank of India was

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[1] M. Zainul Abedin, *Commercial Banking in Bangladesh* (Dhaka: NILG, 1990), pp. 47-51.

[2] M.H.de Kock, *Central Banking* (4th ed., Delhi: Universal Book Stall, 1995), pp. 7-9.

[3] *Ibid.,* p. 9.

established in 1935. State Bank of Pakistan was set up in 1948. The State Bank of Pakistan had two wings; the Eastern wing in the then East Pakistan and the Western wing in the West Pakistan.

After the independence of Bangladesh, the officers, branches and assets of the State Bank of Pakistan in the Eastern wing were declared to be deemed as those of Bangladesh Bank under the Bangladesh Banks (Temporary) Order, 1971 (Acting President's Order. 2 of 1971), promulgated by the Government. All currency notes and coins in circulation of Bangladesh, issued by the said State Bank and the Government of Pakistan were also deemed to have issued by the Bangladesh Bank or, as the case may be, by the Government of Bangladesh and continue as legal tender in Bangladesh until otherwise directed[4]. Bangladesh Bank came into existence on the 31st October 1972 under the Bangladesh Bank Order 1972 (President's Order No. 127 of 1972), which took effect on the 16th December 1971.[5]

3.2 Structure of Bangladesh Bank

The structure of Bangladesh Bank has been discussed below.

3.2.1 Management of Bangladesh Bank

The paid up capital of Bangladesh Bank is Taka 30 million divided into 300,000 shares of Taka 100 each that are fully paid by the Government.[6] A nine member Board of Directors, which is the highest policy making body, directs the affairs and business of Bangladesh Bank. The Board consists of the Governor as Chairman, a Deputy Governor, three senior government officials and four persons having experience and proven capacity in the fields of banking, trade, commerce, industry or agriculture. All of the members are nominated by the government. The Governor as the chief executive officer directs and controls all of the affairs of the Bank on behalf of the Board.[7] The Governor holds office for a

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[4]M. Abul Bashar Bhuiya, *Bangladesh Laws on Banks and Banking* (2nd ed., Dhaka: CKB and Co., 1996), p. 13.

[5]*Banglapedia,* Vol. 1, ed. by Sirajul Islam (Dhaka: Asiatic Society of Bangladesh, 2003), s.v. "Bangladesh Bank" by S M Mahfuzur Rahman, p. 468.

[6] *Ibid*, p. 469.

[7] Bangladesh Bank, *Bangladesh Bank Order 1972* (Dhaka: Department of Public Relations and Publications, Bangladesh Bank, 2003), pp. 5-6.

period of four years and is eligible for re-appointment. He can serve to the age of 65.

Bangladesh Bank has a certain hierarchy, which also serves as the career path for its officers. As the Governor is appointed by the Government from outside of Bangladesh Bank, the highest position a Bangladesh Bank staff can hold is Deputy Governor. The hierarchy of Bangladesh Bank has been presented in Diagram I-1.

Diagram III-1

Hierarchy of Bangladesh Bank

Governor

↓

Deputy Governor

↓

Executive Director/ Economic Adviser

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General Manager/ Systems Manager

↓

Deputy General Manager/ Senior Systems Analyst/ Principal Maintenance Engineer

↓

Joint Director/ Joint Manager/ Systems Analyst/ Sr. Programmer/
Senior Maintenance Engineer/ Operation Manager/ Asstt. Chief Medical Officer

↓

Deputy Director/ Deputy Manager/ Programmer/ Maintenance Engineer/
Computer Operation Supervisor/ Sr. Medical Officer

↓

Assistant Director/ Assistant manager/ Assistant Programmer/
Assistant Maintenance Engineer/ Sr. Computer Operator/ Medical Officer

↓

Officer/ Cash Officer/ Data entry/ Control Supervisor

Source: www.bangladesh-bank.org/aboutus/bbhierarchy.php

3.2.2 Departments

The Head Office of Bangladesh Bank is situated at Motijheel of Dhaka. At present, Bangladesh Bank has ten branches allover the country. Among the ten branches, two are situated in Dhaka city, one at Motijheel and the other at Sadarghat; the rest eight branches are situated in Barisal, Bogra, Chittagong, Khulna, Rajshahi, Rangpur, Sylhet. For carrying on its functions, the Bank is organized into several Departments at the Head Office. The number of the Departments is not fixed; rather to address the changing needs of the day some new Departments are launched. Some times one Department is reorganized or split into two or more Departments. At the same time some Departments are merged with other ones. At present there are forty three Departments at the Head Office. Those are: Accounts and Budgeting Department, Agricultural Credit & Financial Inclusion Department, Bangladesh Bank Training Academy, Bangladesh Financial Intelligence Unit, Banking Regulation & Policy Department, Central Bank Strengthening Project Cell, Chief Economist's Unit, Common Services Department-1, Common Services Department-2, Credit Information Bureau, Debt Management Department, Department of Banking Inspection-1, Department of Banking Inspection-2, Department of Banking Inspection-3, Department of Communications and Publications, Department of Currency Management, Department of Financial Inclusions and Markets, Department of Foreign Exchange Inspection, Department of Off-site Supervision, Deposit Insurance Department, Equity and Entrepreneurship Fund Unit, Expenditure Management Department, Financial Integrity and Customer Services Department, Financial Stability Department, Foreign Exchange Investment Department, Foreign Exchange Operation Department, Foreign Exchange Policy Department, Forex Reserve & Treasury Management Department, Governor's Secretariat, Human Resources Department-1, Human Resources Department-2, Information Systems Development Department, Internal Audit Department, Investment Promotion and Financing Facility Project Cell, IT Operation & Communication Department, Law Department, Monetary Policy Department, Payment Systems Department, Research Department, Security Management Department, SME & Special Programmes Department, Special Studies Cell, Statistics Department.[8]

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[8] www.bangladesh-bank.org/aboutus/depts.php

The total manpower of Bangladesh Bank is 4951 (officials 3961, subordinate staff 990) as on November 30, 2012.

3.2.3 Co-ordination Council and Executive Committee

Bangladesh Bank is reportable to a Co-ordination Council, which is chaired by the Minister for Finance. The Council consists of the following members: [9]

Table III-1

Composition of Co-ordination Council

Sl No.	Designation of the Members	Position on the Council
1)	Minister for Finance	Chairman
2)	Minister for Commerce	Member
3)	Governor, Bangladesh bank	Member
4)	Secretary, Finance Division, Ministry of Finance	Member
5)	Secretary, Internal Resources Division, Ministry of Finance	Member
6)	Member (Programming), Planning Commission	Member

The Co-ordination Council co-ordinates the macro-economic framework including fiscal, monetary and exchange rate strategies and policies. The Council is to ensure consistency among macro-economic targets of growth, inflation and fiscal, monetary and external accounts. It is the duty of Bangladesh Bank to ensure that the macro-economic framework as coordinated by the Co-ordination Council, is reflected in the policies of the Bank. Bangladesh Bank places the following things before the Council:[10]

(a) relevant data relating to monetary expansion and Government borrowing from the banking system; and

(b) the assessment of the Bangladesh Bank regarding the impact of economic policies of the Government on monetary aggregates and balance of payments.

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[9] Bangladesh Bank, *Bangladesh Bank Order 1972* (Dhaka: Department of Public Relations and Publications, Bangladesh Bank, 2003), p. 5.

[10] *Ibid.*, pp.5-6.

There is an Executive Committee for the Bank consisting of the Governor and three Directors of the Board of Directors to deal with and decide any matter within the competence of the Board when the Board is not in session.[11]

3.2.4 Legal Framework

The legal framework of Bangladesh Bank is supported by the Bangladesh Bank Order 1972.[12] Besides this Order, a set of laws, regulations and guidelines have been enacted and promulgated time to time since the establishment of Bangladesh Bank, which empowered the Bank to perform its role as a Central Bank particularly, to control and regulate the country's monetary and financial system. Among those, the important laws and acts include:

(1) Bank Company Act 1991;

(2) The Negotiable Instruments Act 1881;

(3) The Bankers Book Evidence Act 1891;

(4) Foreign Exchange Regulation Act 1947;

(5) Financial Institutions Act 1993;

(6) Bank Deposit Insurance Act 2000;

(7) Money Loan court Act 2003;

(8) Money Laundering Prevention Act 2012;

(9) Anti-terrorism Act 2000;

(10) Anti-terrorism (Amendment) Act 2012; and

(11) Bangladesh Bank (Amendment) Act 2003.

The regulations and guidelines broadly include the Bangladesh Bank Regulations and Foreign Exchange Regulations.[13]

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[11] *Ibid.,* pp. 7-8.

[12] Sadiqunnabi Choudhury, "Monetary Policy in Bangladesh-Should We Go for Inflation targeting?" *Journal of the Institute of Bankers Bangladesh,* vol. 51, no.2 (July-December 2004), p.119.

[13] www.bangladesh-bank.org/aboutus/regulationguideline/lawsnacts.php,

3.3 Functions of Bangladesh Bank

Historically the Central Bank mandate in Bangladesh has been of broad nature. The functions of Bangladesh Bank are embodied in the Bangladesh Bank Order 1972. According to this Order, the main functions of the Bangladesh Bank are as follows: [14]

(a) to regulate the issue of the currency and the keeping of reserves;
(b) to manage the monetary and credit system of Bangladesh with a view to stabilizing domestic monetary value;
(c) to preserve the par value of the Bangladesh Taka;
(d) to promote and maintain a high level of production, employment and real income in Bangladesh;
(e) to foster growth and development of the country's productive resources for the national interest.

It is evident that, Bangladesh Bank had been entrusted with a wide range of functions. Some amendments were incorporated in Bangladesh Bank Order 1972 in the year 2003 under the Bangladesh Bank (Amendment) Act, 2003 and the functions were modified substantially. The amended Act of 2003 is even broader. According to the Bangladesh Bank (Amendment) Act 2003, the functions of Bangladesh Bank are as follows: [15]

(a) to formulate and implement monetary policy;
(b) to formulate and implement intervention policies in the foreign exchange market;
(c) to give advice to the Government on the interaction of monetary policy with fiscal and exchange rate policy, on the impact of various policy measures on the economy and to propose legislative measures it considers necessary or appropriate to attain its objectives and perform its functions;
(d) to hold and manage the official foreign reserves of Bangladesh;

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[14] Bangladesh Bank, "Notes on the Monetary Policy Strategy of the Bangladesh Bank", Policy Note Series: PN 0602, Vol.1, no.2 (Dhaka: Policy Analysis Unit, Research Department, Bangladesh Bank, October 2005), p.2.

[15] Bangladesh Bank, *Bangladesh Bank Order 1972*, *op. cit.,* pp. 4-5.

(e) to promote, regulate and ensure a secure and efficient payment system, including the issue of bank notes;

(f) to regulate and supervise banking companies and financial institutions.

The newer piece of legislation allowed even greater freedom to the Central Bank in terms of the Monetary Policy formulation, but hints at a pro-active stance regarding the exchange management. However, with the Bangladesh Taka having been successfully floated on May 31, 2003, the market is expected to bring about any necessary adjustment in the exchange rate prompted by economic fundamentals. Consequently, Bangladesh Bank is left with the residual responsibility to smoothen the short-term volatility in the exchange rate. It is noteworthy that, the analysis of the interaction between Monetary Policy and Fiscal Policy was incorporated as a major responsibility of the Central Bank in the 2003 amendment.[16]

However, the Bangladesh Bank mentions in its own publications that it performs all the core functions of a typical monetary and financial sector regulator, and a number of other non core functions. The major functional areas mentioned in the official website of the Bank include:[17]

(1) Formulation and implementation of monetary and credit policies.

(2) Regulation and supervision of banks and non-bank financial institutions, promotion and development of domestic financial markets.

(3) Management of the country's international reserves.

(4) Issuance of currency notes.

(5) Regulation and supervision of the payment system.

(6) Acting as banker to the Government .

(7) Money Laundering Prevention.

(8) Collection and furnishing of credit information.

(9) Implementation of the Foreign exchange regulation Act.

(10) Managing a Deposit Insurance Scheme.

It is worth mentioning here that, the functions mentioned in the official website of the Bank were found little different at different times when the researcher visited.

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[16] Bangladesh Bank, *Monetary Policy Review*, Vol.1, no.1 (Dhaka: Policy Analysis Unit, Research Department, Bangladesh Bank, October 2005), p.13.

[17] http://www.bangladesh-bank.org/aboutus/index.php

Recently Bangladesh Bank announced its vision and mission explicitly in its website and in some other publications. The vision and mission of the bank are as follows:

Vision

Bangladesh Bank states its vision as to develop continually as a forward-looking central bank with competent and committed professionals of high ethical standards, conducting monetary management and financial sector supervision to maintain price stability and financial system robustness, supporting rapid broad based inclusive economic growth, employment generation and poverty eradication in Bangladesh.[18]

Mission

The mission of Bangladesh Bank is to carry out the following main functions as the country's central bank:[19]

(I) Formulating monetary and credit policies;

(II) Managing currency issue and regulating payment system;

(III) Managing foreign exchange reserves and regulating the foreign exchange market;

(IV) Regulating and supervising banks and financial institutions, and advising the government on interactions and impacts of fiscal, monetary and other economic policies.

It has been observed that, functions of the same institution i. e., Bangladesh Bank are enunciated differently in different places, though they are not much differentiated from each other.

The functions of Bangladesh Bank are akin to those performed by any Central Bank in the world. Formulation of Monetary Policy is one of the key functions of Bangladesh Bank. Monetary Policy in Bangladesh is formulated around price stability and economic growth rates as the basic policy targets. Levels and growth paths of the relevant monetary aggregates such as reserve money; broad money and domestic credit are projected and monitored as

[18] www.bangladesh-bank.org/aboutus/bbind_dtl.php?contentid=2

[19] *Ibid.*

intermediate targets in conducting Monetary Policy.[20] Bangladesh Bank employs a judicious mix of instruments to achieve the targets. The instruments include Bank Rate, *Repurchase Agreement (Repo)* and *reverse repo* interest rates of Bangladesh Bank, the Cash Reserve Requirement (CRR), Statutory Liquidity Ratio (SLR), credit control and credit rationing. Before the implementation of FSRP, Monetary Policy in Bangladesh was conducted with full direct control on interest rates and exchange rates, as also on the volumes and directions of credit flows. With the implementation of Financial Sector Reform Project (FSRP), the emphasis has been shifted to indirect instruments of monetary management and market determined interest rates. Until the earlier months of FY2005, Bangladesh Bank continued with the growth supportive accommodative monetary stance. But the demand stimulus from the accommodative stance led to strong credit growth and balance of payments pressure, the later aggravated by continuing oil import price hike. In this perspective, Bangladesh Bank adopted tightened monetary stance in the second half of FY2005[21] which is still in effect.

Bangladesh Bank acts as the banker of the banks and stands as the 'lender of last resort' in crises. It keeps deposits of the scheduled banks. The Bank regulates and supervises different aspects of the banking companies and for this purpose formulates different policies and guidelines, imposes instructions and restrictions on the banking sector; It also revises the policies from time to time to serve the changing situations and to achieve international standard. Significant changes have been occurred in the role of Bangladesh Bank under FSRP.

Bangladesh Bank is also the banker to the Government. It is obliged to accept all deposits and collect money for the Government and the local authorities free of charge. It manages the public debt and makes advances to the Government. Bangladesh Bank holds Government securities, treasury bills and bonds and renders necessary advices to the Government.

Bangladesh Bank follows a "Fixed Reserve System" regarding note issue. According to this practice, of the total amount of assets of the Issue Department against the notes in circulation, assets of at least Taka 40.00 crore are held in

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[20] Bangladesh Bank, *Monetary Policy Statement July 13, 2006* (Dhaka: Bangladesh Bank), p.1.

[21] Bangladesh Bank, *Annual Report 2004-2005* (Dhaka: Bangladesh Bank, 2006), p. 22.

gold coins, silver bullion, Special Drawing Rights (SDR), Asia Monetary Units, Islamic Dinar or other approved foreign currencies. There is no upper limit for such holdings.[22]

Bangladesh has been a member of the International Monetary Fund (IMF) since 1972. Bangladesh Bank acts as both the fiscal agent and the depository agent for the IMF. As fiscal agent, Bangladesh Bank is authorized to carry out all operations and transactions with the Fund. As depository, Bangladesh Bank maintains the Fund's currency holdings and ensures that the assets and liabilities of Fund membership are properly reflected in its accounts and presented in its financial statements.[23]

3.4 Growth Trend of Bangladesh Bank

Growth trend of Bangladesh Bank has been analyzed with the help of growth of branch and working strength and growth trend of balance sheets of Banking and Issue departments of Bangladesh Bank. Growth of branch and working strength shows the physical growth of Bangladesh Bank. The balance sheet analysis of the Banking Department reflects the matrix of financial transaction of Bangladesh Bank, while the balance sheet analysis of the Issue Department gives the picture of the trend of Note Issue by Bangladesh Bank.[24]

3.4.1 Growth of Branch and Working Strength

In the year of establishment i.e., 1972, Bangladesh Bank had four branches through out the country. Two more branches were opened in 1974 increasing the number of branches to six. Six branches remained for three years till 1976. In the year 1977, one more branch was opened and the number of branches stood at seven. This number remained for long thirteen years till 1989. In the year 1990, the number of branches increased by two, making the number of total branches nine.[25] Till June 2012, no more branches were opened.[26] The growth trend of branches and employees of Bangladesh Bank is shown in Table III-2.

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[22] Wasim Md. Mazbahul Haque, "Financial Development in Bangladesh", unpublished Ph.D. Thesis (Rajshahi: Institute of Bangladesh Studies, Rajshahi University, 2004), p.79.

[23] Bangladesh Bank, *Annual Report 2004-2005, op.cit.,* p.115.

[24] Haque, "Financial Development", *op.cit.,* pp. 80, 88.

[25] Bangladesh Bank, *Economic Trends,* various issues (Dhaka: Statistics Department, Bangladesh Bank).

Table III-2

Number of Branches and Employees of Bangladesh Bank

Period	No. of Branches	No. of Employees
1972-73	4	2,562
1973-74	4	2,693
1974-75	6	2,854
1975-76	6	3,106
1976-77	6	3,411
1977-78	7	3,654
1978-79	7	3,944
1979-80	7	4,099
1980-81	7	4,448
1981-82	7	4,565
1982-83	7	4,584
1983-84	7	5,082
1984-85	7	5,267
1985-86	7	5,524
1986-87	7	5,568
1987-88	7	5,558
1988-89	7	5,756
1989-90	7	5,749
1990-91	9	6,076
1991-92	9	6,233
1992-93	9	6,497
1993-94	9	6,435
1994-95	9	6,345
1995-96	9	6,281
1996-97	9	6,215
1997-98	9	6,129
1998-99	9	6,178
1999-2000	9	6,061
2000-01	9	5,926
2001-02	9	5,769
2002-03	9	5,576
2003-04	9	5,461
2004-05	9	5,596
2005-06	9	5,481
2006-07	9	5,402
2007-08	9	5,304
2008-09	9	5,259
2009-10	9	5,071
2010-11	9	4,878

Source: Bangladesh Bank, *Economic Trends,* various issues.

The Table shows that, in FY 1972-73, the number of employees of Bangladesh Bank was 2,562. From then for the next fourteen years to FY 1986-87, the number of employees gradually increased. In FY 1986-87, the number of

[26] Bangladesh Bank opened its latest branch on 16 January 2013 at Mymensingh pulling the number of branches at ten.

employees was more than double than the number at the inception period of FY 1972-73. In FY 1987-88, for the first time the number of employees decreased, though by ten only. After that, the working strength of Bangladesh Bank fluctuated by minor values in different years till FY 2010-11. In FY 1992-93, the number of employees reached to ever-highest 6,497. From FY 2004-05, the number of employees of Bangladesh Bank is on a decreasing trend. In FY 2010-11 the number was 4,878, which is less by 193 than the preceding FY 2009-10.

3.4.2 Growth Trend of Balance Sheets of Banking and Issue Departments

The general functions of Bangladesh Bank are carried out through two departments of the Bank, namely Banking Department and Issue Department. The growth trend of the Banking Department and the Issue Department are discussed below.

3.4.2.1 Banking Department

The functions of the Banking Department of Bangladesh Bank are similar to the functions of other commercial banks with the exception that it does not transact with general public but transacts with other financial institutions and with different Government concerns. This Department, unlike commercial banks does not aim to earn profit through transaction.[27] The Banking Department has two sides on its balance sheet viz., assets side and liabilities side. The components in the assets side are ‘notes & coin’, ‘bills purchased & discounted’, ‘balance abroad’, ‘loan & advances’, ‘government debtor balance’, ‘investment’ and ‘other assets’. On the other hand, the liabilities side is comprised of ‘paid up capital’, ‘other funds’, ‘deposits’, ‘bills payable’ and ‘other liabilities”. To trace the growth trend of Bangladesh Bank, both the assets side and the liabilities side of the balance sheet of Banking Department have been analyzed in the study.

3.4.2.1.1 Growth Trend of Assets of Banking Department

The components of assets of Banking Department are arranged in three categories on the balance sheet. The first category includes ‘Notes & Coin’, ‘Bills Purchased & Discounted’ and ‘balance abroad’. The second category includes

[27] Haque, “Financial Development in Bangladesh”, *op.cit.,* p. 80.

'Loan & Advances', 'Government Debtor Balance' and 'Investment'. The third category on the balance sheet includes 'Other Assets'. The first two categories are known as traditional assets, whereas the third one as non-traditional asset. The growth trend of assets is shown in Table III-3. The Table shows that, the consolidated amount in the first category, comprising of 'Notes & Coin', 'Bills Purchased & Discounted' and 'Balance Abroad' increased from Taka 1,710.8 million in the year 1975 to Taka 2,22,000.9 million in the year 2011 registering annual average SGR of 25.73 percent. The total amount in the second category comprising of 'Loan & Advances', 'Government Debtor Balance' and 'Investment' increased from Taka 3,856.0 million in the year 1975 to Taka 288382.1 million in the year 2011, registering an annual average SGR of 22.78 percent. The Table also shows that, the amount of 'Other Assets' in the third category was Taka 121.7 million in the year 1975, which gradually increased to Taka 331857.0 million in the year 2011, with the annual average SGR of 34.89 percent. The 'Total Assets' as a whole swelled from Taka 5,688.5 million in the year 1975 to Taka 842240.0 million in the year 2011 registering annual average SGR of 16.54 percent.

The above analysis depicts that the annual average SGR is more for 'Other Assets' than the other components of the balance sheet. It implies that, the growth rate of non-traditional assets was faster than that of traditional assets in the period under consideration.

Table III-3

Assets of Banking Department of Bangladesh Bank and Their Growth Pattern (Taka in million)

End of Period	Notes and Coin, Bills Purchased and Discounted, Balance Abroad	SGR Percentage of Notes and Coin, Bills Purchased, and Balance Abroad	Loan and Advances, Government Debtor Balance, Investment	SGR Percentage of Loan and Advances, Government Debtor Balance, Investment	Other Assets	SGR Percentage of Other Assets	Total Assets	SGR Percentage of Total Assets
1	2	3	4	5	6	7	8	9
1975	1710.8		3856.0		121.7		5688.5	
1976	3948.7	130.81	2847.8	-26.15	120.7	-0.82	6917.2	21.60
1977	2186.5	-44.63	4278.8	50.25	213.1	76.55	6678.4	-3.45
1978	3787.2	73.21	3777.0	-11.73	417.8	96.06	7982.0	19.52
1979	6164.1	62.76	4710.7	24.72	2002.5	379.30	12877.3	61.33
1980	6649.3	7.87	8682.7	84.32	1006.0	-49.76	16338.0	26.87
1981	6592.9	-0.85	12057.3	38.87	1216.3	20.90	19866.5	21.60
1982	7030.5	6.64	15357.1	27.37	3061.7	151.72	25449.3	28.10
1983	12500.9	77.95	9653.1	-37.14	5239.1	71.12	27403.1	7.68
1984	11214.1	-10.37	13694.0	41.86	4675.3	-10.76	29583.4	7.96
1985	9673.8	-13.74	20588.5	50.35	6075.2	29.94	36337.5	22.83
1986	7911.4	-18.22	16399.4	-20.35	8289.3	36.44	32600.1	-10.29
1987	27019.1	241.52	18013.9	9.84	9932.4	19.82	54965.4	68.61
1988	33441.4	23.77	14893.4	-17.32	12412.4	24.97	60747.2	10.52
1989	16769.3	-49.85	27442.4	84.26	13023.1	4.92	57234.8	-5.78
1990	24157.0	44.05	25465.6	-7.20	14727.3	13.09	64349.9	12.43
1991	50138.4	107.55	16674.1	-34.52	16367.4	11.14	83179.9	29.26
1992	61322.2	22.31	13355.4	-19.90	18469.2	12.84	93146.8	11.98
1993	74290.7	21.15	13808.8	3.39	22356.1	21.05	110455.6	18.58
1994	91632.9	23.34	17031.0	23.33	16688.7	-25.35	125352.6	13.49
1995	54200.8	-40.85	32774.2	92.44	16463.8	-1.35	103438.8	-17.48

(Continued to next page)

Table III-3 (Concluded)

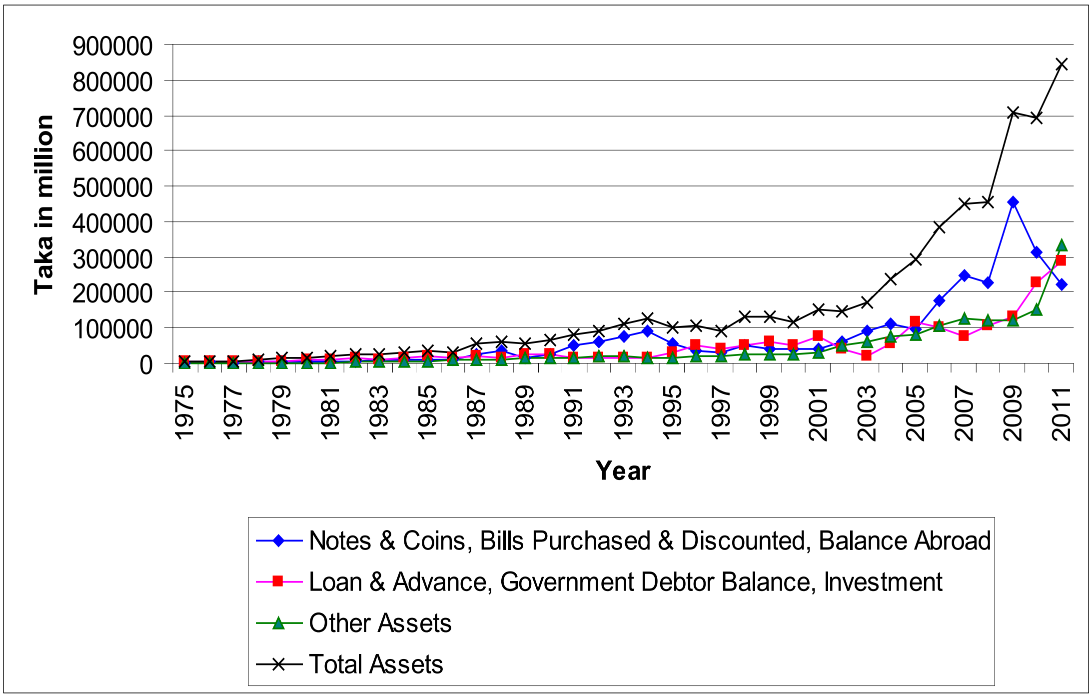
End of Period	Notes and Coin, Bills Purchased and Discounted, Balance Abroad	SGR Percentage of Notes and Coin, Bills Purchased, and Balance Abroad	Loan and Advances, Government Debtor Balance, Investment	SGR Percentage of Loan and Advances, Government Debtor Balance, Investment	Other Assets	SGR Percentage of Other Assets	Total Assets	SGR Percentage of Total Assets
1996	37297.5	-31.19	50040.2	52.68	18308.5	11.20	105646.2	2.13
1997	30274.4	-18.83	40398.6	-19.27	21151.7	15.53	91824.7	-13.08
1998	52496.9	73.40	51733.4	28.06	26247.6	24.09	130477.9	42.09
1999	42657.1	-18.74	62060.9	19.96	27245.9	3.80	131963.9	1.14
2000	40176.8	-5.81	49359.1	-20.47	26203.5	-3.83	115739.4	-12.29
2001	42036.5	4.63	78316.2	58.67	30223.8	15.34	150576.5	30.10
2002	59109.0	40.61	38125.0	-51.32	49912.0	65.14	147146.0	-2.28
2003	91565.0	54.91	17847.2	-53.19	61082.3	22.38	170494.5	15.87
2004	109493.8	19.58	56953.6	219.12	73513.5	20.35	239960.9	40.74
2005	95099.1	-13.15	115917.3	103.53	83330.6	13.35	294347.0	22.66
2006	175547.1	84.59	100099.5	-13.65	106653.3	27.99	382300.8	29.88
2007	247313.7	40.88	75654.7	-24.42	126215.2	18.34	449183.6	17.49
2008	229155.6	-7.34	107852.5	42.56	119321.4	-5.46	456329.5	1.59
2009	454922.4	98.52	131844.8	22.25	121441.1	1.78	708208.3	55.20
2010	315028.6	-30.75	225676.5	71.17	150824.9	24.20	691530.0	-2.35
2011	222000.9	-29.53	288382.1	27.79	331857.0	120.03	842240.0	21.79
Annual Average SGR		25.73		22.78		34.89		16.56

Source: Appendix: Table-2.

The trend pattern of different components of assets of Banking Department of Bangladesh Bank is shown in the following Figure III-1.

Figure III-1

Trend Pattern of Different Components of Assets of Banking Department of Bangladesh Bank



Source: Table III-3.

It is observed in the Figure that, all the components had overall rising trend, except some variations over the years. In 2010, absolute value of 'Notes and Coin, Bills Purchased and Balanced Abroad' fell dramatically from its peak, causing a reduction in the 'Total Assets' in that year. This component of the asset side of Banking Department continued the decreasing trend in 2011 also. But the increase in the other two components, especially a steep rise in the 'Other Assets' kept the 'Total Assets' moving uptrend.

3.4.2.1.2 Growth Trend of Liabilities of Banking Department

The components of liabilities of Banking Department are arranged in three categories on the balance sheet. The first category includes 'Paid up Capital' and 'Other Funds', the second category includes 'Deposits' and 'Bills Payable'. The third category on the balance sheet includes 'Other Liabilities'. The first two categories are known as traditional liabilities, whereas the third one as non-traditional liability. The growth trend of liabilities is shown in Table III-4.

Table III-4

Liabilities of Banking Department of Bangladesh Bank and Their Growth Pattern (Taka in million)

Year	Paid up Capital and Other Funds	SGR Paid up Capital and Other Funds	Deposits, Bills Payable	SGR Percentage of Deposits, Bills Payable	Other Liabilities	SGR Percentage of Other Liabilities	Total Liabilities	SGR Percentage of Total Liabilities
1	2	3	4	5	6	7	8	9
1975	182.5		2947.6		2558.4		5688.5	
1976	222.5	21.92	4552.6	54.45	2192.9	-14.29	6968.0	22.49
1977	262.5	17.98	4522.0	-0.67	1893.9	-13.63	6678.4	-4.16
1978	302.5	15.24	5101.5	12.82	2578.0	36.12	7982.0	19.52
1979	385.0	27.27	8579.2	68.17	3918.5	52.00	12882.7	61.40
1980	635.0	64.94	11068.6	29.02	4634.3	18.27	16338.0	26.82
1981	945.0	48.82	14074.2	27.15	4847.3	4.60	19866.5	21.60
1982	1255.0	32.80	18409.4	30.80	5784.9	19.34	25449.3	28.10
1983	1570.0	25.10	20974.4	13.93	4858.7	-16.01	27403.1	7.68
1984	1950.0	24.20	21282.1	1.47	6351.3	30.72	29583.4	7.96
1985	2330.0	19.49	24663.7	15.89	9343.8	47.12	36337.5	22.83
1986	2710.0	16.31	24447.9	-0.87	8112.2	-13.18	35270.1	-2.94
1987	3090.0	14.02	38778.8	58.62	13096.5	61.44	54965.4	55.84
1988	3470.0	12.30	43900.6	13.21	13376.6	2.14	60747.2	10.52
1989	3732.3	7.56	41423.0	-5.64	12079.5	-9.70	57234.8	-5.78
1990	4117.8	10.33	48299.9	16.60	11932.2	-1.22	64349.9	12.43
1991	4506.9	9.45	63319.8	31.10	15353.2	28.67	83179.9	29.26
1992	5965.9	32.37	76964.3	21.55	10216.6	-33.46	93146.8	11.98
1993	5428.5	-9.01	91619.7	19.04	13407.4	31.23	110455.6	18.58
1994	5808.4	7.00	98120.2	7.10	21424.0	59.79	125352.6	13.49
1995	5747.8	-1.04	74704.4	-23.86	22986.6	7.29	103438.8	-17.48

(Continued to next page)

Table III-4 (concluded)

Year	Paid up Capital and Other Funds	SGR Paid up Capital and Other Funds	Deposits, Bills Payable	SGR Percentage of Deposits, Bills Payable	Other Liabilities	SGR Percentage of Other Liabilities	Total Liabilities	SGR Percentage of Total Liabilities
1996	6427.9	11.83	76251.5	2.07	22966.8	-0.09	105646.2	2.13
1997	7107.9	10.58	60989.5	-20.02	23727.3	3.31	91824.7	-13.08
1998	7787.9	9.57	84397.3	38.38	38292.7	61.39	130477.9	42.09
1999	8467.9	8.73	82805.2	-1.89	40690.8	6.26	131963.9	1.14
2000	9147.8	8.03	61318.1	-25.95	45273.5	11.26	115739.4	-12.29
2001	9697.9	6.01	81363.5	32.69	59515.1	31.46	150576.5	30.10
2002	10248.0	5.67	75931.0	-6.68	60967.0	2.44	147146.0	-2.28
2003	10732.6	4.73	84018.9	10.65	75743.0	24.23	170494.5	15.87
2004	10797.8	0.61	89049.6	5.99	140113.5	84.99	239960.9	40.74
2005	10797.9	0.00	120751.2	35.60	162797.9	16.19	294347.0	22.66
2006	10797.9	0.00	147499.2	22.15	224002.8	37.60	382299.9	29.88
2007	10347.8	-4.17	171654.6	16.38	267181.2	19.28	449183.6	17.50
2008	23916.8	131.13	215406.6	25.49	217006.1	-18.78	456329.5	1.59
2009	31086.3	29.98	371738.0	72.58	305384.0	40.73	708208.3	55.20
2010	28638.9	-7.87	319682.2	-14.00	343208.9	12.39	691530.0	-2.35
2011	35778.1	24.93	344040.3	7.62	462420.7	34.73	842239.1	21.79
Annual Average SGR		17.69		16.41		18.46		16.41

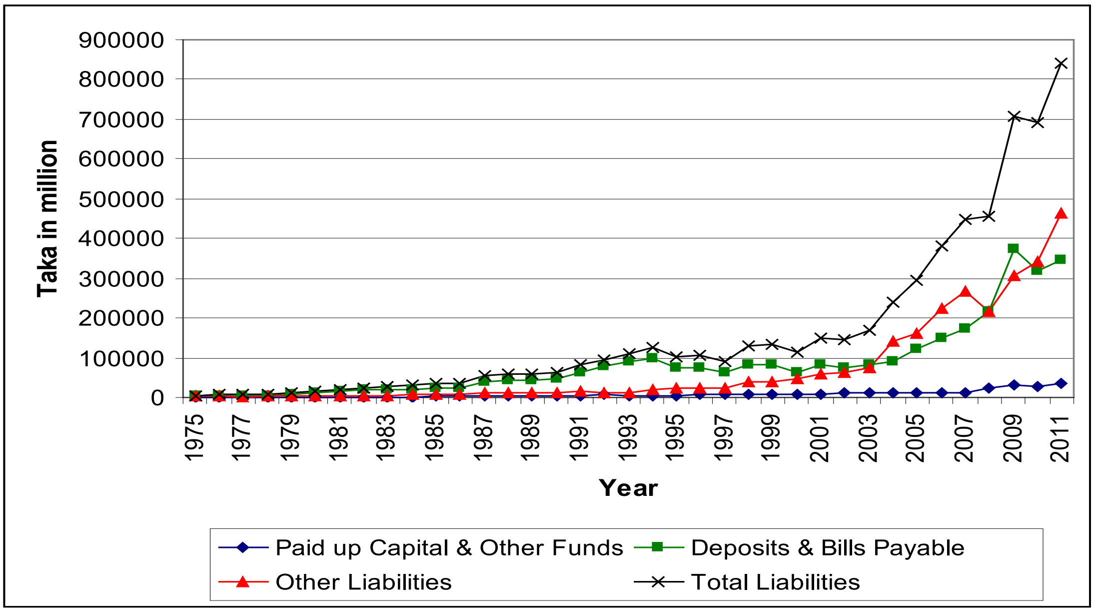
Source: Appendix: Table-3.

The Table shows that, the consolidated amount in the first category comprising of 'Paid up Capital and Other Funds' increased from Taka 182.5 million in the year 1975 to Taka 35778.1 million in the year 2011, registering an annual average SGR of 17.69 percent. The amount of 'Deposits' and 'Bills Payable' in the second category increased from Taka 2,947.6 million in the year 1975 to Taka 344040.3 million in the year 2011, registering an annual average SGR of 16.41 percent. The Table shows that, the amount of 'Other Liabilities' was Taka 2,554.4 million in the year 1975, which gradually increased to Taka 462420.7 million in the year 2011, with the annual average SGR of 18.46 percent. The 'Total Liabilities' as a whole swelled from Taka 5,688.5 million in the year 1975 to Taka 842239.1 million in the year 2011, registering annual average SGR of 16.41 percent.

The above analysis depicts that the annual average SGR is more for 'Other Liabilities' than the other components on the balance sheet. It implies that, the growth rate of non-traditional liabilities was faster than that of traditional liabilities. The trend pattern of different components of liabilities of Banking Department of Bangladesh Bank is shown in the Figure III-2.

Figure III-2

Trend Pattern of Different Components of Liabilities of Banking Department of Bangladesh Bank



Source: Table III-4.

It is observed in the Figure that, all the components have overall rising trend, except some variations over the years. A sharp fall in 'Deposits and Bills Payable' category in 2010 is evident in the Figure. This fall coupled with a moderate decline in 'Paid up Capital and Other Funds' in the same year made the 'Total Liabilities' decrease in the year under report. In 2011, all the components were on uptrend.

3.4.2.2 Issue Department

The function of Issue Department of Bangladesh Bank is to issue notes in the economy. The Issue Department has two sides on its balance sheet viz., assets side and liabilities side. Asset side of this Department shows the determinants of issued notes and the Liabilities side shows the total amount of issued notes.[28] The components in the asset side are 'Foreign Assets', 'Taka Coin', 'Securities of Bangladesh Government', 'Internal Bills of Exchange' and 'Other Commercial Papers'. On the other hand, the liabilities side is comprised of 'Notes in the Banking Department' and 'Notes in Circulation'. To trace the growth trend of Bangladesh Bank, both the assets side and the liabilities side of the balance sheet of Issue Department of the Bank have been analyzed in the study.

3.4.2.2.1 Growth Trend of Assets of Issue Department

All the components of assets of issue Department are brought under three categories. The first category includes 'foreign assets'. The second category includes 'taka coin'. The third category on the balance sheet includes 'Securities of Bangladesh Government', 'Internal Bills of Exchange' and 'Other Commercial Papers'. The growth trend of assets of Issue Department is shown in Table III-5.

The Table shows that, the amount of 'Foreign Assets' increased from Taka 700.0 million in the year 1975 to Taka 507622.4 million in the year 2011, registering annual average SGR of 29.51 percent.

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[28] *Ibid.,* p.88.

Table III-5

Assets of Issue Department of Bangladesh Bank and Their Growth Pattern (Taka in million)

End of Period	Foreign Assets	SGR of Foreign Assets	Taka Coin	SGR of Taka Coin	Securities of Bangladesh Govt., Internal Bills of Exchange, Commercial Papers and Silver Bullion	SGR of Securities of Bangladesh Govt., Internal Bills of Exchange, Other Commercial Papers and Silver Bullion	Total Assets	SGR of Total Assets
1975	700.0		87.9		2955.8		3743.7	
1976	1000.0	42.86	105.6	20.14	2815.9	-4.73	3921.5	4.75
1977	2000.0	100.00	101.2	-4.17	3156.4	12.09	5257.6	34.07
1978	2000.0	0.00	47.2	-53.36	4686.5	48.48	6733.7	28.08
1979	2846.1	42.31	35.0	-25.85	4580.4	-2.26	7461.5	10.81
1980	1349.6	-52.58	21.2	-39.43	7516.9	64.11	8887.7	19.11
1981	835.0	-38.13	27.9	31.60	9021.5	20.02	9884.4	11.21
1982	803.0	-3.83	56.5	102.51	9743.5	8.00	10603.0	7.27
1983	936.5	16.63	24.7	-56.28	13650.0	40.09	14611.2	37.80
1984	2411.3	157.48	34.1	38.06	16735.2	22.60	19180.6	31.27
1985	2400.2	-0.46	21.2	-37.83	17466.3	4.37	19887.7	3.69
1986	2515.9	4.82	27.9	31.60	18770.6	7.47	21314.4	7.17
1987	2712.2	7.80	61.2	119.35	22471.8	19.72	25245.2	18.44
1988	2774.5	2.30	26.7	-56.37	25419.5	13.12	28220.7	11.79
1989	2692.5	-2.96	84.8	217.60	27791.5	9.33	30568.8	8.32
1990	2742.8	1.87	177.3	109.08	30681.2	10.40	33601.3	9.92
1991	2831.1	3.22	130.5	-26.40	32542.8	6.07	35504.4	5.66
1992	10886.2	284.52	86.6	-33.64	30707.7	-5.64	41680.5	17.40
1993	23033.3	111.58	246.1	184.18	25650.7	-16.47	48930.1	17.39
1994	35092.9	52.36	576.8	134.38	26041.1	1.52	61710.8	26.12
1995	41096.2	17.11	320.5	-44.43	28737.7	10.36	70154.4	13.68
1996	41188.9	0.23	103.4	-67.74	32705.0	13.81	73997.3	5.48

(**Continued to next page)**

Table III-5 (Concluded)

End of Period	Foreign Assets	SGR of Foreign Assets	Taka Coin	SGR of Taka Coin	Securities of Bangladesh Govt., Internal Bills of Exchange, Commercial Papers and Silver Bullion	SGR of Securities of Bangladesh Govt., Internal Bills of Exchange, Other Commercial Papers and Silver Bullion	Total Assets	SGR of Total Assets
1997	41147.8	-0.10	492.8	376.60	40896.2	25.05	82536.8	11.54
1998	41081.2	-0.16	375.1	-23.86	46482.8	13.66	87939.1	6.55
1999	41001.6	-0.19	195.8	-47.80	62472.3	34.40	103669.7	17.89
2000	41599.8	1.46	194.5	-0.66	85854.1	37.43	127648.4	23.13
2001	31730.7	-23.72	453.8	133.32	106033.2	23.50	138217.7	8.28
2002	42250.0	33.15	329.0	-27.50	101574.0	-4.21	144153.0	4.29
2003	62721.0	48.45	501.0	52.28	91414.0	-10.00	154636.0	7.27
2004	83032.6	32.38	375.3	-25.09	99421.3	8.76	182829.2	18.23
2005	83846.0	0.98	587.3	56.49	135357.9	36.15	219791.2	20.22
2006	84930.8	1.29	337.6	-42.52	229093.1	69.25	314361.5	43.03
2007	106486.2	25.38	346.6	2.67	243147.7	6.13	349980.5	11.33
2008	158599.2	48.94	244.6	-29.43	244834.8	0.69	403678.6	15.34
2009	224528.8	41.57	442.6	80.95	219625.2	-10.30	444596.6	10.14
2010	405923.7	80.79	285.0	-35.61	166980.2	-23.97	573188.9	28.92
2011	507622.4	25.05	204.0	-28.42	123985.4	-25.75	631811.8	10.23
Annual Average SGR		**29.51**		**27.34**		**12.87**		**15.72**

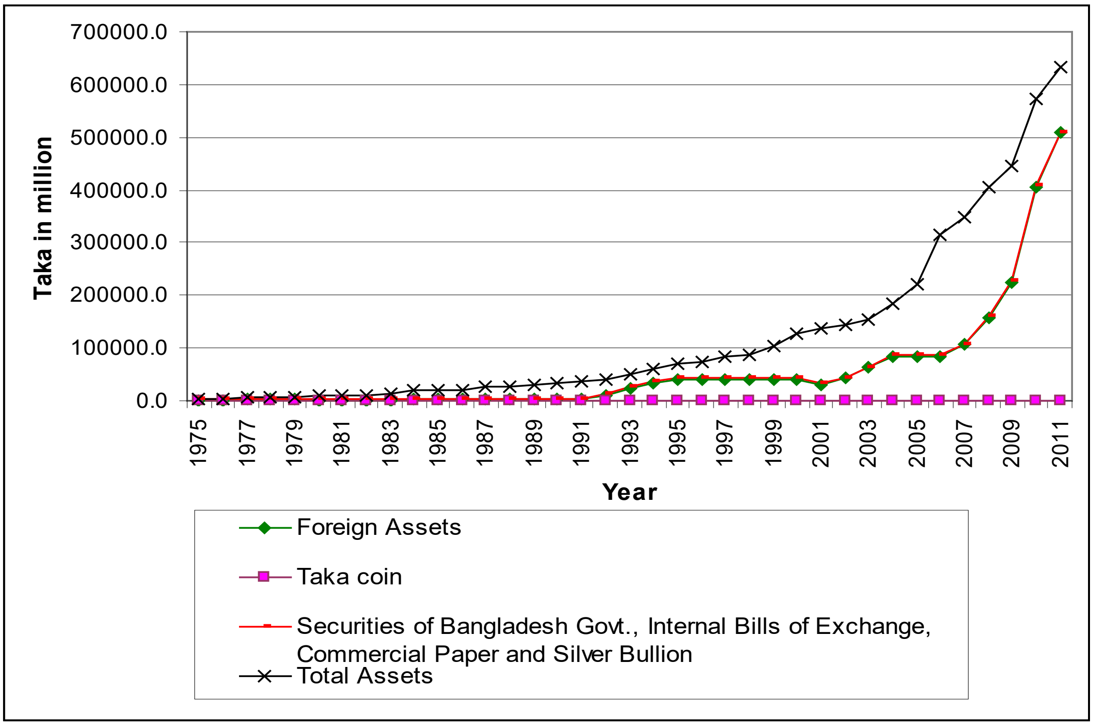
Source: Appendix: Table-4.

The amount of 'Taka Coin' increased from Taka 87.9 million in the year 1975 to Taka 204.0 million in the year 2011, registering annual average SGR of 27.34 percent. The Table also shows that, the consolidated amount of 'Securities of Bangladesh Government', 'Internal Bills of Exchange' and 'Other Commercial Papers' in the third category was Taka 2,955.8 million in the year 1975, which gradually increased to Taka 123985.4 million in the year 2011 with the annual average SGR of 12.87 percent. The 'Total Assets' of Issue Department as a whole swelled from Taka 3,743.7 million in the year 1975 to Taka 631811.8 million in the year 2011, registering an annual average SGR of 15.72 percent.

The above analysis indicates that the annual SGR percentages of all the components were very erratic. Perhaps it happened due to utilizing different types of monetary instruments for different situations to achieve monetary goals.[29] The trend pattern of different components of assets of Issue Department of Bangladesh Bank is shown in Figure III-3.

Figure III-3

Trend Pattern of Different Components of Assets of Issue Department of Bangladesh Bank



Source: Table III-5.

[29] *Ibid.,* p. 90.

It is seen in the Figure that, all the components have overall rising trend, except some variations over the years. It is of interest to observe that, the categories 'Foreign Assets' and 'Securities of Bangladesh Govt., Internal Bills of Exchange, Commercial Paper and Silver Bullion' were almost identical and they overlapped each other in the Figure.

3.4.2.2.2 Growth Trend of Liabilities of Issue Department

The balance sheet of the Issue Department of Bangladesh Bank comprises of two categories of components, viz., 'Notes in the Banking Department' and 'Notes in Circulation'. The growth trend of liabilities of Issue Department is shown in Table III-6.

Table III-6

Different Components of Liabilities of Issue Department of Bangladesh Bank and their Growth Pattern (Taka in Million)

Year	Notes in the Banking Department	SGR of Notes in the Banking Department	Notes in Circulation	SGR of Notes in Circulation	Total Notes Issued/ Liabilities	SGR of Total Notes Issued/ Liabilities
1975	9.5		3734.2		3743.7	
1976	13.5	42.11	3908.0	4.65	3921.5	4.75
1977	12.6	-6.67	5245.0	34.21	5257.6	34.07
1978	0.9	-92.86	6732.8	28.37	6733.7	28.08
1979	11.3	1155.56	7540.2	11.99	7461.5	10.81
1980	18.4	62.83	8869.3	17.63	8887.7	19.11
1981	4.7	-74.46	9879.7	11.39	9884.4	11.21
1982	8.0	70.21	10595.0	7.24	10603.0	7.27
1983	8.6	7.50	14602.6	37.83	14611.2	37.80
1984	8.2	-4.65	19172.4	31.29	19180.6	31.27
1985	7.1	-13.41	20150.6	5.10	19887.7	3.69
1986	5.0	-29.58	21309.4	5.75	21314.4	7.17
1987	9.3	86.00	25235.9	18.43	25245.2	18.44
1988	8.5	-8.60	28212.2	11.79	28220.7	11.79
1989	4.8	-43.53	30564.0	8.34	30568.8	8.32
1990	6.2	29.17	33589.1	9.90	33601.3	9.92

(Continued to next page)

Year	Notes in the Banking Department	SGR of Notes in the Banking Department	Notes in Circulation	SGR of Notes in Circulation	Total Notes Issued/ Liabilities	SGR of Total Notes Issued/ Liabilities
1991	3.7	-40.32	35500.7	5.69	35504.4	5.66
1992	3.7	0.00	41676.8	17.40	41680.5	17.40
1993	0.3	-91.89	48929.8	17.40	48930.1	17.39
1994	7.3	2333.33	61703.5	26.11	61710.8	26.12
1995	7.8	6.85	70146.6	13.68	70154.4	13.68
1996	6.5	-16.67	73990.8	5.48	73997.3	5.48
1997	0.8	-87.69	82536.0	11.55	82536.8	11.54
1998	3.0	275.00	87936.1	6.54	87939.1	6.55
1999	9.2	206.67	103660.5	17.88	103669.7	17.89
2000	8.9	-3.26	127639.5	23.13	127648.4	23.13
2001	9.2	3.37	138208.5	8.28	138217.7	8.28
2002	5.0	-45.65	144148.0	4.30	144153.0	4.29
2003	8.0	60.00	154628.0	7.27	154636.0	7.27
2004	9.3	16.25	182819.9	18.23	182829.2	18.23
2005	7.4	-20.43	219783.8	20.22	219791.2	20.22
2006	5.0	-32.43	314356.5	43.03	314361.5	43.03
2007	8.4	68.00	349972.1	11.33	349980.5	11.33
2008	3.8	-54.76	403674.8	15.34	403678.6	15.34
2009	3.1	-18.42	444593.5	10.14	444596.6	10.14
2010	7.1	129.03	573181.8	28.92	573188.9	28.92
2011	0.1	-98.59	631811.7	10.23	631811.8	10.23
Annual Average SGR		104.67		15.72		15.71

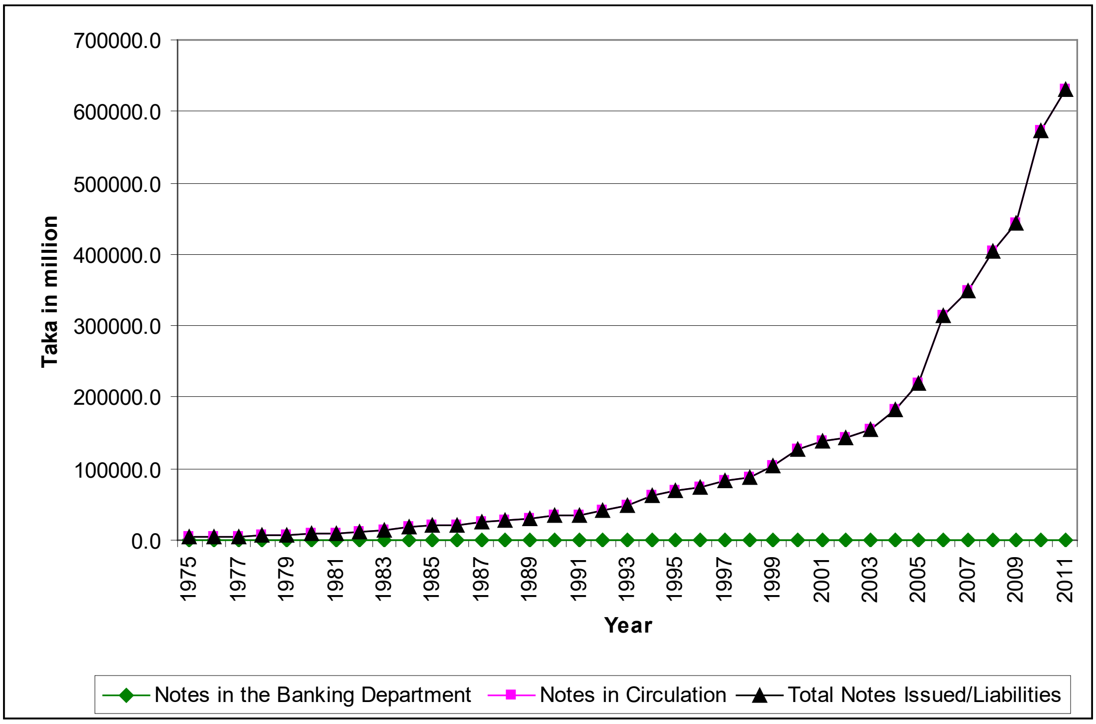
Source: Appendix: Table-5.

The Table shows that, the amount of 'Notes in the Banking Department' decreased from Taka 9.5 million in the year 1975 to Taka 0.1 million in the year 2011 registering annual average SGR of 104.67 percent. The amount of 'Notes in Circulation' increased from Taka 3,734.2 million in the year 1975 to Taka 631811.7 million in the year 2011 registering annual average SGR of 15.72 percent. The 'Total Liabilities' of Issue Department as a whole swelled from Taka 3,743.7 million in the year 1975 to Taka 631811.8 million in the year 2011 registering annual average SGR of 15.71 percent. The above analysis shows that the annual average SGR for the components of 'Notes in Circulation' and 'Total Liabilities' were almost equal, indicating that the contribution of 'Notes in the Banking Department' was very much negligible.

The trend pattern of different components of liabilities of Issue Department of Bangladesh Bank is shown in the Figure III-4.

Figure III-4

Trend Pattern of Different Components of Liabilities of Issue Department of Bangladesh Bank



Source: Table III-6.

It is observed in the Figure that, the component 'Notes in Circulation' and the 'Total Notes Issued/ Liabilities' are almost identical reflecting very negligible share of the other component 'Notes in the Banking Department' in the total liabilities of Issue Department of Bangladesh Bank.

3.4.3 Income Statement of Bangladesh Bank

The income statement of Bangladesh Bank comprises of 'Total Income', 'Total Expenditure' and 'Net Profit'. The Bank earns income from three broad sources, viz., foreign sources, domestic sources and revaluation gain. Again, foreign sources have two heads, viz., interest and commission & discount. The income statement of Bangladesh Bank and its growth pattern for the period of 1972-2005 are shown in Table III-7. From the Table it is seen that, in FY 1972-73, 'Total Income' of Bangladesh Bank was Taka 146.50 million, which at the end of FY 2010-11, increased to Taka 98625.40 million registering annual average SGR of 28.19 percent. The value of 'Total Expenditure' of Bangladesh Bank was Taka 52.50 million in FY 1972-73, which at the end of FY 2010-11 increased to Taka 10199.40 million with annual average SGR of 27.98 percent. In FY 1972-73, 'Net Profit' of Bangladesh Bank was Taka 94.30 million; at the end of FY 2010-11, it increased to Taka 88425.90 million registering annual average SGR of 35.04 percent.

Table III-7

Income Statement of Bangladesh Bank

Period	Total Income (Taka in million)	SGR percentage of Total Income	Total Expenditure (Taka in million)	SGR percentage of Total Expenditure	Net Profit (Taka in million)	SGR percentage of Net Profit
1972-73	146.50		52.20		94.30	
1973-74	172.40	17.68	61.00	16.86	111.40	18.13
1974-75	342.20	98.49	68.20	11.80	274.00	145.96
1975-76	365.10	6.69	141.70	107.77	223.40	-18.47
1976-77	422.00	15.58	93.80	-33.80	328.20	46.91
1977-78	614.30	45.57	308.00	228.36	306.30	-6.67
1978-79	988.10	60.85	437.80	42.14	550.30	79.66
1979-80	1498.50	51.65	488.00	11.47	1010.50	83.63
1980-81	1955.30	30.48	645.20	32.21	1310.10	29.65
1981-82	2597.60	32.85	1456.90	125.81	1140.70	-12.93
1982-83	2646.80	1.89	1505.80	3.36	1141.00	0.03
1983-84	3218.00	21.58	1621.30	7.67	1596.70	39.94
1984-85	4940.60	53.53	1568.70	-3.24	3371.90	111.18
1985-86	4273.20	-13.51	1924.50	22.68	2348.70	-30.34
1986-87	3908.40	-8.54	2060.10	7.05	1848.30	-21.31
1987-88	4643.90	18.82	2505.70	21.63	2138.20	15.68
1988-89	5723.40	23.25	3098.50	23.66	2624.90	22.76
1989-90	6691.70	16.92	3652.10	17.87	3039.60	15.80
1990-91	7367.70	10.10	3090.50	-15.38	4277.20	40.72

(Continued to next page)

Period	Total Income (Taka in million)	SGR percentage of Total Income	Total Expenditure (Taka in million)	SGR percentage of Total Expenditure	Net Profit (Taka in million)	SGR percentage of Net Profit
1991-92	7658.00	3.94	2298.00	-25.64	5360.00	25.32
1992-93	6903.20	-9.86	1681.70	-26.82	5221.70	-2.58
1993-94	6651.30	-3.65	1887.10	12.21	4764.20	-8.86
1994-95	8380.60	26.00	2393.30	26.82	5987.30	25.67
1995-96	8406.40	0.31	3104.40	29.71	5302.00	-11.45
1996-97	9360.30	11.35	3016.90	-2.82	6343.40	19.64
1997-98	10593.90	13.18	2887.50	-4.29	7706.40	21.49
1998-99	11715.60	10.59	3847.00	33.23	7868.60	2.10
1999-2000	11593.50	-1.04	3633.70	-5.54	7959.80	1.16
2000-01	11725.80	1.14	4566.40	25.67	7159.50	-10.05
2001-02	11331.50	-3.36	1833.40	-59.85	9494.10	26.61
2002-03	11256.20	-0.66	3655.70	21.86	7600.50	-19.95
2003-04	21006.90	86.63	11612.10	217.64	9394.80	23.61
2004-05	24157.80	15.00	5239.10	-54.88	18918.70	101.37
2005-06	36215.00	49.91	12174.80	132.38	24040.20	27.07
2006-07	42794.10	18.17	8188.30	-32.74	34605.80	43.95
2007-08	40620.30	-5.08	9092.00	11.04	31528.30	-8.89
2008-09	30884.30	-23.97	5826.30	-35.92	25058.00	-20.52
2009-10	19269.20	-37.81	6391.00	9.69	12878.20	-48.61
2010-11	98625.40	411.83	10199.40	59.59	88425.90	586.63
Annual Average SGR		**28.19**		**27.98**		**35.04**

Source: Bangladesh Bank, *Economic Trends,* various issues.

From the Table it is found that, the annual SGR percentages of all the three components were very much erratic. There is not any definite pattern in income, expenditure or profit of the Bank. The annual average SGR of profit is substantially greater than those of income and expenditure.

3.5 Conclusion

Bangladesh Bank is the apex of the financial system of Bangladesh. After the independence of Bangladesh, it ascended from the eastern wing of the State

Bank of Pakistan. The paid up capital of the Bank is fully paid by the Government. At present, the Bank has ten branches all over the country. For efficient functioning, the Bank is divided into forty three Departments at the head office.

The Bangladesh Bank Order 1972 determines the main functions of Bangladesh Bank. This Order was amended in 2003, when formulation and implementation of Monetary Policy was specifically delegated to the Bangladesh Bank as a major function. The direction of the affairs and business of Bangladesh Bank rests on the Board of Directors, led by the Governor of the Bank. The Bank is reportable to the Co-ordination Council, which is chaired by the Minister for Finance.

The number of branches of Bangladesh Bank was more than double but the number of employees was less than double from inception. Growth rate of non-traditional assets was faster than the traditional assets of Banking Department of Bangladesh Bank in the period under consideration. Similar trend was found for the liabilities of Banking Department of the Bank. In the Issue Department, all the asset components grew harmoniously; but the annual growth rates of all the components were very erratic. In the liabilities side of the Issue Department, the total liabilities was dominated by a single component namely 'notes in circulation'; movement in the other component 'notes in the Banking Department' was found negligible. However, the annual average growth rates of the components of the Issue Department were relatively smooth.

The next chapter deals with the Monetary Policy pursued by Bangladesh Bank.

CHAPTER IV

MONETARY POLICY OF BANGLADESH BANK

4.1 Introduction

Conceptually, the Monetary Policy framework refers to the logical and sequential set of actions that a Central Bank has to design, where the instruments and goals remain at the two ends with the targets being in between. In current practice, Monetary Policy decisions usually involve setting the interest rate on overnight loans in the money market. The successful prediction of successive short-term rates eventually allows the private sector to apprehend the longer term interest rates, which essentially guide private investment decisions as well as household asset behaviour, though with a time lag.[1]

It is of interest to note that, in the original Bangladesh Bank Order 1972, there was no single word of "Monetary Policy" written in any of the articles or clauses. The Bangladesh Bank (Amendment) Act, 2003 amended Bangladesh Bank Order in the year 2003 where the objective of Monetary Policy was clearly stated in the preamble. In this amendment, Monetary Policy appeared for the first time as the main function of the Bank.[2]

4.2 Monetary Policy Framework of Bangladesh Bank

Bangladesh Bank as the Central Bank of the country has been entrusted with the responsibility of formulating and implementing Monetary Policy. In formulating Monetary Policy, Bangladesh Bank at first sets the real goals for the economy in terms of rate of growth of final output and the rate of inflation.[3] These objectives

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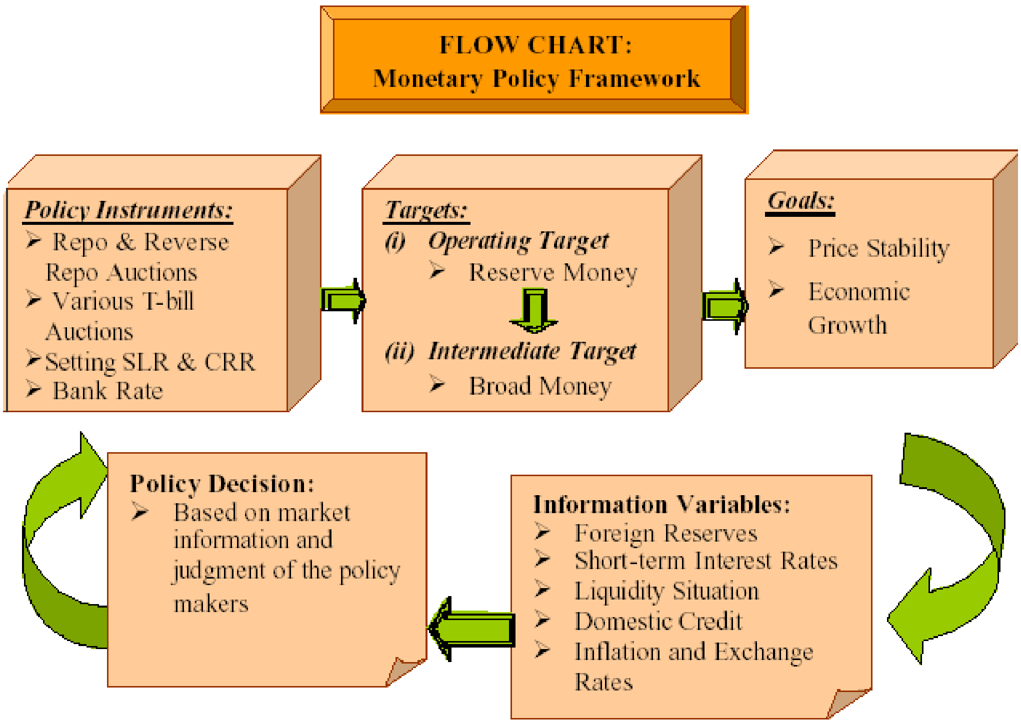
[1] Bangladesh Bank, *Monetary Policy Review*, Vol.2, No.1 (Dhaka: Policy Analysis Unit, Research Department, Bangladesh Bank, October 2006), p.14.

[2] M. Sadiqunnabi Choudhury, "Monetary Policy in Bangladesh- Should We go for Inflation Targeting?" *Journal of the Institute of Bankers Bangladesh*, vol. 51, No. 2 (July - December, 2004), pp.119-20.

[3] Syed Ahmed Khan, "An Evaluation of Monetary Policy before and after Financial Sector Reforms in Bangladesh", *Journal of the Institute of Bankers Bangladesh*, vol. 48 (Jan, 2001-June, 2002), p. 51.

are then sought to be achieved through one or more operating target like reserve money and intermediate target like broad money.[4] Monetary authorities then set policy instruments at levels commensurate with achieving the stated targets. These targets are not goals *per se*, but help achieving the final objectives of Monetary Policy.[5] The flow Figure in Diagram-1 provides a simple illustration of the Monetary Policy Framework of Bangladesh Bank.

Diagram 1



Source: Bangladesh Bank, *Monetary Policy Review,* Vol.1 No.1, p.20.

4.2.1 Targets of Monetary Policy in Bangladesh

Monetary Policy in Bangladesh is formulated around price stability and economic growth rates as the basic policy targets. In terms of the conduct of Monetary Policy, Bangladesh Bank pursues the Policy within a framework of monetary targeting. In this approach, levels and growth paths of the relevant monetary aggregates such as reserve money and broad money are projected and

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[4] Bangladesh Bank, *Monetary Policy Review,* vol.1, no.1 (Dhaka: Bangladesh Bank, October 2005), p. 20.

[5] Khan, "Evaluation of Monetary Policy", *op.cit.*, p.51.

monitored as operating target and intermediate target respectively.[6] The major advantage of monetary targeting is that, it enables the Central Bank to adjust its Monetary Policy to cope with domestic shocks and output fluctuations. It can send immediate signals to the public and markets about Monetary Policy objectives.[7]

4.2.1.1 Policy Targets of Monetary Policy

Policy targets are the goals of Monetary Policy. Central Bank of a developed economy usually pursues Monetary Policy towards achieving a single goal, usually price stability. But a Central Bank of a developing economy has to have multiple goals and manage complex trade-offs. In its monetary policy framework, Bangladesh Bank has two policy targets viz., (a) price stability and (b) economic growth. It is clear that, these goals overlap and though these are mentioned here as Monetary Policy targets, coordination between Monetary Policy and Fiscal Policy is needed to attain these targets.

4.2.1.1.1 Price Stability

In the past decade, many developed countries and some developing countries started implementing Monetary Policy framework of formal inflation targeting. Inflation targeting has clear institutional commitment to achieve price stability as long run and low inflation as short run Monetary Policy goal. Empirical study of three pioneer inflation targeting countries, New Zealand, Canada and United Kingdom showed that inflation had remained within the intended range, causing substantial reduction in the unemployment rate and higher growth of the economies.[8] Formal inflation targeting implies setting price stability as the sole objective and ultimate target of Monetary Policy and assigning the responsibility of achieving it to an independent Central Bank.[9] Available evidence suggest that, a developing country like Bangladesh is not yet in a position to rely on the low inflation environment and adopt inflation targeting thereby to reach the poverty and output growth targets of the country.[10] But recognizing the advantages of low inflation and stability of price level,

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[6] Bangladesh Bank, *Monetary Policy Review,* vol. 1, no. 1, *op.cit.,* p. 2.

[7] *Ibid*.

[8] Choudhury, “Monetary Policy in Bangladesh”, *op.cit.,* p.113.

[9] *Ibid.*

[10] Bangladesh Bank, *Monetary Policy Review*. vol. 1, no, 1, *op.cit.,* p.1.

Bangladesh Bank sets price stability as one of the two policy targets in the monetary policy framework.

Consumer Price Index (CPI) inflation, expressed as the rate of change of CPI is used in Bangladesh for assessing price stability in conducting Monetary Policy.[11] The target level of CPI inflation is chosen taking into account the country's past long run inflation performance, and the domestic and external factors driving the current trend of domestic inflation. Though the 12-month average CPI inflation (base: 1995-96) of Bangladesh is of single digit value, it is on rising trend over the last couple of years. In Fiscal Year (FY) 2008-09 it was 6.66 percent after a soothing decline from 9.94 percent of FY 2007-08. But after that, in FY 2009-10 it increased to 7.31 percent and in FY 2010-11, inflation soared to 8.80 percent.[12]

4.2.1.1.2 Economic Growth

Today economic growth is being increasingly considered to be the most important objective by almost all developing countries. For developing economies like Bangladesh with significant underemployment and under-exploitation of productive factors, stimulating higher growth is imperative for rapid reduction and eventual elimination of endemic poverty, and is therefore an overriding priority. Addressing this priority warrants fiscal intervention and co-coordinated implementation of Fiscal and Monetary Policy. Accordingly Bangladesh Bank sets economic growth as a policy target. The Bank eyes economic growth in terms of sustained and stable output growth.[13]

Real GDP growth rate (base: FY 1995-96) of Bangladesh is on rising trend since FY 2008-09. In FY 2008-09 it was 5.7 percent following declining trend for successive four years. In FY 2009-10, the growth rate increased to 6.1 percent followed by further growth to 6.7 percent (provisional estimate) in FY 2010-11.[14]

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[11] Bangladesh Bank, “Monetary Policy Statement” (Dhaka: Bangladesh Bank, January, 2006), p.2.

[12] Bangladesh Bank, *Economic Trends*, vol. XXXVII, no. 6 (Dhaka: Statistics Department, Bangladesh Bank, December 2012), p. 10.

[13] Bangladesh Bank, *Monetary Policy Review,* vol. 1, no. 1. *op.cit.* p. 1.

[14] Bangladesh Bank, *Annual Report 2010-11* (Dhaka: Bangladesh Bank, 2012), p. 228.

4.2.1.2 Intermediate Targets of Monetary Policy

The policy targets of Monetary Policy are sought to be achieved through intermediate targets. Bangladesh Bank sets policy instruments at levels commensurate with achieving the intermediate targets.[15] These targets are classified into two targets; Operating Target and Intermediate Target, combined known as intermediate targets. Intermediate targets are variables that affect the ultimate objective of Monetary Policy, but are not controlled by the Central Bank.[16] Bangladesh Bank uses Broad Money (M_2) as intermediate target and Reserve Money (RM) as operating target of Monetary Policy.[17]

4.2.1.2.1 Broad Money

In the current monetary targeting regime, Bangladesh Bank programs the required limit of monetary expansion considering M_2 as broad money.[18] Based on the quantity theory assumption that inflation rises and falls with increase and decrease in the rate of growth of money stock, the annual monetary program targets a growth path for broad money consistent with inflation and real GDP growth targets of Monetary Policy, allowing for the likely changes in income velocity of money.[19]

Bangladesh Bank calculates broad money (M2) as

M2 = Currency Outside Banks + Demand Deposits + Time Deposits

It has been found that, ‘time deposits’ is the largest component in the money supply of Bangladesh. Data on the major components of money supply in terms of broad money have been presented in Table IV-1.

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[15] Khan,” Evaluation of Monetary Policy”, *op.cit.,*

[16] Choudhury, “Monetary Policy in Bangladesh”, *op.cit.,* p.115.

[17] Bangladesh Bank, *Monetary Policy Review,* vol. 1, no. 1, *op.cit.,* P. 2.

[18] *Ibid.*

[19] Bangladesh Bank, “Monetary Policy Statement” (January 2006), *op.cit.,* p.6.

Table IV-1

Major Components of Money Supply

(Taka in crores)

Period	Currency Outside Banks	Demand Deposits	Deposits with Bangladesh Bank other than DMB	Time Deposits	Time Deposit as % of M2	Narrow Money	Narrow Money as % of M2	Broad Money (M2)
1974-75	290.2	508.9	-	460.4	36.6	799.2	63.4	1259.6
1975-76	329.9	552.2	-	514.7	36.8	882.2	63.2	1396.9
1976-77	356.3	616.4	-	767.0	44.1	972.9	55.9	1739.9
1977-78	504.3	719.5	-	916.9	42.8	1224.1	57.2	2141.0
1978-79	613.3	911.4	-	1235.2	44.8	1524.8	55.2	2760.0
1979-80	693.4	1038.2	-	1513.2	46.6	1731.8	53.4	3245.0
1980-81	914.8	1071.3	-	2149.7	52.0	1986.3	48.0	4136.0
1981-82	877.5	1134.5	-	2536.6	55.8	2012.1	44.2	4548.7
1982-83	1138.6	1495.0	-	3264.0	55.3	2634.3	44.7	5898.3
1983-84	1556.3	1993.4	-	4835.9	57.7	3549.9	42.3	8385.8
1984-85	1722.9	2508.7	-	6302.4	59.8	4231.8	40.2	10534.2
1985-86	1953.1	2974.3	-	7410.2	60.1	4927.9	39.9	12338.1
1986-87	2074.9	3186.3	-	9090.3	63.3	5262.8	36.7	14353.1
1987-88	2415.0	2632.7	-	11360.3	69.2	5047.7	30.8	16408.0
1988-89	2615.6	2845.1	-	13617.4	71.4	5460.7	28.6	19078.1
1989-90	3188.3	3180.4	-	15928.9	71.4	6368.7	28.6	22297.6
1990-91	3611.8	3591.9	-	17800.7	71.2	7203.7	28.8	25004.4
1991-92	4072.6	4184.6	-	20268.7	71.1	8257.2	28.9	28525.9
1992-93	4480.1	4582.5	-	22473.0	71.3	9062.6	28.7	31535.6
1993-94	5416.0	5751.1	-	25235.9	69.3	11167.1	30.7	36403.0
1994-95	6565.1	6614.3	-	29032.9	68.8	13179.4	31.2	42212.3
1995-96	7123.3	7336.1	-	31231.1	68.4	14459.4	31.6	45690.5
1996-97	7574.6	7592.4	-	35460.3	70.0	15167.0	30.0	50627.5
1997-98	8153.3	7735.2	-	39980.5	71.6	15888.5	28.4	55869.0
1998-99	8686.6	8562.8	-	45777.3	72.6	17249.4	27.4	63026.7
1999-2000	10176.0	9705.3	-	54881.1	73.4	19881.3	26.6	74762.4
2000-01	11478.3	10869.1	-	64826.8	74.4	22347.4	25.6	87174.1
2001-02	12531.4	11620.4	9.3	74454.9	75.5	24161.1	24.5	98616.0
2002-03	13901.8	12827.9	13.7	87251.1	76.5	26743.4	23.5	113994.5
2003-04	15811.0	14612.6	24.4	99273.7	76.5	30448.0	23.5	129721.7
2004-05	18518.1	16849.9	36.1	116042.3	76.6	35404.1	23.4	151446.4
2005-06	22862.1	19739.6	50.6	138021.9	76.4	42652.3	23.6	180674.2
2006-07	26643.8	23462.5	61.7	161336.2	76.3	50168.0	23.7	211504.2
2007-08	32689.9	26517.6	106.9	189480.5	76.2	59314.4	23.8	248794.9
2008-09	36049.2	30236.5	141.2	230073.0	77.6	66426.9	22.4	296499.9
2009-10	46157.1	41621.8	209.4	275042.8	75.8	87988.3	24.2	363031.1
2010-11	54795.1	48106.2	199.8	337418.9	76.6	103101.1	23.4	440520.0

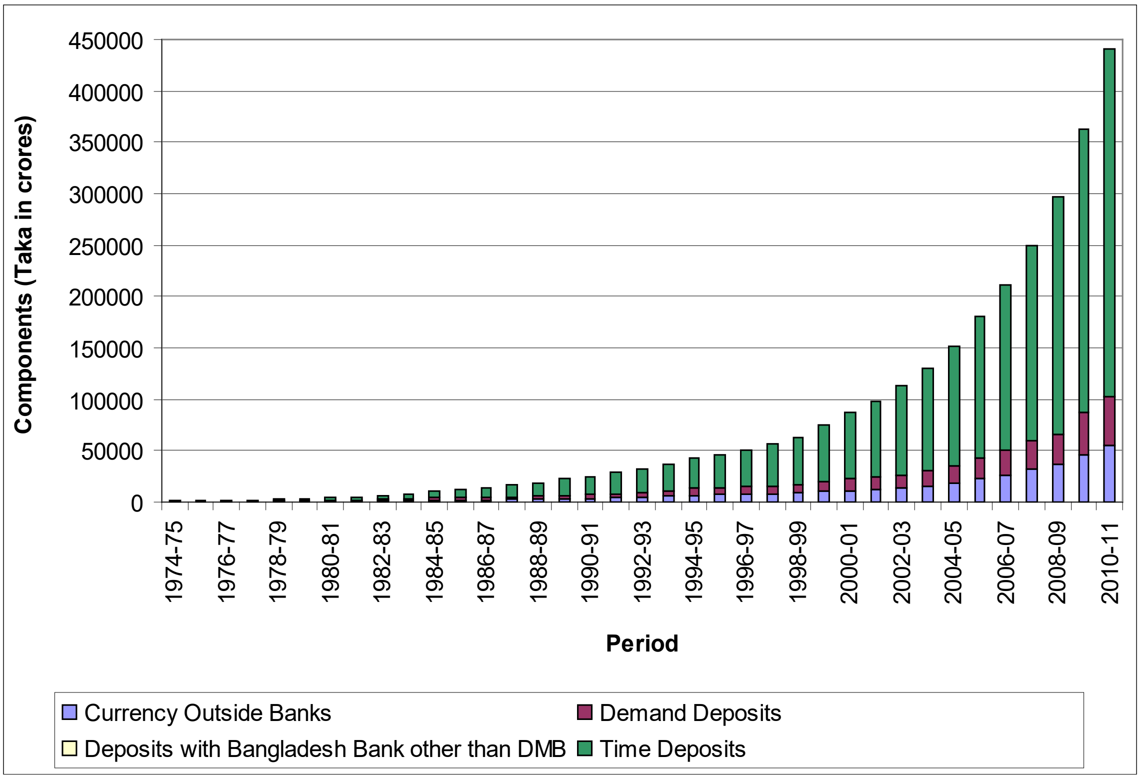
Source: Appendix: Table-6.

It is evident from the Table IV-1 that, 'time deposit' had been the largest component of money supply (M2) and it continued to be the same till Fiscal Year 2010-11. Till FY 1997-98, demand deposit was larger than currency outside banks; but from FY 1998-99, the latter surpassed the former by small margin. This trend is continuing to date.

The components of money supply have been presented in the Figure IV-1.

Figure IV-1

Components of Money Supply



Source: Table IV-1.

The dominant presence of time deposit in the composition of money supply is clearly visible in the Figure IV-1.

in FY 2010-11 the growth rate of 'Time Deposits' was 22.68 percent, which was little more than the previous Fiscal Year's growth rate of 19.55 percent, the growth rate of 'Currency Outside Banks' was 16.54 percent, which was less by around ten percentage points than the previous Fiscal Year's growth rate of 28.04 percent and growth rate of 'Demand Deposits' was 15.58 percent, which was substantially less than the previous Fiscal Year's growth rate of 37.65 percent. All these resulted in a decline in the growth rate of M_2 in FY 2010-11 to 21.34 percent from the previous Fiscal Year's growth rate of 22.44 percent. The growth rates of the components of money supply have been presented in Table IV-2.

Table IV-2
Growth Rates of Components of Money Supply

(in percent)

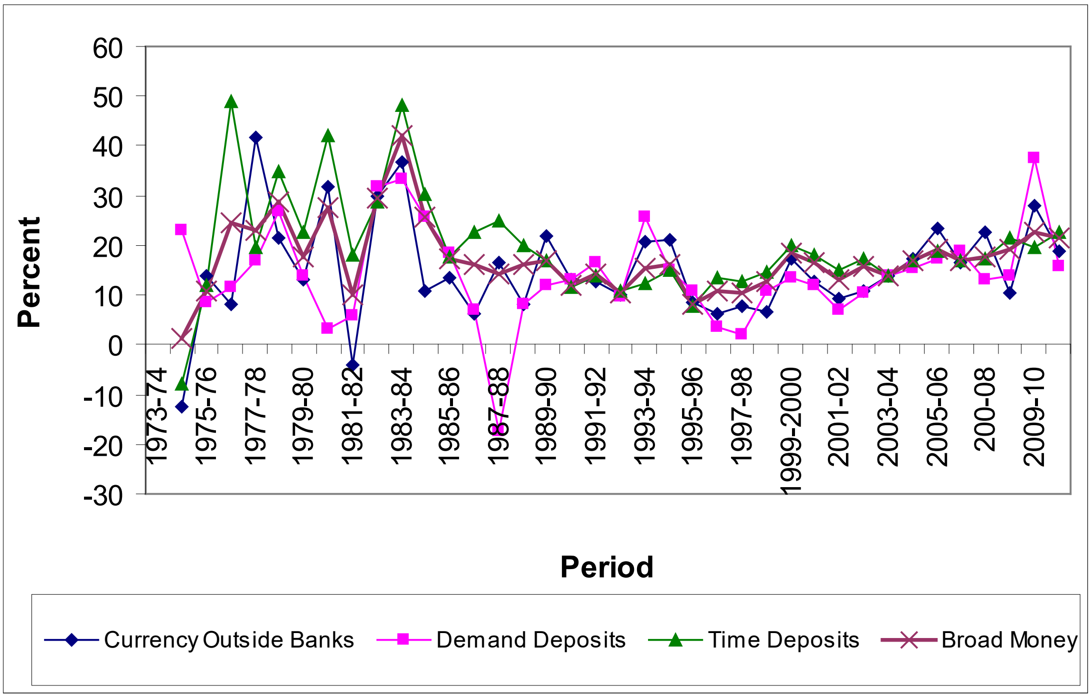
Period	Currency Outside Banks	Demand Deposits	Time Deposits	Deposits with Bangladesh Bank other than DMB	Narrow Money	Broad Money
1974-75	-12.35	22.92	-7.77	-	7.23	1.21
1975-76	13.68	8.51	11.79	-	10.39	10.90
1976-77	8.00	11.63	49.02	-	10.28	24.55
1977-78	41.54	16.73	19.54	-	25.82	23.05
1978-79	21.61	26.67	34.71	-	24.56	28.91
1979-80	13.06	13.91	22.51	-	13.58	17.57
1980-81	31.93	3.19	42.06	-	14.70	27.46
1981-82	-4.08	5.90	18.00	-	1.30	9.98
1982-83	29.75	31.78	28.68	-	30.92	29.67
1983-84	36.69	33.34	48.16	-	34.76	42.17
1984-85	10.70	25.85	30.33	-	19.21	25.62
1985-86	13.36	18.56	17.58	-	16.45	17.12
1986-87	6.24	7.13	22.67	-	6.80	16.33
1987-88	16.39	-17.37	24.97	-	-4.09	14.32
1988-89	8.31	8.07	19.87	-	8.18	16.27
1989-90	21.90	11.79	16.97	-	16.63	16.88
1990-91	13.28	12.94	11.75	-	13.11	12.14
1991-92	12.76	16.50	13.86	-	14.62	14.08
1992-93	10.01	9.51	10.88	-	9.75	10.55
1993-94	20.89	25.50	12.29	-	23.22	15.43
1994-95	21.22	15.01	15.05	-	18.02	15.96
1995-96	8.50	10.91	7.57	-	9.71	8.24
1996-97	6.34	3.49	13.54	-	4.89	10.81
1997-98	7.64	1.88	12.75	-	4.76	10.35
1998-99	6.54	10.70	14.50	-	8.57	12.81
1999-2000	17.15	13.34	19.89	-	15.26	18.62
2000-01	12.80	11.99	18.12	-	12.40	16.60
2001-02	9.17	6.91	14.85	-	8.12	13.13
2002-03	10.94	10.39	17.19	47.31	10.69	15.59
2003-04	13.73	13.91	13.78	78.10	13.85	13.80
2004-05	17.12	15.31	16.89	47.95	16.28	16.75
2005-06	23.46	17.15	18.94	40.17	20.47	19.30
2006-07	16.54	18.86	16.89	21.94	17.62	17.06
200-08	22.69	13.02	17.44	73.26	18.23	17.63
2008-09	10.28	14.02	21.42	32.09	11.99	19.17
2009-10	28.04	37.65	19.55	48.30	32.46	22.44
2010-11	18.71	15.58	22.68	-4.58	17.18	21.34

Source: Researcher’s own calculation from Table IV-1.

The growth rates of the major components of M_2 have been presented in Figure IV-2. It is evident in the Figure that, actual growth of broad money in Bangladesh has been erratic. From FY 2001-02, an upward trend in the growth rate of M2 with minor fluctuations is also noticeable in the Figure.

Figure IV-2

Growth Rates of Components of Money Supply



Source: Table IV-2.

4.2.1.2.2 Reserve Money

Bangladesh Bank uses Reserve Money (RM), which is called inter alias high power money and base money, as the operating target in its Monetary Policy in order to achieve the projected growth of the intermediate target i.e., broad money. The relationship between the operating target and intermediate target is established in the following equation:

$$M2 = \mu * RM$$

Where,

M2 = Broad money

μ = Money multiplier, and

RM = Reserve money

On the demand side, reserve money consists of currency outside banks, currency in tills of DMBs and deposits of the banks and financial institutions with Bangladesh Bank. This can be expressed as, RM = Currency Outside Banks + Currency in Tills of DMBs + Deposits of Banks and Financial Institutions (in Taka A/C) with Bangladesh Bank.

Data on reserve money and its components have been shown in the Table IV-3.

Table IV-3

Reserve Money and Its Components

Taka in crores

End of Period	Currency Outside Banks	Currency in Tills of DMBs	Deposits with BB			Reserve Money (1+2+3+5)	Growth Rate of Reserve Money (%)
			By DMBs		By NBDCs, NBFIs, OFIs etc in Taka A/C		
			In Taka A/C	In F/C clearing Account			
	1	2	3	4	5	6	7
1993-94	5416.0	691.5	4769.4	431.0	…	11307.9	
1994-95	6565.1	623.4	2687.6	753.9	…	10630.0	-5.99
1995-96	7123.3	776.0	2273.6	830.1	…	11003.0	3.51
1996-97	7574.6	880.1	3017.8	922.0	…	12394.5	12.65
1997-98	8153.3	923.3	3655.9	885.1	…	13617.6	9.87
1998-99	8686.6	1026.9	3812.5	1216.7	…	14742.7	8.26
1999-00	10176.0	1088.4	4183.4	1616.3	…	17064.1	15.75
2000-01	11478.3	1354.5	3385.7	2708.9	…	18927.4	10.92
2001-02	12531.4	1348.8	6683.5	2960.6	9.3	20573.0	8.69
2002-03	13901.8	1440.5	6085.5	2871.6	13.7	21441.5	4.22
2003-04	15811.0	1476.4	6558.6	2333.8	24.4	23870.4	11.33
2004-05	18518.1	1809.8	7036.4	2004.9	36.1	27400.4	14.79
2005-06	22862.1	2032.0	9010.0	3426.6	50.6	33954.7	23.92
2006-07	26643.8	2143.6	10573.6	4650.4	61.7	39422.7	16.10
2007-08	32689.9	2958.6	11806.7	5227.5	106.9	47562.1	20.65
2008-09	36049.2	3399.5	23159.5	6640.7	141.2	62749.4	31.93
2009-10	46157.1	4308.3	23468.0	6367.5	209.4	74142.8	18.16
2010-11	54795.1	5731.8	29007.7	7766.5	199.8	89734.4	21.03

Source: Bangladesh Bank, *Economic Trends,* vol. XXXVII, no. 12 (Dhaka: Statistics Department, December 2012), p. 16.

It is observed in the Table that, currency outside banks has been the most dominant component of reserve money followed by deposits of DMBs (in Taka A/C) with Bangladesh Bank. It is also observed that, in FY 2010-11, growth rate of reserve money was 21.03 percent, which was higher than the growth rate of 18.16 percent in FY 2009-10. This rate registered a sharp decline from the growth rate of 31.93 percent recorded in FY 2008-09, just after a sharp rise from 20.65 percent in FY 2007-08.

Assuming that money multiplier is fairly stable, Bangladesh Bank tries to fulfill the demand for RM with its targeted supply equation:

RM = NDA + NFA

Where,

NDA = Net Domestic Assets of Bangladesh Bank, which comprises of Net credit to the Government + Credit to other public and private sectors Credit to the Deposit Money Banks (DMBs) + Net other assets; and

NFA = Net Foreign Assets of Bangladesh Bank.

To equilibrate the supply of reserve money with its estimated demand, Bangladesh Bank has the options to try through the variation of net domestic assets or its net foreign assets. But, practically net foreign asset is beyond direct control of Bangladesh Bank. Moreover, as exchange rate is now floating, Bangladesh Bank has nothing to do with net foreign assets. So, the Bank tries to equilibrate the demand and supply of reserve money through the variation of net domestic assets. It can directly affect the reserve money through the supply of credit to the Government by purchasing or selling Government T-bills or bonds and securities. Bangladesh Bank can affect the excess reserves of the commercial banks through sale or purchase of its own securities i.e., Bangladesh Bank Bills or the Government T-bills. Through variation of discount rate, Bangladesh Bank regulates the borrowing of the commercial banks from its discount window. The Bank has indirect monetary instruments like *repo*, reverse *repo* and interbank *repo* operations that can affect reserve money through the variation of NDA.[20] Level of reserve money is regulated with these instruments towards maintaining broad money on the growth path, targeted in the monetary programme.

4.2.2 Instruments Employed to Achieve the Targets

Bangladesh Bank sets policy instruments at levels commensurate with achieving the intermediate targets. It employs a judicious mix of instruments to achieve the

[20] Choudhury, “Monetary Policy in Bangladesh”, *op.cit.,* p.116.

targets. These include Bank Rate, Repurchase Agreement *(Repo)* and *reverse repo* interest rates of Bangladesh Bank, the Cash Reserve Requirement (CRR), Statutory Liquidity Ratio (SLR), credit control and credit rationing. Before the implementation of FSRP, Monetary Policy in Bangladesh was conducted with full direct control on interest rates and exchange rates, as also on the volumes and directions of credit flows. With the implementation of FSRP in 1990, the emphasis has been shifted to indirect instruments of monetary management and market determined interest rates.[21] A brief account of the instruments is given below.

4.2.2.1 Bank Rate

Bank Rate is used as one of the main monetary instruments by Central Bank to control monetary aggregates. Bangladesh Bank uses Bank Rate, although not very frequently, to control the volume of credit and money supply.[22] Until 1990, the use of Bank Rate as the lending rate of Bangladesh Bank was virtually non-existent in Bangladesh. This rate was changed on a few occasions only to align it with the refixation of the rates of deposits and advances.

4.2.2.2 Statutory Ratios for Scheduled Banks

The Cash Reserve Requirement (CRR) and Statutory Liquidity Ratio (SLR) are effective means of announcing the Monetary Policy stance. The financial markets of Bangladesh are yet to gain sufficient depth to respond with the changes in policy interest rates. To compensate for this inadequate interest rate responsiveness of markets, policy interest rate interventions in Bangladesh are at times supplemented by changes in the CRR and SLR for scheduled banks, thus influencing the volumes as well as costs of funds available for credit growth. Commercial banks' demand and time liabilities are at present subject to SLR of 19.0 percent inclusive of average 6.0 percent (at least 5.5 percent in any day) CRR on bi-weekly basis. The CRR is to be kept with the BB and the remainder as qualifying secured assets under the SLR, either in cash or in Government securities.[23] For a tightening mode Bangladesh Bank adjusts the CRR and SLR upward and *vice versa*.

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[21] Khan, “Evaluation of Monetary Policy”. *op.cit.,* p.49.

[22] *Ibid*., p.61.

[23] Bangladesh Bank, *Annual Report 2010-11*, *op.cit.*, p. 47.

4.2.2.3 *Repo* and *Reverse Repo* Interest Rates

Repo (repurchase agreement) and *reverse repo* interest rates of Bangladesh Bank and treasury bill/bond auction yields are the key policy rates in the present indirect monetary management. After the implementation of Financial Sector Reform Programme (FSRP), in order to reinforce indirect monetary operation and to manage the day-to-day liquidity position in the market, Bangladesh Bank has introduced *repo*, *reverse repo* and *interbank repo* operations in July 2002, April 2003 and July 2003, respectively, while money at call still remains at the core of overnight money market in Bangladesh.

Both *Repo* and *Reverse Repo* transactions are conducted through auctions held on each working day at Bangladesh Bank. Through *Repo* operation, Bangladesh Bank lends fund to a bank or financial institution by purchasing security, which the bank or financial institution repurchases upon maturity. The *Reverse Repo* facility enables participating institutions to purchase government securities from Bangladesh Bank upon commitment of resale after the agreed upon term. Both *Repo* and *Reverse Repo* arrangements are for overnight to seven day terms.

In addition to the *Repo* and *Reverse Repo* arrangements, the Bangladesh Bank also allows the banks and other financial institutions to make secondary transaction of treasury bills and other government securities in their possession, which is called "*Interbank Repo*". The rate in the *interbank repo* operation is freely determined in the market place where the central bank exercises zero intervention. *Interbank Repo* transactions can be made for a term depending on the maturity of the bills and bonds. However, it is observed from the market that a majority of the deals are for one- to- two days.[24]

The *repo, reverse repo*, T-bill auctions in turn have an impact on the inter-bank call money rate. While adjusting the excess liquidity in the banking system through these instruments, Bangladesh Bank simultaneously resets the *repo* and *reverse repo* rates on a daily basis. Control over liquidity may also be effective in influencing the market for foreign currency, and hence the short term equilibrium value of the exchange rate.

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[24] Bangladesh Bank, *Monetary Policy Review,* vol. 1, no. 1, *op.cit*., p. 47.

In tightening the Monetary Policy stance Bangladesh Bank raises these rates in turn to raise the rates of other financial costs and returns, restraining demand growth in the real sector.[25]

4.3 Analysis of Monetary Policy Pursued by Bangladesh Bank

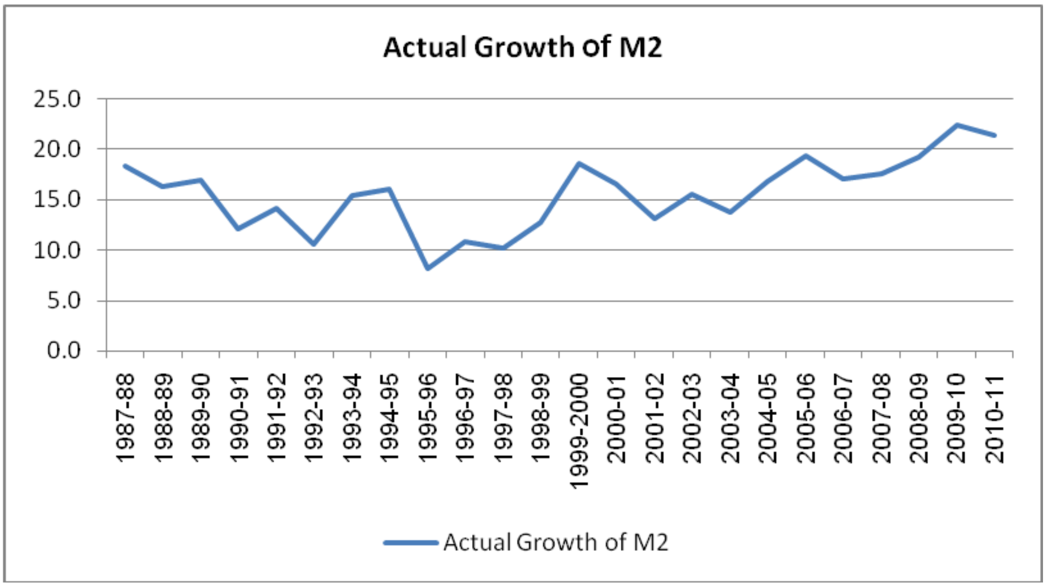
It has been mentioned earlier in this Chapter that, Bangladesh Bank pursues Monetary Policy within a framework of monetary targeting, where levels and growth paths of broad money and reserve money are projected and monitored as intermediate target and operating target respectively. The Bank employs a judicious mix of instruments to achieve these targets. To analyze the Monetary Policy, it is necessary to analyze the targets and the instruments empirically.

4.3.1 Analysis of Money Supply in Bangladesh

To analyze the Monetary Policy, the intermediate target i.e., broad money has been analyzed first.

On a year-on-year basis, broad money growth rate stood at 21.34 percent in FY2011 which was lower than the 22.44 percent growth rate recorded in Fiscal Year 2010, but higher than the growth rate of 19.17 percent in Fiscal Year 2009.[26] Figure IV-3 depicts the trend of broad money growth in Bangladesh.

Figure IV-3



Source: Table IV-2.

[25] Bangladesh Bank, *Monetary Policy Statement*, July 13, 2006 (Dhaka: Bangladesh Bank, 2006),p. 4.

[26] Bangladesh Bank, *Economic Trends,* vol. XXXVII, no. 12 (Dhaka: Statistics Department, December 2012), pp. 3.

It is evident in the Figure that actual growth of broad money in Bangladesh has been erratic. From FY 2001-02. an upward trend in the growth rate of M2 with minor fluctuations is also noticeable in the Figure.

Bangladesh Bank projects the growth rate of broad money every year for the purpose of attaining the policy targets of Monetary Policy. But it has been found that, except a few instances most of the time the actual growth of broad money was higher than the projected growth rate. Data of projected and actual growth of broad money have been presented in the Table IV-4.

Table IV-4

Growth Rate of Projected and Actual Broad Money

(in percent)

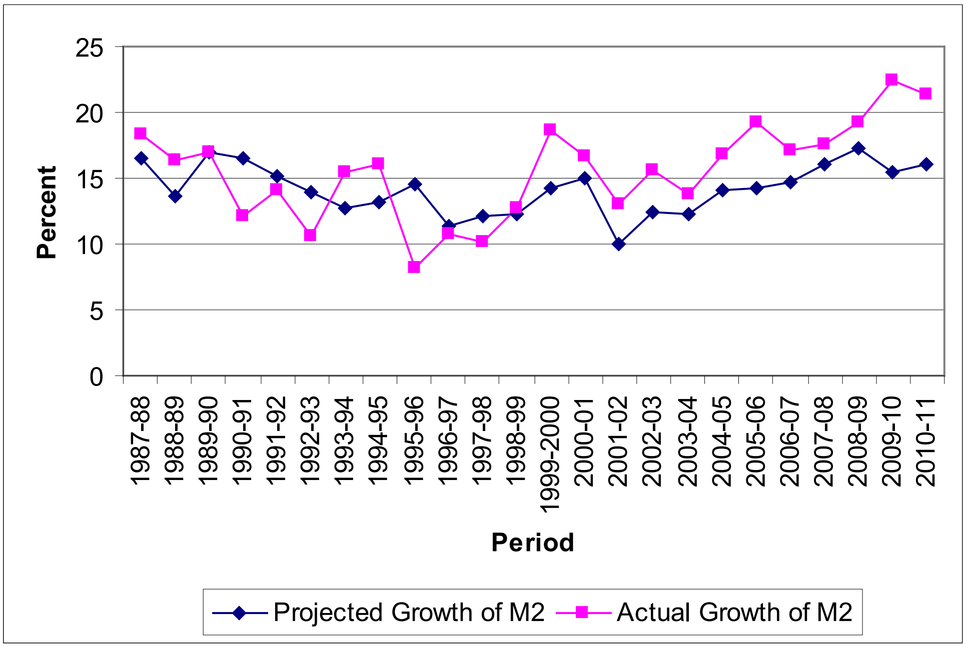
Period	Projected Growth of M_2	Actual Growth of M_2	Difference
1987-88	16.5	18.3	1.8
1988-89	13.7	16.3	2.6
1989-90	17.0	16.9	-0.1
1990-91	16.5	12.1	-4.4
1991-92	15.2	14.1	-1.1
1992-93	14.0	10.6	-3.4
1993-94	12.8	15.4	2.6
1994-95	13.2	16.0	2.8
1995-96	14.5	8.2	-6.3
1996-97	11.3	10.8	-0.5
1997-98	12.1	10.2	-1.9
1998-99	12.2	12.8	0.6
1999-2000	14.2	18.6	4.4
2000-01	15.0	16.6	1.6
2001-02	10.0	13.1	3.1
2002-03	12.5	15.6	3.1
2003-04	12.2	13.8	1.6
2004-05	14.1	16.8	2.7
2005-06	14.3	19.3	5.0
2006-07	14.7	17.1	2.4
2007-08	16.0	17.6	1.6
2008-09	17.2	19.2	2.0
2009-10	15.5	22.4	6.9
2010-11	16.0	21.4	5.4

Source: Bangladesh Bank, *Annual Report,* various issues.

It is observed in the Table that, the actual growth rate of M2 never matched the projected growth rate of M2. In FY 2010-11, the projected growth rate was 16 percent while the actual growth rate was 21.4 percent, above by 5.4 percentage points. The difference was even more in the previous Fiscal Year. The only period in the near past when the difference between these two was below one percent was FY 1998-99. In this year, the actual growth rate was above the projected growth rate by 0.6 percentage points. From then on till FY 2010-11, the actual growth rate was always more than the projected growth rate. Indeed the actual growth rate was below the projected growth rate on some occasions before FY 1998-99. A graphical presentation of the two growth rates has been placed in Figure IV-4. The gap between the actual and projected growth rate of M2 is clearly visible in the Figure. It can be observed that, for most of the time, specially from FY 1998-99, the actual growth rate remained above the projected growth rate.

Figure IV-4

Projected and Actual Growth Rate of M2



Source: Table IV-3.

An implicit assumption behind monetary targeting for the conduct of Monetary Policy is the existence of a stable money demand function in the economy.[27] Akhtar Hossain in his study using error correction modeling found a cointegral relationship among real money, real output and the deposit rate of interest. The relationship was found stronger considering broad money as the proxy for money supply.[28] Hossain's overall finding suggests that, there exists a

[27] Akhtar Hossain, *Macroeconomic Issues and Policies* (New Delhi: Sage Publications India Pvt Ltd., 1996), 161.

[28] For detail, see, Akhtar Hossain, "An Examination of Some Key Issues in the Conduct of Monetary Policy in Bangladesh", *Development Issues of Bangladesh-II,* ed. by Ali Ashraf et. al. (Dhaka: University Press Limited, 2003).

stable money demand function in Bangladesh. In another study by applying the methods of cointegration and error correction, Hossain taking the sample period of 1977-1988 found the money demand function stable for Bangladesh.[29] If money demand function is considered stable, then the variation in money supply presupposes variation in reserve money.

Reserve money and its sources are presented in Table IV-5.

Table IV-5

Reserve Money and Its Sources

(Taka in crore)

End of Period	Net Foreign Assets	**Domestic Credit**					Net Other Assets	Net Domestic Assets	Reserve Money
		Govern-ment (Net)	Other Public Sector	Private Sector	Deposit Money Banks	Total			
	1	2	3	4	5	6= (2+3+4+5)	7	8= (6+7)	9= (1+8)
1993-94	8159.1	1009.6	1635.9	0	2576.7	5222.2	-2073.4	3148.8	11307.9
1994-95	8772.4	1254.0	1056.8	15.7	2733.8	5060.3	-3202.7	1857.6	10630.0
1995-96	5297.0	3036.8	1195.5	15.7	3413.7	7661.7	-1955.7	5706.0	11003.0
1996-97	4920.4	4488.9	1192.6	15.7	3600.3	9297.5	-1823.4	7474.1	12394.5
1997-98	5305.1	5295.5	1404.8	15.7	3749.4	10465.4	-2152.9	8312.5	13617.6
1998-99	4617.2	6359.9	1365.6	808.4	4622.8	13156.7	-3031.2	10125.5	14742.7
1999-00	5666.1	8098.0	1320.7	900.4	4289.2	14608.3	-3210.3	11398.0	17064.1
2000-01	4812.4	10107.3	1305.1	987.5	4368.6	16768.5	-2653.5	14115.0	18927.4
2001-02	7230.4	12834.3	1277.6	1008.1	4729.3	19849.3	-6506.7	13342.6	20573.0
2002-03	11809.7	7353.3	1281.9	1141.7	4846.8	14623.7	-4991.9	9631.8	21441.5
2003-04	13542.3	11847.6	1241.1	1241.3	5852.1	20182.1	-9854.0	10328.1	23870.4
2004-05	14689.2	15674.3	1105.6	1341.4	6132.5	24253.8	-11542.6	12711.2	27400.4
2005-06	18654.5	25026.1	1016.0	1429.9	6346.3	33818.3	-18518.1	15300.2	33954.7
2006-07	28774.3	25931.1	988.0	1576.1	6442.1	34937.3	-24288.9	10648.4	39422.7
2007-08	32835.8	25997.3	946.4	1696.8	7334.2	35974.7	-21248.4	14726.3	47562.1
2008-09	43244.9	28955.4	853.1	2022.1	6846.8	38677.4	-19172.9	19504.5	62749.4
2009-10	61204.9	22320.6	830.7	2588.7	6613.9	32353.9	-19416.0	12937.9	74142.8
2010-11	61388.7	32049.7	776.7	3143.7	18608.8	54578.9	-26233.2	28345.7	89734.4

Source: Bangladesh Bank, *Economic Trends,* vol. XXXVII, no. 12 (Dhaka: Statistics Department, December 2012), p. 17.

[29] Hossain, *Macroeconomic Issues*, *op.cit.,* p. 173.

In the Table IV-5 it can be observed that, 'Net Foreign Assets (NFA)' always held a big share in the reserve money of Bangladesh. In FY 2002-03 it surpassed the other source 'Net Domestic Assets (NDA)'. Gradually NFA became dominant in the composition of reserve money. In FY 2010-11, NDA was Taka 28,345.7 crore, while NFA was Taka 61,388.7 crore, more than double of NDA.

It has been mentioned earlier in this Chapter that, NFA remains outside the control of Bangladesh Bank. Taking into account the large share of NFA in the reserve money composition, this implies that, control of Bangladesh Bank over broad money is substantially limited. The second largest source of reserve money is 'Net Credit to Government'. This source derives mainly from Government budget deficits and thus manifests fiscal dominance.

4.3.2 Analysis of the Instruments of Monetary Policy of Bangladesh Bank

Before the implementation of FSRP, Monetary Policy in Bangladesh was pursued based on direct instruments. At present Bangladesh Bank's Monetary Policy and programs seek to impact consumer price levels both by influencing key financial sector prices (policy interest rates, viz., *repo* and reverse *repo* rates) and by influencing broad money growth with changes in reserve money as instrument. Besides day to day changes in reserve money, cash reserve and statutory liquidity requirements (CRR, SLR) are also adjusted occasionally in influencing the M_2 growth path.

4.3.2.1 Bank Rate

Bank rate as a Monetary Policy instrument was not proved very significant in Bangladesh. The existence of refinance facilities at rates lower than the Bank Rate substantially eroded its significance.[30] It is also noteworthy that, the Bangladesh Bank has of late encouraged the activation of the inter-bank call money market instead of the reliance of commercial banks on the rediscount window of Bangladesh Bank.[31] Since 1990, Bank Rate has been put in use as an instrument to change the cost of borrowing and consequently to affect the market

[30] After the introduction of FSRP, the refinance facility was replaced by rediscount facility at bank rate to eliminate discrimination in access to Central Bank funds. Refinance facility is now available for agricultural credit provided by Bangladesh Krishi Bank and for projects of Bangladesh Rural Development Board financed by Sonali Bank.

[31] Bangladesh Bank, *Monetary Policy Review, op.cit.,* vol. 1, no. 1, *op.cit.,* p. 21.

rate of interest.[32] Yearly data on bank rate along with the statutory liquidity requirements have been presented in Table IV-6.

Table IV-6

Bank Rate, SLR & CRR

End of Period	Bank Rate	Statutory Liquidity Requirement (SLR)	Cash Reserve Ratio (CRR)
1974-75	8.00	25.00	5.00
1975-76	8.00	25.00	5.00
1976-77	8.00	25.00	5.00
1977-78	8.00	25.00	5.00
1978-79	8.00	25.00	5.00
1979-80	8.00	25.00	5.00
1980-81	10.50	25.00	5.00
1981-82	10.50	25.00	5.00
1982-83	10.50	25.00	5.00
1983-84	10.50	25.00	5.00
1984-85	11.00	24.00	5.00
1985-86	11.25	24.00	5.00
1986-87	10.75	20.00	5.00
1987-88	10.75	25.00	10.00
1988-89	10.75	25.00	10.00
1989-90	9.75	25.00	10.00
1990-91	9.75	23.00	8.00
1991-92	8.50	20.00	5.00
1992-93	6.50	20.00	5.00
1993-94	5.50	20.00	5.00
1994-95	5.50	20.00	5.00
1995-96	6.50	20.00	5.00
1996-97	7.50	20.00	5.00
1997-98	8.00	20.00	5.00
1998-99	8.00	20.00	5.00
1999-2000	7.00	20.00	4.00
2000-01	7.00	20.00	4.00
2001-02	6.00	20.00	4.00
2002-03	6.00	20.00	4.00
2003-04	5.00	16.00	4.00
2004-05	5.00	16.00	4.50
2005-06	5.00	18.00	5.00
2006-07	5.00	18.00	5.00
2007-08	5.00	18.00	5.00
2008-09	5.00	18.00	5.00
2009-10	5.00	18.50	5.50
2010-11	5.00	19.00	6.00

Source: For Bank Rate: Bangladesh Bank, *Economic Trends,* various issues;
For SLR & CRR: Bangladesh Bank, *Annual Report,* various issues.

[32] *Banglapedia,* vol. 7, ed. by Sirajul Islam (Dhaka: Asiatic Society of Bangladesh, 2003), s.v. “Monetary Policy” by Syed Ahmed Khan and Abdus Samad Sarker, p.62.

The Table shows that, until FY 1979-80 Bank Rate was eight percent. In FY 1980-81 the Rate was raised to 10.50 percent. Gradually The Rate was increased to 11.25 percent in FY 1985-86. This was the highest Bank Rate in the history of Bangladesh. In the next Fiscal Year i.e., FY 1986-87 the Rate was lowered to 10.75 percent. This rate was gradually lowered to 5.50 percent in FY 1993-94. It was raised step by step to 8 percent in August 1999. Bank Rate was again lowered gradually in phases. In the second quarter (October- December) of FY 2003-04 the Bank Rate settled at 5 percent. From then on Bank Rate has been unchanged to date.

4.3.2.2 Statutory Ratios for Scheduled Banks

Bangladesh bank brings changes in the CRR and SLR for scheduled banks to influence the funds available for credit growth. Data on SLR and CRR have been placed in Table IV-6. Bangladesh Bank changes these rates infrequently. A major reduction was called for in FY 2003-04, when SLR was reduced from 20 percent of the previous Fiscal Year to 16 percent. In FY 2004-05, CRR was adjusted upward to 4.50 percent from 4.0 percent. In FY 2005-06, the CRR and SLR were revised upward from 4.5 percent and 16.0 percent respectively to 5.0 per cent and 18.0 percent of time and demand liabilities of scheduled banks, with a view to slowing down overall growth of domestic credit, as well as the growth of credit to the private sector.[33] In FY 2009-10, SLR and CRR were revised further upward to 18.50 percent and 5.50 percent respectively in a tightening stance. In a further tightening stance, in FY 2010-11, SLR and CRR were again increased to 19.0 percent and 6.00 percent respectively.

4.3.2.3 *Repo* and *Reverse Repo* Interest Rates

As already have been mentioned, *Repo* and *reverse repo* rates are the key instruments employed by Bangladesh Bank in the current monetary targeting regime. The *repo* rate from first Quarter of FY 2005-06 to the first Quarter of FY 2011-12 have been shown in Figure IV-5. It can be observed in the Figure that, the *repo* rate fell sharply in the fourth Quarter of FY 2008-09 from its third Quarter. From the third quarter of FY 2009-10, the rate began increasing. It is still on an uptrend.

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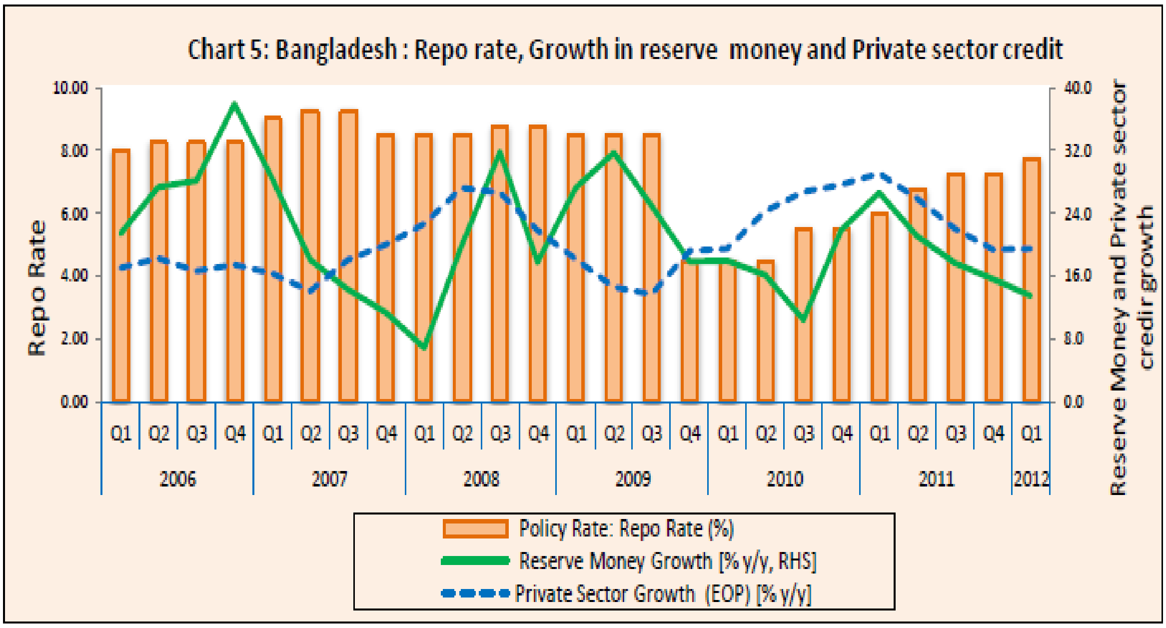
[33] *Ibid.*

Figure IV-5



Source: Bangladesh Bank, *Monetary Policy Statement (July-December 2012).*

4.4 Changing Stance of Monetary Policy

The first phase of Monetary Policy in Bangladesh after liberation during the period of 1970s was characterized by heavy deficit financing by the Government to support the nationalized corporations, to reconstruct and rehabilitate the war-torn infrastructure and also to revive the economic activities. In this period, the monetary authorities in Bangladesh attempted to ensure adequate flow of credit to agriculture, industry and other priority sectors of the economy. The necessity of monetary restrain to attain price stability was compromised by easy Monetary Policy during the period of 1970s.[34] During this period, the primary target of Monetary Policy was not to regulate the quantity of money, but the direction of the flow of money and credit in support of the Government financial programme and priority. In 1975, Bangladesh entered into a standby arrangement with IMF and the country's Monetary Policy got a changed shape, which necessitated an explicit target of safe limit of monetary expansion on annual basis. Consequently Bangladesh Bank started setting short-term objectives of Monetary Policy and tried to achieve the target by employing the direct method of control. The principal target of monetary control was broad money.[35]

[34] Khan, "Evaluation of Monetary Policy", *op.cit.,* p. 52.

[35] *Banglapedia*, vol. 7, *op.cit.,* p.62.

Prior to 1990, the policy was based on a method of direct control over various instruments, such as the volume and direction of credit and interest rates. Since the adoption of Financial Sector Reform Program in 1989, the policy stance has been gradually shifted towards indirect control. Reforms led to abandonment of directed lending and gradual liberalization of the structure of interest rates.[36] Bangladesh Bank has made greater efforts to use indirect but market based instruments to manage liquidity and bring about a realistic structure of interest rates. In this respect the introduction of *repo* in 2002 and reverse *repo* in 2003 are noteworthy developments.[37] In the external front Bangladesh remained under the fixed exchange rate system until 1979. Thereafter it switched over to a pegged exchange rate system experimenting with a variety of currency baskets along the way. The policy focus here was to maintain the country's international competitiveness and thereby strengthen the current account position and improve the exchange rate stability. With a view to embracing the market-based exchange rate system, Bangladesh entered into a floating exchange rate regime effective from May 31, 2003.

Until the earlier months of FY2005, Bangladesh Bank continued with the growth supportive accommodative monetary stance.[38] At the beginning of the FY05, Bangladesh Bank pursued an accommodative Monetary Policy due to additional expenditures incurred by the government to pay for oil imports as well as to rebuild following the losses caused by two consecutive floods occurring within the quarter. Another reason for the accommodating Monetary Policy arose from the anticipation that the country's major exporting sector i.e., the garments sector, might experience a jolt following the expiry of MFA by end-December 2005.[39]

In the backdrop of accommodative Monetary Policy stance, the private sector credit growth combined with agricultural credit write-off following the floods, the high world price of many importables and the depreciation of Taka against major currencies started creating inflationary pressure in the economy.

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[36] Bangladesh Bank, "Notes on the Monetary Policy Strategy", *op.cit.,* p.1.

[37] Bangladesh Bank, *Monetary Policy Review*, vol.1, no.1, *op.cit.,* p.113.

[38] Bangladesh Bank, *Annual Report 2004-05* (Dhaka: Bangladesh Bank, 2005), p. 22.

[39] Bangladesh Bank, *Monetary Policy Review*, vol.1, no.1, *op.cit.*, p.113.

Further, there was the concern over an adverse trend in the current account balance; all these factors prompted the Bangladesh Bank from an accomodative to a tightened Monetary Policy stance from the third quarter of FY05. Consequently, the Bangladesh Bank revised the Cash Reserve Requirement (CRR) for the scheduled banks from 4 to 4.5 percent of their demand and time liabilities effective from March 1, 2005, but kept the SLR at the existing level of 16 percent.[40]

Yield on short-term treasury bills and bonds, *repo* and reverse *repo* rates were also raised substantially (typically in excess of 50 percent) to mop up excess liquidity in the money market during the second half of FY05.[41] Interest yield on government securities continued to rise in recent months, consistent with a moderately tight Monetary Policy being pursued by the Bangladesh Bank in the face of continued high credit demand by the private sector.[42]

Price developments early in the FY06 prompted Bangladesh Bank to continue with the tightened bias in its Monetary Policy stance. In September 05, Bangladesh Bank announced upward revision of the SLR and CRR to 18 and 5 percent respectively that took effect from October 1, 2005. In support of the policy stance, the Central Bank's *repo*, reverse *repo* (both 1-2 day and 3-9 day term) rates as well as the 28-day T-bill rate all rose moderately between September 05 and June 06. Further, no *repo* auction took place either in the first or in the last quarter of FY06. By contrast, Bangladesh Bank used its reverse *repo* tool more frequently to mop up excess liquidity from the market.[43]

4.5 Foreign Exchange Policy of Bangladesh Bank

Foreign exchange policy has very important bearing on the economy, specially on the monetary aggregates. In an open economy, the exchange rate channel plays a pivotal role owing to the increased globalisation of economies all over the world. This channel is particularly concerned with the interrelationships between

[40] *Ibid*., p.114.

[41] *Ibid.*

[42] *Ibid*.

[43] Bangladesh Bank, *Monetary Policy Review*, vol. 2, no.1, *op.cit.,* p.141.

net private capital inflow and stance of Monetary Policy.[44] The net private capital inflow determines the money supply in Bangladesh on the asset side via Net Foreign Assets (NFA) with Bangladesh Bank. Again, this inflow is determined by the foreign exchange policy of the country. So, it is of utmost importance that, the foreign exchange policy goes in consonance with the Monetary Policy. In this respect, Article 22 of the Bangladesh Bank Order, 1972 states,

> The bank shall sell to or buy from any authorized dealer in Bangladesh approved foreign exchange at such rates of exchange and on such conditions as it may determine pursuant to its monetary and exchange rate policy.

4.5.1 Foreign Exchange Administration in Bangladesh

The statute for foreign exchange administration in Bangladesh is the "Foreign Exchange Regulation Act, 1947 as adapted in Bangladesh. According to this Act, responsibility and authority of administration of foreign exchange is vested by the Government with Bangladesh Bank. The Bank pursues foreign exchange policy in consultation with the Ministry of Finance of Bangladesh Government.[45] It manages foreign exchange licensing, foreign exchange dealers, money changers and such other allied functions as delegated under the above mentioned Act. It has exclusively three full fledged departments instituted in its Head Office relating to foreign exchange, namely Foreign Exchange Policy Department, Foreign Exchange Investment Department and Forex Reserve & Treasury Management Department. Besides, some other Departments like Monetary Policy Department and Accounts and Budgeting Department of the Central Bank also perform some functions relating to foreign exchange and foreign exchange reserve in Bangladesh. Bangladesh Bank delegated much of its routine works regarding buying and selling of foreign exchange and exchange control to Authorized Dealers (ADs) and Authorized Money Changers (AMCs). The Bank issued detailed "Exchange Control Manual" and "Guidelines for Foreign Exchange Transactions" containing instructions to be followed by the ADs and the AMCs in transactions relating to foreign exchange. It also reviews exchange control

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[44] Shamim Ahmed and Md. Ezazul Islam, "The Monetary Transmission Mechanism in Bangladesh: Bank Lending and Exchange Rate Channels", *The Bangladesh Development Studies,* vol. XXX, nos. 3 & 4 (September-December 2004), p. 49.

[45] Mirza Azizul Islam, "Foreign Exchange Policy of Bangladesh: Not Floating Does Not Mean Sinking", *CPD Occasional Paper,* no. 20 (Dhaka: Centre for Policy Dialogue, 2003), p. 2.

measures from time to time and revises instructions on policy and measures through different foreign exchange circulars.

Certain scheduled banks after satisfying the Bangladesh Bank that, they have adequate number of staff/officers properly trained in handling foreign exchange transactions and are able to comply with the requirements of the administration of exchange control, are authorized by the Central Bank to deal in foreign exchange and are known as "Authorized Dealers" (ADs). License to deal in foreign exchange is given in respect of individual branches of ADs. The ADs have generally been delegated power to buy foreign exchange from the customers without limit, sell foreign exchange against imports which are authorized under the Import Policy of the country, provide forward exchange covers in respect of eligible transactions, sell foreign exchange for travel abroad at prescribed quota and sell foreign exchange to customers to cover remittances of various nature. Bangladesh Bank grants two types of licences to the ADs viz., (i) universal licence and (ii) limited licence. With a universal licence, an AD is authorized to conduct all types of permitted foreign exchange transactions in all permitted currencies, while a limited licence auhtorises handling of only those transactions which are specifically mentioned in the licence by Bangladesh Bank.[46]

Besides the ADs, Bangladesh Bank has authorized certain establishments like hotels, selected shops and other organizations, visited by foreign tourists and also certain bank branches located in the port area or in and around the border outposts to buy foreign currency from tourists and incoming Bangladeshi nationals. These establishments and banks, in whose favour such licences are granted are known as "Authorised Money Changers". AMCs may be of two types viz., (i) full-fledged money changer and (ii) restricted money changer. A full-fledged money changer is authorized to undertake both purchase and sell transactions, while a restricted money changer is authorized only to purchase foreign currency notes, coins and travelers' cheques subject to surrender of all their collections to an AD at official rate.[47]

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[46] L. R. Chowdhury, *A Text Book on Foreign Exchange* (Dhaka: Fair Corporation, 2000), pp. 7 & 8.

[47] *Ibid.,* pp. 8 & 9.

The Central Banks of Bangladesh, India, Iran, Nepal, Pakistan, Sri Lanka, Bhutan and Myanmar have an Agreement to settle current transactions among these countries through the Asian Clearing Union (ACU) mechanism. All such payments to the ACU member countries excepting those covered by loan/ credit agreements are settled through the ACU mechanism in Asian Monetary Unit (AMU, also called ACU dollar) which is defined as equivalent to the US Dollar.[48]

4.5.2 Foreign Exchange Market in Bangladesh

The parties in the foreign exchange market in Bangladesh are Bangladesh Bank, the ADs and the customers. The market in Bangladesh is a three-tired one, as transactions in this market are done in three tiers, viz.,[49]

- Between Bangladesh Bank and the ADs;
- Between banks and their correspondents and branches abroad;
- Between banks and their customers.

Bangladesh Bank purchases and sells US Dollar from and to the ADs on spot basis. ADs maintain clearing accounts with Bangladesh Bank in Dollar, Pound Sterling, Mark and Yen to settle their mutual claims. The amount of foreign currency holdings by the ADs are subject to certain limits prescribed by Bangladesh Bank. In the event of speculation on an appreciation of the value, ADs may buy more foreign currencies than their needs, but at the end of each day they are to maintain the limits by selling excess currencies either in the inter-bank market or to customers. In case of shortfall of the limit, ADs are to cover it either through purchase from the market or from Bangladesh Bank. The foreign exchange market of the country is confined to Dhaka only.[50]

Foreign exchange market in Bangladesh is underdeveloped and still in its rudimentary stage. At present it does not have any secondary market, nor have any particular place like stock exchange for buying and selling of foreign currencies. Transactions of foreign exchanges take place on the floor of the ADs

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[48] Bangladesh Bank, "Guidelines for Foreign Exchange Transactions", vol. 1 (Dhaka: Bangladesh Bank, n.d), p. 4.

[49] Chowdhury, *A Text Book on Foreign Exchange, op. cit.,* pp. 106 & 107.

[50] *Banglapedia*, vol. 4, ed. by Sirajul Islam (Dhaka: Asiatic Society of Bangladesh, 2003), s.v. "Foreign Exchange Market" by Syed Ahmed Khan and A Samad Sarker, p.237.

or through private negotiation.[51] The market is oligopolistic in nature and is dominated by few large banks. These banks instead of developing themselves into buyers or sellers remained as mere dealers, which is another shortcoming of the foreign exchange market of Bangladesh.[52] Bangladesh Bank has taken the following measures to help stimulate the inter-bank foreign exchange market:[53]

(i) Bangladesh Bank has stopped sales and purchases with ADs of any currency other than the US Dollar, to encourage interbank cross currency transactions;

(ii) The Bank has raised its transaction threshold to US$ 50,000 for its deal with ADs. The ADs are now free to quote their own spot and forward exchange rates for inter-bank transactions and for transactions with non-bank customers;

(iii) Bangladesh Bank has abolished the foreign exchange holding limits of the Ads. Now they are required to be within the open position limits prescribed by Bangladesh Bank in respect of exposure to exchange rate fluctuation risk;

(iv) Bangladesh Foreign Exchange Dealers Association (BAFEDA) has been formed and a "Code of Conduct" for treasury operations and interbank foreign exchange market has been formulated;

(v) ADs have been allowed to maintain foreign currency Clearing Accounts in Euro, Japanese Yen, as well as US Dollar and Pound Sterling with Bangladesh Bank.

In July 1972, a Secondary Exchange Market (SEM) developed in Bangladesh parallel to the official inter-bank exchange market. The SEM was triggered by the restrictions imposed on foreign exchange by the Government of Bangladesh in order to control capital flight.[54] The SEM rate was much higher than the official rate. On March 17, 1988 the SEM rate, instead of the official rate,

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[51] Chowdhury, *A Text Book on Foreign Exchange, op. cit.,* p. 106.

[52] *Banglapedia*, vol. 4, *op. cit.,* p. 237.

[53] Official web site of Bangladesh Bank, http://www.bangladesh-bank.org/regulationguideline/foreignexchange/CONVERTK.HTML, visited on July 15, 2008.

[54] Sayera Younus and Mainul Islam Chowdhury, "An Analysis of Bangladesh's Transition to Flexible Exchange Rate Regime", *Working Paper Series*, no. WP 0706 (Dhaka: Bangladesh Bank, Policy Analysis Unit, December 2006), p. 3.

was applied to all encashment of export receipts of the industrial unit in the Export Processing Zones (EPZs). The rate was also applied to encashment of funds brought in from abroad by the units in EPZs for meeting their local expenses.[55] Up to 1990, multiple exchange rates were allowed under different export benefit schemes such as, Wage Earners' Scheme (WES), Export Performance Licensing Scheme (XPL),[56] Export Performance Benefit Scheme (XPB), Export Bonus Scheme, Import Entitlement Certificates (IECs), Exchange Fluctuation Acquisition Scheme (EFAS) and Home Remittances Scheme, which gave rise to a wide divergence between the official exchange rate and the SEM rate. In 1992, the SEM system was abolished, and the exchange rate system was unified.[57]

A kerb market, where the currency racketeers transact foreign currencies through a chain of middlemen, but is not formally recognized is also existent in Bangladesh. This market emerged almost at the same time of forming the secondary market; the incentive was also the same- the restricted regime of foreign exchange transaction in the early seventies. The kerb market remains beyond the control of Bangladesh Bank and operates in the lanes and by-lanes of Dhaka city around the foreign exchange branches of the authorized banks. Huge volume of *hundi* is also transacted in this market.

4.5.3 Foreign Exchange Policy of Bangladesh at Different Times

Immediately after liberation in January 1972, the Bangladesh currency Taka was pegged to the British Pound Sterling under a “fixed exchange rate” regime. The exchange rates for currencies other than Sterling were based on the London market rates for the currencies concerned. As later in 1972 the Pound Sterling was floated with US Dollar, Taka was also floated with Dollar via Pound Sterling.[58] For most of the 1970s, Bangladesh Bank followed the fixed exchange rate system for determination of exchange rate of the currency of the country.

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[55] http://intl.econ.cuhk.edu.hk/exchange_rate_regime/index. php? cid=29, visited on July 11, 2008.

[56] In 1985, the Export Performance Licensing Scheme (XPL) was replaced with an Export Performance Benefit Scheme (XPB)

[57] *Banglapedia*, vol. 4, *op. cit.,* p. 236.

[58] Younus and Chowdhury, “Analysis of Bangladesh’s Transition”, *op.cit.*, p. 1.

As in many other developing economies, external forces like International Monetary Fund (IMF) played considerably influential role in shaping the foreign exchange policy of Bangladesh. Since the early 1970s, the IMF along with the leading economists has been propagating for market oriented financial system including foreign exchange market and for necessary reforms therein. Bangladesh has initiated a series of reform measures since 1976.[59] In 1979, Bangladesh Bank switched to a "pegged exchange rate" system, where Taka was pegged to a basket of currencies of Bangladesh's major trading partners, keeping Pound as the intervention currency.[60] The justification of adopting trade-weighted basket of currencies method was to minimize the effects of exchange rate fluctuations on the domestic economy. Initially the basket consisted of currencies of five major trading partners of Bangladesh; later the basket was expanded further incorporating currencies of some other important trade partners who accounted for 70 percent of the foreign trade of Bangladesh.[61] This policy shift was a part of the "structural adjustment program" that aimed at achieving sustainable macroeconomic stability for rapid economic growth.[62] The main focus of this policy was to maintain the country's international competitiveness and thereby strengthen the current account position and improve the exchange rate stability.[63] Under this system, Bangladesh Bank used to suggest an administratively determined preannounced rate band within which the purchase or sale of the intervention currency could take place between authorized dealers and the Central Bank. Bangladesh Bank occasionally adjusted the rate to maintain export competitiveness of the country.

In 1983, the intervention currency was changed from Pound Sterling to US Dollar making Taka pegged to a trade-weighted basket of currencies, with US Dollar as the intervention currency.[64] The justification of switching to US Dollar was the increasing volume of official foreign trade of the country in US Dollar

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[59] Shah Md. Ahsan Habib, "Foreign Exchange Deregulation and Convertibility of Currency", in "Reading Materials on International Finance", reading materials prepared for the course on "International Finance", organized by Bangladesh Institute of Bank Management, September 24 – October 05, 2000 at Dhaka, p. 208.

[60] Younus and Chowdhury, "Analysis of Bangladesh's Transition", *op.cit.,* p. 1.

[61] Chowdhury, *A Text Book on Foreign Exchange, op.cit.,* p. 92.

[62] Bangladesh Bank, *Monetary Policy Review,* vol. 1, no.1, p. 72.

[63] *Ibid.*, p. 113.

[64] *Banglapedia*, vol. 4, *op. cit.,* p.236.

compared to Pound Sterling.[65] In 1985, Bangladesh Bank introduced Real Effective Exchange Rate (REER) index based on a trade-weighted basket of currencies for periodical adjustment of exchange rate that acted as a benchmark for the banks to set their own foreign exchange rates.[66] For this purpose, given an existing nominal exchange rate (NER), the corresponding REER was estimated compared to some base year. Then the desired REER was determined taking into account qualitatively some domestic and external variables. Domestic variables included the domestic inflation rate, credit growth in the private and public sector and the growth of broad money and liquidity, while the external variables included the level of international reserves, current account gap, trends of exchange rate changes in the local inter-bank foreign exchange market and trends in the exchange rates of major neighbouring trade partners.[67] If the estimated REER diverged significantly from the desired REER, corrective measures were initiated in the form of adjustment in the exchange rate.

Until the initiation of convertibility of Taka in 1994, Bangladesh Bank used to declare the mid-rate along with specified buying and selling rates for US Dollar for transactions with the ADs. Initially the spread between the buying and selling rates was Tk. 0.10.[68] From December 03, 2000 Bangladesh Bank adopted the practice of declaring a Tk .0.50 band for the buying and selling transactions, which was widened to Tk. 1.00 from May 25, 2001.[69] The banks could determine their own rates independently for inert-bank transactions and transactions with the customers. Usually there was a tendency for these rates to be higher than the pre-announced rate band applicable for the transactions between Bangladesh Bank and the ADS.[70]

It has been mentioned earlier that, Bangladesh Bank has been switching gradually to market oriented approach for its foreign exchange policy since the second half of the seventies, mainly if not solely driven by external pressures.

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[65] Sayera Younus, "Exchange Market Pressure and Monetary Policy", *Working Paper Series*, no. WP 0603 (Dhaka: Bangladesh Bank, Policy Analysis Unit, December 2005), p. 2.

[66] Younus and Chowdhury, "Analysis of Bangladesh's Transition", *op. cit.,* p. 3.

[67] Islam, "Foreign Exchange Policy of Bangladesh", *op. cit.,* pp. 1 & 2.

[68] Banglapedia, vol. 4, *op. cit.,* p. 236.

[69] Islam, "Exchange Rate Policy of Bangladesh", *op. cit.,* p. 3.

[70] Bangladesh Bank, *Annual Report 2004-05, op. cit.,* p. 52.

Bangladesh accepted Extended Fund Facility (EFF) from IMF in 1980, which was suspended later in the face of failure of Bangladesh to execute some stringent conditionality. It availed Structural Adjustment Facility (SAF) loan from IMF during 1986-89 and again Extended SAF (ESAF) loan during 1990-93. Financial liberalization was one core conditionality of all these loans.[71] In line of liberalization, under the 'Structural Adjustment Program (SAP)' and the 'Financial Sector Reform Program (FSRP)' Taka has been made convertible on current account in April 1994 by removing some exchange controls.[72] Thus Taka has become fully convertible for settlement of trade related transactions, marking a big step towards a relatively open foreign exchange market.

With a view to make the exchange tare system more liberalized and market-oriented, Bangladesh Bank introduced market-based "floating exchange rate" system on May 31, 2003. Prior to this regime, Bangladesh Bank used to declare the mid-rate along with a rate band of specified buying and selling rates for US Dollar applicable to its transactions with the ADs; the band was widened in phases to Tk. 1.00.[73] The banks were free to determine their own rates for inert-bank transactions and transactions with the customers. There was a general tendency for these rates to be higher than the pre-announced rate band for the transactions between Bangladesh Bank and the ADS.[74] In the floating exchange rate regime, exchange rate is determined entirely based on the market forces, supply of and demand for the concerned currencies. Bangladesh Bank no longer uses any preannounced rate for transactions with the banks; rather it influences the market exchange rate of Taka indirectly. It intervenes in the market occasionally by purchasing or selling foreign exchange in the inter-bank foreign exchange market to maintain orderly adjustment in the exchange rate. Bangladesh Bank purchases foreign exchanges at times of surplus of liquidity and sells when there is scarcity of the same in the market.[75] Year wise volume of

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[71] M. Zainul Abedin, "Impact of Monetary and Fiscal Reforms on Macro Economic Performance: Recent Trends in Bangladesh", *Bangladesh Journal of Political Economy*, vol. XIII, no. 2 (July 1995), pp. 48 & 49.

[72] Shah Md. Ahsan Habib and Md. Abdur Rashed Kabir,"Real Exchange Behaviour of Taka" *Bank Parikrama*, vol. XXVII, no. 1 (March 2003), p. 40.

[73] Islam, "Exchange Rate Policy of Bangladesh", *op. cit.,* p. 3.

[74] Bangladesh Bank, *Annual Report 2004-05, op. cit.,* p. 52.

[75] Bangladesh Bank, *Monetary Policy Review*, vol. 1, no. 1, *op. cit.,* p. 73.

sales and purchases of foreign exchange by Bangladesh Bank in the floating exchange rate regime have been shown in Table IV-7.

Table IV-7

Sales and Purchases of Foreign Exchange by Bangladesh Bank

(in million US Dollar)

Particulars	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Sale	——	——	459.5	413.0	——	533.0			1279.0
Purchase	503.9	314.0	70.1	77.0	649.5	——	499.2	2161.0	316.5

Source: Bangladesh Bank, *Annual Report, various issues.*

It is evident in the Table that, in the first two Fiscal Years of the floating exchange rate system, Bangladesh Bank did not sell any foreign exchange in the market, but purchased, which indicates healthy inflow of foreign exchange through export and remittances. During these two Fiscal Years, Taka-Dollar exchange rates were almost stable. In FY 2002, FY 2003 and FY 2004 period average exchange rates were Taka 57.43, 57.90 and 58.94 respectively per US Dollar.[76] But during the last half of FY 2005, owing to relatively faster growth in import payments than export receipts, the demand for foreign exchange was much stronger than supply of the same.[77] This generated some depreciating pressure on the Taka-Dollar exchange rates and the period average rate depreciated from Taka 58.94 per US Dollar in FY 2004 to Taka 61.39 per US Dollar in FY 2005.[78] To mitigate this mismatch between the supply of and demand for foreign exchange, Bangladesh Bank intervened in the market by selling a sizeable amount of foreign currency of US Dollar 459.5 million against the purchase of US Dollar 70.1 million in FY 2005. Pressure in the foreign exchange market continued in FY 2006 mainly from continued price hike of oil and petroleum products and major import commodities coupled with higher growth in lending to the private sector, which led to rapid growth in imports demand in the face of slowdown in export earnings.[79] The

[76] Bangladesh Bank, *Economic Trends,* vol. XXXII, no. 10 (October 2007), pp. 84 & 85.

[77] Bangladesh Bank, *Annual Report 2004-05*, *op. cit.,* p. 52.

[78] Bangladesh Bank, *Economic Trends,* vol. XXXII, no. 10, pp. 84 & 85.

[79] Bangladesh Bank, *Annual Report 2005-06*, *op. cit.,* p. 57.

period average exchange rate depreciated from Taka 61.39 per US Dollar in FY 2005 to Taka 67.08 per US Dollar in FY 2006.[80] To ease the situation by increasing the supply of foreign currencies in the market, Bangladesh Bank sold US Dollar 413.0 million as against the purchase of US Dollar 77.0 million in FY 2006. At the end of June 2007, Taka-Dollar exchange rate remained relatively stable with exchange rates at Taka 68.70-69.30 per US Dollar.[81] During FY 2007, Bangladesh Bank purchased US Dollar 649.5 million to absorb excess liquidity from the market. The weighted average exchange rate came down from Taka 68.8000 per US Dollar at the end of June 2007 to Taka 68.5297 per US Dollar at the end of June 2008.[82] During FY 2008, the Bank sold US Dollar 533.0 million (net) to increase liquidity in the foreign exchange market. In the subsequent years Bangladesh Bank intervened in both sides of the foreign exchange market mainly to prevent erratic undue movements in the exchange rates, to ensure adequate liquidity in the domestic foreign exchange market and to build official reserves.[83]

In addition to such occasional interventions, Bangladesh Bank employs tightening or loosening policy in the money market through the auctions of T-bills, *repo* and reverse *repo*s to influence the exchange rate indirectly. These market-based instruments are used to manage liquidity and maintain short-term interest rates at levels appropriate for foreign exchange stability.[84]

The transition to floating exchange rate regime proved exceptionally smooth in Bangladesh, though the attempt sparked much debate and skepticism mounted over probable increase in volatility of exchange rate, apprehended due to adoption of floating exchange rate system.[85] There had been no large volatility of the Taka-US Dollar exchange rate during and immediately after the transition. Just before the float in May 2003, the exchange rate was 57.4 and just after the float in June 2003, the rate moved up to 58.4. From June 2003 to April 2004, the

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[80] Bangladesh Bank, *Economic Trends,* vol. XXXII, no. 10, *op. cit.,* pp. 84 & 85.

[81] Bangladesh Bank, *Annual Report 2006-07*, *op. cit.,* p. 90.

[82] Bangladesh Bank, *Annual Report 2007-08*, *op. cit.,* p. 101.

[83] Bangladesh Bank, *Annual Report 2008-09*, p. 99, *Annual Report 2009-10*, p. 105 & *Annual Report 2010-11*, p. 113.

[84] Bangladesh Bank, *Monetary Policy Review,* vol. 1, no. 1, *op. cit.,* pp. 72 & 73.

[85] For arguments opposing the transition see, Mirza Azizul Islam, "Foreign Exchange Policy of Bangladesh: Not Floating Does Not Mean Sinking", *CPD Occasional Paper,* no. 20 (Dhaka: Centre for Policy Dialogue, 2003).

exchange rate remained fairly stable experiencing a depreciation of less than one per cent.[86] This notable success was the outcome of mainly the elaborate preparatory steps, which Bangladesh Bank took prior to moving towards the new regime. The Bank strengthened the monitoring of the key market variables and liquidity forecasting; it carefully observed the open exchange position of the commercial banks. Further, it withdrew necessary amount of liquidity from the money market using reverse *repo* immediately before the move towards floating regime to avoid any undue fluctuation in the foreign exchange market resulting from speculation.[87] However, since mid 2004 pressure has been building due to several domestic as well as external factors like faster growth of import bills, resulting from two consecutive floods and crop damages creating supply shocks in the economy, rise in the international commodity prices, particularly of crude oil and the expiry of Multi Fibre Agreement (MFA).[88] All these factors caused the interest rate in the inter-bank call money to rise and local currency to depreciate. In this backdrop, Bangladesh Bank intervened in the foreign exchange market by selling US Dollar, which has been discussed earlier.

4.6 Limitations of Monetary Policy

There are certain factors which pose limitations to the efficacy of Monetary Policy pursued by Bangladesh Bank. A brief discussion of those limitations has been given below.

4.6.1 Unorganized Money Market

Many developing countries are characterized by the presence of unorganized money market parallel to the organized money market in the economy. The unorganized market comprises largely by 'indigenous' bankers and do not have any clear demarcation between short-term and long-term finance, not even between the purpose of finance, but has very high rate of interest. In a large number of developing countries, the credit needs of agriculture, small business and industry and a large number of traditional enterprises are still met by the non-banking traditional institutions.[89] The unorganized money market controls a large part of

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[86] Younus and Chowdhury, "Analysis of Bangladesh's Transition", *op.cit.,* p. 4.

[87] *Ibid.*

[88] *Ibid.*

[89] Bhatt, 'Some Aspects of Financial Policies". *op. cit.,* p. 64.

domestic financing and puts limitations on the effectiveness of Monetary Policy pursued by the Central Banks.[90]

4.6.2 Narrow Security Market

Central Banks are to rely on Bank Rate as a quantitative control measure in their Monetary Policy. But in the developing countries the security markets are extremely narrow or even do not exist and commercial bills are virtually absent. This substantially limits the working of Open Market Operations of the Central Banks. Sayers viewed Open Market Operations here "as to be practically prohibitive."[91] In these economies Bank Rate becomes almost insignificant as a discount rate and loses effectiveness as a Monetary Policy tool. Its significance lies primarily as a rate on advances only. The effectiveness of Bank Rate in regulating the movement of foreign short-term funds and its efficacy as a pace-setter for other market rates of interest become blurred.[92] The inoperative Bank Rate restricts the Central Bank's Open Market Operations to such extent that Sayers viewed the Central Banker as sitting in "splendid isolation, twiddling his thumbs".[93]

4.6.3 External Factor

Inflation is not always caused by only demand pulled factors. Specially the recent global price hikes are caused mainly by supply side constraints. Price hike of oil and food in the international market caused by supply shocks are transmitted to the domestic economy through external channels.[94] Moreover the frequent in-country natural calamities also create supply shock driven inflation. Bangladesh Bank's Monetary Policy, like other countries has little to do immediately regarding these supply side constraints.

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[90] H. V. R. Iengar*, Monetary Policy and Economic Growth* (Bombay: Vora & Co., Publishers Pvt. Ltd., 1962), pp. 192 & 193.

[91] R. S. Sayers, "Central Banking in Underdeveloped Countries", (Commemoration Lectures, National Bank of Egypt, Cairo, April 1956), *Central Banking after Bagehot* (London: Oxford University Press, 1957), p. 127.

[92] Iengar*, Monetary Policy and Economic Growth, op.cit.,* p. 194.

[93] Sayers, "Central Banking in Underdeveloped Countries", *op.cit.,* p. 113.

[94] Bangladesh Bank, *Annual Report*, various issues.

4.6.4 Lack of Central Bank Independence

Bangladesh Bank enjoys substantial degree of independence. But still Government's budget deficit poses threat to the efficacy of Monetary Policy in Bangladesh. The institutional arrangement between Bangladesh Bank and the Government is such that the latter can borrow virtually any amount from the former as and when needed. It has been found that, the deficit financing in Bangladesh was largely volatile on which the Government had little control. In such a situation, to restrict the growth of reserve money only with monetary management is not possible.

4.7 Conclusion

Monetary Policy in Bangladesh is being pursued within the background of structural rigidities of Bangladesh economy. At the same time, in the present globalised atmosphere, the external factors also generate substantial influence on it. The interrelationship between money supply and inflation rate although has not been straight forward in Bangladesh, monetary restrain and/or easy Monetary Policy was pursued by Bangladesh Bank as per the changing requirements of the economy. The Bank brought about significant changes in conducting Monetary Policy regarding its instruments. It is also trying to maintain the international standard in conducting Foreign Exchange Policy. It is generally recognized that, the Central Bank solely on its own cannot ensure price stability. A well coordinated effort of Monetary Policy and Fiscal Policy is imperative to attain the policy goals. Central Bank independence is also a vital element to ensure proper efficacy of Monetary Policy.

The next Chapter deals with the role of Bangladesh Bank as a banker of the scheduled banks.

CHAPTER V

ROLE OF BANGLADESH BANK AS A BANKER OF THE SCHEDULED BANKS

5.1 Introduction

Central Banks around the globe perform the role of bankers' banks of their own financial systems. In fact, this role is more fundamental and universally acknowledged duty of a Central Bank than to serve as a banker to the public and to the government.[1] The relationship between the Central Bank and the commercial banks is similar to that between commercial banks and members of the public.[2] Bangladesh Bank is no exception of that; rather being a Central Bank of a developing economy, it is supposed to assert more comprehensive role in this respect than those of the developed countries. Article 7A of the Bangladesh Bank Order, 1972 entrusted Bangladesh Bank with the function among others to regulate and supervise the banking companies and financial institutions. The Bank Company Act, 1991 provides the legal basis in this regard to issue necessary regulations requiring the bank companies to comply with.

Bangladesh Bank provides financial support to the banks in crises and stands as the 'lender of last resort'. It also keeps deposits of the scheduled banks. But the phenomenon 'banker of the banks' does not confine to these two functions only. As a banker of the banks, Bangladesh Bank also regulates and supervises different aspects of the banking companies, which in turn facilitate the business of the banking companies as well as, financial health of the country. For the purpose of regulation and supervision, it formulates different policies and guidelines, imposes instructions and restrictions on the banking sector. It also revises the policies from time to time to serve the changing situations and to achieve international standard. These policies, guidelines, instructions,

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[1] R. S. Sayers, *Central Banking after Bagehot* (London: Oxford University Press, 1957), p. 120.

[2] Subrata Ghatak, *Monetary Economics in Developing Countries* (London: The Macmillan Press Ltd, 1981), p. 38.

restrictions and revisions are conveyed to the banks through different circulars. Significant changes have been occurred in the role of Bangladesh Bank under the Financial Sector Reform Programme (FSRP), which Bangladesh Bank embarked upon in 1990. The role, Bangladesh Bank performs as a banker of banks has been discussed in the subsequent sections of this chapter.

5.2 Lender of the Last Resort

A brief sketch of the theoretical background and historical evolution of the role of Central Bank as lender of the last resort will help us to understand the role, played by Bangladesh Bank in this regard. The idea of the Central Bank as lender of last resort is as old as the idea of central banking itself. The phrase 'lender of last resort' was coined by Walter Bagehot in 1873 in his still celebrated book *Lombard Street: a Description of the Money Market.*[3] He used this idea to outline the responsibility of the Bank of England specially in a situation like peak of business cycle. The principle of central banking for the Bank of England according to Bagehot regarding this function was to hold a larger stock of reserves in its banking department than prudent profit maximisation would require. The larger stock of reserves was to enable the Bank of England to ride out temporary shocks to balance of payments without imposing domestic monetary contraction, and to respond in a measured way to more deep seated external drains so as to give the domestic banking system time to adjust.[4] After final recognition of this idea and successful handling of some crises by the Bank of England, this function was also assumed by similar banks in other countries and came to be regarded as a *sine qua non* of central banking.[5]

For well over a century the concept of lender of last resort lay at the heart of discussions of central banking. But, in the recent years, there have been major changes in the theory of central banking. Maintenance of gold reserves now ceased to be an over-riding priority for the Central Banks. Modern financial

[3] M. H. de Kock, *Central Banking* (4th ed.; New Delhi: Universal Book Stall, 1995), p. 92.

[4] For details see, David Laidler, "Central Bank as the Lender of Last Resort- Trendy or Passe", a paper prepared for presentation at the conference on *Central Banking and the Financial System*, held under the auspices of the National Bank of Poland, October 7-8, 2004 in Warsaw.

[5] Kock, *Central Banking*, *op. cit.,* p. 92.

institutions have to operate within stringent regulatory and supervisory framework. Banks are now subject to prudent capital adequacy requirements and are exposed to regular oversight of activities, mainly by assigned departments of Central Bank and sometimes by separate regulators. All these developments relieve the modern Central Banks considerably from providing liquidity to the banks in a conventional 'lender of last resort way'.

Bangladesh Bank provides credit to the financial institutions when there are no better sources open to these institutions. Until 2002, Bangladesh Bank used the Bank Rate as a principal instrument to lend the desired level of liquidity in the financial system. Bank Rate was employed also as a prime instrument in its credit policy and hence of Monetary Policy. Bangladesh Bank assumed significantly important role as lender of last resort, through Bank Rate specially in the absence of a well organized money market. At present, Bank Rate is 5 percent, which is in effect since November 06, 2003.[6] Bangladesh Bank has of late started to use indirect but market based instruments of Monetary Policy to manage liquidity in the financial sector.[7] It introduced Repo (Repurchase Agreement) in July 2002 in this respect and placed greater importance on it than the Bank Rate for lending to the financial institutions.[8] Through Repo Operation, Bangladesh Bank lends fund to the banks and financial institutions by purchasing security, which the bank or financial institutions repurchase upon maturity. The Repo rate is determined through an auction process, held on each working day at Bangladesh Bank.[9]

Total borrowing by Deposit Money Banks (DMBs) from Bangladesh Bank has been shown in Table V-1. The Table shows that, Bangladesh Bank is not only the lender of last resort, but also is the largest source of borrowing for the banking companies.

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[6] Bangladesh Bank, *Annual Report 2006-07* (Dhaka: Department of Public Relations and Publications, Bangladesh Bank, 2008), p. 45.

[7] Bangladesh Bank, *Monetary Policy Review,* vol. 1, no. 1 (Dhaka: Policy Analysis Unit, Research Department, Bangladesh Bank, October 2005), p. 113.

[8] *Ibid.,* p. 47.

[9] *Ibid.*

Table V-1

Borrowing of Deposit Money Banks

(Taka in crores)

End of Period	Borrowing of Deposit Money Banks					Share of Borrowing from Bangladesh Bank in Total DMB Borrowing (in percent)	SGR of DMB Borrowing from Bangladesh Bank (in percent)
	From Government	From Bangladesh Bank	From Banks	From other Financial Institutions	Total		
1	2	3	4	5	6	7	8
1974-75	42.7	108.8	22.0	33.0	206.5	52.69	—
1975-76	23.4	64.7	40.9	44.8	173.8	37.23	-40.53
1976-77	11.7	115.9	44.0	60.0	231.6	50.04	79.13
1977-78	51.5	229.6	55.3	29.0	365.4	62.84	98.10
1978-79	66.4	364.8	39.0	37.1	507.3	71.91	58.89
1979-80	112.7	724.1	27.7	35.9	900.4	80.42	98.49
1980-81	133.3	921.3	9.7	39.0	1103.3	83.50	27.23
1981-82	209.5	1339.6	19.1	42.3	1610.5	83.18	45.40
1982-83	280.3	1218.9	28.1	53.6	1580.9	77.10	-9.01
1983-84	401.3	1275.0	65.6	81.3	1823.2	69.93	4.60
1984-85	479.1	2080.8	85.0	110.4	2755.3	75.52	63.20
1985-86	630.2	2277.5	132.0	0.4	3040.1	74.92	9.45
1986-87	601.8	1953.1	126.6	0.4	2681.9	72.83	-14.24
1987-88	410.0	2589.1	317.6	13.8	3330.5	77.74	32.56
1988-89	410.9	3254.4	240.9	10.0	3916.2	83.10	25.70
1989-90	408.0	4117.7	201.6	13.8	4741.1	86.85	26.53
1990-91	438.9	4175.2	172.1	—	4786.2	87.23	1.40
1991-92	494.1	3628.9	114.7	10.0	4247.7	85.43	-13.08
1992-93	517.9	3080.3	59.6	—	3657.8	84.21	-15.12
1993-94	536.0	2687.4	325.6	—	3549.0	75.72	-12.76
1994-95	605.8	3001.5	625.6	—	4232.9	70.91	11.69
1995-96	627.4	3622.3	572.1	—	4821.8	75.12	20.68
1996-97	676.9	3928.5	651.9	—	5257.3	74.72	8.45
1997-98	710.7	4041.4	1020.9	—	5773.0	70.01	2.87
1998-99	671.2	4956.2	1106.2	48.4	6782.0	73.08	22.64
1999-2000	590.4	4566.1	1509.1	19.8	6685.4	68.30	-7.87
2000-01	558.3	4648.2	1995.8	—	7202.3	64.54	1.80
2001-02	602.4	4993.5	1368.6	7.0	6971.5	71.63	7.43
2002-03	578.7	4906.9	1349.1	—	6834.7	71.79	-1.73
2003-04	622.3	5382.0	1932.9	63.5	8000.7	67.27	9.68
2004-05	659.2	5599.9	1384.8	499.9	8143.8	68.76	4.05
2005-06	626.2	7046.6	2590.5	656.1	10919.4	64.53	25.83
2006-07	602.1	5735.6	1613.8	661.8	8613.3	66.59	-18.60
2007-08	758.8	6684.7	4086.1	1564.7	13094.3	51.05	16.55
2008-09	1208.5	6102.0	2594.2	1213.6	11118.3	54.88	-8.72

(Continued to next page)

2009-10	1749.5	5852.1	5087.3	1561.7	14250.6	41.07	-4.10
2010-11	1959.3	17833.4	3960.3	2329.2	26082.2	68.37	204.74
2011-12	2320.0	21671.6	9197.0	3377.7	36566.3	59.27	21.52
Annual Average						**69.85**	**21.16**

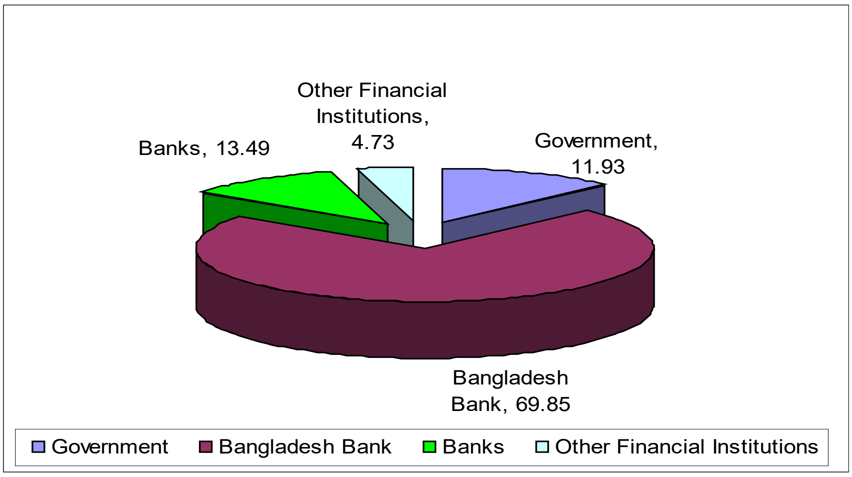
Source: Bangladesh Bank, *Economic Trends*, various issues and the Researcher's own calculation.

The Table shows that, in FY 1974-75 total borrowing of DMBs from all the sources was Taka 206.5 crore, out of which borrowing from Bangladesh Bank alone was Taka 108.8 crore, constituting 52.69 percent share in the total borrowing. In the next thirty-two fiscal years to FY 2005-06, total borrowing of the DMBs and DMB's borrowing from Bangladesh Bank increased commendably with very few exceptions. Share of borrowing from Bangladesh Bank in total DMB borrowing was the highest 87.23 percent in FY 1990-91. In FY 2011-12, the share was 59.27 percent. In the period under consideration, average share of borrowing from Bangladesh Bank in total DMB borrowing was 69.85 percent and the average Simple Growth Rate (SGR) of DMB borrowing from Bangladesh Bank was 21.16 percent, both demonstrating the 'lender of last resort' role of Bangladesh Bank.

The annual average percentage share of borrowing from different sources in total DMB borrowing from FY 1974-75 to FY 2011-12 has been depicted in Figure V-1. The highest share of Bangladesh Bank by huge margin is distinctly seen in the Figure.

Figure V-1

Average Shares of Different Sources in Total DMB Borrowing (from FY 1974-75 to FY 2011-12)



Source: Table V-1.

5.3 Keeping Deposits of the Banks

Bangladesh Bank as a banker of the banks keeps deposits of the banks operating in Bangladesh. It does not pay any interest to the banks for such deposits. The banks are to maintain Statutory Liquidity Requirement (SLR) inclusive of Cash Reserve Requirement (CRR) as certain percentage of their deposits on bi-weekly basis. The CRR is to be kept with the Bangladesh Bank and the remainder may be kept in cash or in Government securities. Balances of DMBs with Bangladesh Bank have been shown in Table V-2.

Table V-2
Balances of Deposit Money Banks with Bangladesh Bank

(Taka in crores)

End of Period	Cash Reserve Requirement	As Excess Reserve	Total Deposit	Growth Rate of Total Deposit (%)
1974-75	53.80	38.00	91.80	
1975-76	61.80	36.40	98.20	6.97
1976-77	77.20	28.80	106.00	7.94
1977-78	91.20	17.40	108.60	2.45
1978-79	117.00	36.70	153.70	41.53
1979-80	142.50	106.80	249.30	62.20
1980-81	174.60	89.70	264.30	6.02
1981-82	196.70	56.90	253.60	-4.05
1982-83	257.30	0.60	257.90	1.70
1983-84	372.00	34.00	406.00	57.43
1984-85	478.10	135.20	613.30	51.06
1985-86	569.00	106.80	675.80	10.19
1986-87	673.80	294.40	968.20	43.27
1987-88	1569.90	311.60	1881.50	94.33
1988-89	1833.00	233.90	2066.90	9.85
1989-90	2067.80	161.70	2229.50	7.87
1990-91	1880.20	422.10	2302.30	3.27
1991-92	1366.70	618.80	1985.50	-13.76
1992-93	1531.20	2290.10	3821.30	92.46
1993-94	1754.80	3095.20	4850.00	26.92
1994-95	2012.20	1753.10	3765.30	-22.36
1995-96	2179.70	1125.90	3305.60	-12.21
1996-97	2427.60	1674.40	4102.00	24.09
1997-98	2716.90	2002.10	4719.00	15.04
1998-99	3089.70	2611.30	5701.00	20.81
1999-2000	2928.40	2906.60	5835.00	2.35
2000-01	3390.60	3271.00	6661.60	14.17
2001-02	3842.50	2841.00	6683.50	0.33
2002-03	4390.70	1694.80	6085.50	-8.95
2003-04	4956.60	1602.00	6558.60	7.77
2004-05	6663.30	373.10	7036.40	7.29

(continued to next page)

2005-06	8622.70	387.30	9010.00	28.05
2006-07	10010.20	563.40	10573.60	17.35
2007-08	11750.30	56.40	11806.70	11.66
2008-09	14132.00	9027.50	23159.50	96.16
2009-2010	18741.50	4726.50	23468.00	1.33
2010-11	24955.90	4051.80	29007.70	23.61
2011-12	29830.80	2831.50	32662.30	12.60
Annual Average Growth Rate				**20.18**

Source: Bangladesh Bank, *Economic Trends,* various issues.

Bangladesh Bank changes the ratios of SLR and CRR from time to time in pursuance of its Monetary Policy to control money supply in the economy. At present SLR is 19 percent inclusive of average 6.0 percent CRR, which is in effect since 15 December 2010.[10]

5.4 Bank of Clearance, Settlement and Transfer

Cash continues to be the predominantly used medium of transactions in Bangladesh owing to its intrinsic convenience, while the domestic cheque system acts as the second most important medium of payment for national payments. The domestic cheque system includes all non-cash payment instruments like cheques, bank drafts, payment orders, dividend, refund warrants, bills etc. Apart from such non-cash payment instruments, transactions through credit card, debit card and ATM are becoming popular specially in the urban areas. Such non-cash transactions call for inter-bank clearance, settlement and transfer—daily and periodically. Bangladesh Bank as a banker of the banks facilitates the inter-bank clearance, settlement and transfer.

Bangladesh Bank performs the core functions relating to the payment systems under Article 26 of the Bangladesh Bank Order, 1972 through its Department of Currency Management & Payment Systems. Article 7 (A) of the same Order mentions "to promote, regulate and ensure a secured and efficient payment system, including the issue of bank notes" as a main function of Bangladesh Bank. The Bank provides inter-bank settlement facilities to the financial intermediaries through the current accounts, they hold on its books.[11]

[10] Bangladesh Bank, *Annual Report 2006-07*, *op. cit.,* p. 45.

[11] Bangladesh Bank, *Annual Report 2004-05*, *op. cit.,*p. 81.

Prior to 7 October 2010 there had been four payment and settlement systems operating in Bangladesh. They were: [12]

(a) Bangladesh Bank's Clearing Houses in Dhaka and its branches in seven other cities;

(b) Sonali Bank's Clearing Houses in 31 towns where there are no Bangladesh Bank branches;

(c) Bangladesh Bank large value cheque settlement system;[13] and

(d) Bangladesh Bank Foreign Currency Clearing System in Dhaka.

Four clearings were held each day at Bangladesh Bank's Clearing Houses in each branch.

With a view to develop a fast, secure and inclusive electronic payment system, Bangladesh Bank took several initiatives to replace the traditional paper based clearing and settlement system by an IT-centric clearing system. The initiatives are mentioned below.

5.4.1 Bangladesh Automated Clearing House (BACH)

Bangladesh Bank started working to implement Bangladesh Automated Clearing House (BACH), the first electronic clearing house in the country with the technical and financial assistance from Department for International Development (DFID) of United Kingdom (UK), from October 2006. It started 'Live Operation' on 7 October 2010.[14] BACH has two components – the Bangladesh Automated Cheque Processing System (BACPS) and the Electronic Funds Transfer (EFT). BACPS system supports both intraregional and inter-regional clearing and is based on a centralised processing center located in Dhaka and in designated clearing regions. For the functioning of BACH all the clearing instruments, i.e. cheques, drafts, pay orders, dividend and refund warrants, etc. have been standardised. Each instrument was encoded with MICR line which includes information on the amount, transaction code, clients account, routing number and

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[12] Bangladesh Bank, *Annual Report 2006-07*, *op. cit.,*p. 94.

[13] Cheques drawn on Bangladesh Bank by commercial banks, used mainly for inter-bank transactions and for Government payments are considered as large value transactions.

[14] Bangladesh Bank, *Annual Report 2010-11* (Dhaka: Department of Public Relations and Publications, Bangladesh Bank, 2008), pp. 121 & 123.

the cheque leaf's serial number. At present, 85,000 (approximately) regular and 3000 high value cheques and other instruments are cleared through BACPS. On an average, 85 percent of the clearing instruments are cleared through clearing house. Total amount of regular value instruments cleared is approximately Taka 25 billion and it is approximately Taka 20 billion for high value instruments.[15]

Bangladesh Electronic Funds Transfer Network (BEFTN) is a critical component in the development of a modern payments system infrastructure. BEFTN started its 'Live Operation' on 28 February 2011 with 47 banks of the country. The network started with credit transactions and will gradually progress to debit transactions. A wide variety of credit transfer applications such as payroll, foreign and domestic remittances, social security, company dividends, retirement, expense reimbursement, bill payments, corporate payments, Government tax payments, veterans payments, Government license fees and person to person payments as well as debit transfer applications such as mortgage payments, membership dues, loan payments, insurance premiums, utility bill payments, company cash concentration, Government tax payments, Government licenses and fees are settled under the network. At the initial stage, approximately 1500-1600 EFT transactions are processed on an average with an increasing trend. The amount transferred using EFTN is approximately Taka 120 million per day. The ultimate objective of the EFT system is to lessen paper-based payment methods and encourage paper-less payment methods for faster and cost-effective transactions specially at the corporate levels.[16]

5.4.2 National Payment Switch (NPS)

Bangladesh Bank has taken initiative to establish National Payment Switch (NPS) in order to facilitate interbank electronic payments originating from different delivery channels e.g. Automated Teller Machines (ATM), Point of Sales (POS), Internet, Mobile Applications, etc. The main objective of NPS is to create a common platform among the existing shared switches already built-up by different private sector operators. NPS will facilitate the expansion of the card based payment networks substantially and promote e-commerce throughout the country. Online payment of Government dues, using cards and account number information through internet will greatly be enhanced using NPS.

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[15] *Ibid.,* p. 123.

[16] *Ibid.,* p. 124.

Bangladesh Bank has established a Center for Payment Expertise (CPE) for developing expertise on the core competencies for payment systems policy and operations.[17]

5.4.3 Mobile Financial Service (MFS)

Bangladesh Bank introduced mobile financial services in Bangladesh in order to bring the vast unbanked / under-banked population under the umbrella of formal financial service. A variety of services including disbursement of inward foreign remittance and domestic fund, payment of utility bills, salary, allowances, pension, buying and selling of goods and services, balance inquiry, tax payment, Government subsidy payment and payment of the benefits of social safety nets can easily and quickly be provided through mobile financial services. This service is available 24 hours a day and seven days a week.

Bangladesh Bank issued the 'Guidelines for Mobile Financial Services for the Banks' on 22 September 2011.[18] Till March 2012, excluding remittance-only deployments, number of banks licensed by Bangladesh Bank was 10 and the number of live MFS deployments was five. During this time 9093 agents have been appointed and 4,42,269 mobile accounts have been opened. Total value of transactions was Taka 207 crore.[19] At present, daily volume of transaction through MFS is Taka 350 million. The volume of transaction is increasing at a rate of 15 percent per month. Approximately Taka 35 billion has been disbursed through MFS. Around 12000 railway tickets are sold per month using MFS.[20]

5.4.4 e-commerce & m-commerce

In order to start m-commerce in Bangladesh, mobile network operators have been given permission to sell railway tickets and tickets of cricket matches organised by the Bangladesh Cricket Board (BCB) using mobile technology.

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[17] *Ibid.*

[18] Bangladesh Bank, DCMPS Circular No. 08, dated September 22, 2011.

[19] Bangladesh Bank, *Mobile Financial Services in Bangladesh: An Overview of Market Development* (Dhaka: Research Department, Bangladesh Bank, July 2012), p, 9..

[20] Bangladesh Bank, *Developmental Central Banking in Bangladesh: Recent Reforms and Achievements (2009-2012)* (Dhaka: Bangladesh Bank, n. d.), p. 16.

Bangladesh Bank has issued directives regarding ecommerce activities like online payment of utility bills; online funds transfer between clients of the banks, credit card based internet payment in local currency, etc.[21]

5.5 Licensing of Banking Companies

Licensing of the bank companies in Bangladesh has been entrusted to Bangladesh Bank under section (31) of the Bank Companies Act (BCA), 1991. Every bank company in Bangladesh is to make an appeal in writing to Bangladesh Bank within certain period of time for getting the license. Bangladesh Bank may impose any condition that it considers fit and reasonable during issuing the license.[22] According to sub-section (4) of section (31), before granting the licence Bangladesh Bank has the authority to be satisfied by inspecting, or otherwise that the company is or will be in a position to pay the claims of its present or future depositors in full and the affairs of the company are not being or are not likely to be conducted in a manner detrimental to the interests of its present or future depositors. A banking company incorporated outside Bangladesh, subject to compliance with all the provisions of this Act, shall be provided the same facilities as the companies incorporated in Bangladesh.[23]

Bangladesh Bank may cancel a licence granted to a banking company if the company ceases to carry on banking business in Bangladesh, if the company at any time fails to comply with any of the conditions imposed upon it under subsection (2); or if at any time that company fails to fulfill any of the conditions mentioned under subsection (4).[24] In specific cases the Bank may provide the banking companies an opportunity of taking the necessary steps for complying with the provisions of those clauses.

5.6 Capital Adequacy of Banks

Adequate capital provides the banks the necessary financial strength to absorb potential losses incurring from different types of risks, which the banks are

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[21] Bangladesh Bank, *Annual Report 2010-11, op. cit.,* p.124.

[22] Abdul Kuddus Biplab, *Bank Company Laws Manual* (Dhaka: Hosne Ara (Onu) and Murshida Akhter, 2006), p. 43.

[23] *Ibid.*, p. 44.

[24] *Ibid.,* p. 45.

typically exposed to. Though capital by itself cannot provide the liquidity needed in such circumstances, but by being demonstrably sufficient to safeguard the bank's solvency, it preserves the confidence of the depositors and makes a bank less likely to suffer a run on its deposits. Moreover, a bank with a sound capital position enjoys confidence of other financial institutions, replaces any outflow of funds with new deposits and thus minimizes the fear of financial instability.[25] Bangladesh Bank as the regulator of the banks in Bangladesh formulated the policy on capital adequacy, fixed the norms of adequacy and from time to time made amendments to upgrade the norms of adequacy to international standard.

Until January 1996, banks in Bangladesh were to follow the capital-to-liabilities approach regarding capital adequacy. According to this approach, banks were required to maintain at least six percent of their demand and time liabilities as capital base, or Taka 200 million for banks incorporated in Bangladesh and Taka 100 million for banks incorporated outside Bangladesh, whichever is higher.[26] In January 1996, Bangladesh Bank replacing the old approach introduced an arrangement for assessing capital adequacy of banks on the basis of risk-weighted assets in line with Basel Accord I.[27] The policy on capital adequacy takes account of different degrees of credit risk and covers both on-balance sheet and off-balance sheet transactions. This policy required the banks to maintain a ratio of capital to Risk-Weighted Assets (RWA) of not less than eight percent with at least four percent in core capital. In September 2002, Bangladesh Bank raised the minimum capital requirement from eight percent to nine percent of RWA, wherein core capital should not be less than 4.5 percent.[28] In November 2002, Bangladesh Bank issued a master circular on capital adequacy which required the banks to maintain substantially higher capital requirements of Taka 400 million (40 crore) for locally incorporated banks and an amount equivalent to US$ ten million for banks incorporated outside Bangladesh.[29] In March 2003 Bangladesh Bank made significant amendment in

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[25] Bangladesh Bank, *Financial Sector Review,* vol. 1, no. 1 (Dhaka: Policy Analysis Unit, Research Department, Bangladesh Bank, May 2006), p. 115.

[26] *Ibid.*

[27] Bangladesh Bank, BRPD Circular No. 1, dated January 08, 1996.

[28] Bangladesh Bank, BRPD Circular No. 8, dated September 07, 2002.

[29] Bangladesh Bank, BRPD Circular No. 10, dated November 25, 2002.

the capital regulation.[30] According to this amendment, the scheduled banks are required to maintain paid up capital and reserve fund of Taka one billion (100 crore) or nine percent RWA, whichever is higher. With a view to strengthening the capital base of banks and make them prepare for the implementation of Basel II Accord, Bangladesh Bank made another amendment in the capital adequacy policy which requires the banks to maintain capital to RWA ratio of 10% at the minimum with core capital not less than 5% by December 31, 2007.[31]

To cope with the international best practices and to make the bank's capital more risk sensitive as well as more shock resilient, 'Guidelines on Risk Based Capital Adequacy (RBCA) for Banks' (Revised regulatory capital framework in line with Basel II)[32] have been introduced from January 01, 2009 parallel to existing BRPD Circular No. 10, dated November 25, 2002. At the end of one year parallel run period with Basel I, Basel II regime has been started and the guidelines on RBCA have come fully into force from January 01, 2010.[33] These guidelines have been structured on following three aspects:[34]

(a) Minimum capital requirement has been defined and to be maintained by a bank on solo basis as well as consolidated basis against RWA for credit, market, and operational risks.

(b) Process for assessing the overall capital adequacy aligned with comprehensive risk management of a bank.

(c) Framework of public disclosure on the position of a bank's risk profiles, capital adequacy, and risk management system.

Main features of the Guidelines are as follows:[35]

5.6.1 Definition of Capital

Capital has been defined differently for the local banks and for the foreign banks operating in Bangladesh.

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[30] Bangladesh Bank, BRPD Circular No. 10, dated March 30, 2003.

[31] Bangladesh Bank, BRPD Circular No. 5, dated May 14, 2007.

[32] Bangladesh Bank, BRPD Circular No. 35/2010.

[33] Bangladesh Bank, *Guidelines on Risk Based Capital Adequacy: Revised Regulatory Framework in Line with Basel II* (Dhaka: Bangladesh Bank, August 2010), p. i.

[34] Bangladesh Bank, *Prudential Regulations for Banks: Selected Issues* (Dhaka: Bangladesh Bank, September 2011), p. 7.

[35] *Ibid*., pp. 7 & 8.

5.6.1.1 Capital for Local Banks

Regulatory capital for the local banks has been categorized into three tiers viz., tier 1 capital called 'Core Capital', tier 2 capital called 'Supplementary Capital' and tier 3 capital called 'Additional Supplementary Capital'. The constituents of these capitals are as follows:

5.6.1.1.1 Tier 1 Capital

Tier-1 capital, called 'Core Capital' consists of the highest quality capital elements. The following components constitute the core capital for the local banks:

(a) Paid up capital;
(b) Non-repayable share premium account;
(c) Statutory reserve;
(d) General reserve;
(e) Retained earnings;
(f) Minority interest in subsidiaries;
(g) Non-cumulative irredeemable preference shares;
(h) Dividend equalization account.

5.6.1.1.2 Tier 2 Capital

Tier-2 capital, called 'Supplementary Capital' represents other elements, which fall short of some of the characteristics of the core capital but contribute to the overall strength of a bank. The following components constitute the Tier 2 capital for the local banks.

(a) General provision maintained against unclassified loans,
(b) Revaluation reserves:
  - Revaluation reserve for fixed assets,
  - Revaluation reserve for securities,
  - Revaluation reserve for equity instrument.

(c) All other preference shares,
(d) Subordinated debt.

5.6.1.1.3 Tier 3 Capital

Tier 3 capital, called 'Additional Supplementary Capital', consists of short-term subordinated debt. This would be used solely for the purpose of meeting a proportion of the capital requirements for market risk.

5.6.1.2 Capital for Foreign Banks Operating in Bangladesh

5.6.1.2.1 Tier 1 Capital

Tier 1 capital for the foreign banks operating in Bangladesh consists of the following items.

a) Funds from head office,

b) Remittable profit retained as capital,

c) Any other items approved by Bangladesh Bank for inclusion in Tier 1 capital.

5.6.1.2.2 Tier 2 Capital

Tier 2 capital consists of the following items.

a) General provision,

b) Borrowing from head office in foreign currency in compliance with the regulatory requirement,

c) Revaluation reserve for securities,

d) Any other items approved by Bangladesh Bank for inclusion in Tier 2 capital.

5.6.2 Conditions for Maintaining Regulatory Capital

The calculation of Tier 1 capital, Tier 2 capital, and Tier 3 capital shall be subject to the following conditions:[36]

a) The amount of Tier 2 capital will be limited to 100% of the amount of Tier 1 capital.

b) 50% of revaluation reserves for fixed assets and securities eligible for Tier 2 capital.

c) 10% of revaluation reserves for equity instruments eligible for Tier 2 capital.

d) Subordinated debt shall be limited to a maximum of 30% of the amount of Tier 1 capital.

e) Limitation of Tier 3: A minimum of about 28.5% of market risk needs to be supported by Tier 1 capital. Supporting of market risk from Tier 3 capital shall be limited up to maximum of 250% of a bank's Tier 1 capital that is available after meeting credit risk capital requirement.

[36] *Ibid.,* p.8.

5.6.3 Eligible Regulatory Capital

To obtain the eligible regulatory capital for calculating Capital Adequacy Ratio (CAR), banks are required to make following deductions from their Tier-1 capital:[37]

a) Intangible assets e.g., book value of goodwill and value of any contingent assets, etc. which are shown as assets.

b) Shortfall in provisions required against classified assets.

c) Shortfall in provisions required against investment in shares.

d) Remaining deficit on account of revaluation of investments in securities after netting off from any other surplus on the securities.

e) Reciprocal/crossholdings of bank's capital/subordinated debt artificially intended to inflate the capital position of banks.

f) Holding of equity shares in any form exceeding the approved limit under section 26 (2) of Bank Company Act, 1991. The additional/unauthorized amount of holdings will be deducted at 50% from Tier 1 capital and 50% from Tier 2 capital.

g) Investments in subsidiaries which are not consolidated: The normal practice is to consolidate subsidiaries for the purpose of assessing the capital adequacy of banking groups. Where this is not done, deduction is essential to prevent the multiple uses of the same capital resources in different parts of the group. The deduction for such investments will be 50% from Tier 1 capital and 50% from Tier 2 capital. The assets representing the investments in subsidiary companies whose capital had been deducted from that of the parent would not be included in total assets for the purposes of computing the CAR.

Eligible Tier 2 capital will be derived after deducting components (if any) qualified for deduction. Total eligible regulatory capital will be calculated by summing up the eligible Tier 1, Tier 2 and Tier 3 capital.

5.6.4 Minimum Capital Requirement (MCR)

Minimum Capital Requirement (MCR) for each scheduled bank in Bangladesh will be 9% of total Risk Weighted Assets (RWA) from July 2010 to June 2011 and 10% of total RWA from July 2011 to onwards or the amount determined by Bangladesh Bank from time to time. Banks have to maintain at least 50% of required capital as Tier 1 capital.[38]

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[37] *Ibid.,* p.9.

[38] *Ibid.*

5.6.5 Calculating Risk-weighted Assets

Under the guidelines, for calculating Risk Weighted Assets, Standardized Approach for Credit Risk, Standardized (Rule Based) Approach for Market Risk and Basic Indicator Approach for Operational Risk are being followed. These approaches are specifically explained in the Guidelines.[39]

5.6.6 Supervisory Review Process (SRP) - Supervisory Review Evaluation Process (SREP)

According to the Guidelines, banks would have a process for assessing overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital at an adequate level. Banks have been asked to form an exclusive body (called SRP team) where risk management unit is an integral part, and a process document (called Internal Capital Adequacy Assessment Process-ICAAP) for assessing their overall risk profile, and a strategy for maintaining adequate capital.[40]

Supervisory Review Evaluation Process (SREP) of Bangladesh Bank includes dialogue between the Bangladesh Bank and the bank's SRP team followed by findings/evaluation of the bank's ICAAP. During SRP-SREP dialogue Bangladesh Bank will review and determine additional capital to MCR of banks.[41]

5.6.7 Reporting Requirement

The banks are required to submit the Risk Based Capital Adequacy (RBCA) report in prescribed formats on quarterly basis within the next 30 days of each quarter-end to the Department of Off-site Supervision of Bangladesh Bank.[42]

5.6.8 Penalty for non-compliance

Bangladesh Bank may impose penalty and/or punishment as per Bank Company Act, 1991, if a bank fails to meet minimum capital or CAR within the stipulated period or willfully furnishes any false information in the reporting or fails to submit the RBCA report within stipulated time without any acceptable/ satisfactory reason.[43]

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[39] *Ibid.,* p.10.

[40] *Ibid.,* pp.10 & 11.

[41] *Ibid.,* p.11.

[42] *Ibid.*

[43] *Ibid.*

5.7 Quality of Loan Portfolio

The lending function of any bank is typically exposed to credit risk or default risk. Default loans or non-performing loans have many adverse economic implications like stoppage of creating new loans, erosion of bank's profitability, liquidity and solvency, which in turn might lead towards collapse of the banking financial system. Proper and prudent management of default risk helps reduce non-performing loans and thus contribute to the quality of loan portfolio. Since 1980s, the Central Banks of the developing world following the practices of the developed economies, have adopted the "prudential norms for asset classification" with a view to ensure transparency and quality of the loan portfolio of the banks.[44] Bangladesh Bank as the regulator of the banking system of Bangladesh took various measures in this regard, which may be grouped as follows:

(1) Policy on Loan Classification and Provisioning;
(2) Payment of Dividend by Bank Companies;
(3) Policy for Rescheduling of Loans;
(4) Policy for Loan Write-off;
(5) Policy on Single Borrower Exposure;
(6) Large Loan Restructuring Scheme (LLRS);
(7) Restriction on Lending to Directors of Private Banks;
(8) Credit Information Bureau (CIB).

These policies and regulations have been discussed in brief in the following sub-sections to see as to how the Bangladesh Bank acts as a banker of the banks in respect of loan portfolio of the banks.

5.7.1 Policy on Loan Classification and Provisioning

In November 1989, Bangladesh Bank formally introduced loan classification and provisioning system in Bangladesh.[45] During the early phases of classification, the Development Financial Institutions (DFIs) were kept outside the classification system. Later on in 1997, they were brought under the system. The process of gradually upgrading the policies on loan classification and provisioning to the

[44] Toufic Ahmad Choudhury and Bishnu Kumar Adhikary, "Loan Classification, Provisioning Requirement and Recovery Strategies: a Comparative Study on Bangladesh and India," *Bank Parikrama*, vol. XXVII, nos. 2 & 3 (June & September 2002), pp. 134 & 135.

[45] Bangladesh Bank, BCD Circular No. 34, dated November 16, 1989.

international level is going on. The main features of the current loan classification and provisioning system are as follows.[46]

5.7.1.1 Categories of Loans

All loans and advances from the banking sector of Bangladesh will be grouped into four categories viz., (i) continuous loan, (ii) demand loan, (iii) fixed term loan and (iv) short-term agricultural credit for the purpose of classification.[47]

5.7.1.2 Basis for Loan Classification

According to the current policy on loan classification and provisioning, the banks are to use both objective criteria and qualitative judgment criteria to deem a loan classified or unclassified.

5.7.1.2.1 Objective Criteria

Overdue criterion shall be followed as objective criteria for the purpose of loan classification. All unclassified loans other than Special Mention Account (SMA) are to be treated as standard. A continuous loan, demand loan or a term loan, which had remained overdue for a period of 90 days or more, is to be put into SMA. This will help banks to look at accounts with potential problems in a focused manner and it will capture early warning signals for accounts showing first sign of weakness. Loans in the SMA are to be reported to the Credit Information Bureau (CIB) of Bangladesh Bank. These loans shall not be treated as defaulted loan. Details of the objective criteria are presented in the matrix shown in Table V-3.

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[46] Bangladesh Bank, BRPD Circular No. 05, dated June 05, 2006.

[47] This categories have been explained in Chapter I of this dissertation, p. 32.

Table V-3

Objective Criteria of Loan Classification System in Bangladesh

Types of Loan	Length of Overdue	Status of Classification
Continuous Loan Overdue period will be accounted from the day following the date of expiry of such loan.	➢ 6 months or beyond but Less than 9 months	Sub-standard
	➢ 9 months or beyond but Less than 12 months	Doubtful
	➢ 12 months or beyond	Bad-Debt
Demand Loan Overdue period will be accounted from the day following the date of expiry of such loan.	➢ 6 months or beyond but Less than 9 months	Sub-standard
	➢ 9 months or beyond but Less than 12 months	Doubtful
	➢ 12 months or beyond	Bad/Loss
Fixed Term Loan Repayable within 5 Years Overdue period will be accounted from the day following the date of expiry of the due date of payment of installment of such loan.	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due within 6 months	Sub-standard
	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due within 12 months	Doubtful
	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due within 18 months	Bad/Loss
Fixed Term Loan Repayable in more than 5 Years Overdue period will be accounted from 6 months following the expiry of the due date of payment of installment of such loan.	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 12 months	Sub-standard
	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 18 months	Doubtful
	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 24 months	Bad-Debt
STAG/ Micro Credit Overdue period will be accounted from the due date of repayment as stipulated in the loan agreement	➢ 12 months or beyond but Less than 36 months	Sub-standard
	➢ 36 months or beyond but Less than 60 months	Doubtful
	➢ 60 months or beyond	Bad-Debt

Source: Researcher's own construction from Bangladesh Bank, *Prudential Regulations for Banks: Selected Issues* (Dhaka: BB, September 2011), pp. 20-21.

5.7.1.2.2 Qualitative Judgment

Qualitative judgment is to be followed in the following cases.[48]

(i) If any uncertainty or doubt arises in respect of recovery of any continuous loan, demand loan or fixed term loan, the loan is to be classified on the basis of qualitative judgment, be it classifiable or not on the basis of objective criteria.

(ii) If any situational changes occur in the stipulations in terms of which the loan was extended or if the capital of the borrower is impaired due to adverse conditions or if the value of the securities decreases or if the recovery of the loan becomes uncertain due to any other unfavorable situation, the loan is to be classified on the basis of qualitative judgment.

(iii) If any loan is illogically or repeatedly re-scheduled or the norms of re-scheduling are violated or instances of frequently exceeding the loan-limit are noticed or legal action is lodged for recovery of the loan or the loan is extended without the approval of the proper authority, it is to be classified on the basis of qualitative judgment.

Despite the probability of any loan's being affected due to the reasons stated above or for any other reasons, if there exists any hope for change of the existing condition by resorting to proper steps, the loan is to be classified as 'Sub-standard '. But even if after resorting to proper steps, there exists no certainty of total recovery of the loan, it is to be classified as ' Doubtful ' and even after exerting the all-out effort, there exists no chance of recovery, it is to be classified as ' Bad-Debt '.[49]

The concerned bank is to classify on the basis of qualitative judgment and can declassify the loans if any qualitative improvement occurs. If any loan is classified by the inspection team of Bangladesh Bank, the loan can be declassified only with the approval of the Board of Directors of the bank, prior to which, the Chief Executive Officer (CEO) and concerned branch manager shall have to certify that, the conditions of declassification have been fulfilled.[50]

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[48] Bangladesh Bank, *Prudential Regulations for Banks: Selected Issues, op.cit.,* pp. 21 & 22.

[49] *Ibid.* p. 22

[50] *Ibid.*

5.7.1.3 Accounting of the Interest of Classified Loans

If any loan or advance is classified as 'Sub-standard' and 'Doubtful', interest accrued on such loan is to be credited to Interest Suspense Account, instead of crediting to Income Account. In case of rescheduled loans the unrealized interest is to be credited to the same account, instead of crediting the interest to Income Account. As soon as any loan or advance is classified as 'Bad Debt', charging of interest in the same account will cease. In case of filing a law-suit for recovery of such loan, interest for the period till filing of the suit can be charged in the loan account in order to file the same for the amount of principal plus interest. But interest thus charged in the loan account has to be preserved in the 'Interest Suspense ' account. If any interest is charged in any 'Bad-Debt' account for any other special reason, the same is to be preserved in the 'Interest Suspense' account. Interest accrued on SMA will be credited to Interest Suspense Account, instead of crediting to Income Account.[51]

If classified loan or part of it is recovered i.e., real deposit is effected in the loan account, in such cases at first the interest charged and not charged is to be recovered from the said deposit and the principal to be adjusted afterwards.[52]

5.7.1.4 Maintenance of Provision

Bangladesh Bank required the banks through the policy on loan classification and provisioning to maintain provision against classified loans as well as unclassified loans. The provisional requirements against loans are given below:

5.7.1.4.1 Provision against Unclassified Loans

Banks are required to maintain “general provision” on unclassified loans in the following way.[53]

(i) 1% against all unclassified loans (other than loans under (a) Consumer Financing (b) loans against shares etc. and (c) Special Mention Account);

(ii) 5% on the unclassified amount for Consumer Financing, whereas 2% has to be maintained on the unclassified amount for (i) Housing finance and (ii) Loans for professionals to set up business under Consumer Financing Scheme;

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[51] *Ibid.*

[52] *Ibid.*

[53] *Ibid.*, p.23.

(iii) 2% against unclassified amount of any kind of funded loan disbursed to stock dealers enlisted with Stock Exchange, separate subsidiary company established by a bank company for dealing business in share brokerage and merchant banking and any other company or institution or individual for dealing such business;

(iv) 5% on the outstanding amount of loans kept in the 'Special Mention Account' after netting off the amount of Interest Suspense.

5.7.1.4.2 Provision against Classified Loans

Required rates of provision on classified loans have been presented in Table V-4.

Table V-4

Rate of Provision against Classified Loans

<table>
<tr><th>Categories of Loan</th><th>Status of Classification</th><th>Rate of Provision</th></tr>
<tr><td rowspan="3">Continuous, Demand and Fixed Term Loans</td><td>Sub-standard</td><td>20%</td></tr>
<tr><td>Doubtful</td><td>50%</td></tr>
<tr><td>Bad/Loss</td><td>100%</td></tr>
<tr><td rowspan="2">Short-term Agricultural and Micro-Credits</td><td>All credits except Bad/Loss</td><td>5%</td></tr>
<tr><td>Bad/Loss</td><td>100%</td></tr>
</table>

Source: Bangladesh Bank, BRPD Circular No.05, dated June 05, 2006.

Banks are required to maintain general provision against Off-balance sheet exposures in the following manner.[54]

(i) 5% provision effective from December 31, 2007, and

(ii) 1% provision effective from December 31, 2008.

5.7.1.5 Base for Provision

Provision will be maintained at the above rate on the balance to be ascertained by deducting the amount of 'Interest Suspense' and value of eligible securities from the outstanding balance of classified accounts.

5.7.1.6 Eligible Securities

Bangladesh Bank specified the securities and the percentage portion of the securities at which they will be considered as eligible to determine the amount of classified loans for the purpose of maintenance of provision. The securities and the corresponding rates are presented in Table V-5.

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[54] *Ibid.*, p.24.

Table V-5

Types of Securities and Their Rates to be Considered as Eligible

Types of Securities	**Rates to be Considered**
Deposit under lien against the loan	100%
Government bond/savings certificate under lien	100% of the value
Guarantee given by Government or Bangladesh Bank	100% of the value
Gold or gold ornaments pledged with the bank	100% of the market value
Easily marketable commodities kept under control of the bank	50% of the market value
Land and building mortgaged with the bank	Maximum 50% of the market value
Shares traded in the stock exchange	50% of the average market value for last six months or 50% of the face value, whichever is less.

Source: Researcher's own construction from Bangladesh Bank, BRPD Circular No.05, dated June 05, 2006.

In order to facilitate the on-site inspection by the Department of Bank Inspection of Bangladesh Bank, the banks are advised to maintain complete statement of eligible securities on a separate sheet in the concerned loan file. Information, such as description of eligible securities, their assessment by recognized firm, marketability of the commodity, control of the bank, and reasons for considering eligible securities etc. will have to be included in that sheet.[55]

5.7.2 Payment of Dividend by Bank Companies

To ensure maintenance of provision by the banks, in October 2002 Bangladesh Bank made the payment of dividend by bank companies subject to compliance of among others, provision maintenance conditions.

It was stressed that, prior to declaration of dividend, the concerned bank shall have to obtain a certificate from the external auditor specifically to this effect that provisions have been properly maintained having complied with the rules, regulations and norms issued by Bangladesh Bank and there is no short-fall in respect of maintenance of capital adequacy and provision. If any post-facto review during on-sight inspection by Bangladesh Bank reveals any deviation in compliance of the above conditions in declaring dividend of any year, prior permission from Bangladesh Bank shall have to be obtained before declaration of dividend for the next year. [56]

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[55] *Ibid*., p.25.

[56] Bangladesh Bank, BRPD Circular No. 18, dated October 20, 2002.

5.7.3 Policy for Rescheduling of Loans

To realize defaulted loans, Bangladesh Bank introduced the opportunity of loan rescheduling for the first time in December 1995.[57] But in the face of the wicked practice by the defaulted borrowers to avail the opportunity of loan rescheduling again and again without any definite business rationale, Bangladesh Bank in January 2003 announced a revised policy for rescheduling of loans in suppression of the previous instructions. Subsequently some other conditions were also incorporated in the policy. The main features of the policy are as follows. [58]

5.7.3.1 Guidelines for Consideration of Loan Rescheduling Applications

The current policy for rescheduling of loans starts with a set of guidelines, which Bangladesh Bank prepared for the banks to follow while considering a loan rescheduling application. The main instructions of the guidelines are as follows.[59]

(i) The banks shall examine the causes as to why the loan has become non-performing. If it is found from such review that the borrower has diverted the funds elsewhere or the borrower is a habitual loan defaulter the bank shall not consider the application for loan rescheduling. Instead, the bank shall take or continue legal steps for recovery of the loans;
(ii) Banks must assess the borrower's overall repayment capacity taking into account the borrower's liability position with other banks;
(iii) Banks shall review the borrower's cash flow statement, audited balance sheet, income statement and other financial statements;
(iv) if required, bank officers should ensure, by spot inspection of the borrower's company/business place, that the concerned company/business enterprise will be able to generate surplus to repay the rescheduled liability;
(v) If a bank is satisfied after due diligence mentioned above that the borrower will be able to repay, the loan may be rescheduled. Otherwise, the bank shall take all legal steps to realize the loan, make necessary provision and take measures to write-off;
(vi) The rescheduling shall be for a minimum reasonable period of time.

[57] Bangladesh Bank, BCD Circular No. 18, dated December 11, 1995.
[58] Bangladesh Bank, BRPD Circular No. 01, dated January 13, 2003.
[59] *Ibid.*

5.7.3.2 Rescheduling of Term Loans

According to the current policy for rescheduling of loans, the banks for rescheduling of Term Loans are to follow the following conditions.[60]

(i) Application for first rescheduling will be considered only after cash payment of at least 15% of the overdue installments or 10% of the total outstanding amount of loan, whichever, is less is made;

(ii) Rescheduling application for the second time will be considered after cash payment of minimum 30% of the overdue installments or 20% of the total outstanding amount of loan, whichever, is less is made;

(iii) Application for rescheduling for more than two times will be considered after cash payment of minimum 50% of the overdue installments or 30% of the total outstanding amount of loan, whichever is less.

5.7.3.3 Rescheduling of Demand and Continuous Loan

For rescheduling of Demand and Continuous Loans, the required rates of down payments, depending on the loan amount have been shown in Table V-6.

Table V-6

Rescheduling of Demand and Continuous Loan

Amount of Overdue Loan	Rates of Down Payment
Up to Tk.1 crore	15%
Tk. 1 crore to Tk. 5 crore	10% (but not less than Tk.15 lac)
Tk. 5 crore and above	5% (but not less than Tk.50 lac)

Source: Bangladesh Bank, BRPD Circular No. 01, dated January 13, 2003.

If any Continuous or Demand Loan is rescheduled by restructuring/converting partly or wholly into Term Loan and repayment installments have been fixed, application for rescheduling such loans shall be considered on cash payment of minimum 30% of the overdue installments or 20% of the total outstanding amount of loan, whichever is less. For subsequent rescheduling, minimum 50% of the overdue installments or 30% of the total outstanding amount of loan amount shall have to be deposited in cash.[61]

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[60] *Ibid.*

[61] *Ibid.*

5.7.3.4 Other Terms and Conditions of Rescheduling

The borrowers whose credit facility has been rescheduled will get new loan facility subject to fulfillment of the following conditions.[62]

(i) The defaulting borrower who has availed interest waiver must settle at least 15% of the compromise amount (excluding the down payment on rescheduling as per present guidelines) to avail any further credit facility from any bank;

(ii) In case of borrowing from other banks, the same rule will be applicable, i.e. the borrower will have to settle at least 15% of compromise amount (excluding the down payment on rescheduling as per present guidelines), subject to the submission of no objection certificate from the rescheduling bank;

(iii) Export borrowers may be granted further credit facility (after being identified as not a willful defaulter), if required, subject to settlement of at least 7.5% of the compromise amount (excluding the down payment on rescheduling as per present guidelines) being paid;

(iv) Information on the loan accounts rescheduled shall be reported to the Credit Information Bureau (CIB) of Bangladesh Bank.

For rescheduling of the loan, which is related to the Director/ ex-directors of a bank company, prior approval of Bangladesh Bank shall have to be obtained.[63]

5.7.4 Policy for Loan Write-off

Writing off bad loans having adequate provision is an internationally accepted practice in banking business. Owing to the reluctance of banks in Bangladesh in resorting to this system, their balance sheets are becoming artificially inflated. In this context, Bangladesh Bank formulated a policy for loan write-off for compliance by banks. [64]

According to this policy, Banks may write off bad/loss loans at any time. Those loans, which have been classified as bad/loss for the last five years and for which 100% provisions have been kept, should be written off without delay. Banks may write off loans by debit to their current year's income account where

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[62] Bangladesh Bank, BRPD Circular No. 02, dated February 14, 2006 & Bangladesh Bank, BRPD Circular No. 03, dated March 19, 2006.

[63] *Ibid.*

[64] Bangladesh Bank, BRPD Circular No. 02, dated January 13, 2003.

100% provision kept is not found adequate for writing off such loans. A separate "Debt Collection Unit" should be set up in the bank for recovery of written off loans. In spite of writing off the loans, the concerned borrower shall be identified as defaulter as usual. The writing off loans and advances shall be reported to the CIB of Bangladesh Bank.

All out efforts should be continued for realizing written off loans. Any defaulted loan, for which no legal action has been initiated earlier, cases must be filed in the court of law before writing it off. Any agency outside the bank can be engaged to accelerate the settlement of law suits, filed against the written off loans or to realize the receivable written off loans.

In case of writing off loans sanctioned to the Director or ex-director of the bank or loans sanctioned during the tenure of his directorship in the bank to the enterprise in which the concerned Director has interest, prior approval of Bangladesh Bank shall have to be obtained.

5.7.5 Policy on Single Borrower Exposure

Bangladesh Bank has advised the scheduled banks in Bangladesh from time to time to fix limits on their large loan[65] exposures and their exposures to single and group borrowers for ensuring improved risk management through restriction on credit concentration.[66] Following the international practice, Bangladesh Bank derives the exposure ceiling for single borrower from a bank's total capital as defined under capital adequacy standards. The exposure limits are uniform for both local and foreign banks in Bangladesh.[67] In April 2005, Bangladesh Bank announced its policy on single borrower exposure consolidating all the instructions issued so far.[68] It also incorporated some amendments to the previous instructions. The main features of the current policy on single borrower exposure are as follows.

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[65] According to BRPD Circular No. 05 of Bangladesh Bank dated April 09, 2005, loan sanctioned to any individual or enterprise or any organization of a group amounting to 10% or more of a bank's capital shall be considered as large loan.

[66] Bangladesh Bank, "Prudential Regulations for Banks: Selected Issues", http://www.bangladesh-bank.org/, p. 27, visited on July 12, 2007.

[67] Bangladesh Bank, BRPD Circular No. 08, dated March 18, 2003.

[68] Bangladesh Bank, BRPD Circular No. 05, dated April 09, 2005.

5.7.5.1 Exposure Limit

As a result of increase in capital of almost all the banks, the single borrower exposure limit has been reduced from 50% to 35%. The exposure limits for different types of credits are settled as follows.[69]

(i) The total outstanding financing facilities by a bank to any single person or enterprise or organization of a group shall not at any point of time exceed 35% of the bank's total capital subject to the condition that the maximum outstanding against fund based financing facilities do not exceed 15% of the total capital;

(ii) Non-funded credit facilities, e.g. letter of credit, guarantee etc. can be provided to a single large borrower. But under no circumstances, the total amount of the funded and non-funded credit facilities shall exceed 35% of a bank's total capital;

(iii) In case of export sector, single borrower exposure limit shall remain unchanged at 50% of the bank's total capital. But funded facilities in case of export credit also shall not exceed 15% of the total capital.

5.7.5.2 Prudential Norms for Sanctioning Large Loan

According to the present policy, loan sanctioned to any individual or enterprise or any organization of a group amounting to 10% or more of a bank's total capital shall be considered as large loan. The limits set by Bangladesh Bank for the banks to sanction large loans on the basis of their respective classified loans have been presented in Table V-7.

Table V-7

Limits for Sanctioning Large Loans

Rate of Net Classified Loans	Highest Rates Fixed for Large Loans against Bank's Total Loans & Advances
Upto 5%	56%
More than 5% but upto 10%	52%
More than 10% but upto 15%	48%
More than 15% but upto 20%	44%
More than 20%	40%

Source: Bangladesh Bank, BRPD Circular No. 05, dated April 09, 2005.

In order to determine the above maximum rates of large loans, all non-funded credit facilities e.g. letter of credit, guarantee etc. included in the loan shall be considered as 50% credit equivalent. However, the entire amount of non-funded credit facilities shall be included in determining the total credit facilities provided to an individual or enterprises or an organization of a group.[70]

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[69] Bangladesh Bank, BRPD Circular No. 05, dated April 09, 2005.

[70] *Ibid.*

5.7.5.3 Other Terms and Conditions

The Policy on Single Borrower Exposure has some other important terms and conditions regarding specially large loan, which are stated below.[71]

(i) Banks should collect the large loan information on their borrowers from CIB of Bangladesh Bank before sanctioning, renewing or rescheduling large loans in order to ensure that credit facilities are not being provided to defaulters;

(ii) Banks must perform Lending Risk Analysis (LRA) before sanctioning or renewing large loans. If the rating of an LRA turns out to be "marginal", a bank shall not sanction the large loan, but it can consider renewal of an existing large loan taking into account other favorable, conditions and factors. However if the result of an LRA is unsatisfactory, neither sanction nor renewal of large loans can be considered;

(iii) While sanctioning or renewing of large loan, a bank should judge its borrowers overall debt repayment capacity taking into consideration the borrower's liabilities with other banks and financial institutions;

(iv) The banks shall examine the borrower's cash flow statement, audited balance sheet, income statement and other financial statements to make sure that the borrower has the ability to repay the loan;

(v) Sanctioning, renewing or rescheduling of large loans should be approved by the Board of Directors in case of local banks. Such decisions should be taken by the Chief Executives in case of foreign banks.

The current policy requires the banks to submit the monthly statement of large loan in specified format to the Department of Off-site Supervision of Bangladesh Bank within ten days after the end of respective month.[72]

5.7.6 Large Loan Restructuring Scheme (LLRS)

In order to make the system of restructuring or rescheduling of loans by individual banks bilaterally with the large borrowers who have liabilities with more than one bank, more transparent, Bangladesh Bank introduced the Large Loan Restructuring Scheme (LLRS) for implementation by banks. LLRS is applicable to the loans provided by more than one bank under or outside consortium arrangement with outstanding of Tk.50.00 crore and above. The main features of the Scheme are as follows.[73]

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[71] Bangladesh Bank, “Prudential Regulations for Banks: Selected Issues”, http://www.bangladesh-bank.org/.

[72] *Ibid.*

[73] Bangladesh Bank, BRPD Circular No. 13, dated December 23, 2002.

Under the purview of LLRS, a two tier committee has been constituted for the proper implementation of LLRS. The tiers are (i) Standing Committee and (ii) Inter-bank Committee.

(i) Standing Committee

The Standing Committee comprises of the chief executives of all banks participating in LLRS. All the banks working in the country participate in the scheme in their own interest and are members on the Committee. The Committee is entrusted with responsibilities like laying down policies and guidelines for restructuring and rescheduling of large loans and monitoring the performance of the scheme. Deputy Governor in charge of the Department of Off-site Supervision of Bangladesh Bank holds the position of Chairman on the Committee.

(ii) Inter-bank Committee

The Inter-bank Committee comprises of the financing banks. In case of consortium loans, the Chief Executive of the lead bank and in other cases the Chief Executive of largest financing bank shall be the Chairman of the Inter-Bank Committee. The responsibilities of the Committee include examining the viability of restructuring and rescheduling proposals of the loans and approving the proposals in appropriate cases. The committee may, if necessary, engage external consultants for evaluation of restructuring proposals. If any proposal for restructuring is not found suitable, the Committee will advise the banks to initiate appropriate legal steps for recovery of the debt.

LLRS is a voluntary and non-statutory mechanism based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). The Standing Committee shall prepare specimen of such agreements in consultation with lawyers having expertise in the field. In the Debtor-Creditor Agreement there should be a clause containing "stand still" agreement binding for 90 days or 180 days by both sides. Under this clause both the debtor and creditors shall agree to a legally binding "stand-still" whereby both the parties commit themselves not to take recourse to any legal action during the "stand-still" period. This is supposed to facilitate the evaluation and processing of debt restructuring proposal without any outside intervention.

Banks are to send a quarterly statement containing the information of the debt rescheduled and restructured under LLRS to the Department of Off-Site Supervision of Bangladesh Bank.[74]

5.7.7 Restriction on Lending to Directors of Private Banks

To ensure transparency and accountability in the loan portfolio of banks, Bangladesh Bank in August 1999 rescinding the previous instructions in this regard,[75] issued a new set of stringent restrictions on lending to directors of private banks. Later on, few new restrictions were also incorporated in these instructions. The existing major restrictions on lending to Directors of private banks are briefly as follows.[76]

(i) Any loan facility or guarantee or security provided to a Director of a bank or to his relatives must be sanctioned by the Board of Directors of the bank and approved in the general meeting and has to be specifically mentioned in the balance sheet of the bank. The total amount of the loan facilities extendable to a director or to his relatives should not exceed 50% of the paid-up value of the shares of that bank held in Director's own name;

(ii) Subject to compliance of the conditions mentioned in paragraph no (i) above, loan facilities in excess of Tk.50 lacs (including all direct or indirect loan facilities) can be extended in favor of any Director or his relatives or proprietorship or partnership firms and private or public limited companies wherein those persons have interests, obtaining no-objection from Bangladesh Bank. If the amount of direct loans is more than Tk.10 lacs, no-objection from Bangladesh Bank is to be obtained, subject to the limit as outlined above;

(iii) Any Director of a bank will be treated to have interest in any industrial or commercial organization/ loan account, If he/ she even without being apparently involved in that organization/ loan account, conducts or directs accounts thereof or otherwise has control thereupon or extends collateral security or guarantee against any loans thereof;

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[74] *Ibid.*

[75] Bangladesh Bank, BCD Circular Letter No. 15, dated July 18, 1995.

[76] Bangladesh Bank, BRPD Circular No. 7, dated August 5, 1999
Bangladesh Bank, BRPD Circular No. 11, dated September 20, 1999
Bangladesh Bank, BRPD Circular No. 2, dated January 21, 2002

(iv) In case of extending loan facilities in favor of the organization wherein the Director has interest, all kinds of legal formalities have to be properly executed as per norms;

(v) If any loans availed in the names of the Directors or organizations wherein they have interests, turn to defaulted ones, legal action has to be initiated instantly;

(vi) Any change/cancellation/return of security, collateral security, guarantee etc, provided against the loan of any Director or ex-director of a bank will require prior permission from Bangladesh Bank;

(vii) Without prior permission from Bangladesh Bank, no remission facilities can be allowed to any loan accounts wherein bank's Director or ex-director has interest.

5.7.8 Credit Information Bureau (CIB)

In the backdrop of huge Non Performing Loans (NPLs) of the banks of Bangladesh during 1980s, Bangladesh Bank set up a full fledge Credit Information Bureau (CIB) in August 18, 1992 under the FSRP.[77] CIB database consists of detailed information in respect of individual borrowers, owners and guarantors. The main objective of establishing the CIB was to minimize the extent of NPLs by facilitating the banks and financial institutions with credit reports of the loan applications so that the lending institutions do not encounter any credit risk while extending any lending or rescheduling facility. Bangladesh Bank instructed the banks to collect the required information from the CIB before taking steps on fresh loan application of any borrower or before renewal of regular loan account or rescheduling from January 01, 1993 onwards, to verify as to whether the applicant has availed of any loan facility from any other bank.[78] Banks shall take the decision of sanctioning, renewing or rescheduling the loan at their own discretion and responsibility having examined the eligibility of the borrower after receiving total information on the borrower from the Bureau.

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[77] Bangladesh Bank, *Annual Report 2006-07*, p. 47.

[78] Bangladesh Bank, CIB Circular No. 02, dated December 27, 1992.

Initially to collect information from the CIB was optional, but in June 1995, it was made compulsory to obtain information on borrower from the CIB before sanctioning of fresh loan, renewal of regular loan or rescheduling of loan for Taka ten lacs and above in favour of any borrower.[79] Subsequently, the amount was raised to Tk. 50 lacs and above.[80] In October 2000, it was also made compulsory to obtain information on borrower from the CIB before sanctioning, renewal and rescheduling of large loan as well as in case of opening of L/C and issuance of Bank Guarantee.[81] Moreover, it was stressed that, no loan facility shall be extended to any defaulters and for this purpose banks at their own interest shall collect credit information from the CIB.

Due to increase in the number of applicants, borrowers and lenders, banks and financial institutions as well as bank branches, the workload of the Bureau is constantly increasing. The number of CIB report, supplied during FY 2010-11 was 11,84,132 compared to 10,02,674 in FY 2009-10 showing an annual increase by 18.10 percent. As per existing service standard, the CIB reports are supplied within five working days from receiving the request, the volume of which was around 5500 per day during FY 2010-11.[82] As per reporting of scheduled banks/financial institutions, the classified loan decreased 10.8 percent at the end of June 2011 compared to 13.1 percent in the preceding year. The percentage of such classified loan was 34.9 in December 2000.[83]

In order to ensure prompt collection of credit data from the sources as well as instantaneous delivery of credit report to the users by applying latest computer technology, the CIB started diagnostic analysis of the customer and the central bank with effect from 13 July 2007 under DFID financial assistance aimed at implementing on-line services between the Bureau and the lending institutions. CIB online services have been opened up on 19 July 2011. Now physical presence is no longer needed for collection of CIB reports and submission of credit information to the CIB database.[84]

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[79] Bangladesh Bank, BCD Circular No. 07, dated June 17, 1995.

[80] Bangladesh Bank, BCD Circular No. 09 dated June 29, 1995.

[81] Bangladesh Bank, BRPD Circular No. 13 dated October 26, 2000.

[82] Bangladesh Bank, *Annual Report 2010-11* (Dhaka: Department of Public Relations and Publications, Bangladesh Bank, 2012), p57.

[83] *Ibid.*

[84] *Ibid.*

5.8 Management and Supervision

Policies, guidelines and many activities of Bangladesh Bank serve multiple objectives. So, it is difficult to arrange these into mutually exclusive distinct groups. The grouping in this Chapter was designed on the basis of similarity of objectives, keeping in mind the overlapping nature of achievable objectives. For efficient management and supervision of the financial system, Bangladesh Bank formulated the following measures.

(i) Guidelines on Managing Core Risks in Banking;
(ii) Prudential Guidelines for Consumer Financing and Small Enterprise Financing;
(iii) Supervision of Banks;
(iv) Deregulation of Interest Rates on Deposit and Lending;
(v) Bank Charges.

These guidelines and measures serve other objectives also like quality of loan portfolio, etc. The measures are discussed in brief below.

5.8.1 Guidelines on Managing Core Risks in Banking

The banking industry today performs a lot of diversified and complex financial activities. This makes the industry vulnerable to numerous risks as akin to credit, market, operational, supervisory etc. risks. The risks are compounded due to deregulation and globalization of banking business. In recognition of the importance of an effective risk management system, Bangladesh Bank adopted several initiatives to handle the banking industry with international best practices for risk management. In October 2003, Bangladesh Bank issued "Guidelines on Managing Core Risks in Banking" to the banks for complying with five core risk management in the banks. The five core risks are (a) Credit Risks, (b) Asset and Liability/Balance Sheet Risks, (c) Foreign Exchange Risks, (d) Internal Control and Compliance Risks and (e) Money Laundering Risks.[85] The guidelines contained minimum instructions for the banks and the banks were advised to build up their own risk management system based on the guidelines by June 2004. A document (interpretation to measure risks using Gap Analysis) has been issued for the banks which may help banks to measure and manage their Liquidity Risk, Interest Risk and Foreign exchange risk and minimize their losses.

[85] Bangladesh Bank, BRPD Circular No. 17, dated October 07, 2003.

With the aim to fully implement a risk grading system, Bangladesh Bank developed an integrated credit risk grading manual and forwarded it to the banks.[86] In the 'Guidelines on Managing Core Risks in Banking', a very noteworthy development was the introduction of Credit Risk Grading (CRG) system. The CRG is an outcome of collective information based on pre-specified scale of a risk grade scorecard supplied with the guidelines. In this system, risk grades are attached to different categories of loans in ascending order indicating increasing degrees of risk. The grading system is to be used for assessing the underlying credit-risk status for a given exposure before a bank lends to its borrowing clients.[87] The CRG scale consists of eight categories, which along with risk rating, risk grade and definitions of the categories in terms of aggregate score, based on the risk Grade Scorecard, have been shown in Table V-8.

Table V-8

Credit Risk Grading System

Categories and Risk Rating			Risk Grade	Definition (Aggregate Score based on Risk Grade Scorecard)
Superior	-	Low Risk	1	
Good	-	Satisfactory Risk	2	≥ 95
Acceptable	-	Fair Risk	3	75 – 94
Marginal	-	Watch List	4	65 – 74
Special Mention			5	55 – 64
Sub-standard			6	45 – 54
Doubtful and Bad			7	35 – 44
Loss			8	≤ 35

Source: Bangladesh Bank, "Managing Core Risks in Banking: Credit Risk Management", pp. 9-10.

The risk grading matrix is the minimum standard risk rating and the banks were advised to adopt and adapt more sophisticated risk grades in line with the size and complexity of their business. Banks were advised to implement Credit Risk Grading by March 31, 2006 for all exposures other than those covered under Consumer and Small Enterprises financing Prudential Guidelines and also under Short-term Agricultural and Micro Credit. Bangladesh Bank monitors the progress of implementation of the guidelines through its on-site inspection teams during routine inspection.

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[86] Bangladesh Bank, BRPD Circular No. 18, dated December 11, 2005.

[87] Bangladesh Bank, *Annual Report 2006-07,* p. 34.

The guidelines also contain important directives for internal control and compliance, asset and liability management, strategy paper regarding how to address the major risk elements involved in the foreign exchange activities and many rigorous measures for proper compliance of the provisions of the 'Money Laundering Prevention Act 2002. Apart from these guidelines, policy on capital adequacy of banks and the policy on loan classification and provisioning, formulated by Bangladesh Bank and discussed earlier, are also very important instruments regarding risk management in the banking sector.

Bangladesh Bank has introduced Guidelines on Information and Communication Technology for Scheduled Banks to manage another core risk for the banks to take adequate measures to prevent the information from unauthorized access, modification, disclosure and destruction so that customers' interest is fully protected.[88] This guideline has recently been updated and renamed as "Guideline on ICT Security for Banks and Financial Institutions, 2010".

5.8.2 Prudential Guidelines for Consumer Financing and Small Enterprise Financing

In the recent times, there had been significant increase in credit disbursement in the arena of Consumer Financing and encouraging credit flow in the Small Enterprise Financing sector. In this perspective, Bangladesh Bank issued two separate guidelines to the banks for better management of credit in those two sectors in the year 2004.[89] Some amendments were made in these guidelines in the subsequent years and the amendments were also reviewed as well. At present, loans in these two areas are to be classified into eight categories instead of previous four categories.[90] Banks have been advised to implement the guidelines by January 01, 2006.[91] Bangladesh Bank monitors the progress of implementation of these regulations/guidelines through its on-site inspection teams through routine inspection. Recently the rate of general provision has been reviewed. Earlier banks were advised to maintain 5% general provision against

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[88] Bangladesh Bank, *Prudential Regulations for Banks: Selected Issues* (Dhaka: Bangladesh Bank, September 2011), p. 38.

[89] Bangladesh Bank, BRPD Circular No. 07, dated November 03, 2004.

[90] Bangladesh Bank, BRPD Circular No. 20, dated December 20, 2005.

[91] Bangladesh Bank, BRPD Circular No. 19, dated December 20, 2005.

unclassified loan amount for consumer financing. In February 2006, the rate of general provision has been reduced to 2% from 5% on the unclassified amount for (i) housing finance and (ii) loans for professionals to set up business under consumer financing scheme.[92]

5.8.3 CAMELS Rating

To evaluate the performance of the banking sector, Bangladesh Bank developed CAMELS rating under Financial Sector Reform Programme (FSRP). Under CAMELS framework, six crucial dimensions of banking operations are analyzed and evaluated. The indicators used in the rating system are (i) capital adequacy, (ii) asset quality, (ii) management soundness, (iv) earnings, and (v) liquidity, and (vi) sensitivity to market risk.[93] The banks, based on their performance in respect of the above indicators, are rated between 1-5 grades in ascending order, where rating 1 stands for the best performance and 5 for the worst. The ratings and respective status of banks are presented in Table V-9.

Table V-9

CAMELS Rating and Status of Banks

CAMEL Rating	Status of Banks
1	Strong
2	Satisfactory
3	Fair
4	Marginal
5	Unsatisfactory

Source: Bangladesh Bank, *Annual Report 2006-07*, p. 42.

Any bank rated 4 or 5 i.e., 'Marginal' or 'Unsatisfactory' under composite CAMELS rating is generally identified as a problem bank, activities of which are closely monitored by the Bangladesh Bank.[94]

As of end 2010, CAMELS rating of 5 banks was 1 or "Strong"; 32 banks were rated 2 or "Satisfactory"; rating of 7 banks was 3 or "Fair"; 2 were rated 4 or "Marginal" and 1 bank got 5 or "unsatisfactory" rating.[95]

[92] Bangladesh Bank, BRPD Circular No. 01, dated February 08, 2006.

[93] Earlier there were five components excluding “sensitivity to market risk” and the name of the framework was CAMEL. Later recognizing the importance of the sensitivity of the banks to interest rate movement, Bangladesh Bank added the new component in the CAMEL framework and renamed the framework as CAMELS. The revised CAMELS rating system is in effect since July 1, 2006.

[94] Bangladesh Bank, *Annual Report 2010-11, op. cit.,* p. 47.

5.8.4 Early Warning System (EWS)

To address the difficulties faced by the banks in any of the areas of CAMELS, Bangladesh Bank is presently employing Early Warning System (EWS) of supervision. Any bank found to have difficulty in any areas of operation, is brought under early warning category. These banks are monitored very closely to help improve their performance. As on June 2011, there were two banks in the EWS.[96]

Besides EWS, Bangladesh Bank maintains a "problem bank list". Activities of the problem banks are closely monitored by Bangladesh Bank with special guidance and care.

5.8.5 Supervision of Banks

Bangladesh Bank as the regulator and supervisor of the banking system of the country is entrusted with the authority of inspection of the banks and financial institutions of the country. This authority is assigned to Bangladesh Bank under section (44) of the Bank Company Act 1991. Supervision is done with a view to promoting and maintaining soundness, solvency and systematic stability of the financial sector as well as to protecting interest of depositors

Mainly two types of supervisions are conducted, viz., (i) off-site supervision and (ii) on-site supervision. Department of Off-site Supervision carries out the off-site supervision. As part of Bank's statutory function, currently five departments of Bangladesh Bank namely Department of Banking Inspection-1 (DBI-1), Department of Banking Inspection-2 (DBI-2), Department of Banking Inspection-3 (DBI-3), Foreign Exchange Inspection and Vigilance Department (FEIVD) and Anti-Money Laundering Department (AMLD) are conducting the on-site inspection activities. These five departments conduct on-site inspection on SCBs, DFIs, PCBs (including banks under Islamic Shariah), FCBs and other institutions including Investment Corporation of Bangladesh (ICB) and Money Changers.[97]

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[95] *Ibid., p. 48.*

[96] *Ibid.,* p. 41.

[97] Bangladesh Bank, *Annual Report 2010-11, op. cit.,*p. 57.

Basically, Bangladesh Bank conducts three types of inspections namely (i) comprehensive inspection, (ii) risk based inspection/system check inspection, and (iii) special inspection. In comprehensive inspection, overall performance/conditions of the banks such as capital adequacy, asset quality, liquidity, earnings, management competence etc. are evaluated. Departments also monitor implementation of the suggestions or recommendations made in the inspection reports. Risk based inspection is conducted to examine the compliance of the Core Risk Management Guidelines issued by Bangladesh Bank as well as to evaluate and monitor risk management systems and control environment of the banks. The frequency of the inspection is annual and areas covered are risks associated with credit, internal control and compliance, asset liability management and information system. Special inspections are conducted on the banks on specific/particular issue(s) as well as to investigate complaints received from the depositors, general public or institutions.[98]

Commercial Banks having CAMELS rating between 3-5 are inspected every year. Banks rated 1 or 2 are inspected once in every two years. Branches of scheduled banks covering around 60-70 percent of total loans and advances are normally brought under the comprehensive inspection programme. Inspections of the banks are conducted based on four reference dates: 31 December, 31 March, 30 June and 30 September instead of only one reference date i.e. 31 December. This system has been adopted to enhance the effectiveness of onsite inspection and to reduce the time gap between on-site and off-site supervision.[99]

In FY 2011, DBI-1 conducted a total of 725 comprehensive inspections including 35 Head Offices and 690 branches, core risk inspections on 39 banks and special inspection on 134 bank branches. DBI-2 conducted a total of 1149 comprehensive inspection including 5 Head Offices and 1149 bank branches. The Department also conducted 76 comprehensive inspections on financial institutions (FIs) including 24 head offices and 52 branches and 10 inspections on ICB including its head office and 9 branches. Besides, the Department conducted 22 risk based inspections on banks. Moreover, the Department also conducted

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[98] *Ibid.,* p. 57-58.

[99] *Ibid.,* p.58.

224 special inspections on banks, 8 special inspections on FIs and 1 on ICB. DBI-3 conducted a total of 445 comprehensive inspections on banks including 5 head offices and 440 branches. The Department conducted 4 risk based and 40 special inspections on banks.[100]

Foreign Exchange Inspection and Vigilance Department (FEIVD) conducts inspection on foreign trade financing, treasury functions and foreign exchange risk management of banks, foreign exchange transactions of banks and money changers. In FY 2011, the Department conducted a total of 251 comprehensive inspections on banks including 45 head offices and 206 authorised dealer branches. The Department also conducted 393 special inspections on various banking irregularities, 46 special inspections on foreign exchange risk management and 380 inspections on money changers. In FY 2011, Anti-Money Laundering Department (AMLD) conducted system check inspection in 47 head offices and 365 bank branches under core risk programme. The Department also conducted special inspection on 131 branches and head offices of 10 banks. In the reporting year, 5 banks have been fined for non-compliance of the Money Laundering Prevention Act, 2009.[101]

5.8.6 Interest Rates on Deposit and Lending

Until 1989, Bangladesh Bank fully controlled the interest rate structure of the banking sector in terms of determination of interest rates on deposit and lending. Later, to encourage price competition within the banking industry, Bangladesh Bank lifted almost all its control from the interest rate structure. Banks are now free to fix their rates of interest on their deposits of different types after withdrawal of restriction about the floor rate of interest in 1997.[102] Banks are also free to fix their rates of interest on lending except for export sector, which has been fixed at 7% per annum with effect from January 10, 2004. [103] The maximum rate of interest on agriculture and term loans to industrial sector is 13%. The maximum rate of interest

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[100] *Ibid.*

[101] *Ibid.,* p. 59.

[102] Bangladesh Bank, BRPD Circular No. 01, dated February 19, 1997

[103] Bangladesh Bank, BRPD Circular No. 01, dated January 10, 2004.

on import financing of rice, wheat, edible oil (crude and refined), pulse, gram, onions, dates and sugar (refined & raw sugar/raw cane sugar) is in force at 12%. The key features of interest rate on deposit and lending are as follows.[104]

The key features of interest rate on deposit and lending are as follows:

i) In case of Fixed Term Loan and Continuous Loan, interest will be calculated on the basis of the product of the day end balance but interest must be charged on quarterly basis.

ii) Banks are allowed to charge penal interest.

iii) The loan accounts under the Prudential Guidelines for Consumer Financing and Small Enterprise Financing will be repaid according to Equal Monthly Installment (EMI) method.

iv) Banks have been advised not to pay/charge any interest beyond their announced rate of interest on deposit and lending as per existing interest rate policy.

v) No additional charges shall be collected along with the rate of interest/profit on loans other than the announced Schedule of Charges.

vi) Banks are allowed to differentiate interest rate up to a maximum of 3% considering comparative risk elements involved among borrowers in same lending category. With progressive deregulation of interest rates, banks have been advised to announce the mid-rate of the limit (if any) for different sectors and they may change interest 1.5% more or less than the announced mid-rate on the basis of the comparative credit risk.

5.8.7 Bank Charges

With the rescinding of earlier instructions[105] on bank charges, Bangladesh Bank made the banks free to fix the fees and commissions relating to the services offered by them to their customers. [106] While applying bank charges the banks are to ensure the following matters:[107]

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[104] Bangladesh Bank, *Prudential Regulations for Banks: Selected Issues* (Dhaka: Bangladesh Bank, September 2011), p. 33.

[105] Bangladesh Bank, F.F. Circular No. 16 dated March 31, 1982 and BCD Circular No. 7, dated March 12, 1986

[106] Bangladesh Bank, BRPD Circular No. 03, dated January 11, 1990.

[107] *Ibid.*

(i) in applying the fees there should be no discriminations among customers for similar services;

(ii) Each bank will prepare its schedule of charges and commissions etc. and ensure that these are publicly accessible at each branch;

(iii) Each bank will forward a copy of the schedule of charges and commissions to the Banking Regulation and Policy Department of Bangladesh Bank. Any changes to such schedules as may be made from time to time must be forwarded to Bangladesh Bank forthwith.

5.9 Governance in Bank Management

Good governance assumes more importance for the banks than any other business organization as they deal with huge public money and interests of the depositors. To ensure good governance in the bank management, Board of Directors and management of a bank should comprise of competent and professionally skilled persons. It is also necessary to specify demarcation of responsibilities and authorities between these controlling bodies over bank's affairs for the sake of transparency and accountability of all concerned. To establish good governance and to develop transparency and accountability in bank management Bangladesh Bank formulated various rules, regulations and directives and made amendments to these occasionally. These rules, regulations and directives may be grouped as follows:

(i) Constitution of the Board of Directors and fit and proper test for appointment of bank Directors;

(ii) Appointment of Chief Executive and Advisor in banks;

(iii) Corporate governance in bank management;

(iv) Constitution of the Audit Committee of Board of Directors.

5.9.1 Constitution of the Board of Directors and Fit and Proper Test for Appointment of Bank Directors

The responsibilities of the Board of Directors of a bank-company are more important than those of other companies; because in case of a bank-company it is essential to earn and maintain confidence of the depositors as its business is mainly run with the depositors' money.[108] Bangladesh Bank has been very keen

[108] Bangladesh Bank, *Prudential Regulations for Banks, op. cit.,* P. 53.

in the constitution of the Board of Directors of the banks. In April 2003, Bangladesh Bank imposed some restrictions regarding constitution of the Board of Directors and fit and proper test criteria for consideration and compliance of the appointing authority of the private banks regarding appointment or reappointment and filling up of casual vacancy of the offices of bank Directors. [109] The main instructions are as follows.

5.9.1.1 Constitution of the Board of Directors

While constituting the Board of Directors, the banks are to follow the following instructions.[110]

(i) The Board of Directors of the bank-companies shall be constituted of maximum 13 Directors;

(ii) Not more than one member of a family will become Director of a bank through appointment/reappointment of the Directors against retirement or filling casual vacancy. For this purpose, family members shall include spouse, parents, children, brothers and sisters of the Director and other persons dependent on him/her.

5.9.1.2 Fit and Proper Test

Bangladesh Bank set some conditions to be fulfilled regarding experience, moral integrity and suitability and termed those as "Fit and Proper Test" for appointment of bank Directors. The conditions are as follows.[111]

(i) The concerned person must have management/business or professional experience for at least ten years;

(ii) (S)he has not been convicted in any criminal offence or involved in any fraud/forgery, financial crime or other illegal activities;

(iii) (S)he has not been subject to any adverse findings in any legal proceedings,

(iv) (S)he has not been convicted in regard to contravention of rules, regulations or disciplines of the regulatory authorities relating to financial sector;

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[109] Bangladesh Bank, BRPD Circular No. 12, dated April 26, 2003.

[110] *Ibid.*

[111] *Ibid.*

(v) (S)he has not been involved with a company/firm whose registration/license has been revoked or cancelled or which has gone into liquidation;

(vi) Loans taken by him/her or allied concern from any bank or financial institution have not become defaulted;

(vii) (S)he has not been adjudicated a bankrupt by a court;

(viii) (S)he must be loyal to the decisions of the Board of Directors. However, in case of note of dissent, (s)he may record it in the minutes of the Board meeting and/or bring it to the notice of Bangladesh Bank considering its merit.

5.9.2 Appointment of Chief Executive and Adviser in Banks

In September 2002, Bangladesh Bank replacing the previous instructions[112] issued a new guideline regarding appointment as well as dismissal, release or removal of Chief Executive and Adviser in bank companies. Later on some other instructions were also conveyed in this respect. The main directives regarding appointment of Chief Executive and Adviser in bank companies presently in effect are as follows. [113]

5.9.2.1 Permission of Bangladesh Bank

Before appointment as Chief Executive or Adviser, prior permission in writing from Bangladesh Bank should be obtained. In order to have such permission, full bio-data and terms and conditions of appointment (mentioning direct and indirect payable salary and allowances along with the facilities) should be submitted to Bangladesh Bank. The decision of Bangladesh Bank regarding the appointment of Chief Executive and Adviser will be considered as final and the Chief Executive and Adviser, appointed in this manner shall not be dismissed, released or removed without the prior permission of Bangladesh Bank.

5.9.2.2 Moral and Financial Integrity

In case of appointment to the post of Chief Executive /Adviser, the following matters should be ensured.[114]

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[112] Bangladesh Bank, BCD Circular Letter No. 06, dated October 09, 1995 and Bangladesh Bank, BRPD Circular Letter No. 12, dated May 10, 1999.

[113] Bangladesh Bank, BRPD Circular No. 15, dated September 03, 2002

Bangladesh Bank, BRPD Circular No. 06, dated March 16, 2003.

[114] *Ibid.*

(i) The concerned person was not involved in any illegal activity while performing duties in his own or banking profession;

(ii) (s)he has not been convicted by any Criminal Court of Law;

(iii) (s)he has not violated any rules, regulations or procedures /norms set by any controlling authority;

(iv) (s)he was not associated with any such company /organization, registration or license of which has been cancelled or which has gone into liquidation;

(v) (s)he has not been disqualified to be the Chairman or Director or Chief Executive of any Company ;

(vi) (s)he has never been adjudicated an insolvent .

5.9.2.3 Experience and Suitability

For appointment of Chief Executive/ Adviser in banks, Bangladesh Bank set the following requirements regarding experience and suitability to be fulfilled:[115]

(i) For appointment as Chief Executive, the concerned person will have experience for at least 15 years as an active officer in bank or financial institution and at least for two years in the post immediate to the post of the Chief Executive of a bank. For appointment as Adviser, 15 years' job experience in bank or financial institution or administrative experience will be regarded as eligibility;

(ii) Higher academic education in the field of Economics, Banking and Finance or Business Administration will be regarded as additional qualification for the concerned person;

(iii) In respect of service, the concerned person should have high record of performance;

(iv) It should be ensured that the concerned person was not dismissed from his service when he was Chairman/Director/ official of any company;

(v) No Director of the bank or financial institution or person who has business interest in that bank will be considered eligible for appointment to the post of Chief Executive/ Adviser.

5.9.2.4 Tenure and Age Limit

The tenure of the Chief Executive shall be for at least three years, which is renewable. The tenure of the Adviser shall not exceed one year.[116] No person crossing the age of 65 years shall hold the post of Chief Executive of a bank.[117]

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[115] *Ibid.*

[116] Bangladesh Bank, BRPD Circular No. 16, dated August 09, 2003.

5.9.3 Corporate Governance in Bank Management

In July 2003, Bangladesh Bank rescinding the previous instructions[118] newly specified the demarcation of responsibilities and authorities among the Board of Directors, its Chairman, Chief Executive Officer (CEO) and Adviser to the private banks. The specification was done in respect of its overall financial, operational and administrative policymaking and executive affairs including overall business activities, internal control, human resources management and development, income and expenditure of the banks etc., along with lending and risk management issues. This arrangement is still in effect. The main directives of the circular are as follows.[119]

5.9.3.1 Responsibilities and Authorities of the Board of Directors

The Board of Directors has different types of responsibilities and authorities. These are discussed in brief in the following sub-sections:

5.9.3.1.1 Work-planning and Strategic Management[120]

(i) The Board shall determine the objectives and goals and shall chalk out strategies and work-plans on annual basis. It shall specially engage itself in the affairs of making strategies consistent with the determined objectives and goals and in the issues relating to structural change and reorganization for enhancement of institutional efficiency and other relevant policy matters.

(ii) The board shall have its analytical review incorporated in the Annual Report regarding the success/failure in achieving the business and other targets as set out in its annual work-plan and shall apprise the shareholders of its opinions/recommendations on future plans and strategies. It shall set the Key Performance Indicators (KPIs) for the CEO and other senior executives and have it evaluated at times.

5.9.3.1.2 Lending and Risk Management[121]

(i) The policies, strategies, procedures etc. in respect of appraisal of loan/investment proposal, sanction, disbursement, recovery, reschedulement and write-off thereof shall be made with the

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[117] Bangladesh Bank, BRPD Circular No. 04, dated February 01, 2006.

[118] Bangladesh Bank, BRPD Circular No. 09, dated September 17, 1996

[119] Bangladesh Bank, BRPD Circular No. 16, dated July 24, 2003.

[120] *Ibid.*

[121] *Ibid.*

board's approval. The board shall specifically distribute the power of sanction of loan/investment and such distribution should desirably be made among the CEO and his subordinate executives as much as possible. No Director shall interfere directly or indirectly into the process of loan approval;

(ii) The Board shall frame policies for risk management and get them complied with and shall monitor at quarterly rests the compliance thereof.

5.9.3.1.3 Internal Control Management

The board shall remain vigilant on the internal control system of the bank in order to attain and maintain satisfactory qualitative standard of its loan/investment portfolio. It shall review at quarterly rests the reports submitted by its Audit Committee regarding compliance of recommendations made in internal and external audit reports and the Bangladesh Bank inspection reports.

5.9.3.1.4 Human Resources Management and Development[122]

(i) Policies relating to recruitment, promotion, transfer, disciplinary and punitive measures, human resources development etc. and service rules shall be framed and approved by the Board. Such recruitment and promotion shall have to be carried out complying with the service rules. No member of the Board of Directors shall be included in the selection committees for recruitment and promotion;

(ii) The Board shall focus its special attention to the development of skills of bank's staff, and to the adoption of modern electronic and information technologies and the introduction of effective Management Information System (MIS).

5.9.3.1.5 Financial Management[123]

(i) The annual budget and the statutory financial statements shall finally be prepared with the approval of the Board. It shall at quarterly rests review/monitor the positions in respect of bank's income, expenditure, liquidity, non-performing asset, capital base and adequacy, maintenance of loan loss provision and steps taken for recovery of defaulted loans including legal measures;

(ii) The Board shall frame the policies and procedures for bank's purchase and procurement activities and shall accordingly approve the distribution of power for making such expenditures. The maximum possible delegation of such power shall rest on the CEO and his subordinates. The decision on matters relating to infrastructure development and purchase of land, building, vehicles etc. for the purpose of bank's business shall, however, be adopted with the approval of the Board.

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[122] *Ibid.*

[123] *Ibid.*

5.9.3.1.6 Formation of Supporting Committees

An executive committee, whatever name called, may be formed with the Directors for taking decisions on urgent matters. There shall be no committee or sub-committee of the Board other than the Executive Committee and the Audit Committee. No alternate Director shall be included in these committees.[124]

5.9.3.1.7 Appointment of Chief Executive Officer (CEO)

The Board shall appoint a competent CEO for the bank with the approval of the Bangladesh Bank.[125]

5.9.3.2 Responsibilities of the Chairman of the Board of Directors

Bangladesh Bank specified the following responsibilities for the Chairman of the Board of Directors:[126]

(i) As the Chairman of the Board of Directors (or Chairman of any committee formed by the Board or any Director) does not personally possess the jurisdiction to apply policymaking or executive authority, he shall not participate in or interfere into the administrative or operational and routine affairs of the bank;

(ii) The Chairman may conduct on-site inspection of any bank-branch or financing activities under the purview of the oversight responsibilities of the Board. He may call for any information relating to bank's operation or ask for investigation into any such affairs; he may submit such information or investigation report to the meeting of the Board or the executive committee and if deemed necessary, with the approval of the Board, he shall effect necessary action thereon through the CEO. Any complaint against the CEO shall have to be apprised to Bangladesh Bank through the board along with the statement of the CEO.

5.9.3.3 Responsibilities of the Adviser

The Adviser, whatever name called, shall advise the Board of Directors or the CEO on such issues only for which he is engaged in terms of the conditions of his appointment. He shall neither have access to the process of decision-making nor shall have the scope of effecting executive authority in any matters of the bank including financial, administrative or operational affairs.[127]

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[124] *Ibid.*

[125] *Ibid.*

[126] *Ibid.*

[127] *Ibid.*

5.9.3.4 Responsibilities and Authorities of the CEO

The CEO of the bank, whatever name called, shall discharge the responsibilities and effect the authorities as follows:[128]

(i) The CEO shall discharge his responsibilities in terms of the financial, business and administrative authorities vested upon him by the Board. He shall remain accountable for achievement of financial and other business targets by means of business plan, efficient implementation thereof and prudent administrative and financial management;

(ii) The CEO shall ensure compliance of the Bank Companies Act, 1991 and/or other relevant laws and regulations in discharging routine functions of the bank. The CEO shall report to Bangladesh Bank of issues violative of the Bank Companies Act, 1991 or of other laws/regulations and, if required, may apprise the Board post facto;

(iii) The recruitment and promotion of all staff of the bank except those in the two tiers below him shall rest on the CEO. He shall act in such cases in accordance with the approved service rules on the basis of the human resources policy and sanctioned strength of employees as approved by the Board. The authority relating to transfer of and disciplinary measures against the staff, except those at one tier below the CEO, shall rest on him. Besides, under the purview of the human resources policy he shall nominate officers for training etc.

5.9.4 Constitution of the Audit Committee of Board of Directors

In April 2003, Bangladesh Bank advised the banks to constitute Audit Committee of Board of Directors and issued some rules for compliance by the banks.[129] The Audit Committee will assist the Board in fulfilling its oversight responsibilities including implementation of the objectives, strategies and overall business plans set by the Board for effective functioning of the bank. The committee will review the financial reporting process, the system of internal control and management of financial risks, the audit process, and the bank's process for monitoring compliance with laws and regulations and its own code of business conduct.

The Audit Committee will comprise of three members. Members of the committee will be nominated by the Board of Directors from the Directors. Members may be appointed for a three-year term of office. Company secretary of the bank will be the secretary of the Audit Committee.

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[128] *Ibid.*

[129] BRPD Circular No. 12, dated December 23, 2002.

The Audit Committee should hold at least three or four meetings in a year and it can sit any time as it may deem fit. The committee may invite such other persons (e.g. the CEO, head of internal audit) to its meetings, as it deems necessary. The internal and external auditors of the bank should be invited to make presentations to the audit committee as appropriate.

5.10 Customer Protection

The resilience of banking institutions and stability of the system are important to safeguard depositors' interest, and ensure uninterrupted intermediation process. Under a market-oriented operating environment, it is essential to develop necessary infrastructure for customer protection. Customer protection is necessary not only for the customers, it equally serves the banking companies indirectly, as it reduces the risk of a systemic crisis involving, for example, panic withdrawals of deposits from sound banks and breakdown of the payments system. Bangladesh Bank adopted the following measures with a view to protecting the interest of the customers of the banking industry in Bangladesh.

(a) banks are required to establish clear procedures including setting up of "Complaint Cell" to handle customer complaints;

(b) better disclosure and transparency standards have been introduced and dissemination to the public at large has been mandated;

(c) strong regulatory oversight to ensure fair practices by banks;

(d) establishment of "Deposit Insurance Scheme" (DIS).

Moreover, the bank companies have been asked to disclose more information in their financial statements as par the International Accounting Standards (IAS) with a view to providing the investors, depositors and other stakeholders with transparent and adequate information about the bank. "Deposit Insurance Scheme" and "Complaint Cell" have been discussed below.

5.10.1 Deposit Insurance Scheme (DIS)

Bangladesh Bank introduced Deposit Insurance Scheme (DIS) in Bangladesh in August 1984. The purpose of the Scheme was to help increase market discipline, reduce moral hazard in the financial sector and provide safety nets at the minimum cost to the public in the event of a bank failure. Under the scheme, deposits of all scheduled banks are insured up to Taka 100,000 per depositor.[130] To facilitate this, Bangladesh Bank formed a fund namely, Deposit Insurance Trust Fund. It may be mentioned here that, Bangladesh Bank is a member of the International Association of Deposit Insurers (IADI).

The scheme is now being governed by the "Bank Deposit Insurance Act 2000".It was made mandatory for all the scheduled banks in Bangladesh, existing on the date of enforcement of this Act and to be established after enforcement of this Act, to be insured with the fund. The scheduled banks existing on the date of enforcement of this Act were deemed to have been insured with the fund from the same date.[131] Each insured bank is required to pay the premium to the fund at the rate of 0.07% per annum on such portion of its deposit as may be determined by Bangladesh Bank from time to time.[132] Revised risk based premium rate was introduced in January 2007. As per new schedule, the banks under problem bank category will have to pay 0.09 percent whereas other banks will pay 0.07 percent as premium on their deposits.[133] Bangladesh Bank has the power (with prior approval of the Government) to increase or decrease the rate or premium. Premium is to be paid at such time and mode as specified by Bangladesh Bank.[134] If any insured bank fails to pay its premium, Bangladesh Bank may debit the amount equal to that of the premium from the account of the said bank maintained with Bangladesh Bank and direct it to the fund as premium of that bank. If any insured bank fails for more than once to pay the premium, Bangladesh Bank, allowing the chance of hearing and by notification in the official gazette, may refrain that bank from accepting deposit for the time as specified in the notification.[135]

All premiums collected from the insured banks and other receivables are deposited to an account called the "Deposit Insurance Trust Fund” (DITF)

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[130] Bangladesh Bank, *Annual Report* 2010-*11*, *op. cit.,*p. 49.

[131] Bangladesh Bank, *Prudential Regulations for Banks*, *op. cit.,*p. 34,

[132] Bangladesh Bank introduced revised risk based premium rate from January 2007. As per new schedule, the “problem banks’ are required to pay 0.09 percent, whereas other banks are required to pay 0.07 percent as premium on their deposits.

[133] Bangladesh Bank, *Annual Report 2010-11, op. cit.,* p. 49.

[134] Bangladesh Bank, *Prudential Regulations for Banks*, *op. cit.,* p. 34.

[135] *Ibid.*

account maintained at the Bangladesh Bank. Monies of the fund shall not be spent for any purposes other than for repayment of dues of the depositors of the liquidated bank and for the cost of maintenance of the fund. At the end of June 2011, the total assets of the DITF stood at Taka 17.9 billion of which Taka 17.7 billion were invested in Government securities.[136] The Board of Directors of the Bangladesh Bank acts as the Trustee Board for the DITF.

Liabilities of the Deposit Insurance Trust Fund (DITF) are as follows: [137]

(i) in case of liquidation of any insured bank, Bangladesh Bank shall pay each of its depositors the amount equal to one's deposit, not exceeding maximum Tk. one lac, from the fund;

(ii) the official liquidator shall submit the list of deposits of the depositors to Bangladesh Bank within less than 90 days after assuming his office;

(iii) the Trustee Board shall arrange for payment the due amounts to the depositors from the fund within less than 90 days after receipt of the list;

(iv) if the amount of the deposited monies of the fund falls short of the payable amount, Government shall, through Bangladesh Bank lend the fund the amount of short-fall at Bank Rate-based interest.

Bangladesh Bank has advised the banks for bringing DIS into the notice of the public through displaying it in their display boards.

5.10.2 Complaint Cell

In the face of huge number of complaints submitted to Bangladesh Bank regarding different irregularities of the banks, Bangladesh Bank advised the banks to set up "Complaint Cell" in each bank to deal with respective customer complaints. Bangladesh Bank also outlined the operational activities, formation and monitoring method as follows:[138]

(i) The Complaint Cell will be formed at the Head Office of each bank under direct supervision of the chief executive;

(ii) The Cell will take necessary measures to settle the complain against concerned officer/ employee at the earliest possible time. Generally

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[136] Bangladesh Bank, *Annual Report 2010-11*, *op. cit.,* p. 49.

[137] Bangladesh Bank, *Prudential Regulations for Banks*, *op. cit.,* pp. 34-35.

[138] Bangladesh Bank, BRPD Circular No. 01, dated January 05, 2005.

the complain will have to be settled within ten days from receipt of the complain. In no case the time length will exceed 45 days;

(iii) The chief executive will monitor the activities of the Cell regularly;

(iv) The Cell will have to be equipped with adequate manpower;

(v) The banks will take necessary steps to bring the matter of forming the Complaint Cell into the notice of the branch offices and the customers;

(vi) The banks are to send quarterly statement on the measures taken about the complains received in the Complaint Cell in prescribed format to the Department of Banking Inspection-1 of Bangladesh Bank.

A Division of Bangladesh Bank named Foreign Exchange Inspection & Vigilance Division is also looking into the complaints. This Division checks the performance, effectiveness and functioning of the complaint cells of the banks and monitors the status of customer complaints. The Division is also attending to the individual complaint if it is felt necessary.[139]

5.11 Conclusion

Bangladesh Bank like other Central Banks of the world performs multifarious tasks as a banker of the banks of the country's financial system. The Bangladesh Bank Order 1972 assigns regulation and supervision of the banking companies to the Bangladesh Bank, whereas the Bank Company Act 1991 empowers Bangladesh Bank with the necessary authority for this purpose. Under the purview of FSRP, significant changes have been witnessed in the role of Bangladesh Bank as a banker of the banks.

. The relationship between Bangladesh Bank and the commercial banks is much similar to the relationship between a commercial bank and its clients, though there are significant differences in objectives, implications and instruments in the two relationships. It lends to the banks like a commercial bank does to its borrowers. In fact, Bangladesh Bank is the 'lender of last resort' for the banks and financial institutions of Bangladesh. It uses the Bank Rate to rediscount the eligible bills and bonds to lend to the banks and financial institutions in liquidity crises. Bangladesh Bank also keeps deposits of the banks in the form of CRR. The Bank does not pay any interest for such deposits.

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[139] Bangladesh Bank, *Annual Report 2006-07*, *op. cit.,* p. 43.

Bangladesh Bank is the licensing authority for the banks, both local and foreign, operating in Bangladesh. For granting license, Bangladesh Bank makes some conditions fulfilled by the banks. It can also cancel a licence granted to a banking company on account of some reasons.

To establish good governance and to develop transparency and accountability in bank management, Bangladesh Bank formulated various rules, regulations and guidelines and from time to time made amendments and additions therein. Bangladesh Bank recently specified constitution of the Board of Directors and set fit and proper test criteria for appointment or reappointment and filling up of casual vacancy of the offices of bank Directors. It set strict guidelines regarding appointment of Chief Executive and Advisor in the banks. The guidelines are also applicable for dismissal, release or removal of Chief Executive and Advisor. For corporate governance, Bangladesh Bank specified clearly the demarcation of responsibilities and authorities among the Board of Directors, its Chairman, Chief Executive Officer (CEO) and Advisor to the private banks.

As a guardian of the financial system, Bangladesh Bank adopted some measures to provide safety net to the depositors and in turn to the financial system and made the banks comply with those measures. Among those, establishment of Deposit Insurance Scheme (DIS) and Complaint Cell at each bank are specially noteworthy.

The next chapter deals with the role of Bangladesh Bank, it plays as a banker to the Government.

CHAPTER VI

ROLE OF BANGLADESH BANK AS A BANKER TO THE GOVERNMENT

6.1 Prelude

Acting as a banker to the Government is a fundamental function of any Central Bank of the world. The history of central baking reveals that, the rise of Central Banks was largely determined by this function along with issuing note of a bank which in course of time turned into a Central Bank. According to M. H. de Kock,

> In many of the older countries, one bank gradually came to assume more and more the position of a central bank, due mainly to its enjoying the sole or the principal right of note issue and acting as the Government's banker and agent.[1]

At present, acting as the Government's bank is mentioned explicitly in the central banking charters or statutes. In India, in terms of Section 20 of the Reserve Bank of India Act, 1934, the Reserve Bank of India is obligated to undertake the receipts and payments of the Central Government and to carry out the exchange, remittance and other banking operations, including the management of the public debt of the country. Further, as per Section 21 of the said Act, the reserve Bank is to transact Government business of the Union in India.[2] Bangladesh Bank acts as the banker and debt manager to the Government of Bangladesh in terms of Article 20 of the Bangladesh Bank Order 1972.[3] An agreement has also been made between the Government of Bangladesh and the Bangladesh Bank on September 10, 1985 regarding settlement of these sorts of functions.[4] As a banker to the Government, Bangladesh Bank has well defined obligations and provides several services. Bangladesh Bank was found to perform the role of Government's banker in four broad areas viz., credit to the Government, public debt management, treasury functions and advisory role. Besides these areas, the Bank also carries on some other functions for the Government.

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[1] M.H.de Kock, *Central Banking* (New Delhi: Universal Book Stall, 1995), p. 1.

[2] Official website of the Reserve Bank of India, www.rbi.org.in.scripts/ FAQView.aspx?Id=61

[3] Government of Bangladesh, "Bangladesh Bank Order 1972*", The Bangladesh Gazette, Extraordinary,* Part IIIA (Dhaka: GoB, October 31, 1972).

[4] Bangladesh Bank, *Annual Report 2008-09* (Dhaka: Bangladesh Bank, 2009), p. 61.

6.2 Credit to the Government

A major function of Bangladesh Bank is to extend credit to the Government of Bangladesh. This function originates from a Fiscal Policy implication. With a view to foster economic growth and accelerate poverty reduction, the Government of Bangladesh has been pursuing expansionary Fiscal Policy since its independence. As a result, total expenditure very often exceeds total revenue causing fiscal deficit. This deficit is financed by public debt, in other words, Government borrowing or credit to Government. The Government borrows from domestic as well as external sources. In the domestic arena, accumulation of public debt takes place from three main sources, viz., (1) Bangladesh Bank, (2) Deposit Money Banks and (3) Non-banks (including NSD).[5] The Government of Bangladesh borrows mainly for two reasons. It borrows firstly, which is the most significant, to finance the budget deficit and secondly, to meet cash flow mismatch.[6]

Bangladesh Bank extends credit to the Government mainly in two forms, viz., (i) loans and advances, and (ii) investment. These are discussed below.

6.2.1 Loans and Advances

The principal component of the loans and advances provided by Bangladesh Bank to the Government is ‘Ways and Means Advance’. To finance small amount of deficit, a petty cash account namely ‘Ways and Means Advance’ is maintained by Bangladesh Bank. The Government can borrow from this account to a certain limit. Earlier this limit was Taka 64 crore. In fiscal year 2006-07, the limit was raised to Taka 1000 crore with effect from July 01, 2006.[7] At present the limit is Taka 2000 crore. Bangladesh Bank charges a nominal rate of interest against Ways and Means advance. The rate of interest for the amount within the mentioned limit is equal to the interest rate of *reverse repo*.[8] The amount exceeding the limit is treated as Current Overdraft. This amount is charged with

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[5] Md. Ezazul Islam, “Public Debt Sustainability in Bangladesh”, PN 0802 (Dhaka: Bangladesh Bank), p. 3.

[6] Bangladesh Bank, *Annual Report 2006-07* (Dhaka: Bangladesh Bank, 2007), p. 25.

[7] *Ibid.*

[8] *Ibid.*

interest rate of *reverse repo* +1%. Besides the Ways and Means Advance to the Government, the Bangladesh Bank also extends advance to the autonomous and semi-autonomous bodies. These two advances constitute the total loans and advances to the Government by Bangladesh Bank. Year wise data on the loans and advances to the Government by the Bank have been presented in Table VI-1.

6.2.2 Investment

Bangladesh Bank invests in Treasury bills (T-bills) and Bangladesh Government Treasury Bonds (BGTBs), hereafter mentioned as bonds. Moreover, in Fiscal Year 2006-07, a system of devolvement and private placement of Treasury bills and bonds with Bangladesh Bank was introduced to mitigate risk of inadequate response from the market.[9] In Fiscal Year 2010-11, the total volume of investment by Bangladesh Bank in Government securities was Taka 20625.2 crore. Year wise data on investment of Bangladesh Bank in Government securities have been presented in Table VI-1.

Table VI-1
Credit to the Government by Bangladesh Bank (Gross)

(Taka in crores)

Period	Loan & Advance	Share of Loan & Advance in Total Credit (%)	Investment	Share of Investment in Total Credit (%)	Total Credit
1973-74	20.0	5.44	347.5	94.56	367.5
1974-75	20.0	4.77	399.3	95.23	419.3
1975-76	20.0	3.72	517.9	96.28	537.9
1976-77	20.0	4.65	410.2	95.35	430.2
1977-78	20.0	3.67	524.4	96.33	544.4
1978-79	20.0	4.07	471.9	95.93	491.9
1980-81	20.0	1.61	1220.1	98.39	1240.1
1981-82	20.0	1.63	1206.8	98.37	1226.8
1982-83	20.0	2.04	962.1	97.96	982.1
1983-84	20.0	2.12	924.7	97.88	944.7
1984-85	20.0	2.01	972.9	97.99	992.9
1985-86	0.0	0.00	1022.1	100.00	1022.1
1986-87	20.0	1.95	1005.6	98.05	1025.6
1987-88	34.3	2.77	1203.0	97.23	1237.3
1988-89	12.5	1.30	946.6	98.70	959.1
1989-90	31.9	1.89	1659.0	98.11	1690.9

(Continued to the next page)

[9] *Ibid*.

Table VI-1 (Concluded)

Period	Loan & Advance	Share of Loan & Advance in Total Credit (%)	Investment	Share of Investment in Total Credit (%)	Total Credit
1990-91	31.0	1.77	1723.5	98.23	1754.5
1991-92	30.3	2.25	1315.3	97.75	1345.6
1992-93	25.8	1.56	1632.1	98.44	1657.9
1993-94	25.8	2.06	1224.1	97.94	1249.9
1994-95	25.2	1.73	1429.9	98.27	1455.1
1995-96	69.1	2.43	2770.2	97.57	2839.3
1996-97	69.1	1.63	4158.3	98.37	4227.4
1997-98	69.1	1.37	4964.5	98.63	5033.6
1998-99	69.1	1.13	6027.5	98.87	6096.6
1999-2000	69.1	0.88	7765.8	99.12	7834.9
2000-01	69.1	0.71	9700.0	99.29	9769.1
2001-02	69.1	0.52	13189.2	99.48	13258.3
2002-03	69.1	0.55	12475.7	99.45	12544.8
2003-04	89.0	0.78	11379.9	99.22	11468.9
2004-05	84.0	0.55	15262.4	99.45	15346.4
2005-06	69.1	0.28	24581.6	99.72	24650.7
2006-07	1005.1	3.93	24550.1	96.07	25555.2
2007-08	2271.4	8.90	23252.4	91.10	25523.8
2008-09	3973.0	12.24	28474.1	87.76	32447.1
2009-10	5.1	0.02	21788.2	99.98	21793.3
2010-11	10732.9	34.23	20625.2	65.77	31358.1

Source: Bangladesh Bank, *Economic Trends,* various issues and the researcher's own calculation.

It can be seen in the Table that, in Fiscal Year 2010-11, total credit extended by Bangladesh Bank to the Government was Taka 31,358.1 crore, where 'Loan and Advance' was Taka 10,732.9 crore and investment was Taka 20625.2 crore. It is also evident that, 'Investment' by Bangladesh bank constitutes the major share in total credit to the Government from Bangladesh Bank, whereas 'Loan and Advance' constitutes a nominal share. In Fiscal Year 2010-11, 'Loan and Advance' was 34.23 percent of total credit, which was the highest share of this category in the whole period under consideration. On the other hand, in the same Fiscal Year, 'Investment' constituted 65.77 percent of total credit, which was the lowest share of this category in the same period.

6.3 Debt Management

Bangladesh Bank acts not only as the source of fund, but also as the manager of the debt of the Government of Bangladesh. The Bank acts as the debt manager obligated by article 20 of the Bangladesh Bank Order 1972, the agreement between Ministry of Finance (MoF) and Bangladesh Bank on September 10, 1985 and article 3 of Treasury rule appendix 1.[10] Debt management appeared to be the most important aspect of the role of Bangladesh Bank as a banker to the Government. In the wake of persistent saving-investment gap, export-import gap, and fiscal deficit, the public debt management became an essential issue for sustained macro stability of Bangladesh.[11] The domestic debt management strategy of the country is determined by a Cash and Debt Management Committee (CDMC). CDMC was formed in Fiscal Year 2005-06 comprising higher officials of the Ministry of Finance and Bangladesh Bank.[12] The Committee meets on a quarterly basis and a market based strategy is adopted by considering a host of factors like market conditions, monetary developments, inflation, Government cash flow needs, the maturity profile and risks in the debt portfolio, etc.[13] The semi-annual and annual borrowing plans are prepared based on the strategy. These borrowing plans are implemented by Bangladesh Bank. On behalf of the Government, Bangladesh Bank issues and services public debt through a network of Primary Dealers. Bangladesh Bank also deals with the business related to foreign debt with the instructions of Ministry of Finance.[14] The main features of Bangladesh Bank's debt management are as follows.

6.3.1 Issuing Government Securities

Bangladesh Bank issues Treasury bills and bonds of different maturities on behalf of the Government. The Bank issues these securities with two-fold objectives. First, to use these as a tool for mobilizing fund for financing Government deficit at lower cost and second, to use these as a Monetary Policy instrument to mop up excess liquidity prevailing in the market.[15] Adopting a market based approach, a volume based system of auctions of the Treasury bills and bonds was introduced in Fiscal Year 2006-07. As par this system

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[10] Bangladesh Bank, *Annual Report 2008-09, op. cit.,* p. 56.

[11] Md. Ezazul Islam and Bishnu Pada Biswas, "Public Debt Management and Debt Sustainability in Bangladesh", Working Paper Series 0705 (Dhaka: Bangladesh Bank, December 2006), p. 4.

[12] Bangladesh Bank, *Annual Report 2006-07, op. cit.,* p. 25.

[13] Bangladesh Bank, *Annual Report 2008-09, op. cit.,* p. 61.

[14] *Ibid.*

[15] *Ibid.,* p. 55.

Bangladesh Bank publishes auction calendar for both the Treasury bills and bonds stating auction date and the amount to be auctioned.[16] This step has ensured transparency in the system of auction of Government securities and has also helped determine competitive price. The Treasury bills and bonds are described below.

6.3.1.1 Treasury Bills

Generally Treasury bills are short term Government securities with maturity of a period less than one year. However, in Bangladesh, two and five year bills are also regarded as Treasury bills. T-bills are auctioned on weekly basis according to the auction calendar, published by Bangladesh Bank. Usually these bills are designated by the number of days to their maturity. The T-bills are eligible for Statutory Liquidity Requirement (SLR) of the banks and financial institutions. Bangladesh Bank issues six types of Treasury bills in Bangladesh. These are:

(i) 28 days T-bill;
(ii) 91 days T-bill;
(iii) 182 days T-bill;
(iv) 364 days T-bill;
(v) 2 years -T-bill;
(vi) 5 years T-bill.

However, for some reasons the Bank occasionally discontinues some of the bills and at present all the bills are not in force. To match the tenor of T-bills with international convention, the system of auction of 5-year T-bill was discontinued with effect from March 10, 2004 and 2-year T-bill was abolished with effect from September 01, 2006.[17] The Bank discontinued the 28-day T-bills from its regular auction to avoid its overlapping with the 30-day Bangladesh Bank bill from July 01, 2008 in line with the Fiscal and Monetary Policy Co-ordination Council's recommendation.[18] As a result, in Fiscal Year 2010-11, three types of Treasury bills viz., 91-day, 182-day and 364-day T- bills were in force.[19] Detail of auctions of government Treasury Bills of fiscal Year 2011 have been presented in Table VI-2.

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[16] Bangladesh Bank, *Annual Report 2006-07*, *op. cit.,* p. 25.

[17] *Ibid.,* p. 52.

[18] Bangladesh Bank, *Annual Report 2008-09*, *op. cit.,* p. 55.

[19] Bangladesh Bank, *Annual Report 2010-11, op. cit.,* p. 67.

Table VI-2

Auctions of Government Treasury Bills held in Fiscal Year 2011

Tenor of Bills	Bids Offered		Bids Accepted		Outstanding Bills as of End June 11 (Billion Taka)	Yield Range* (%)
	No.	Face Value (Billion Taka)	No.	Face Value (Billion Taka)		
91-day	334	84.0	211	58.5	28.8	2.43-7.00
182-day	345	76.6	223	54.4	43.3	3.49-7.25
364-day	372	64.1	232	40.2	59.6	4.24-7.55
Devolvement to Bangladesh Bank/ Primary Dealers				53.3		
Total	**1051**	**224.8**	**666**	**206.3**	**131.7**	**2.43-7.55@**

Note: * = Range of the weighted average annual yield of the accepted bids.

@ = Overall range of Treasury bills of different terms.

Source: Bangladesh Bank, *Annual Report,* various years.

A total of 1051 bids for Treasury bills of different tenors amounting to Taka 224.8 billion were received in Fiscal Year 2011, of which 666 bids amounting to Taka 206.3 billion were accepted. Of this Taka 206.3 billion, Taka 53.3 billion was devolved to Bangladesh Bank/ Primary Dealers. The weighted average yield-to-maturity against the accepted bids ranged from 2.43 percent to 7.55 percent in the period under consideration. The overall data on auctions of Government Treasury Bills from Fiscal Year 2006-07 to Fiscal Year 2010-11 have been presented in Table VI-3.

Table VI-3

Auctions of Government Treasury Bills (from FY 2007 to FY 2011)

End of Fiscal Year	Bids Offered		Bids Accepted			Outstanding Bills as on End June (billion Taka)	Yield Range* (%)
	No. of Bids	Face Value (billion Taka)	No. of Bids	Face Value (billion Taka)	Devolvement to BB (billion Taka)		
2007	1376	478.4	1255	413.70	40.3	140.00	7.10-9.30@
2008	2681	646.9	972	224.90	213.8	113.70	7.28-8.48@
2009	1395	436.6	410	132.30	110.4	131.80	3.02-8.60@
2010	1476	417.0	385	118.46	92.3	101.82	1.11-5.42@
2011	1051	224.8	666	153.00	53.3	131.70	2.43-7.55@

Note: * = Range of the weighted average annual yield of the accepted bids.

@ = Overall range of Treasury bills of different terms in the specific Fiscal Year.

Source: Bangladesh Bank, *Annual Report,* various years and the researcher's own calculation.

6.3.1.2 Bangladesh Government Treasury Bond (BGTB)

To mobilize long-term fund for financing Government expenditure programme, Bangladesh Government Treasury Bonds (BGTB) with different maturities have been introduced under Public Debt Rules 1946.[20] At present there are Treasury bonds of four tenors. These are:

(i) 5-year Treasury bond;
(ii) 10-year Treasury bond;
(iii) 15-year Treasury bond; and
(iv) 20-year Treasury bond.

The bonds have been issued at par through yield-based multiple price auctions held in Bangladesh Bank. BGTBs are issued at coupon rates which are redeemable at their auction dates and are payable at six monthly intervals from the date of issue. The primary issues of the bonds shall be sold by the Bangladesh Bank in auctions as per auction calendar announced prior to each financial year and also as per auction notice announced one week ahead of each auction. At present the auctions for bonds are held on monthly basis. Individuals and institutions residents in Bangladesh as well as non-resident individuals and institutions are eligible to purchase the bonds. The non-resident individuals and institutions can purchase with fund from non-resident foreign currency account with a bank in Bangladesh in the name of the investor subject to the condition that, the bonds cannot be resold to a resident within one year of purchase. The bonds are redeemable upon maturity as well as freely tradable in the secondary market. Like the T-bills the bonds are also eligible for SLR of the banks and the financial institutions.[21] Data on the auctions of BGTBs held in Fiscal Year 2011 have been presented in Table VI-4.

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[20] Bangladesh Bank, *Annual Report 2007-08* (Dhaka: Bangladesh Bank, 2008), p. 64.

[21] *Ibid.*

Table VI-4

Auctions of Bangladesh Government Treasury Bonds in FY 2011

Total No. of Auctions	Tenor of Bonds	Bids Offered		Bids Accepted			Outstanding Bonds as on June 2011 (billion Taka)	Yield Range* (%)
		No. of Bids	Face Value (billion Taka)	No. of Bids	Face Value (billion Taka)	Devolvement to BB/PD (billion Taka)		
12	5-Year	192	55.2	117	36.6	15.9	198.5	7.88-8.26
12	10-Year	199	55.6	118	36.5	16.0	224.9	8.79-9.50
12	15-Year	165	20.7	105	15.0	5.2	62.3	8.84-9.35
12	20-Year	186	19.7	105	12.6	4.9	48.3	9.20-9.65
48		**742**	**151.2**	**445**	**100.7**	**42.0**	**534.0**	**7.88-9.65@**

Note: * = Range of the weighted average annual yield of the accepted bids.

@ = Overall range of Treasury bonds of different terms.

Source: Bangladesh Bank, *Annual Report,* various years and the researcher's own calculation.

It is found that, Treasury bonds bearing half-yearly interest coupons, with tenors of 5-year, 10-year, 15-year and 20-year were auctioned as usual in every month in FY 2011. A total of 742 bids for Taka 151.2 billion were received where 445 bids for Taka 142.7 billion were accepted. Of this Taka 142.7 billion, Taka 42.0 billon was devolved on Bangladesh Bank/ Primary Dealers. The outstanding amount of bonds stood at Taka 534.0 billion at the end of June 2011. The overall weighted average yield-to-maturity for the Treasury bonds ranged from 7.88 percent to 9.65 percent in Fiscal Year 2010-11. The overall data on auctions of Bangladesh Government Treasury Bonds from Fiscal Year 2006-07 to Fiscal Year 2010-11 have been presented in Table VI-5.

Table VI-5

Auctions of Bangladesh Government Treasury Bonds

(from FY 2007 to FY 2011)

End of Fiscal Year	Bids Offered		Bids Accepted			Outstanding Bonds as on End of each Fiscal Year (billion Taka)	Yield Range* (%)
	No. of Bids	Face Value (billion Taka)	No. of Bids	Face Value (billion Taka)	Devolvement to BB/PD (billion Taka)		
2007	479	82.60	337	59.20	0.94	86.70	10.90-12.50@
2008	1147	269.30	305	61.30	42.70	192.70	10.60-15.95@
2009	793	239.90	270	68.70	56.00	314.80	9.20-13.07@
2010	767	218.49	159	48.44	39.41	396.26	7.47-9.42@
2011	742	151.20	445	100.70	42.00	534.00	7.88-9.65@

Note: * = Range of the weighted average annual yield of the accepted bids.

@ = Overall range of Treasury bonds of different terms in the specific Fiscal Year.

Source: Bangladesh Bank, *Annual Report,* various years and the researcher's own calculation.

It should be mentioned here that, auction of 15-year and 20-year Treasury bonds were introduced in Fiscal Year 2007-08. Before that only 5-year and 10-year Treasury bonds were in force.

It was found that, the outstanding amount of bonds gradually increased over time. At the end of June 2011 the amount was Taka 534.0 billion, which was 34.8 percent higher than that of the previous year.

6.3.1.3 Bangladesh Government Islamic investment Bond (Islamic Bond)

In October 2004, Bangladesh Bank issued a *Mudaraba* bond namely Bangladesh Government Islamic investment Bond (Islamic Bond) on behalf of the Government. This was done mainly to facilitate the Islamic banks and financial institutions to invest their funds to be considered as liquid assets for meeting the Statutory Liquidity Requirement (SLR).[22] This bond is also open for investment by any private individuals, companies or corporations as well as non-resident Bangladeshis. The Government Islamic Investment Bond (GIIB) is governed by the Islamic *Shariah* i.e., on the principles of *Mudaraba* where the Bangladesh Bank acts as *Mudarib*. Profit Sharing Ratios (PSR) related to the GIIB are determined separately for each deal.[23] Three types of GIIBs were introduced which are still in operation. These are (i) 6-month GIIB, 1-year GIIB, and (iii) 2-year GIIB. Data on the sale, financing and net outstanding of GIIB have been presented in Table VI-6.

Table VI-6

Bangladesh Government Islamic Investment Bond

(Billion Taka)

Particulars	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**
(i) Sale	14.8	15.6	16.4	23.4	25.3
(ii) Financing	6.6	15.5	12.1	15.4	22.8
(iii) Net Outstanding	8.2	0.1	4.3	8.0	2.5

Source: Bangladesh Bank, *Annual Report,* various years.

It is observed in the Table that, the sale of Islamic bonds has been increasing gradually over time.

[22] Bangladesh Bank, *Annual Report 2006-07, op. cit.,* p. 55.

[23] *Ibid.*

There are primary and secondary market of both Treasury bills and bonds in Bangladesh, which are still in developing stage. The response to primary market is meager while the existence of the secondary market is very insignificant.[24] By operating the bills and bonds effectively Bangladesh Bank can influence the reserve position of the banks and financial institutions which will in turn make the banks and financial institutions more efficient in their fund management. This will also reduce the dependency of these institutions to the refinance window of the Central Bank. It opens the prospect for Bangladesh Bank to regulate the monetary and credit situation of the country more effectively.[25]

6.3.2 Primary Responsibilities of Bangladesh Bank in Debt Management

Besides issuing the Government securities, the Bangladesh Bank shoulders a wide range of responsibilities in the public debt management. The primary responsibilities of Bangladesh Bank regarding the management of the public debt include operational and administrative matters pertaining to the issue of government securities. The Bank formulates policies regarding issuance of Government securities. It prepares auction calendar for issuance of Treasury bills and bonds. Bangladesh Bank participates in trading in Treasury bills and bonds in secondary market. It prepares annual budget for Government internal debt servicing. The Bank takes measures against the fraud and forgery of non-marketable Government securities.[26] For specific types of securities, the Bank maintains records of the holders of the government securities. It settles the payment of interest and redemption of securities. Bangladesh Bank makes comparative evaluation of financing proposals. The Bank facilitates a well functioning debt securities market through building up of a long term yield curve and benchmark securities, supply of adequate securities to the market and strengthening the institutional and legal framework. It facilitates the technological infrastructure relating to the public debt management and maintaining and upgrading the same.[27]

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[24] Bangladesh Bank, *Annual Report 2008-09*, *op. cit.,* p. 56.

[25] *Ibid.*

[26] www.bangladesh-bank.org/aboutus/dept/dept_details.php

[27] Bangladesh Bank, *Annual Report 2008-09*, *op. cit.,* p. 61.

6.3.3 Objectives of Bangladesh Bank in Debt Management

Bangladesh Bank tries to achieve some specified objectives in managing the public debt. The main objectives are enunciated in the Bank's *Annual Report 2008-09* as follows:[28]

- Securing of smooth cover of the Government's financing needs through a regular and continued access to the various segments of the domestic money markets;
- Minimization of the cost of the public debt, subject to the prevailing conditions in the domestic markets and acceptable interest rate risk levels;
- Achievement of a balanced and more extended maturity structure of the debt so as to avoid a heavy bunching of maturing debt which could potentially increase abruptly the fiscal burden and/or make the refinancing of the debt more difficult;
- Development of the bond market for the smooth transformation towards the market based debt management.

6.3.4 Focus of the Debt Management Strategy of Bangladesh Bank

Bangladesh Bank's debt management strategy largely focuses on:[29]

- Ensuring funds to meet the government budgetary operations accommodating short term and long term objectives;
- Risk maintenance of debt securities balancing bills and bonds rates in portfolio selection of the government treasury;
- Framing long term fund base with respect to fixed and floating rates bearing in mind cost minimization and liquidity;
- Easing market rigidity fostering technological and manufacturing industry capital base as development concern of the country; and

[28] *Ibid.*

[29] *Ibid.,* p. 56.

- While deriving yield curve, Bangladesh Bank also considers concavity and convexity of time path arising from interest rate risk.

6.4 Treasury Functions of Bangladesh Bank

Bangladesh Bank undertakes general banking business of the Government in terms of section 20 of Bangladesh Bank Order, 1972. The liability of the Bank to the Government in the conduct of the Government business is that of a banker to an ordinary customer. Bangladesh Bank is responsible to maintain Government accounts. To ensure transparency and accountability, Ministry/ division wise accounting system was introduced with effect from July 01, 2006.[30] At present there are a total of 112 Government accounts held with Bangladesh Bank. The Government's principal accounts are maintained at the Local Office of Bangladesh Bank at Motijheel of Dhaka. The Bank appointed Sonali Bank Limited at all places where the Bank has no office or branch of its Banking Department. It verifies and settles the Government transactions maintained by Sonali Bank Limited. Bangladesh Bank provides banking services to the Government such as acceptance of money on Government accounts and payment and/or withdrawal of funds. It also conducts collection and transfer of funds by various means throughout Bangladesh. The Bank publishes the cash balance of the Government account daily. It communicates financial data with the Comptroller General of Accounts (CGA) and other stakeholders of Government transactions.[31] The Government deposits all its cash balances with Bangladesh Bank free of interest.

The Bank performs the treasury functions on behalf of the Government. It collects Government revenue i.e., taxes and fees from different sources. Bangladesh Bank prepares reports on external and commercial audit reports. It executes and maintains foreign currency transactions and prepares statement of daily reserve position. The Bank makes necessary arrangement for withdrawal of

[30] Bangladesh Bank, *Annual Report 2006-07*, *op. cit.,* p. 25.

[31] www.bangladesh-bank.org/aboutus/dept/dept_details.php

fund and submission of reports/ statements from and to the World Bank.[32] It settles transactions among Asian Clearing Union (ACU) member countries through ACU mechanism. The Bank coordinates the IMF country consultations with comprehensive macroeconomic data and information on different sectors of the economy to visiting IMF missions for their surveillance and eventual negotiations for financial and technical assistance. Bangladesh Bank keeps the accounts for the funds from donors and disbursement thereof. It also collects the Foreign Currency (FC) cheques on behalf of the Government. The Bank undertakes repayment of Government external debt including debt servicing and arrangement of miscellaneous outward remittances to meet Government foreign exchange requirement.[33]

6.5 Advisory Role of Bangladesh Bank

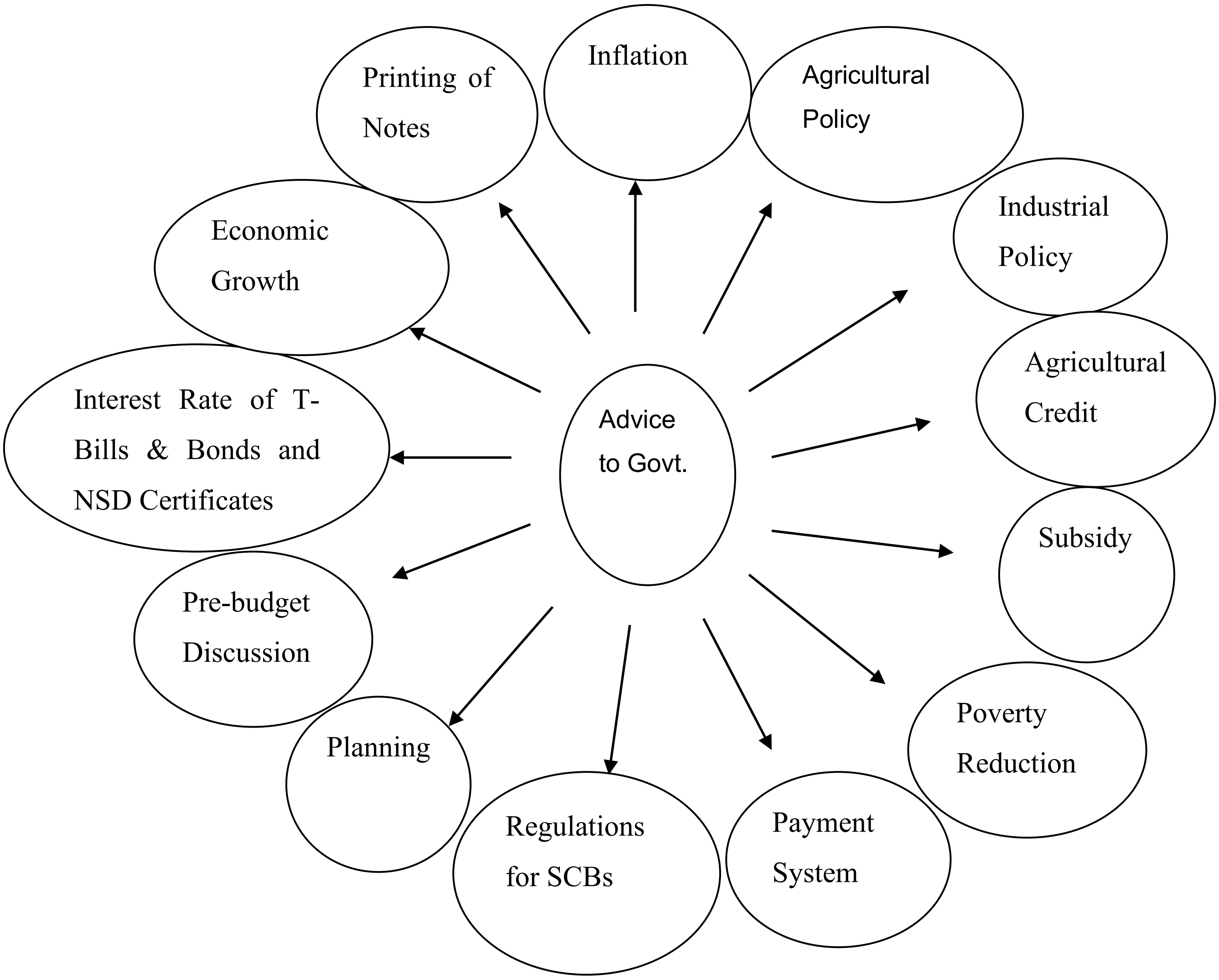
Bangladesh Bank renders advice to the Government on financial matters, whenever called upon to do so. The Government seeks advice from the Bank frequently on various aspects of the economy and financial matters. Usually the Government approaches the Governor of Bangladesh Bank for any advice or opinion. The Governor refers the issue to a Deputy Governor, who again refers the same to the respective line Department and the Department prepares the advice. A host of areas have been identified, where the Government sought advices. The areas are agricultural policy, industrial policy, agricultural loan, subsidy, poverty reduction, payment system, rules and regulations for SCBs, planning, pre-budget discussion, interest rate of Treasury bills, bonds and NSD certificates, printing of notes, economic growth and inflation. Besides the mentioned areas, the Bank regularly replies to the questionnaire of the parliament. The areas are presented in the Diagram VI-1.

[32] *Ibid.*

[33] *Ibid.*

Diagram VI-1

Advices from Bangladesh Bank to Government of Bangladesh



6.6 Other Functions

Besides the above mentioned functions, Bangladesh Bank performs some other significant functions on behalf of the Government. It prepares working papers/ quarterly reviews and provides data/ materials on money, credit and exchange rate for Government bodies regularly. The Bank prepares the full draft of 'Resume of the Activities of Banks and Financial Institutions' published annually by the Ministry of Finance.[34]

[34] *Ibid.*

6.7 Conclusion

It has been observed that, Bangladesh Bank performs a wide range of functions as a banker to the Government of Bangladesh. A healthy relation between the Government and Bangladesh Bank is a precondition for undertaking the functions effectively. The responsibility of ensuring and maintaining that relation largely depends on the Government.

CHAPTER VII

A CRITICAL ANALYSIS OF THE REFORMS UNDERTAKEN BY BANGLADESH BANK

7.1 Introduction

Almost all the countries of the world- developed and underdeveloped, have been undertaking financial sector reform measures since 1970s. The motivation for reforms varies from country to country. In the developed countries the reform was initiated mainly based on the phenomenon called “globilasation” of banks and financial markets, which again was influenced by factors like restrictive regulations in domestic banking, development of Euro-Dollar market, collapse of Brettonwoods system and adoption of floating exchange rate system, abolition of capital control resulting in cross-border exchange and trade, technological development, debt-crisis of early 80s leading to a series of financial crisis etc.[1] But in the developing countries, specially of Asia and Latin America, financial sector reform was introduced as part of their overall economic stabilisation and growth programme.[2]

The theoretical underpinnings to the financial reform programmes were provided by the financial sector models developed by E. S. Shaw and R. I. Mckinnon in the early seventies. They discussed the impact of ‘financial repression”[3] on economies resulting from excessive controls on the functioning of the financial system. They advocated “liberalisation” of the financial markets from rigid Government control to release the impulses of the financial sector for the purpose of economic development. According to Shaw and Mckinnon, as a result

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[1] C. Rangarajan, “The Reform of the Financial Sector: Choices and Lessons” , *RBI Bulletin* (December 1994), cited in A.H.M. Nurul Islam Choudhuri *et.al.*, “An Evaluation of the Impact of Reforms in the Financial Sector”, *Bank Parikrama*, vol. XX, Nos. 3 & 4 (September & December 1995), p. 2.

[2] A.H.M. Nurul Islam Choudhuri *et. al.*, “An Evaluation of the Impact of Reforms”, *lok. cit.,* p. 2.

[3] “Financial Repression” is a situation where the average saver is consistently offered a negative real rate of return of financial assets.

of liberalisation, the interest rates would be raised and become realistic, greater competition would be ensured in the financial markets and ultimately both savings and investment of the economy would be increased.[4]

The experiences of different countries in regard to financial reforms have been mixed: some are successful, while others are unsuccessful. The Latin American countries- Argentina, Chile, Columbia, Brazil, Mexico and Uruguay- started undertaking radical financial reforms in the mid-1970s. But their efforts generally ended with financial distress, which caused the reimposition of regulations.[5] On the other hand, in contrast to quick and sudden dismantling of all financial regulations in Latin America, financial liberalisation progressed very cautiously in Korea, China and Taipei and yet achieved a considerable amount of success.[6] Another study was done by Cho and Khatkhate on five Asian countries: Korea, Philippines, Sri Lanka, Indonesia and Malaysia. The study found that, financial reforms had not made any significant difference to the saving and investment activities in the liberalized countries; though it had greatly contributed to the financialization of savings.[7]

Bangladesh had started adopting a number of financial sector reform measures as a part of its overall economic stabilization and structural adjustment programme since 1990. Though the Government started denationalization of the financial institutions and privatization of commercial banks back in 1983, financial sector experts consider the year 1990 as the “take off” year in regard to financial reforms.[8] Granted this consideration, 21 years have been passed since the inception of reform in the banking sector in Bangladesh. This is now the right time

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[4] A.H.M. Nurul Islam Choudhuri and Toufic Ahmad Choudhury, “Financial Liberalisation in Bangladesh: Conceptual Issues and Impact on Banking Financial Institutions”, *Bank Parikrama*, vol. XVII (1992), pp. 59 & 60 and A.H.M. Nurul Islam Choudhuri and Toufic Ahmad Choudhury, “Financial Sector Reforms: Measures, Outcome and Probable Future Actions”, *Bank Parikrama*, vol. XVIII, nos. 3 & 4 (1992), pp. 19 & 20.

[5] Jungsoo E. Lee, *Financial Sector and Economic Development: A Survey* (Manila: Asian Development Bank, 1991), cited in Choudhuri and Choudhury, “Financial Liberalisation in Bangladesh”, p. 60.

[6] Choudhuri *et. al.,* “Evaluation of the Impact of Reforms”, *op. cit.,* p. 4.

[7] Choudhuri and Choudhury, “Financial Liberalisation in Bangladesh” *op. cit.,* p. 60.

[8] Choudhuri *et.al.*, “Evaluation of the Impact of Reforms”, *op. cit.,* pp. 3 & 4.

to evaluate the successes and failures of the reform initiative, and critically analyse the causes of the successes and failures thereof. The objective analysis has the potential to help the policy makers to formulate appropriate reform agenda and implement the agenda effectively.

7.2 Background of the Reforms in the Banking Sector of Bangladesh

Bangladesh inherited a narrow and thin financial system, overwhelmingly dominated by commercial banks through liberation in December 1971. In the year 1972, the then Government nationalised and reorganised all the financial institutions excepting a few foreign bank's branches and made them to achieve the economic objectives of the Government.[9] With this step, the financial institutions were brought under the ownership as well as regulatory control of the Government. This marked the starting of a regime of rigid Government and Central Bank regulations and control under which the financial institutions in Bangladesh were to operate. The regulations covered fixation of interest rates on deposits as well as credits, directed expansion of bank branches, direction of credit to public sector enterprises and priority sectors etc.[10] The directives of monetary authorities aimed at achieving objectives of supplying cheap money to the State Owed Enterprises (SOE) and the priority sectors like Agriculture, Export and Small and Cottage Industries in the private sector. [11]

During the period 1972-82, financial network of the banking system increased remarkably. Increase in the total number of bank branches, reduction in population per branch, urban-rural proportion of branches in favour of rural areas and growth rates of deposit and credit improved considerably.[12] But the operational efficiency of the banking sector defined in terms of profitability and productivity, was declining sharply.[13] The profitability of the Nationalized Commercial Banks (NCBs) fell down from 0.32 to 0.23 during FY 1973-74 to FY 1982-83. During the same period, productivity of the NCBs fell down from 1.23 to

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[9] Choudhuri and Choudhury, "Financial Sector Reforms", *op. cit.,* p. 20.

[10] *Ibid.*

[11] Abdur Raquib, "Financial Sector Reform in Bangladesh- An Evaluation", *Bank Parikrama*, vol. XXIV, Nos. 3 & 4 (September & December 1999), p. 6.

[12] Choudhuri and Choudhury,"Financial Sector Reforms", *op. cit.,* p. 20.

[13] Profitability is defined by net profit deflated by balance sheet total and productivity is measured as total income divided by total expenditure.

1.11. [14] At that time the NCBs used to follow inappropriate accrual system of income recognition, which made income to appear larger than it should have been. In spite of this inappropriate accounting system the deterioration in the operational efficiency surfaced.[15] Not only operational efficiency, level of customer services of the banks also deteriorated during this period due to complete Government monopolization of banking services.[16]

Until 1999, Bangladesh Bank used to fix and regulate rates of interest on deposits as well as advances of the commercial banks. The banks could not compete with each other nor did the depositors and debtors have any option to bargain for deposits and advances. Consequently, the market suffered from distortions and the prevailing interest rates did not reflect the opportunity cost.[17] The determination of interest rates as well as disbursement of loanable funds at the disposal of banks were based on non-financial criteria and without commercial consideration, instead of by banks using typical financial criteria. One detrimental consequence of administered interest rates without considering the market clearing rates was that, for the NCBs, which were required to conduct priority lending, the real interest rates appeared to be negative in the face of high inflation rates during the mid 70s and up to the end of 1980s.[18] As a result, private banks were reluctant to collect deposits and lend to priority areas. The policy of arbitrarily fixed low interest rate brought about undesirable consequences of distortion in allocation of resources in the economy.[19] Moreover, the schedule of administered nominal interest rate changed infrequently, causing fluctuations in the real rates with changes in inflation, thus contributing to instability.[20] The inefficiency of the legal administrative framework resulted in misdirection of credit, partial waiver of dues and even complete write-off. Bank

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[14] Choudhuri and Choudhury, "Financial Sector Reforms", *op. cit.,* p.21.

[15] *Ibid*.

[16] *Ibid*.

[17] Rehman Sobhan, ed., *Policies for Development*, Vol. 1 of *Report of the Task Forces on Bangladesh Development Strategies for the 1990's* (vol., 4; Dhaka: University Press Limited, 1991), p. 225.

[18] Bangladesh Bank, *Financial Sector Review,* vol. 1, no. 1 (Dhaka: Policy Analysis Unit, Research Department, Bangladesh Bank, May 2006), p. 72.

[19] Raquib, "Financial Sector Reform in Bangladesh", *op. cit.,* p. 6.

[20] M. Kabir Hassan, "The Financial Sector Reform of Bangladesh", *Banking and Finance in Bangladesh: A Collection of Essays*, ed. by Kabir Hassan (Dhaka: Academic Publishers, 1995), p. 127.

advances were classified by Bangladesh Bank mainly based on subjective evaluation of their auditors.[21] The consequences of the rigid Government control and intervention were rightly depicted in the report of the task forces, set up during the first Caretaker Government in Bangladesh as,

> All these combined to yield sub-optimal contribution of the banks and financial institutions to the economy: spread between rates of deposits and lendings turned out to be partly irrational and largely irrelevant; management cost exceeded a level which could be termed as normal; classification of loans and advances were of manifestive of puffed situation and transparency in accounts and operations blurred.[22]

In this perspective, Government undertook the first reform measure in the form of ownership deregulation of NCBs in 1983. The Government denationalized Uttara Bank in 1983 and subsequently Pubali Bank in 1984.[23] To diagnose the malaise in the banking sector of Bangladesh and identify remedial measures for recovery, the Government appointed a National Commission on Money, Banking and Credit (NCMBC) in 1984.[24] The Commission completed a major study in 1986 identifying a number of problems in the banking sector followed by formulation of a set of recommendations thereof.[25] Among the recommendations the most important ones were related to overall structure of the banking system, monetary management of Bangladesh Bank, capital adequacy requirements of the banks, interest rate, refinance policy of Bangladesh Bank, various administrative and judicial steps required for overcoming problems of overdue loans of NCBs and Development Financial Institutions (DFIs), rural and agricultural credit strategy, management and operations of banks for improving internal management control and efficiency, strengthening supervisory and inspection capability of Bangladesh Bank, various preventive and punitive measures for protecting the banks against frauds, and various amendments and/or enactment of laws required for improvement of loan recovery and overall

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[21] Sobhan, ed., *Policies for Development*, *op. cit.,* p. 224.

[22] *Ibid*.

[23] Toufic Ahmad Choudhury and Bishnu Kumar Adhikary, "Loan Classification, Provisioning Requirement and Recovery Strategies: a Comparative Study on Bangladesh and India," *Bank Parikrama*, vol. XXVII, nos. 2 & 3 (June & September 2002), p. 137.

[24] World Bank, "Financial Sector Adjustment Credit (Credit 2152-BD)", *Performance Audit Report*, Report no. 16841 (Washington, D.C.: The World Bank, July 2, 1997), p. 23.

[25] Sobhan, ed., *Policies for Development*, *op. cit.,* p. 224.

financial discipline.[26] Subsequently, a World Bank team conducted an in-depth study on the financial sector of Bangladesh and suggested reforms in the field of (i) fixation of interest rates on deposits and advances, (ii) classification of overdue credits, (iii) restructuring of capital of NCBs and Private Commercial Banks (PCBs) and (iv) market orientation of banking transactions.[27] Largely based on these suggestions, since 1989-90 a number of regulatory reform measures[28] were initiated by Bangladesh Bank.[29] To assist the implementation of the restructuring/ reform measures, one Financial Sector Reform Project (FSRP) was instituted at Bangladesh Bank in 1992 which ended its activities in 1996. A series of major policy actions had been taken under the reform program in line with the goals and objectives of medium term macroeconomic policy matrix.[30]

Just before the expiry of FSRP in 1996, the Government appointed a six member Banking Reform Committee (BRC) to evaluate the overall situation of the NCBs and place recommendations to the Government for bringing financial discipline and improving efficiency of the NCBs.[31] BRC submitted its recommendations in 1999, which gave the highest priority on restructuring of the supervisory and regulatory set up, strengthening of legal framework and effective restructuring of the NCBs, non-interference with the affairs of the Bangladesh Bank Board and a clear guideline for deficit financing of the Government.[32] To further consolidate, strengthen and make the banking sector more dynamic, a

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[26] Toufic Ahmad Choudhury and Ananya Raihan, *Structural Adjustment Participatory Review Initiative, Bangladesh Study Theme 2(C): Implications of Financial Sector Reforms*, http://www.saprin.org/bangladesh/research/ban_finance.pdf, p.11, visited on September 08, 2007.

[27] Sobhan, ed., *Policies for Development*, *op. cit.,* p. 224.

[28] In some literatures financial reforms have been divided into two distinct groups, namely "ownership reform" and "regulatory reform". "Ownership reform" simply indicates the change in ownership of the banking financial institutions (BFIs), from Government to private sector; whereas "regulatory reform" refers to the reformative changes in the regulations in the banking sector; the latter is crucial for financial reform.

[29] Choudhuri and Choudhury,"Financial Sector Reforms", *op. cit.,* p. 23.

[30] Bangladesh Bank, *Financial Sector Review,* vol. 1, no. 1, *op. cit.,* p. 16.

[31] Toufic Ahmad Choudhury and Md. Liakat Hossain Moral,"Commercial Bank Restructuring in Bangladesh: From FSRP to BRC/CBRP", *Bank Parikrama*, vol. XXIV, no. 1 (March 1999), p. 97.

[32] *Bank Shangoskar Committeer Protibedon [Report of the Banking Reform Committee]*, Wahiduddin Mahmud, Chairman (Dhaka: Government of Bangladesh, December 1999), *passim*.

Commercial Bank Restructuring Project (CBRP) funded by the World Bank had been instituted in Bangladesh Bank in May 1997.[33] Reform in the financial sector has become a continuous process in Bangladesh.

The Brettonwoods Institutions (BWIs) like the World Bank and International Monetary Fund (IMF) played influential and significant role in the reform initiative in Bangladesh financial sector. Bangladesh first contracted a loan of SDR 800 million from the IMF under the Extended Fund Facility (EFF) in 1980. In the same year Bangladesh also contracted Structural Adjustment Loan (SAL) from the World Bank. IMF suspended the EFF in July 1981, only after disbursement of SDR 20 million, due to failure of Bangladesh Government in executing the conditionality of drastically reducing the budget deficit.[34] The World Bank lending to Bangladesh continued with the obligation to follow structural adjustment policies and conditionalities. The demand management, structural and institutional policies included in the structural adjustment policies created pressures on the Bangladesh Government to assert among others tight Monetary Policy, financial liberalisation with interest rate reform, denationalization and privatization of institutions, measures to ensure competition in the financial sector and convertibility of Bangladesh Taka.[35] A chronically low savings rate, poor domestic resource mobilisation and low rate of export growth kept Bangladesh heavily dependent on external resources to finance its development programmes.[36] Therefore, Bangladesh again contracted three-year Structural Adjustment Facility (SAF) of IMF for the period of 1986-87 to 1988-89. After one year, Bangladesh availed another three-year loan under Enhanced Structural Adjustment Facility (ESAF) from IMF covering the period of 1990-91 to 1992-93. The Policy Framework Paper (PFP) required under the SAF loans specified strict structural adjustment guidelines, which Bangladesh was obliged to adhere to. The IMF-World Bank loans are soft in respect of concessional interest rates and

[33] Bangladesh Bank, *Annual Report 1996-97*, p. 1.

[34] M. Zainul Abedin, "Impact of Monetary and Fiscal Reforms on Macro Economic Performance: Recent Trends in Bangladesh", *Bangladesh Journal of Political Economy*, vol. XIII, no. 2 (July 1995), pp. 48 & 49.

[35] *Ibid*.

[36] Sultan Hafeez Rahman, "Structural Adjustment and Macroeconomic Performance in Bangladesh in the 1980s", *The Bangladesh Development Studies*, vol. XX, nos. 2 & 3 (June-September 1992), p. 90.

repayment terms; but they are hard considering the obligation of adherence to a set of stringent conditionalities, imposed on the receiving country.[37] In June 1990, Bangladesh received Financial Sector Adjustment Credit (FSAC) in the amount of SDR 132.7 million equivalent to US $ 175 million from the World Bank to finance the financial sector reform programme and restructuring of the NCBs. To assist in the implementation of the programme, the United States Agency for International Development Agency (USAID) provided a parallel grant of US $ 19.4 million, which paved the way to undertake the FSRP, mentioned earlier.[38]

7.3 Objectives of Financial Sector Reform in Bangladesh

The financial sector reform initiative was launched with various objectives in the face of the grief state of the banking sector of Bangladesh, mentioned in the previous section. The broad objectives of FSRP are as follows: [39]

(i) liberalization of the interest rate structure;
(ii) strengthening of banking inspection and supervision;
(iii) maintenance of capital adequacy requirement;
(iv) new system of loan classification;
(v) restructuring of legal framework in the financial sector;
(vi) development of capital market;
(vii) development of banking system and asset quality;
(viii) computerization of central bank as well as commercial banks;
(ix) domestic and foreign training for the development of bank officials.

7.4 Implementation of Reforms in the Financial Sector of Bangladesh

To achieve the stated objectives some reformative steps were initiated. Some new policies were formulated, some existing policies were modified substantially and some new tools were employed in the banking sector. The following measures constitute the main part of the reform package:

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[37] Abedin, "Impact of Monetary and Fiscal Reforms", *op. cit.,* p. 49.

[38] World Bank, "Financial Sector Adjustment Credit (Credit 2152-BD)", *Implementation Completion Report*, Report no. 15027 (Washington, D.C.: The World Bank, September 28, 1995), pp. i & ii.

[39] Bangladesh Bank, *Financial Sector Review*, vol. 1, no. 1, *op. cit.,* p. 16.

(i) Interest rate deregulation;
(ii) New system of loan classification and provisioning;
(iii) New capital adequacy requirement;
(iv) New supervision, operational and management tools;
(v) Reforms in the legal framework.

The measures are briefly discussed below.

7.4.1 Interest Rate Deregulation

Interest rate deregulation was considered as the corner stone of the whole reform initiative. The objective of this reform in this Monetary Policy tool was to remove the distortions in the interest rate structure with a view to encourage price competition within the banking industry and ensure efficient resource allocation and provide increased market oriented incentives for priority sector lending.[40] Even before the implementation of FSRP, in 1989 Bangladesh Bank announced a new policy guideline on interest rate deregulation.[41] According to the new regulation, lending categories were divided into eleven heads and for each category Bangladesh Bank set interest rate bands, within which banks were allowed to determine and fluctuate their suitable interest rates.[42] In 1992, the lending rate bands were withdrawn from all but three sectors (namely agriculture, export and small industry sector) allowing the banks to fix lending interest rate solely on their own judgments.[43] By the same circular Bangladesh Bank removed the ceilings on savings and fixed deposits, though floor rates continued. Bangladesh Bank allowed multiple rates within a lending category and increased the frequency of interest rate changes by individual banks from six months to every month. In 1997, the floor rates of deposits were also removed.[44] From August 1999, interest bands on agriculture and Small and Medium Enterprises

[40] Choudhury and Raihan, *Structural Adjustment, op. cit.,* p.16.

[41] Bangladesh Bank, *BCD Circular No. 33*, dated 16.11.1989.

[42] Abu Ahmed, "Financial Sector Reform: The Interest Rates Aspect", *Bank Parikrama*, vol. XVIII, nos. 3 & 4 (September & December 1993), p. 40.

[43] Bangladesh Bank, *BCD Circular No. 7*, dated 09.03.1992.

[44] Bangladesh Bank, *BPRD Circular No. 1*, dated 11.02.1997.

(SME) sectors were also withdrawn.[45] At present, interest rate band exists only for export sector. Since 1994 the SME sector was subsidized by three percent for term loan, which was removed in July 1999.[46]

Along with interest rate deregulation, since the beginning of 1990, Bangladesh Bank adopted market oriented approach for its Monetary Policy and started to switch from direct quantitative control to indirect methods of monetary management. It began to regulate the money supply through indirect manipulation of reserve money instead of previously followed credit ceiling.[47] In the new shape of Monetary Policy, Bangladesh Bank employs bank rate, Open Market Operations (OMO), rediscount policy and statutory reserve requirements as major instruments of monetary control. To reinforce indirect monetary operation and to manage the day-to-day liquidity position in the market, Bangladesh Bank introduced some new arrangements in recent years namely *repo* (repurchase agreement), *reverse repo* and *interbank repo* operations from July 2002, April 2003 and July 2003, respectively.[48]

7.4.2 New System of Loan Classification and Provisioning[49]

In 1989, under the reform programme, Bangladesh Bank enforced prudential regulations like loan classification and provisioning in the banking sector.[50] The objective of this regulation was to strengthen the financial institutions in Bangladesh and harness the huge and mounting Non Performing Loans (NPLs) and thus ensure quality of loan portfolio in the banking industry. Bangladesh Bank in the subsequent years took necessary steps to gradually elevate the norms of loan classification and provisioning to international standard. According to the

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[45] Md. Ezazul Islam and Mst. Nurnaher Begum, "High Lending Rates in Bangladesh: An Analytical Review", *Bank Parikrama*, vols. XXVIII & XXIX (June 2003-December 2004), p. 106.

[46] Choudhury and Raihan, *Structural Adjustment, op. cit.,* p.17.

[47] *Banglapedia*, vol. 1, ed. by Sirajul Islam (Dhaka: Asiatic Society of Bangladesh, 2003), s.v. "Monetary Policy" by Syed Ahmed Khan and Abdus Samad Sarker.

[48] Bangladesh Bank, *Monetary Policy Review*, vol. 1, no. 1 (Dhaka: Policy Analysis Unit, Bangladesh Bank, October 2005), p. 2.

[49] The new system of loan classification and provisioning has been discussed in detail in Chapter V of this dissertation.

[50] Bangladesh Bank, *Financial Sector Review*, vol. 1, no. 1, *op. cit.,* p. 94.

current loan classification and provisioning system, all loans are to be classified under four broad categories, viz., continuous loan, demand loan, fixed term loan and short term agricultural loans / micro credit. Then each category is to be classified as either 'classified' or 'unclassified'. Classified loans are to be further classified as 'sub-standard', 'doubtful' and 'bad/loss' depending on the length of overdue criteria, determined and occasionally revised by Bangladesh Bank.[51]

As par the current loan classification and provisioning system, banks are required to maintain certain rate of provision against each category of loans. According to the present regulation, excepting the short term agricultural loans / micro credit, the rate of provision is one percent for unclassified loans, 20 percent for sub-standard, 50 percent for doubtful loan and 100 percent for bad loan/ loss. For the category of short term agricultural loans / micro credit, the rates of provision for unclassified, sub-standard, doubtful and bad/loss are five percent, five percent, five percent and 100 percent respectively.[52]

7.4.3 New Capital Adequacy Requirement[53]

Bangladesh Bank also modified its capital adequacy regulations for scheduled banks under the reform package. Until January 1996, banks were required to maintain at least six percent of their demand and time liabilities as capital base, or Taka 200 million for banks incorporated in Bangladesh and Taka 100 million for banks incorporated outside Bangladesh, whichever is higher.[54] In January 1996, it formally introduced risk-based capital requirement in line with Basel Accord I. This policy required the banks to maintain a ratio of capital to Risk-Weighted Assets (RWA) of not less than eight percent with at least four percent in core capital. In September 2002, Bangladesh Bank raised the minimum capital requirement from eight percent to nine percent of RWA, wherein core capital should not be less than 4.5 percent.[55] In November 2002, Bangladesh Bank issued a master circular on capital adequacy which required the banks to

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[51], Bangladesh Bank, BRPD Circular No. 05, dated June 05, 2006.

[52] *Ibid.*

[53] New capital adequacy requirement has been discussed in detail in Chapter V of this dissertation.

[54] Bangladesh Bank, *Financial Sector Review,* vol. 1, no. 1, *op. cit.,* p. 115.

[55] Bangladesh Bank, BRPD Circular No. 8, dated September 07, 2002.

maintain substantially higher capital requirements of Taka 400 million (40 crore) for locally incorporated banks and an amount equivalent to US$ ten million for banks incorporated outside Bangladesh.[56] In March 2003 Bangladesh Bank made significant amendment in the capital regulation.[57] According to this amendment, the scheduled banks are required to maintain paid up capital and reserve fund of Taka one billion (100 crore) or nine percent RWA, whichever is higher. With a view to strengthening the capital base of banks and make them prepare for the implementation of Basel II Accord, Bangladesh Bank made another amendment in the capital adequacy policy which requires the banks to maintain capital to RWA ratio of 10% at the minimum with core capital not less than 5% by December 31, 2007.[58] On January 01, 2009 Bangladesh Bank introduced 'Guidelines on Risk Based Capital Adequacy (RBCA) for Banks' (Revised regulatory capital framework in line with Basel II) instructing the banks to maintain capital to RWA ratio of 10% at the minimum or the amount determined by Bangladesh Bank from time to time with at least 50% of required capital as Tier 1 capital.[59] At the end of one year parallel run period with Basel I, Basel II regime has been started from January 01, 2010 in full swing.[60]

7.4.4 New Supervision, Operational and Management Tools [61]

Under the reform package, Bangladesh Bank restructured its banking supervision through adding off-site surveillance function with on-site supervision. CAMEL rating has been employed since 1994 in this regard. For the problem banks, detected under CAMEL rating, a "Problem Bank Cell" has been instituted in Bangladesh Bank. On the basis of the ratings under CAMEL, Early Warning Signals (EWS) are being issued to applicable banks. The problem banks also have to sign Memorandum of Understanding (MOU) with Bangladesh Bank. In July 2006, a sixth risk component namely "sensitivity to market risk" was incorporated in the CAMEL framework and the framework was renamed as

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[56] Bangladesh Bank, BRPD Circular No. 10, dated November 25, 2002.

[57] Bangladesh Bank, BRPD Circular No. 10, dated March 30, 2003.

[58] Bangladesh Bank, BRPD Circular No. 5, dated May 14, 2007.

[59] Details of this Guidelines have been discussed in Chapter V of this dissertation.

[60] Bangladesh Bank, *Guidelines on Risk Based Capital Adequacy: Revised Regulatory Framework in line with Basel II* (Dhaka: Bangladesh Bank, August 2010),p. i.

[61] These measures are discussed in detail in Chapter V of this dissertation.

CAMELS. Credit Information Bureau (CIB), as a separate department has been set-up in the Central Bank to improve the asset quality. A Large Loan Review Cell (LLRC) has also been installed at Bangladesh Bank.[62]

Bangladesh Bank introduced a number of new management and operational tools for the commercial banks, such as Lending Risk Analysis (LRA), New Loan Ledger (NLL), Performance Planning System (PPS) etc. Along with these tools, upgradation of skills of human resources of the banks and computerization of banking operations were also stressed in the reform agenda.[63]

7.4.5 Reforms in the Legal Framework

Some legal reforms have also been initiated related to banking sector in Bangladesh. Amendments have been made in laws like Bangladesh Bank Order 1972, Bangladesh Banks (Nationalisation) Order 1972, Negotiable Instruments Act 1881, etc. At the same time, some new laws with prudential regulations like Banking Companies Act 1991, lender's recourse related laws like Artha Rin Adalat (Money Loan Court) Act 1990 and Bankruptcy Act 1997 have been enacted and amended further to ensure safety and soundness of the banking system.[64] Accordingly Money Loan Courts and Bankruptcy Courts have also been set up by the Government.

7.5 Outcomes of the Reform Measures

This section analyses the outcomes of the reforms undertaken by Bangladesh Bank. In some cases the post-reform outcomes have been compared to the pre-reform situation. In this study, the pre-reform period comprised of FY 1972-73 to FY 1989-90 and the post-reform period covered FY 1990-91 to FY 2010-11 for the above-mentioned purpose of comparison. Though reform is a continuous and ongoing process, the post-reform period in this study ends in FY 2010-11, because the time span under consideration of this study was 1972 to 2011.

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[62] Choudhury and Raihan. *Structural Adjustment, op. cit.,* p. 19.

[63] *Ibid.*, p. 20.

[64] Choudhury and Adhikary, "Loan Classification," *op. cit.,* p.160.

7.5.1 Interest Rate Deregulation

The reform measures encompassing interest rates and Monetary Policy were implemented with a view to bring price competition in the financial market and ensure efficient resource allocation.[65] So, this measure of interest rate deregulation has been analysed in respect of achieving price competition in the banking sector and efficient resource allocation.

7.5.1.1 Price Competition

In the assessment of policy reforms to achieve price competition within the banking sector, nominal interest rate spread has been considered as a proxy for competition in the financial sector of Bangladesh. In a competitive market, the ideal relationship between the lending interest rate and deposit interest rate can be stated as follows:

$$i_l=\{1/(1 - k)\}*i_d \ ;$$ [66]

where,

i_l = Interest rate on lending

i_d = Interest rate on deposit

k = Required reserve ratio.

Using this formula the nominal interest rate spread can be derived as:

$$i_l - i_d = \{k/(1 - k)\}*i_d$$

The right hand side of the above equation suggests the ideal and desirable interest rate spread of the financial market. The more the actual spread is away from the suggested spread, the more the market deviates from competition and tends to be oligopolistic. A large spread in a deregulated environment indicates the absence of competition within the banking system and reflects the existence of a certain degree of monopoly power on the part of the financial intermediaries.

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[65] Choudhury and Raihan, *Structural Adjustment*, *op. cit.,* p. 29.

[66] Jackline Wahba and Mahmoud Mohieldin, "Liberalizing Trade in Financial Services: The Uruguay Round and the Arab Countries", *World Development*, vol. 26, no (issue). 7 (July 1998), pp. 1348, cited in Islam and Begum, "High Lending Rates in Bangladesh", *op. cit.,* p. 110.

Unduly high interest rate spreads can impinge on the saving and investment potential of an economy.[67]

7.5.1.1.1 Interest Rate Spread in the Pre-reform Period

The nominal interest rate spread in the pre-reform period in Bangladesh was very high. Table VII-1 presents the pre-reform interest rate spread in Bangladesh.

Table VII-1
Interest Rate Spread in the Pre-reform Period

(in percent)

End of Period	Weighted Average Interest Rate on Advances	Weighted Average Interest Rate on Deposits	Actual Spread	Required Reserve Ratio (SLR)	Desirable Lending Rate	Desirable Spread	Difference between Actual and Desirable Spread
(1)	(2)	(3)	(4)=(2)-(3)	(5)	(6)	(7)	(8)=(4)-(7)
1974-75	11.28	3.51	**7.77**	25.00	4.68	**1.17**	6.60
1975-76	11.62	4.23	**7.39**	25.00	5.64	**1.41**	5.98
1976-77	11.03	4.32	**6.71**	25.00	5.76	**1.44**	5.27
1977-78	10.66	4.22	**6.44**	25.00	5.63	**1.41**	5.03
1978-79	11.12	4.27	**6.85**	25.00	5.69	**1.42**	5.43
1979-80	11.04	4.31	**6.73**	25.00	5.75	**1.44**	5.29
1980-81	13.07	6.98	**6.09**	25.00	9.31	**2.33**	3.76
1981-82	13.53	7.29	**6.24**	25.00	9.72	**2.43**	3.81
1982-83	13.55	7.36	**6.19**	25.00	9.81	**2.45**	3.74
1983-84	13.75	8.11	**5.64**	25.00	10.81	**2.70**	2.94
1984-85	14.50	8.13	**6.37**	24.00	10.70	**2.57**	3.80
1985-86	14.66	8.54	**6.12**	24.00	11.24	**2.70**	3.42
1986-87	14.70	8.59	**6.11**	20.00	10.74	**2.15**	3.96
1987-88	14.66	8.69	**5.97**	25.00	11.59	**2.90**	3.07
1988-89	14.68	8.88	**5.80**	25.00	11.84	**2.96**	2.84
1989-90	14.83	9.06	**5.77**	25.00	12.08	**3.02**	2.75
Average			**6.39**			**2.16**	**4.23**

Source: Appendix: Table-7.

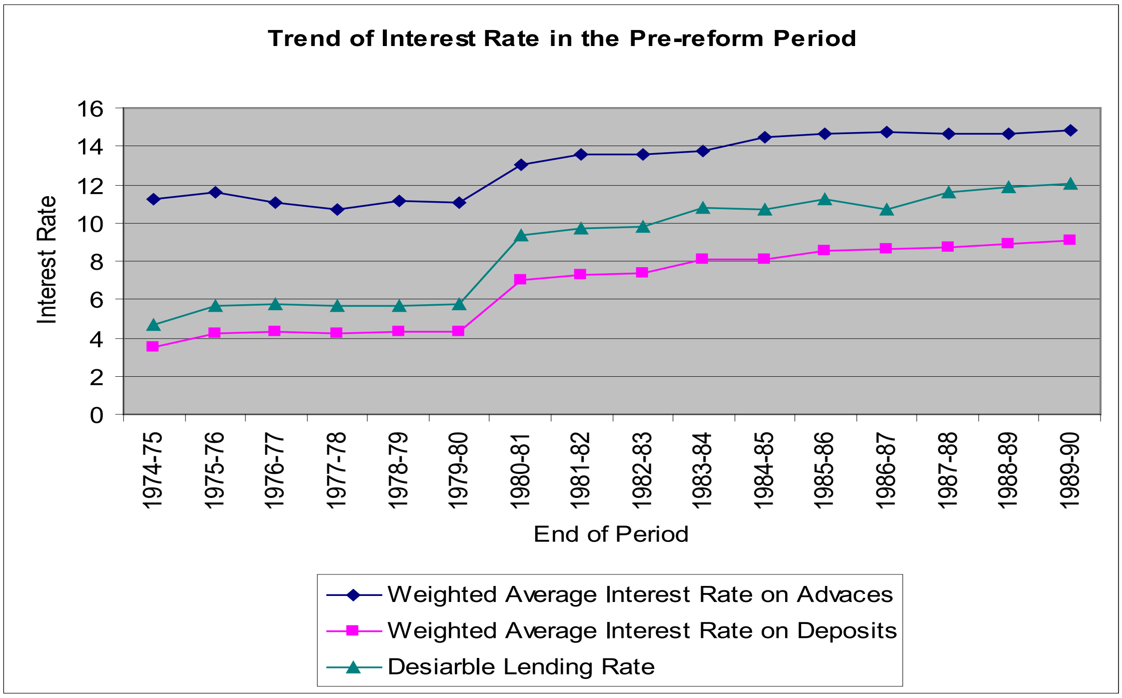
It is observed in the Table that, actual nominal spread was 7.77 percent in FY 1974-75, which was very high and the highest in the pre-reform period indicating absence of price competition in the banking industry. After that, the spread declined continuously with minor exceptions in FY 1978-79, FY 1981-82 and FY 1984-85. After FY 1984-85, the actual spread steadily declined till FY

[67] Islam and Begum, "High Lending Rates in Bangladesh", *op. cit.,* p. 109.

1989-90. The lowest spread was 5.64 percent, maintained in FY 1983-84. In the same period desirable spread was 1.17 percent in FY 1974-75, which gradually increased to 3.02 percent in FY 1989-90. The difference between actual spread and desirable spread tells that the market was not competitive in the pre-reform administered interest rate regime, though the decreasing actual spread and the increasing desirable spread narrowed the difference between them. The average actual spread and average difference between actual and desirable spread in this period were 6.39 percent and 4.23 percent respectively.

The trends of weighted average interest rate on deposits, weighted average interest rate on advances and the desirable lending rates in the pre-reform period are depicted in Figure VII-1. The Figure shows that the weighted average interest rate on advances stayed high above the weighted average interest rate on deposits causing high actual spread during the whole pre-reform period. The weighted average interest rate on advances stayed above the desirable lending rate also, indicating the absence of competition in the market. It is also observed that, the gap between the weighted average interest rate on advances and the desirable lending rate was being narrowed over time, indicating gradual development regarding competition in the banking sector.

Figure VII-1



Source: Table VII-1.

7.5.1.1.2 Interest Rate Spread in the Post-reform Period

The state of post-reform interest rate spread is presented in Table VII-2. It can be observed in the Table that, in the very first year of implementation of reform, the actual spread was 5.88 percent, higher by 0.11 percentage points from that of the immediate past FY 1989-90 (FY 1989-90 is included in Table VII-1). But during the same period, desirable spread fell from 3.02 percent in FY 89-90 to 2.72 percent in FY 1990-91. The increase in actual spread coupled with decrease in desirable spread widened the difference between actual and desirable spread from 2.75 percent in FY 1989-90 to 3.16 percent in FY 90-91, which is .41 percentage points higher than the earlier. Right after that year, actual spread soared to 7.01 percent, which was very high. But in the next year (FY 1992-93), actual spread reached at the all time high level of 7.88 percent in the history of Bangladesh. It is noteworthy that, this level is higher than even the highest level of the pre-reform period, which was 7.77 percent in FY 1974-75. In the subsequent years till FY 2004-05, the financial sector witnessed a declining trend in the actual spread, but still remaining very high. The lowest spread in the post-reform period was 4.86 percent, occurred in FY 2008-09 before turning to 5.30 percent in FY 2009-10.

Table VII-2

Interest Rate Spread in the Post-reform Period

(in percent)

End of Period	Weighted Average Interest Rate on Advances	Weighted Average Interest Rate on Deposits	Actual Spread	Required Reserve Ratio	Desirable Lending Rate	Desirable Spread	Difference between Actual-Desirable Spread
(1)	(2)	(3)	(4)=(2)-(3)	(5)	(6)	(7)	(8)=(4)-(7)
1990-91	14.99	9.11	**5.88**	23.00	11.83	**2.72**	3.16
1991-92	15.12	8.11	**7.01**	20.00	10.14	**2.03**	4.98
1992-93	14.39	6.51	**7.88**	20.00	8.14	**1.63**	6.25
1993-94	12.78	5.34	**7.44**	20.00	6.68	**1.34**	6.11
1994-95	12.22	4.86	**7.36**	20.00	6.08	**1.22**	6.15
1995-96	13.41	6.11	**7.30**	20.00	7.64	**1.53**	5.77
1996-97	13.69	6.67	**7.02**	20.00	8.34	**1.67**	5.35
1997-98	14.02	7.07	**6.95**	20.00	8.84	**1.77**	5.18
1998-99	14.16	7.28	**6.88**	20.00	9.10	**1.82**	5.06
1999-2000	13.86	7.21	**6.65**	20.00	9.01	**1.80**	4.85

(Continued to next page)

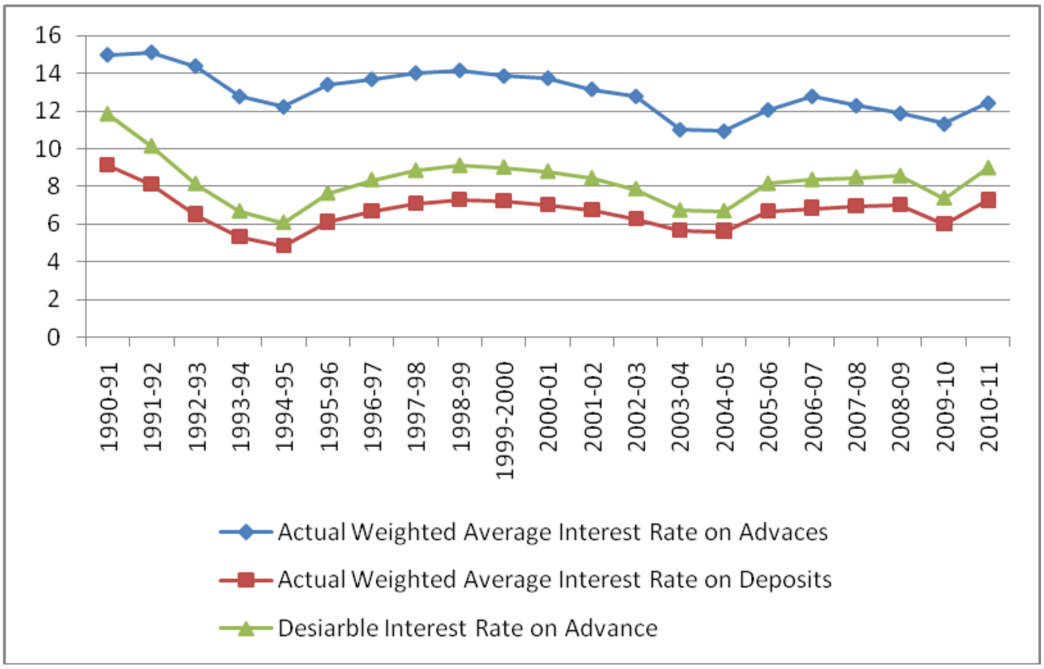
End of Period	Weighted Average Interest Rate on Advances	Weighted Average Interest Rate on Deposits	Actual Spread	Required Reserve Ratio	Desirable Lending Rate	Desirable Spread	Difference between Actual-Desirable Spread
2000-01	13.75	7.03	**6.72**	20.00	8.79	**1.76**	4.96
2001-02	13.16	6.74	**6.42**	20.00	8.43	**1.69**	4.74
2002-03	12.78	6.29	**6.49**	20.00	7.86	**1.57**	4.92
2003-04	11.01	5.65	**5.36**	16.00	6.73	**1.08**	4.28
2004-05	10.93	5.62	**5.31**	16.00	6.69	**1.07**	4.24
2005-06	12.06	6.68	**5.38**	18.00	8.15	**1.47**	3.91
2006-07	12.78	6.85	**5.93**	18.00	8.35	**1.50**	4.43
2007-08	12.29	6.95	**5.34**	18.00	8.48	**1.53**	3.81
2008-09	11.87	7.01	**4.86**	18.00	8.55	**1.54**	3.32
2009-10	11.31	6.01	**5.30**	18.50	7.37	**1.36**	3.94
2010-11	12.42	7.27	**5.15**	19.00	8.98	**1.71**	3.44
Average			**6.32**			**1.02**	**4.96**

Source: Appendix: Table-7.

The difference between actual and desirable spread remained high all through the post-reform period. The simple average actual spread and average difference between actual and desirable spread in the post-reform period were 6.32 percent and 4.96 percent respectively. The trend of interest rate spread in the post-reform period is depicted in Figure VII-2.

Figure VII-2

Trend of Interest Rate in the Post-reform Period



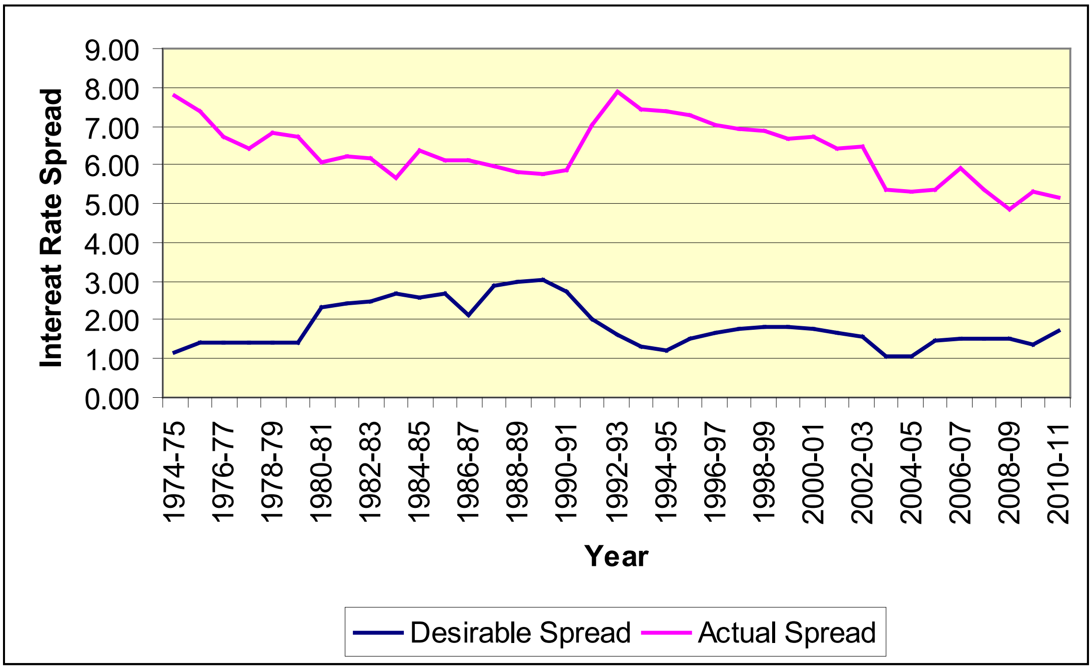
Source: Table VII-2.

The Figure illustrates that, the weighted average interest rate on advances stayed high above the weighted average interest rate on deposits causing high actual spread in the whole post-reform period. The weighted average interest rate on advances stayed above the desirable lending rate also, indicating the absence of competition in the market. Thus, the post-reform period almost resembles of the pre-reform period in respect of interest rate spread. It is also observed that, the gap between the weighted average interest rate on advances and the desirable lending rate were being narrowed over time, but in much slower rate than in the pre-reform period.

The actual and desirable interest rate spread during the whole period, combining the pre and post reform parts have been depicted in Figure VII-3. It is evident from the Figure that the difference between actual and desirable spread remained high during the whole period. The pre-reform and post-reform trends are almost identical indicating ineffectiveness of the reform measures.

Figure VII-3

Actual and Desirable Interest Rate Spread in Bangladesh



Source: Table VII-1 & Table VII-2.

The above discussion suggests that the reform measures failed to bring about any improvement in bringing price competition in the financial sector of Bangladesh. The simple average actual spread stood at 6.32 percent after reform, which is marginally lower by 0.07 percentage points than 6.39 percent of pre-reform period. At the same time, simple average difference between actual and desirable spread in the post-reform period was found 4.96 percent, higher by 0.73 percentage points than 4.23 percent of the pre-reform era.

7.5.1.1.3 Interest Rate Spread in Some South Asian Countries

A comparison of the interest rate spread situation of Bangladesh to that of some South Asian countries shows that the spread remained high not only for Bangladesh, but also for the whole region as well. As consistent data for this indicator is not typically available, it is difficult to compare the weighted average spread internationally. A study on the interest rate spread of Bangladesh, India, Pakistan and Sri Lanka found that (admittedly based on incomplete data), the Bangladesh spread behaviour does not appear to be much of an outlier.[68] The study also found that, India had the most competitive banking system in this region according to the interest rate spread indicator.[69] Interest rate spread in the mentioned countries is presented in Table VII-3.

Table VII-3

Interest Rate Spread in South Asia (in percent)

Year	Pakistan	India	Sri lanka	Bangladesh
2003	6.63	6.09	4.34	6.11
2004	6.33	5.17	4.40	5.27
2005	6.40	4.50	5.99	5.38

Notes: 1. All the figures have been taken for the month of December in each period except the figure for Pakistan in 2005, which has been taken for the month of June.

2. For India, deposit and prime lending rates are the mid-points of the range where the rates relate to five major banks. Moreover, deposit rates are for more than one year maturity. Figures of Bangladesh, Pakistan, and Sri Lanka are weighted average.

Source: Shamim Ahmed and Md. Ezazul Islam, “Interest Rate Spread in Bangladesh: An Analytical Review”, *Policy Note*, no. PN 0701 (Dhaka: Bangladesh Bank, Policy Analysis Unit, July 2006), p. 4.

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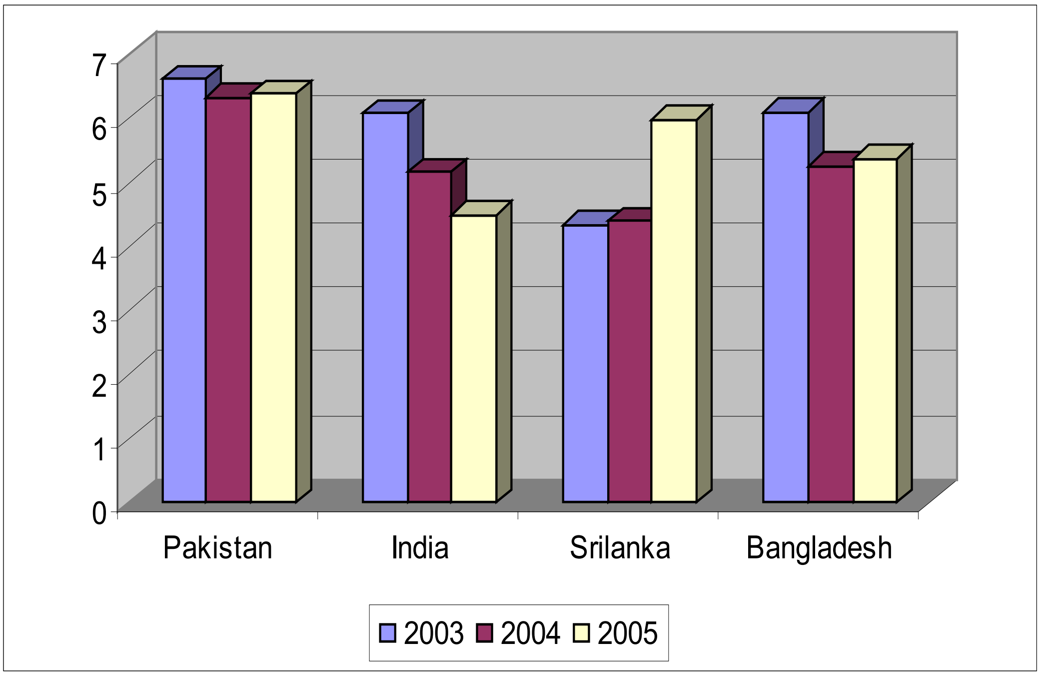
[68] Shamim Ahmed and Md. Ezazul Islam, “Interest Rate Spread in Bangladesh: An Analytical Review”, *Policy Note*, no. PN 0701 (Dhaka: Bangladesh Bank, Policy Analysis Unit, July 2006), p. 4.

[69] *Ibid*.

It is observed in the Table that, in 2005, interest rate spread in Bangladesh was less than that of Sri Lanka and Pakistan, but more than India. India had the lowest spread of 4.50 percent, while Pakistan had the highest spread of 6.40 percent in 2005. Figure VII-4 depicts interest rate spread of the mentioned South Asian countries for the years of 2003, 2004 and 2005.

Figure VII-4

Interest Rate Spread in South Asia



Source: Table VII-3.

7.5.1.2 Resource Allocation

Interest rate deregulation was implemented for not only bringing competition in the banking system, but also for achieving more efficient resource allocation. It was apprehended that even the PCBs would be motivated for priority sector lending.[70] In this section this objective of achieving efficiency in resource allocation in terms of credit allocation has been investigated. Efficiency in resource or credit allocation has been assessed by using three indicators. These are advance -deposit ratio, comparison between advances to broad sectors by DMBs and shares of broad sectors to GDP and finally credit allocation index.

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[70] Choudhury and Raihan, *Structural Adjustment*, *op. cit.*,p.33.

7.5.1.2.1 Advance-Deposit Ratio

The ratio of advance to deposit indicates the extent of utilization of deposited money, in other words, the extent of resource utilization in the economy through banking system.

7.5.1.2.1.1 Advance-Deposit Ratio in the Pre-reform Period

Table VII-4 shows the efficiency of resource allocation in the pre-reform period in terms of advance- deposit ratio of all Deposit Money Banks (DMBs).

Table VII-4

Advance- Deposit Ratio in the Pre-reform Period

(In Crore Taka)

End of Period	Total Deposit	Advances by DMBs (excluding inter-bank)	Advances/Deposit
(1)	(2)	(3)	(4)
1973-74	913.2	737.1	0.807
1974-75	969.3	806.8	0.832
1975-76	1066.9	948.4	0.889
1976-77	1383.4	1188.7	0.859
1977-78	1636.4	1447.4	0.885
1978-79	2146.6	1864.1	0.868
1979-80	2551.4	2540.7	0.996
1980-81	3221.0	3091.1	0.960
1981-82	3671.1	4114.6	1.121
1982-83	4759.0	4706.7	0.989
1983-84	6829.3	6436.3	0.942
1984-85	8811.1	8570.7	0.973
1985-86	10384.5	10456.4	1.007
1986-87	12276.6	11289.1	0.920
1987-88	13993.0	13341.5	0.953
1988-89	16462.5	15886.7	0.965
1989-90	19109.3	19032.5	0.996
Average			**0.939**

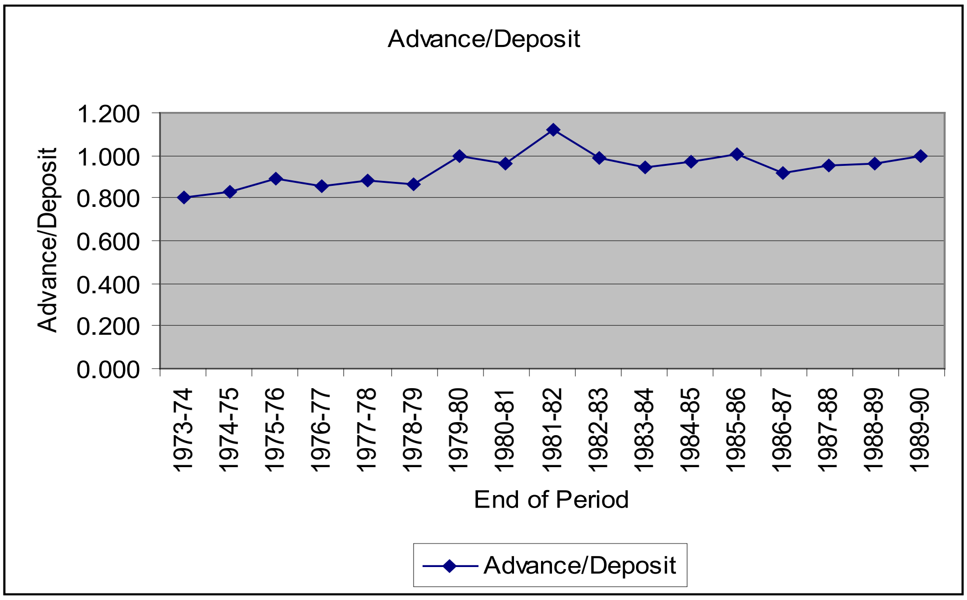
Source: Appendix: Table-8.

It is observed in the Table that, the advance- deposit ratio increased steadily from 0.807 in FY 1973-74 to 1.121 in FY 1981-82, except a decline in FY 1980-81. After that, it declined for two fiscal years and then again increased for next two fiscal years. From FY 1986-87, the ratio, preceded by a decline from 1.007 in FY 1985-86, moved uptrend from 0.920 and reached at 0.996 in FY 1989-90, the end fiscal of the period. The lowest ratio was 0.807 in F 1973-74 and the highest ratio was 1.121 in FY 1981-82. The average advance- deposit ratio in the pre- reform period was 0.939.

Figure VII-5 depicts the trend of advance- deposit ratio in the pre-reform period.

Figure VII-5

Trend of Advance- Deposit Ratio in the Pre-reform Period



Source: Table VII-4.

The upward trend of advance- deposit ratio particularly in the last four fiscal years of the pre-reform period is noticeable in the Figure.

7.5.1.2.1.2 Advance-Deposit Ratio in the Post-reform Period

Efficiency of resource allocation in the post-reform period in terms of advance-deposit ratio has been sown in Table VII-5. It can be seen in the Table that, the post- reform period started with a decline in advance- deposit ratio from 0.996 of the immediate past and end fiscal of the pre-reform period to 0.993 in FY 1990-91. It declined for three more successive years and reached at 0.776 in FY 1993-94. Then the ratio started increasing and reached at 0.972 in FY 1997-98, except a decline in FY 1996-97. From then on, the ratio declined steadily and reached at 0.803 in FY 2006-07. After a decrease in FY 2008-09 following a temporary increase in FY 2007-08, the advance-deposit ratio is on uptrend till date.

Table VII-5

Advance- Deposit Ratio in the Post-reform Period

(In Crore Taka)

End of Period	Total Deposits (TD=DD+TD)	Total Advances by DMBs (Excluding inter-bank)	Advance/Deposit Ratio
1990-91	21392.6	21245.7	0.993
1991-92	24453.3	21586.0	0.883
1992-93	27055.5	23192.5	0.857
1993-94	30987.0	24043.3	0.776
1994-95	35647.2	32433.8	0.910
1995-96	38567.2	36864.8	0.956
1996-97	43052.9	40967.5	0.952
1997-98	47715.7	46402.1	0.972
1998-99	54340.1	52577.8	0.968
1999-2000	64586.4	57916.6	0.897
2000-01	75695.9	67090.9	0.886
2001-02	86075.3	75954.0	0.882
2002-03	100079.0	84571.5	0.845
2003-04	113886.3	95004.0	0.834
2004-05	132892.3	111471.0	0.839
2005-06	157761.5	129648.1	0.822
2006-07	184798.7	148429.8	0.803
2007-08	215998.1	183114.4	0.848
2008-09	260309.5	214218.6	0.823
2009-10	316664.6	264182.2	0.834
2010-11	385525.1	326634.2	0.847
Average			**0.877**

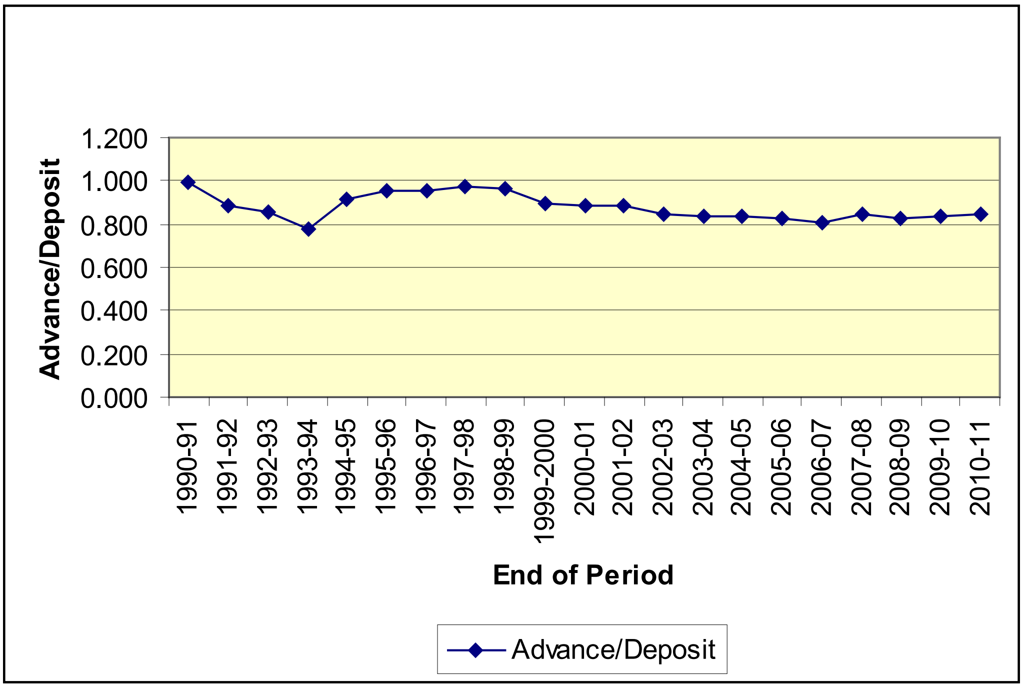
Source: Appendix: Table-8.

The lowest ratio was 0.776 in FY 1993-94 and the highest ratio was 0.993 in FY 1990-91. The average advance- deposit ratio in the post- reform period was 0.877. It is noteworthy that all these three values (lowest, highest and average ratio) are less than their corresponding values of the pre-reform period.

The advances-deposit ratio in the post-reform period is depicted in Figure VII-6.

Figure VII-6

Trend of Advance- Deposit Ratio in the Post-reform Period



Source: Table VII-5.

It should be noted that, the advance- deposit ratio has two limitations to serve as a reliable indicator of efficiency in resource allocation. The limitations are (i) the ratio does not include bank's investment in securities, and thus fails to provide a complete picture of resource deployment; (ii) even with very small amounts of both deposit accretion and credit expansion, the ratio might be high, giving a misleading indication of advance- deposit ratio.[71]

7.5.1.2.2 Advances to Broad Sectors by DMBs and Shares of Broad Sectors to GDP

To capture a clear idea of the efficiency of resource allocation, advances to broad sectors in percentage of total advances by DMBs and the shares of the broad sectors to GDP have been presented in Table VII-6 combining both the pre and post- reform periods.

[71] *Report of the Committee to Review the Working of the Monetary System*, Sukhamoy Chakravarty, Chairman (Bombay: Reserve Bank of India, 1985), p. 68, cited in M. Zainul Abedin, *Commercial Banking in Bangladesh: A Study of Disparities of Regional and Setoral Growth Trends* (Dhaka: National Institute of Local Government, 1990), p. 174.

Table VII-6

Shares of Broad Sectors in Total Bank Advances by Deposit Money Banks and Shares of Broad Sectors to GDP at Current Prices

(in percent)

End of Period	Share of Agriculture in Total Bank Advances	Share of Agriculture to Total GDP	Share of Industry in Total Bank Advances	Share of Industry to Total GDP	Share of Service in Total Bank Advances	Share of Service to Total GDP
1985-86	28.70	40.41	27.32	15.52	39.06	44.08
1986-87	24.66	40.76	29.83	14.84	39.88	44.40
1987-88	24.68	38.79	31.32	15.01	39.16	46.20
1988-89	25.18	37.20	28.49	15.40	41.18	47.39
1989-90	23.26	36.85	41.42	15.80	30.93	47.35
1990-91	21.07	30.37	40.07	21.74	34.82	47.90
1991-92	18.76	29.39	41.28	22.48	34.84	48.14
1992-93	17.79	26.25	41.77	23.82	34.69	49.92
1993-94	18.67	25.63	45.33	24.33	29.94	50.05
1994-95	17.88	26.38	42.04	24.55	33.28	49.06
1995-96	17.31	25.68	42.45	24.87	32.49	47.45
1996-97	16.14	25.78	44.44	25.14	31.77	49.06
1997-98	14.57	25.45	45.57	25.82	31.26	48.73
1998-99	14.89	26.18	45.11	25.16	30.20	48.66
1999-2000	14.61	24.62	42.99	24.39	31.92	47.48
2000-01	13.54	23.29	41.26	25.07	32.48	48.28
2001-02	12.56	21.93	42.19	25.47	33.69	50.06
2002-03	11.02	20.97	44.27	25.33	35.42	50.15
2003-04	10.35	20.18	44.47	25.52	35.78	50.25
2004-05	9.55	19.32	44.26	26.11	37.26	50.49
2005-06	8.79	18.89	45.64	26.87	36.11	50.55
2006-07	7.44	18.61	47.18	27.44	35.59	50.64
2007-08	6.73	18.32	44.82	27.47	37.74	50.57
2008-09	6.58	18.10	45.55	27.67	37.43	50.84
2009-10	6.05	17.98	43.13	27.53	39.36	51.20
2010-11	6.12	17.65	44.02	27.21	39.63	51.63

Source: Appendix: Table-9 & Table-10.

The Table reveals two very distinct features of resource allocation in Bangladesh. These are, a drastic reduction in the share of agriculture sector in total bank advances, which is evident in column 2 and secondly, disparity among the sectors in respect of proportion of share in total advance to share of the respective sectors to total GDP.[72] It is observed that, share of advance to agriculture gradually declined in the pre-reform period as well as in the post-reform period, while the share for industry increased and the same for service sector remained almost stagnant over the same periods. Share of agriculture to total GDP also decreased, while share of industry to GDP and share of service to GDP increased consistently in the mentioned periods. It is generally argued that, in an economy, the sectoral share of credit should be proportional to the sectoral share of GDP.[73] But, the Table shows that, the share of agriculture in bank advances was always much less than its share to GDP, both in the pre and post-reform periods. The Table also shows that, in FY 2010-11 the share of agriculture in advances was around one-third of the sector's contribution to GDP. The scenario was opposite for industry sector, while the experience of service was nearly same to agriculture sector, though not as acute as of the latter. If we consider percentage changes in both the shares (share of the respective sector in advances and share of the same sector to GDP), we find that, generally for a decrease in the share of agriculture to GDP, the share of agriculture in advances decreased by more percentage points.[74] Even in some Fiscal Years, share of agriculture to GDP increased while the share of that sector in advances decreased. Industry and service sectors also experienced similar types of disarray in the mentioned periods regarding percentage changes in shares; but agriculture suffered most.

Sectoral share in bank advances and sectoal share to GDP in FY 1989-90 and FY 2010-11 have been presented in Figure VII-7. The pie charts presented in the Figure show that, just before the reform in FY 1989-90, the share of agriculture in bank advances was less than its share to GDP. The same was true for service; but opposite for industry having the highest 41.42 percent share in advances contributing the lowest 15.80 percent share to GDP.

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[72] The disparity has further been analysed later in this section using credit allocation index.

[73] Abedin, *Commercial Banking in Bangladesh*, *op. cit.,* p. 187.

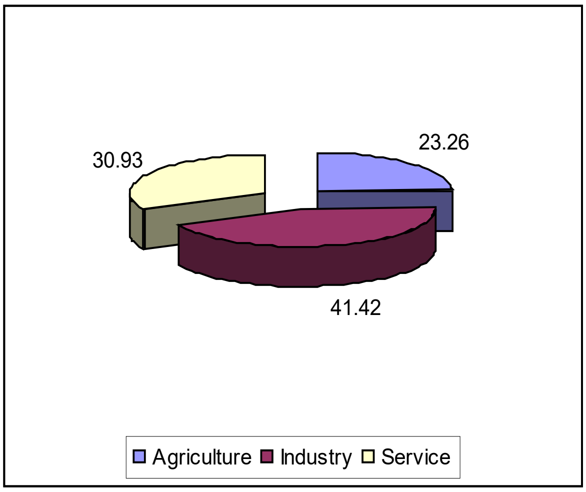
[74] The percentage figures are placed in Appendix: Table-9 & Table-10.

Figure VII-7

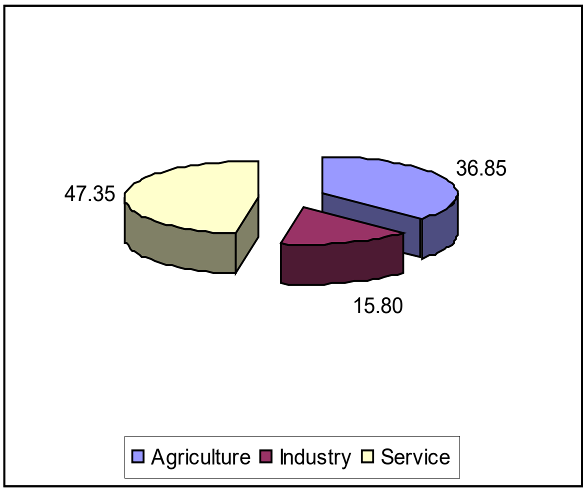
Sectoral Share in Bank Advances and Sectoral Share to GDP

(in percent)

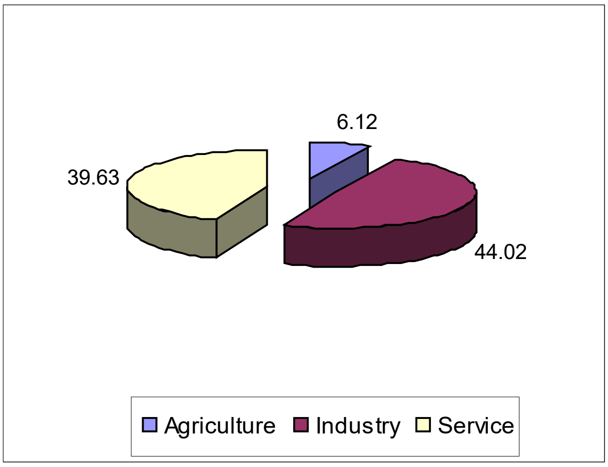
Sectoral Share in Bank Advances in FY 1989-90



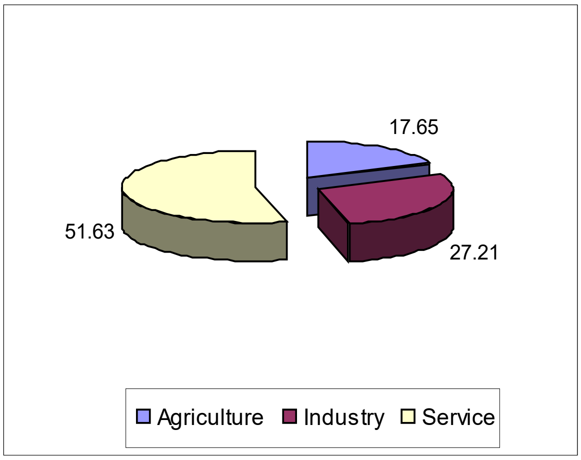
Sectoral Share to GDP in FY 1989-90



Sectoral Share in Bank Advances in FY 2010-11



Sectoral Share to GDP in FY 2010-11



Source: Table VII-6.

In the post-reform period in FY 2010-11, the striking feature is that, the share of agriculture to GDP reduced to 17.65 percent, around one half of the share in FY 1989-90; But at the same time, share of agriculture in advances reduced to almost one fourth of the share in FY 1989-90. So, it is evident that, the sectoral distribution of bank advances in the post-reform period as compared to pre–reform period does not suggest better resource allocation in favour of productive sectors.

7.5.1.2.3 Credit Allocation Index

An effective indicator to assess efficiency in resource allocation is credit allocation index. It is specially useful in indicating sectoral disparity regarding resource allocation. The credit allocation index was calculated on the basis of the following formula:

$I_{ti} = A_{it} / Q_{it}$;

where

I_{ti} = Credit allocation index for i-th sector for year t

A_{it} = Share of the i-th sector in advances by all DMBs for year t

Q_{it} = Share of the i-th sector to GDP for year t

Thus, I_{ti} is a ratio of ratios, as A_{it} and Q_{it} both are two ratios. I_{ti} may either be proportional to, or greater than or less than one. When it is proportional to one for a sector, resource is allocated to that sector proportional to its contribution to GDP, indicating no bias. If it is greater than one for a sector, resource is allocated in favour of that sector; and if it is less than one for a sector, resource allocation is adverse for that sector.

Table VII-7 presents the credit allocation index (hereafter referred to as the index) for broad sectors during FY 1985-86 to FY 2010-11, covering both the pre and post-reform periods.

Table VII- 7

Credit Allocation Index for Broad Sectors

End of Period	Agriculture	Industry	Service
1985-86	0.710	1.761	0.886
1986-87	0.605	2.010	0.898
1987-88	0.636	2.086	0.848
1988-89	0.677	1.850	0.869
1989-90	0.631	2.621	0.653
1990-91	0.694	1.843	0.727
1991-92	0.638	1.836	0.724
1992-93	0.678	1.754	0.695
1993-94	0.728	1.863	0.598
1994-95	0.678	1.712	0.678
1995-96	0.674	1.707	0.685
1996-97	0.626	1.768	0.648

(Continued to the next page)

End of Period	Agriculture	Industry	Service
1997-98	0.572	1.765	0.641
1998-99	0.569	1.793	0.621
1999-2000	0.594	1.763	0.672
2000-01	0.582	1.646	0.673
2001-02	0.573	1.656	0.673
2002-03	0.526	1.748	0.706
2003-04	0.513	1.742	0.712
2004-05	0.494	1.695	0.738
2005-06	0.465	1.698	0.714
2006-07	0.400	1.719	0.703
2007-08	0.368	1.632	0.746
2006-09	0.364	1.646	0.736
2009-10	0.336	1.567	0.769
2010-11	0.347	1.618	0.768

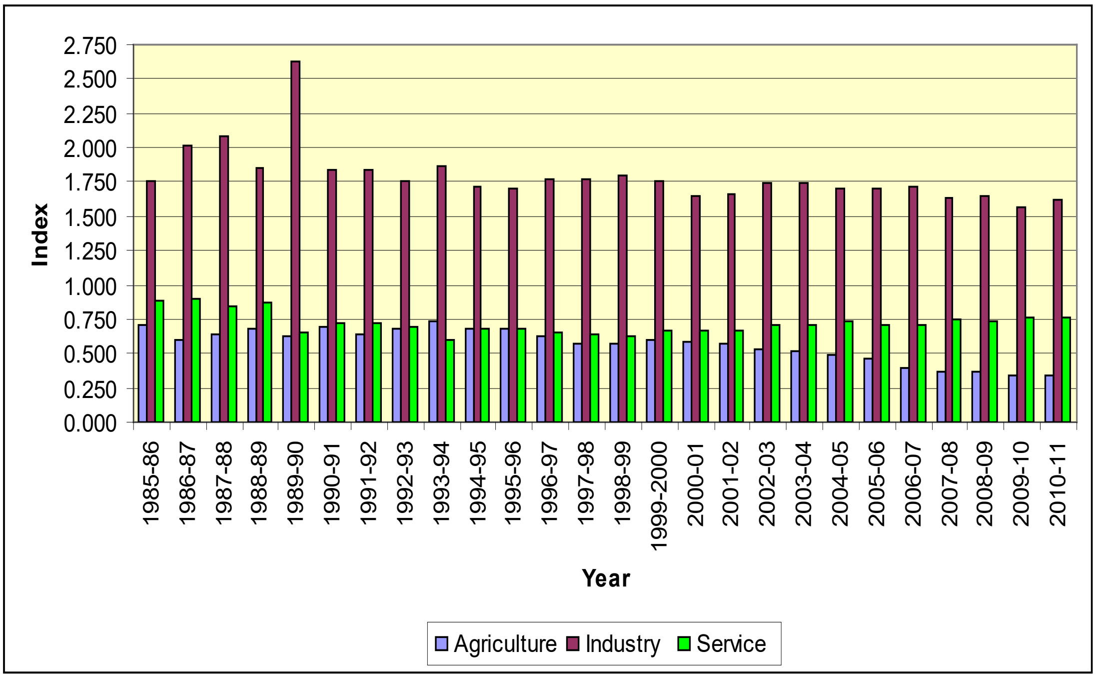
Source: Appendix: Table-10.

The Table shows that, in the pre-reform period, the index for agriculture remained less than one, but for industry, more than one, even in some fiscals more than two, indicating wide disparity between these two sectors. It deserves special mention as it happened at such a time, when the share of agriculture to GDP was more than double than the share of industry to GDP. The index was less than one for service also, but more than that of agriculture. It is also seen in the Table that, in the post-reform period, specially starting from FY 1993-94, agriculture experienced a gradual decline in the index, except an increase in FY 1999-2000. The index for agriculture fell from 0.631 in FY 1989-90 to 0.347 in FY 2010-11 owing to mainly drastic reduction in the share of agriculture in bank advances. The index for industry was more than one with minor fluctuations for the whole post-reform period. The index for service sector was less than one for the entire post-reform period, but considerably higher than that of agriculture, excepting FY 1993-94. The index for service increased from 0.653 in FY 1989-90 to 0.768 in FY 2010-11. Therefore, it can be inferred that, the reform measures could not generate better efficiency in resource allocation to productive sectors.

Credit allocation index for the broad sectors, combining both the pre and post-reform periods has been depicted in Figure VII-8.

Figure VII-8

Credit Allocation Index for Broad Sectors



Source: Table VII- 7.

The Figure shows that, the index for agriculture sector always remained below 0.75, while the index for industry was always above 1.50, making the corresponding bars more than double in height than those of agriculture. The Figure shows that, the bars corresponding to the index for service always remained below 1.00, but taller than those of agriculture.

7.5.2 New System of Loan Classification and Provisioning

In the reform agenda, new system of loan classification and provisioning was implemented to strengthen the financial institutions with the view to improve the quality of the loan portfolio of the banks. The quality of loan portfolio is reflected by the volume of classified loan or in other words, non-performing loan in an economy and loss provisioning by the banking system.[75]

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[75] *Financial Sector Reforms Task Force Report*, Wahiduddin Mahmud, Chairman, http://www.cpd-bangladesh.org/publications/task_force_reports/financreforms.pdf visited on June 17, 2007.

7.5.2.1 Loan Classification

To assess the outcome of new loan classification system in ensuring quality of loan portfolio, ratios of total classified loans to total loans and different categories of classified loans (sub-standard, doubtful and bad/ loss loans) to total classified loans have been shown in Table VII-8.

Table VII- 8

Status of Classified Loans: Sub-Standard, Doubtful and Bad/Loss Loans of All Banks

Year (calendar)	Total Classified Loans (TCL) as % of Total Loans	Sub-Standard Loans as % of TCL	Doubtful Loans as % of TCL	Bad/Loss Loans as % TCL
1990	26.24	N.A	N.A	N.A
1991	26.14	N.A	N.A	N.A
1992	30.70	N.A	N.A	N.A
1993	34.89	N.A	N.A	N.A
1994	34.83	19.22	17.60	63.18
1995	32.04	13.08	12.36	74.56
1996	31.49	13.42	12.27	74.31
1997	37.49	7.88	11.70	80.42
1998	39.18	4.66	7.72	87.62
1999	41.11	5.26	8.27	86.47
2000	34.92	4.37	6.62	89.01
2001	31.49	5.60	5.87	88.53
2002	28.10	8.65	5.27	86.06
2003	22.13	10.24	8.75	80.97
2004	17.63	7.20	6.60	86.19
2005	13.55	8.66	6.96	84.37
2006	13.15	13.13	7.15	79.72
2007	13.23	9.75	7.51	82.74
2008	10.79	9.43	9.42	81.14

Note: TCL = Total Classified Loan**.**

Source:

For 1990 to 1994: Toufic Ahmad Choudhury and Bishnu Kumar Adhikery, “Loan Classification, Provisioning Requirement and Recovery Strategies: A Comparative Study on Bangladesh and India”, *Bank Parikrama,* vol. XXVII, nos. 2 & 3 (2002), p. 151.

For 1995 to 1998: Bangladesh Bank, *Financial Sector Review*, vol. I, no. I (May 2006), p. 98.

For 1999 to 2008: Bangladesh Bank, *Financial Sector Review*, vol. 4, no. 1 (January 2009), p. 53.

Table VII-8 shows that, the percentage of classified loans to total loans increased from 26.24 in 1990 to 34.89 in 1993. From the year 1993 with a downward trend it decreased to 31.49 in 1996. Then there was a jump to 37.49 in 1997. This happened mainly because of the inclusion of the DFIs (BKB, BSB, BSRS and RAKUB) from that year in the loan classification system. Before 1997 the DFIs were kept outside of the classification system.[76] The huge Non-Performing Loans (NPLs) of the DFIs caused the sudden increase in the total classified loan to total loan ratio. The ratio further increased and reached at 41.11 percent in 1999. This was the highest in the whole period under consideration. From 1999 the ratio steadily declined to 10.79 percent in 2008. Sub-standard loans as a percentage of total classified loans were almost declining upto 2000. After that, the ratio increased for four successive years before falling to 7.20 percent in 2004. After 2004 it increased for six years and reached at 13.13 percent in 2006, the highest in the last ten years. After that, the ratio declined. In 2008 the ratio was 9.43 percent. For Doubtful loans, as a percentage of total classified loans, a declining trend was observed till 2002. In 2003 the ratio increased to 8.75 percent. From 2004 it gradually increased and stood at 9.42percent in 2008. The bad/ loss loan as a percentage of total classified loan reveals an alarming picture. Except 1994 throughout the whole period under consideration the ratio was above 70 percent and most of the time it was above 80 percent. It is worthwhile to mention here that, since 2003 the commercial banks have been writing off bad/loss loans as per the directives of Bangladesh Bank. A total of Taka 13050 crore has been written off from the bad loans of the banking system since June 2003 until June 2008; in June 2011 the figure stood at Taka 19390 crore.[77] Otherwise the ratios for the bad/loss loans would have been even more. Thus, in spite of some recent improvements, the Table represents that, the banking sector is yet to be capable enough to harness the alarming growth of classified loans.

Trend of classified loans to total loans of all banks has been depicted in Figure VII-9.

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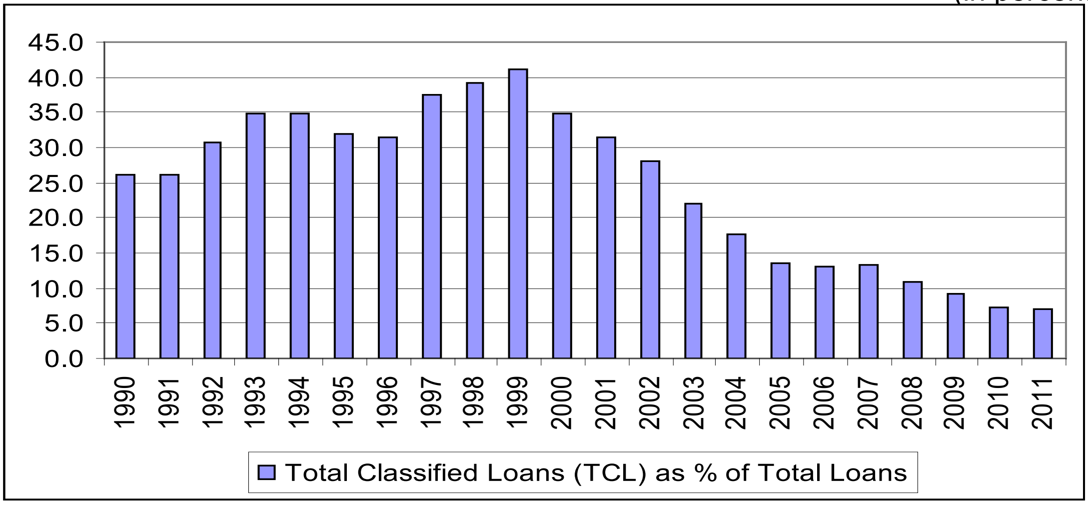
[76] Choudhury and Adhikary, "Loan Classification", *op. cit.,* p. 40.

[77] Bangladesh Bank, *Annual Report 2010-2011*, *op. cit.,* p. 259.

Figure VII-9

Trend of Classified Loans to Total Loans

(in percent)



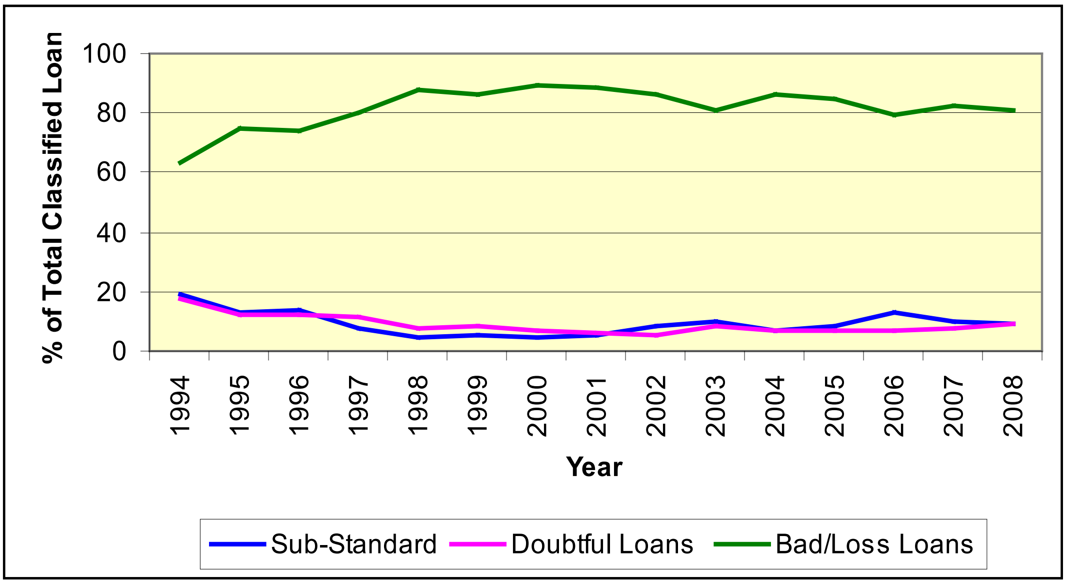
Source: Table VII- 8 and Bangladesh Bank, Annual Report, various issues.

Figure VII-9 shows that, classified loans, as percentage of total loans was highest 41.11 percent in the year 1999. From then onwards, the ratio declined steadily and it was the lowest 7.1 percent in the year 2011 (June), still remaining high.

Trends of sub-standard, doubtful and bad/loss loans to total classified loans of all banks have been depicted in Figure VII-10. The Figure reveals the prevalence of alarmingly high bad/ loss loans in the banking sector. The recent uptrend in doubtful loans can be seen in the Figure. The recent downtrend in sub-standard loans is also shown in Figure VII-10.

Figure VII-10

Trend of Sub-Standard, Doubtful and Bad/Loss Loans of All Banks to Total Classified Loans



Source: Table VII- 8.

It was found that, different clusters of banks suffered from default loans to varying degrees. Prior to the inclusion of the DFIs in the classification system, PCBs recorded the worst position in respect of total classified loans as a percentage of total loans, followed by the NCBs. The percentage for FCBs was considerably lower than the other two groups. In 1997 the DFIs entered into the classification system with huge amount of classified loans, which was reflected in the very high value of 65.72 percent in the first year, making this cluster the worst in respect of total classified loans. In the same year the NCBs surpassed the PCBs and maintained the position till 2011. FCBs were in the best position all along the way, except in the year 1991. The DFIs maintained their worst position till 2011. As of individual group, the percentage of classified loans to total loans for the NCBs increased steadily from 27.5 in 1990 to 45.6 in 1999. From 1999 the ratio declined consistently to 21.4 percent in 2005 before an increase by 1.5 percentage points in 2006. From 2007 the ratio has been steadily declining. The ratio for the PCBs increased from 24.4 percent in 1990 to 44.5 percent in 1994. After 1994, the ratio gradually declined without a minor exception in 1998 and showing a good trend of improvement reached at 3.2 percent in 2010. In 2011 it increased marginally. The FCBs exhibited the best performance. Classified loans as a percentage of total loans for the FCBs improved remarkably from 20.7 percent in 1990 to 0.80 percent in 2006. But from 2006 this ratio was found increasing for the FCBs till 2011. A declining trend of classified loans as a percentage of total loans was observed for DFIs also. The ratio declined from 65.72 percent in 1997 to 21.8 percent in 2011 for the DFIs. But still it is very high. Data of classified loans as a percentage of total loans for different clusters of banks have been presented in Table VII-9. The Table in general shows a declining trend of classified loans to total loans for all clusters of banks except FCBs in the last few years reflecting some improvements for the local banks.

Table VII- 9

Classified Loans as Percentage of Total Loans for Different Clusters of Banks (1990-2011)

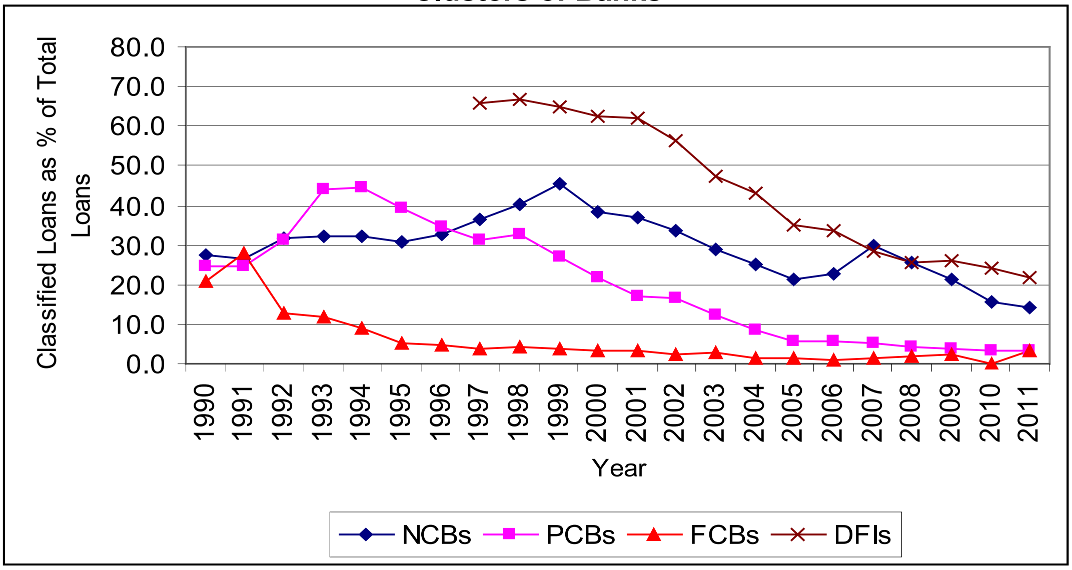
Year	NCBs	PCBs	FCBs	DFIs
1990	27.6	24.4	20.7	N.A
1991	26.7	24.5	27.9	N.A
1992	31.9	31.2	12.6	N.A
1993	32.2	44.2	12.0	N.A
1994	32.1	44.5	8.8	N.A
1995	31.0	39.4	5.4	N.A
1996	32.6	34.8	4.7	N.A
1997	36.6	31.4	3.6	65.7
1998	40.4	32.7	4.1	66.7
1999	45.6	27.1	3.8	65.0
2000	38.6	22.0	3.4	62.6
2001	37.0	17.0	3.3	61.8
2002	33.7	16.4	2.6	56.2
2003	29.0	12.4	2.7	47.4
2004	25.3	8.5	1.5	42.9
2005	21.4	5.6	1.3	34.9
2006	22.9	5.5	0.8	33.7
2007	29.9	5.0	1.4	28.6
2008	25.4	4.4	1.9	25.5
2009	21.4	3.9	2.3	25.9
2010	15.7	3.2	3..0	24.2
2011	14.1	3.5	3.1	21.8

Source: Bangladesh Bank, *Annual Report,* various issues.

The trends of classified loans as percentage of total loans for different clusters of banks have been depicted in Figure VII-11.

Figure VII-11

Trend of Classified Loans as a Percentage of Total Loans for Different Clusters of Banks



Source: Table VII- 9.

The trend of classified loans as percentage of total loans can easily be understood from Figure VII-11. It also makes the comparison among the different clusters of banks easier. It is observed in the Figure that, the percentage values of classified loans to total loans for the DFIs, in spite of a downward trend, stayed above the other three groups from the time of inclusion of this group in the classification system to the end of the period excepting the year 2007, holding the worst position. The FCBs, maintaining a low ratio for a long period was in the best position. The ratio for the PCBs declined sharply from 1994 and stayed next to the FCBs. The ratio for the NCBs also decreased, but holds the second highest ratio from 1997.

In January 2002, Bangladesh Bank revised the "Large Loan Rules" and linked the maximum level of large loan lending to the level of classified loans of the banks. According to the new rule, banks with net classified loan of upto 5 percent will be allowed to sanction a maximum of 56 percent of the total loan and advances as "large loan",[78] earlier which was 80 percent with a comparable classified loan. Banks having net classified loan between 5 percent to 10 percent can now lend 52 percent of their portfolio as large loans against the previously allowed limit of 70 percent. Banks having net classified loan between 10 percent to 15 percent can now lend upto 48 percent as large loans against the previously allowed limit of 60 percent of their loan portfolio. Banks now can lend 44 percent as large loans instead of previous 50 percent with 20 percent net classified loan. It is observed that, while the good banks with low classified loans have been restricted severely, the worse performer has been left almost untouched by the new rule. The limit of large loan for the banks with classified loans upto 5 percent has been reduced by 24 percent, whereas the same for the banks with 20 percent classified loans has been curtailed by 6 percent only. So, the new rule with this flaw might not be able to effectively restrict the lending growth of the banks.

There is no internationally accepted or set general or country specific level of safe limit of classified loan. But a comparison of a country to some neighbouring countries in regard to classified loan or NPL helps understand the

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[78] Bangladesh Bank vide BRPD Circular No. 05, dated April 09, 2005 defined "Large Loan" as loan sanctioned to any individual or enterprise or any organization of a group amounting to 10% or more of a bank's total capital.

comparative position of that country in the regional arena. Table VII- 10 presents data on NPL to total loan of Bangladesh, India, Pakistan and Sri Lanka.

Table VII- 10

Trend of NPL to Total Loan of Some South Asian Countries

(In percent)

Year	**Bangladesh** (December)	**India** (March)	**Pakistan** (September)	**Sri Lanka** (June)
2001	31.5	11.4	23.4	15.3
2002	28.1	10.4	21.8	15.3
2003	22.1	8.8	17.0	13.7
2004	17.6	7.2	11.6	9.1
2005	13.6	5.2	8.3	9.6

Note: Figures in parentheses show the time of yearly classification by respective countries.

Source: IMF, *Global Financial Stability Report*, October 2007, pp. 172 & 173 and Bangladesh Bank, *Financial Sector Review*, various issues.

The Table shows that, Bangladesh had the highest level of NPL compared to the neighbouring countries and hence is in the worst position on the basis of NPL. On the other hand, India having the lowest level of NPL to total loan ratio was in the best position in this region. The above analysis reflects that, in spite of some progress in the recent years, there still prevails a high volume of NPL in the banking sector of Bangladesh, keeping the quality of the loan portfolio of the banks at a low level. This questions the success of the financial institutions strengthening measures under the reform programme.

7.5.2.2 Loss Provisioning

The banks in general have been continuously failing to maintain the required level of provisions against their classified loans. Table VII-11 shows the state of provisioning by the banking system of Bangladesh. It is clear from the Table that, during the years from 1997 to 2011 only in 2009 the banking system maintained the required provision. The Provision Maintenance Ratio (PMR)[79] was very poor till 2007; even the PMR fell to as low as 40.3 percent in the year 2003. During the last four years on the Table, the ratio shows positive indication.

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[79] PMR= (Maintained provision / Required provision)*100.

The required PMR for the banks is 100%.

Table VII-11

Required Provision and Maintained Provision by All Banks

(in billion Taka)

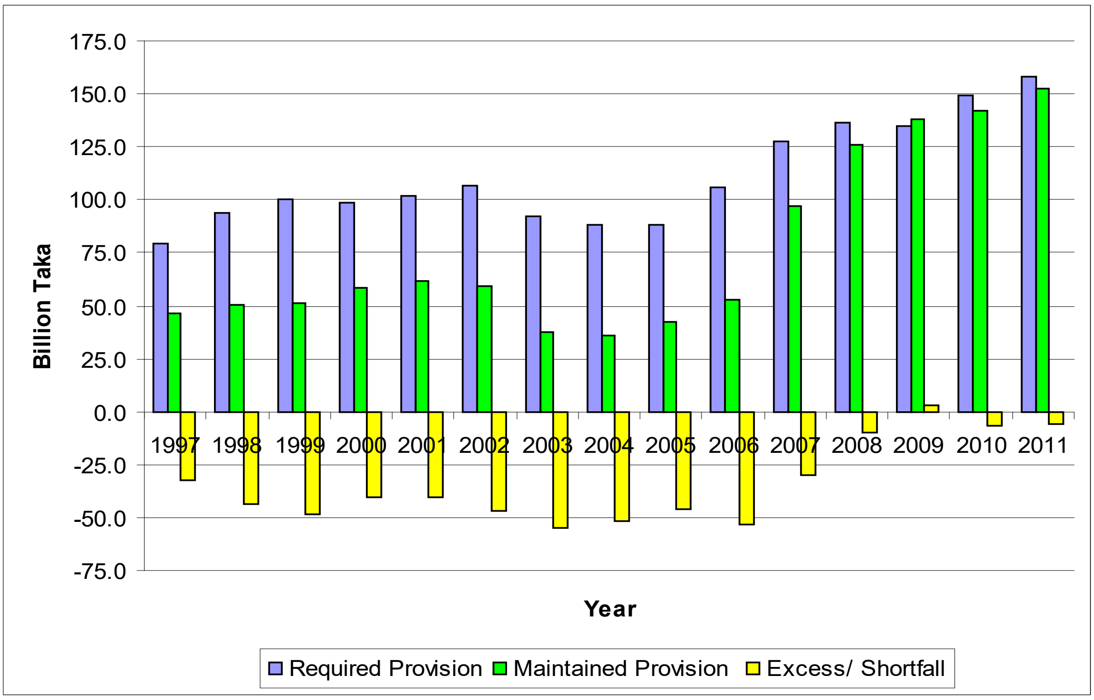
Year	**Required Provision**	**Maintained Provision**	**Excess/ Shortfall**	**Provision Maintenance Ratio (%)**
1997	79.1	46.7	-32.4	59.1
1998	93.5	50.1	-43.4	53.5
1999	100.2	51.5	-48.7	51.4
2000	98.4	58.1	-40.3	59.1
2001	101.6	61.4	-40.2	60.5
2002	106.8	59.6	-47.2	55.8
2003	92.5	37.3	-55.2	40.3
2004	87.8	35.9	-51.9	40.9
2005	88.3	42.6	-45.7	48.2
2006	106.1	52.9	-53.2	49.9
2007	127.2	97.1	-30.1	76.3
2008	136.1	126.2	-9.9	92.7
2009	134.8	137.9	3.1	102.3
2010	149.2	142.3	-6.9	95.4
2011	158.0	152.3	-5.7	96.4

Source: Bangladesh Bank, *Annual Report,* Various issues.

The state of loan loss provisioning has been depicted in Figure VII-12.

Figure VII-12

State of Loan Loss Provisioning by All Banks



Source: Table VII-11.

It is evident in the above Table and the Figure that, between 1997 and 2011, provision shortfall in the banking sector fluctuated within the range of Taka 5.7 billion to Taka 55.2 billion. The shortfall was the highest in the year 2003 with a jump from the previous year. The reason behind this sharp rise in the shortfall might have been the immediate response by the scheduled banks to the new "write-off policy", which had been introduced in January 2003.

An analysis of different categories of banks regarding loan loss provisioning reveals that, the NCBs are in the worst position, but they form the determining cluster in shaping the provisioning status of the whole banking sector. Table VII-12 shows the comparative position of provision adequacy of different clusters of banks in Bangladesh. In the Table it is seen that, till 2006, the PMR of the NCBs was meager and the lowest among the different categories of banks, whereas that of the FCBs was the highest. The FCBs not only maintained the highest ratio, but also were able to maintain much higher ratio than the regulatory requirement. The DFIs and PCBs kept substantially higher ratio than the NCBs, but lower than the required ratio except for the DFIs in 2002, when the PMR of the DFIs was 101.2 percent. The table reveals that, during this period it was the NCBs, which were mainly responsible for the low PMR of the banking industry. A positive trend in the NCBs is seen from 2007. They were found to maintain substantially higher provision than the earlier time and in that year this cluster surpassed the DFIs in respect of maintaining provision. From 2008 NCBs have been maintaining the required provision except a minor shortfall in 2010. The impact of this development has been reflected in the overall provision maintenance situation in the banking industry presented in Table VII-11 earlier. The PCBs also have shown good improvement while the DFIs are lagging behind.

Table VII-12

Comparative Position of Provision Adequacy

(in billion Taka)

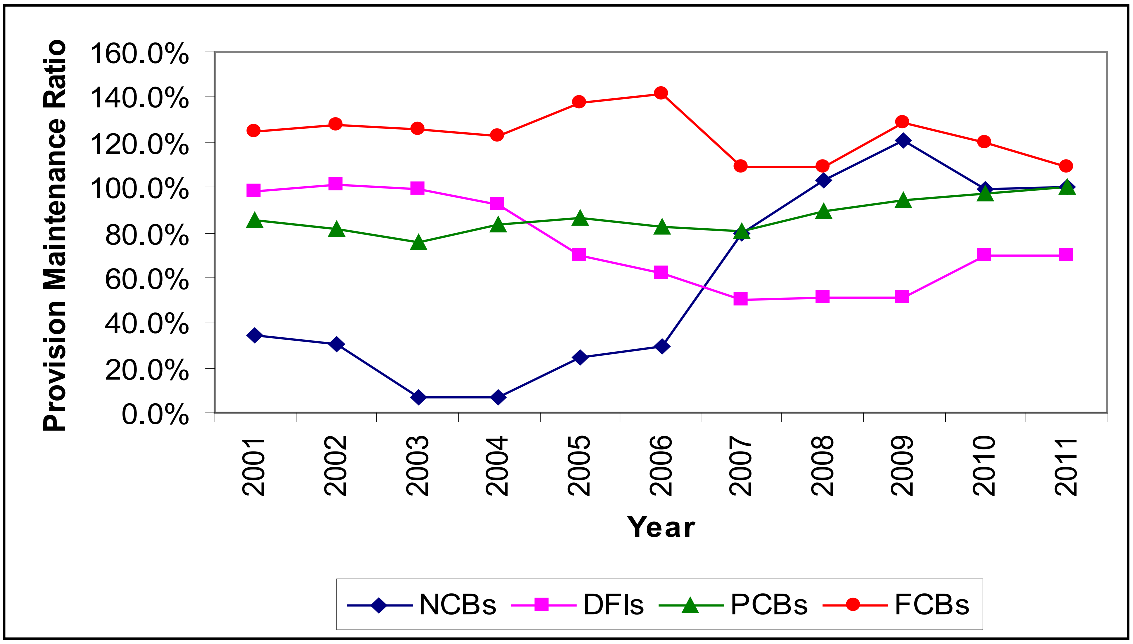
Year	Items	NCBs	DFIs	PCBs	FCBs
2001	Required Provision	59.5	18.4	23.1	1.3
	Maintained Provision	20.7	18	19.6	1.6
	Provision Maintenance Ratio	34.8%	97.9%	85.0%	124.8%
2002	Required Provision	61.5	17.1	27.9	1.2
	Maintained Provision	18.9	17.3	22.8	1.6
	Provision Maintenance Ratio	30.8%	101.2%	81.9%	127.7%
2003	Required Provision	53.3	14.7	23.1	1.4
	Maintained Provision	3.5	14.6	17.5	1.7
	Provision Maintenance Ratio	6.6%	99.2%	75.4%	125.2%
2004	Required Provision	50.7	13.5	22.3	1.3
	Maintained Provision	3.4	12.4	18.5	1.6
	Provision Maintenance Ratio	6.7%	91.9%	83.0%	123.1%
2005	Required Provision	52.8	13.8	20.5	1.6
	Maintained Provision	13.2	9.3	17.8	2.2
	Provision Maintenance Ratio	25.0%	69.4%	86.8%	137.5%
2006	Required Provision	61.6	14.8	27.5	2.2
	Maintained Provision	18.2	9.1	22.6	3.1
	Provision Maintenance Ratio	29.5%	61.5%	82.2%	140.9%
2007	Required Provision	71.7	17.3	34.9	3.5
	Maintained Provision	56.5	8.7	28.2	3.8
	Provision Maintenance Ratio	79.1%	50.3%	80.8%	108.6%
2008	Required Provision	73.1	17.0	41.3	4.6
	Maintained Provision	75.6	8.6	37.0	5.0
	Provision Maintenance Ratio	103.4%	50.6%	89.6%	108.7%
2009	Required Provision	66.0	17.5	46.5	4.6
	Maintained Provision	79.5	8.9	43.6	5.9
	Provision Maintenance Ratio	120.5%	50.9%	93.8%	128.3%
2010	Required Provision	70.6	19.1	53.3	6.2
	Maintained Provision	69.9	13.3	51.8	7.4
	Provision Maintenance Ratio	98.9%	69.7%	97.1%	119.4%
2011	Required Provision	69.8	20.6	60.0	7.5
	Maintained Provision	69.8	14.3	60.0	8.2
	Provision Maintenance Ratio	100.0%	69.4%	100.0%	109.3%

Source: Bangladesh Bank, *Annual Report,* various Issues.

The comparative position of provision maintenance by types of banks has been depicted in Figure VII-13.

Figure VII-13

Provision Maintenance Ratio by Types of Banks



Source: Table VII-12.

It is clear in the Figure that, the FCBs maintained the highest level of PMR and their PMR was always above the regulatory requirement. The steep rise starting from 2006 in the curve representing the NCBs is evident in the Figure.

7.5.2.3 Comparison with International Standard

To compare the loan classification and provisioning system of Bangladesh Bank to the international standard, the current loan classification and provisioning system of Bangladesh has been reproduced in Table VII-13. The international standard of loan classification and provisioning system has been presented in Table VII-14.

Table VII-13

Current Loan Classification and Provisioning System in Bangladesh

Types of Loan	Length of Overdue	Status of Classification	Rate of Provision
Continuous Loan Overdue period will be accounted from the day following the date of expiry of such loan.	➢ Less than 6 months	Unclassified	1%
	➢ 6 months or more but Less than 9 months	Sub-standard	20%
	➢ 9 months or more but Less than 12 months	Doubtful	50%
	➢ 12 months or More	Bad/Loss	100%
Demand Loan Overdue period will be accounted from the day following the date of expiry of such loan.	➢ Less than 6 months	Unclassified	1%
	➢ 6 months or more but Less than 9 months	Sub-standard	20%
	➢ 9 months or more but Less than 12 months	Doubtful	50%
	➢ 12 months or More	Bad/Loss	100%
Term Loan Payable within 5 Years Overdue period will be accounted from the day following the date of expiry of the due date of payment of installment of such loan.	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 6 months	Sub-standard	20%
	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 12 months	Doubtful	50%
	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 18 months	Bad/Loss	100%
Term Loan Payable in more than 5 Years Overdue period will be accounted from 6 months following the expiry of the due date of payment of installment of such loan.	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 12 months	Sub-standard	20%
	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 18 months	Doubtful	50%
	➢ Amount of "defaulted installment" is equal to or more than the amount of installment(s) due in 24 months	Bad/Loss	100%
STAG/ Micro Credit Overdue period will be accounted from 6 months following the expiry of the due date of payment of installment of such loan.	➢ Less than 12 months	Unclassified	5%
	➢ 12 months or more but Less than 36 months	Sub-standard	5%
	➢ 36 months or more but Less than 60 months	Doubtful	5%
	➢ More than 60 months	Bad/Loss	100%

Source: Bangladesh Bank, *Prudential Regulations for Banks: Selected Issues* (Dhaka: BB, September 2011), p. 20-21.

Table VII-14

Loan Classification and Provisioning System (International Standard)

Length of Overdue	Status of Classification	Rate of Provision (Percent)	Frequency of Classification
Less than 3 months	Unclassified	1 -5	At least
Loans overdue for 3 months but less 6 months	Sub-standard	10 – 25	Quarterly
Loans overdue for 6 months but less 9 months	Doubtful	50 - 75	Usually
Loans overdue for 9 months more	Bad/Loss	100	Monthly

Source: Bangladesh Bank, *Financial Sector Review,* vol. 1. no. 1 (May 2006), p. 95.

Table VII-13 and Table-14 show that, loan classification norms of Bangladesh are not up to the international standard in terms of length of overdue, but in case of provisioning, the Bangladesh practice is quite consistent with international standard.

7.5.3 New Capital Adequacy Requirements

It was found that since 1997, the Capital Adequacy Ratio (CAR) in terms of capital to Risk Weighted Assets (RWA) ratio in the banking sector had been consistently below the regulatory standards without few exceptions. Table VII-15 shows capital to risk weighted assets ratio by types of banks from 1997 to 2011. It is observed that during 1997 to 2002, when regulatory CAR was eight percent capital to RWA, the maintained ratio of the banking sector remained within the range of 6.7 to 7.5 percent, i.e., marginally lower than the regulatory requirement. The capital shortfall of the industry remained within the range of 0.5 to 1.3 percent during this span of time. In the year 2003, the regulatory requirement was elevated to 9 percent from 8 percent of RWA and was kept at that level till 2006. In this period maintained ratio of the banking sector fluctuated within the range of 5.6 to 8.7 percent. In these years capital shortfall of the industry remained within the range of 0.3 to 3.4 percent. In 2007 the required CAR was raised to ten percent and it is fixed at that level to date. From 2007 to 2011, it is found that, the industry maintained the ratio in the range of 9.3 to 11.6 percent. In 2008 and 2009, the industry maintained the ratio marginally above the required ratio.

Table VII-15

Capital to Risk Weighted Assets Ratio by Type of Banks

(in percent)

Year	Actual Capital					Regulatory Requirement	Capital Surplus/Shortfall				
	NCBs	PCBs	DFIs	FCBs	Total		NCBs	PCBs	DFIs	FCBs	Total
1997	6.6	8.3	6.0	16.7	7.5	8.0	-1.4	0.3	-2.0	8.7	-0.5
1998	5.2	9.2	6.9	17.1	7.3	8.0	-2.8	1.2	-1.1	9.1	-0.7
1999	5.3	11.0	5.8	15.8	7.4	8.0	-2.7	3.0	-2.2	7.8	-0.6
2000	4.4	10.9	3.2	18.4	6.7	8.0	-3.6	2.9	-4.8	10.4	-1.3
2001	4.3	9.9	3.9	16.8	6.7	8.0	-3.7	1.9	-4.1	8.8	-1.3
2002	4.1	9.7	6.9	21.4	7.5	8.0	-3.9	1.7	-1.1	13.4	-0.5
2003	4.3	10.5	7.7	22.9	8.4	9.0	-4.7	1.5	-1.3	13.9	-0.6
2004	4.1	10.3	9.1	24.2	8.7	9.0	-4.9	1.3	0.1	15.2	-0.3
2005	-0.4	9.1	-7.5	26.0	5.6	9.0	-9.4	0.1	-16.5	17.0	-3.4
2006	1.1	9.8	-6.7	22.7	6.7	9.0	-7.9	0.8	-15.7	13.7	-2.3
2007	7.9	10.6	-5.5	22.7	9.6	10.0	-2.1	0.6	-15.5	12.7	-0.4
2008	6.9	11.4	-5.3	24.0	10.1	10.0	-3.1	1.4	-15.3	14.0	0.1
2009	9.0	12.1	0.4	28.1	11.6	10.0	-1.0	2.1	-9.6	18.1	1.6
2010	8.9	10.1	-7.3	15.6	9.3	10.0	-1.1	0.1	-17.3	5.6	-0.7
2011	9.5	10.4	-7.0	17.1	9.7	10.0	-0.5	0.4	-17.0	7.1	-0.3

Source: Bangladesh Bank, *Annual Report,* various issues.

It is also evident in the Table that, the banking industry maintained the minimum required CAR for the first time in 2008 and in 2009 the maintenance continued with bigger margin. But again in 2010 followed by 2011, it suffered from capital shortfall. The reason of this deterioration was that, after the introduction of Basel II on January 2010, the banks had to take into account two additional risks namely, credit risk and market risk for determination of their capital adequacy.[80]

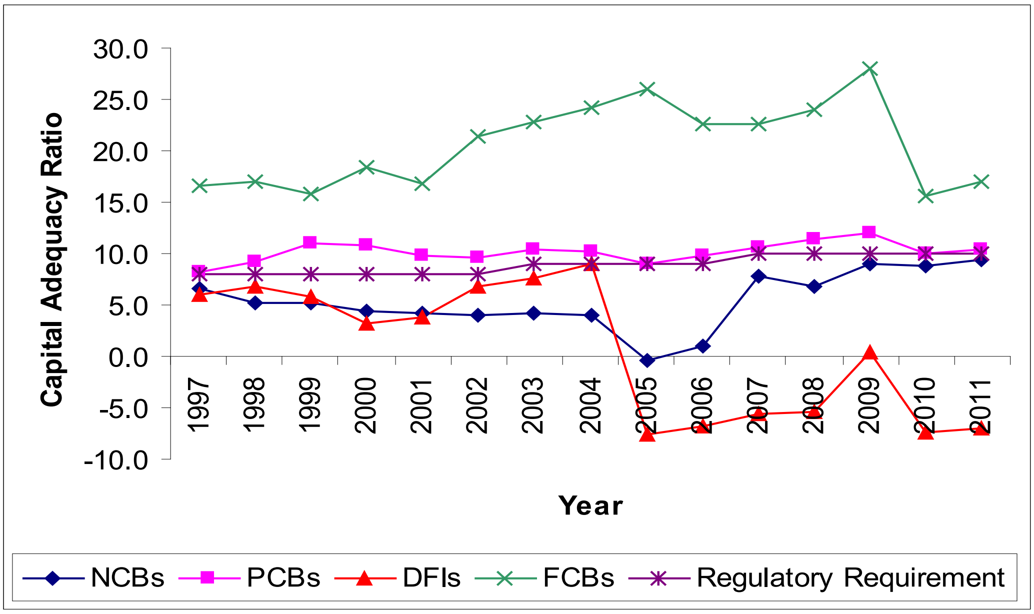
Category wise analysis of the banks shows that, the CAR and capital surplus / shortfall was in varying degrees for different Categories of banks. Table VII-15 shows that, the CAR for the NCBs was below the regulatory requirement during the whole period and accordingly the NCBs suffered capital shortfall. The PCBs remained above the regulatory requirement and experienced capital surplus. The CAR of the DFIs was below the requirement except 2004. From 2005 and onwards the shortfall became severe. The FCBs maintained substantially higher risk-weighted capital ratio than the regulatory requirements throughout the entire period. So, it was found that, significant downward trend of risk-weighted capital ratios for the Government owned NCBS and DFIs pulled

[80] Bangladesh Bank, *Financial Stability Report 2010,* Issue. 1 (Dhaka: Bangladesh Bank, October 2011), p. 25.

down the aggregate risk-weighted capital ratios. Capital adequacy ratios by different types of banks have been depicted in Figure VII-14.

Figure VII-14

Capital Adequacy Ratio by Types of Banks

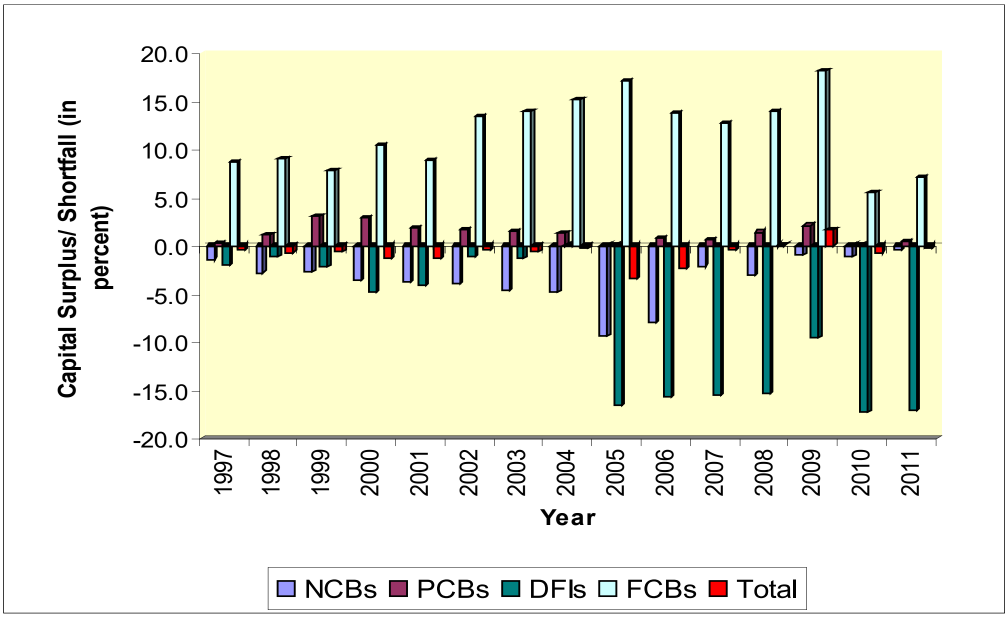


Source: Table VII-15.

Capital surplus / shortfall (in percent) by different types of banks have been depicted in Figure VII-15.

Figure VII-15

Capital Surplus/ Shortfall by Types of Banks (in percent)



Source: Table VII-15.

The Figure VII-14 and Figure VII-15 depict that, the FCBs were always above the regulatory requirement and had substantial capital surplus. The NCBs in contrast, were always below the regulatory requirement and had capital shortfall. The PCBs had marginal surplus. The DFIs were generally in capital shortage; but from 2005 the shortfall is huge.

The capital adequacy regulation required the scheduled banks to maintain at least 50 percent of their risk weighted capital ratio in Tier I capital or core capital.[81] From January 1996 to 29 June 2003, the required ratio of capital to risk weighted assets was 8 percent with at least 4 percent in core capital and after that, the required ratio of capital to risk weighted assets was 9 percent with at least 4.5 percent in core capital. It was found that, though aggregate risk weighted capital ratios for the banking sector were below the regulatory requirements, performance of the banking sector as a whole in terms of Tier I or core capital requirement was noteworthy. In 1999, the ratio of Tier I capital to total capital was 82.13 percent and this ratio increased to 82.73 percent in 2005.[82] In the first, second, third and fourth quarter of calendar year 2010, the ratios were 59, 59, 63 and 67 percent respectively. Lack of suitable instruments, for inclusion in Tier II capital was a good reason for the banks to keep most of the capital in Tier I. However, a cross-country comparison presented in Table VII-16 reveals that, Bangladesh is far below than its south Asian neighbours regarding maintenance of minimum CAR by the banking industry.

Table VII-16

Comparison of CAR among Some South Asian Countries

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(in percent)

Country	**Year**	
	2009	**2010**
Bangladesh	11.7	09.3
India	14.0	14.6
Pakistan	14.0	14.0
Sri Lanka	16.1	14.9

Source: Bangladesh Bank, *Financial Stability Report 2010*, Issue. 1 (October 2011), p. 27.

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[81] Tier I capital and Tier II capital have been have discussed in Chapter V of this dissertation.

[82] Bangladesh Bank, *Financial Sector Review,* vol. 1, no. 1, *op. cit.,* p.117.

7.5.4 New Supervision, Operational and Management Tools

The new supervision, operational and management tools were introduced under the reform agenda in Bangladesh banking sector with the view to improve the performance of this sector. To analyze these new tools, performance of the banking sector has been evaluated under the CAMELS framework, which requires analysis of five indicators, viz., (i) Capital adequacy, (ii) Asset quality, (iii) Management soundness, (iv) Earnings and (v) Liquidity and (vi) Sensitivity to market risk In this section these indicators except “sensitivity to market risk” have been analyzed to evaluate the new tools introduced by Bangladesh Bank.[83]

7.5.4.1 Capital Adequacy

Capital adequacy has already been analyzed earlier in this Chapter in section 7.5.3. The banking sector was found to remain consistently below the regulatory capital requirement. It was also found that, though the PCBs and FCBs maintained the required risk-weighted capital ratio, significant shortfall of this ratio for the DFIs and for the NCBs pulled down the aggregate risk-weighted capital ratio.

7.5.4.2 Asset Quality

The commercial banks were found to have concentration of loans and advances in their total assets. Table VII-17 shows the high concentration of loans and advances and the increasing trend in this category during the last five years under review.

Table VII-17

Industry Asset Composition

(in per cent)

Year	Loans & Advances	Govt. Bills & Bonds	Deposit with Bangladesh Bank	Other Assets
2002	59.0	10.0	6.0	25.0
2003	60.0	11.0	6.0	23.0
2004	61.0	11.0	5.0	23.0
2005	64.0	11.0	5.5	19.5
2006	64.1	10.5	5.6	19.8
2007	62.2	13.7	5.7	18.4
2008	63.6	11.6	5.8	18.8
2009	61.5	13.4	4.5	20.6
2010	64.3	10.1	6.2	19.4

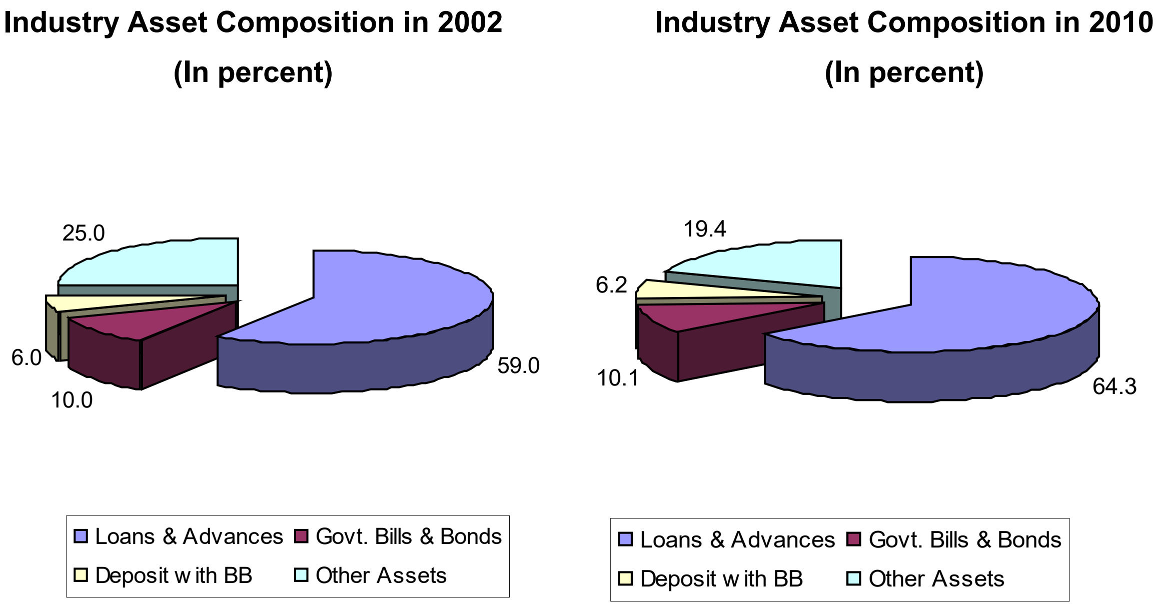
Source: BB, *Annual Report*, various issues.

[83] “Sensitivity to market risk” was incorporated in July 2006. This is comparatively a new indicator for the banking industry and necessary data are not available for this indicator.

It is seen in the Table that, in 2002 loans and advances alone formed 59 percent of the industry assets. In the subsequent years this category witnessed further concentration and in 2010, loans and advances formed 64.4 percent of the industry assets.

High concentration of loans and advances indicates vulnerability of assets to credit risk. In Bangladesh, where the volume of NPL is alarmingly huge, the vulnerability of assets to credit risk is specially significant. The pie Figures in Figure VII-16 depict industry asset composition in 2002 and 2010. The increasing trend of concentration of loans and advances in total assets of the banking industry is evident in the Figure.

Figure VII-16
Industry Asset Composition



Source: Table VII-17.

A very important indicator to assess asset quality in the loan portfolio is the percentage of gross NPLs to total loans. In June 2011, industry NPL to total loans was 7.1 percent.[84] Though on a downward trend, it is still very high even as per the south Asian standard. This implies a poor quality of asset in Bangladesh banking sector. However, in the recent years a declining trend in NPL to total loan ratio is observed in Bangladesh.

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[84] Bangladesh Bank, *Annual Report 2010-11, op. cit.,* p. 257.

7.5.4.3 Management Soundness

Indicators of management soundness are primarily specific to individual situation. Moreover, characteristics of a good management are basically qualitative in nature. So, it is difficult to draw any conclusion regarding management quality on the basis of monetary indicators and these indicators also cannot be easily aggregated across the banking sector. However, Expenditure to Income (EI) ratio is widely used to gauge management soundness of financial institutions. A high and increasing EI ratio indicates operating inefficiency that reveals flaws in management and *vice versa.* Table VII-18 shows the expenditure to income (EI) ratio for different categories of banks in Bangladesh.

Table VII-18

Expenditure- Income Ratio by Types of Banks

(in percent)

Year	Types of Banks				Total
	NCBs	DFIs	PCBs	FCBs	
1997	99.4	142.3	85.9	59.7	**95.3**
1998	99.8	180.4	85.3	60.1	**95.4**
1999	100.5	145.2	90.4	67.4	**96.6**
2000	99.4	175.3	90.8	77.7	**99.9**
2001	99.0	89.1	88.1	75.7	**91.2**
2002	98.5	95.5	91.9	78.3	**93.3**
2003	98.8	101.1	93.1	80.3	**93.9**
2004	102.3	104.0	87.1	76.3	**90.9**
2005	101.9	103.9	89.3	70.8	**92.1**
2006	100.0	103.5	90.2	71.1	**91.4**
2007	100.0	107.7	88.8	72.9	**90.4**
2008	89.6	103.7	88.4	75.8	**87.9**
2009	75.6	112.1	72.6	59.0	**72.6**
2010	80.7	87.8	67.6	64.7	**70.9**
2011	65.9	101.7	69.1	45.4	**69.1**

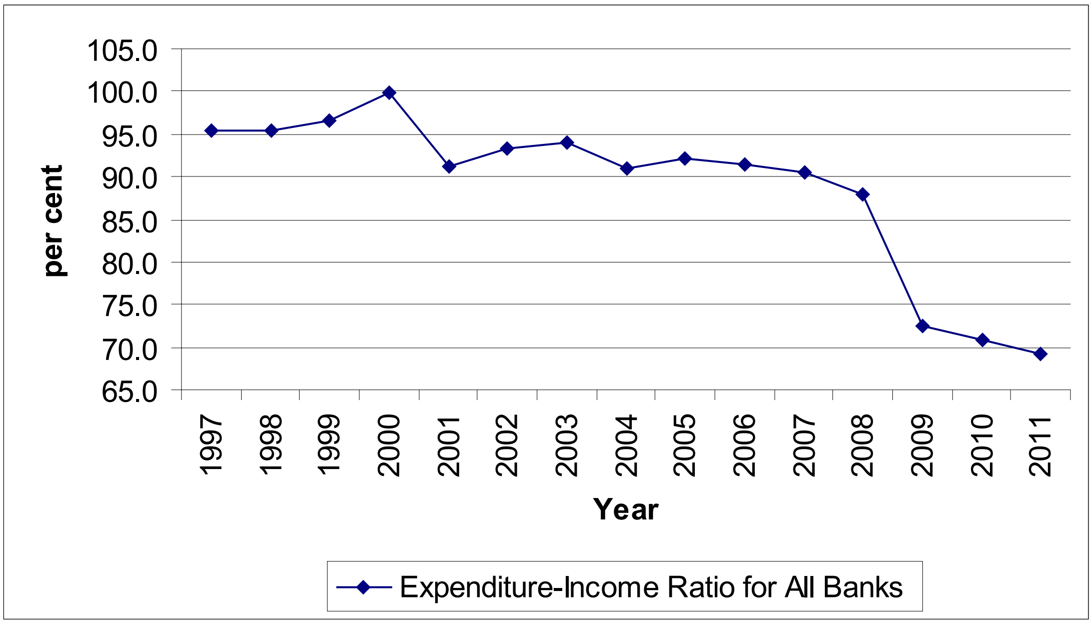
Source: Bangladesh Bank, *Annual Report,* various issues.

It is seen in the Table that, the EI ratio was very high for the NCBs indicating their management inefficiency. Since 1997, it was above 98 percent and sometimes above 100 percent till 2007. After 2007 a positive notion is observed here. In 2011, this ratio was 65.9 percent. The EI ratio was worst for the DFIs as the ratio remained above 10 percent for most of the period. In 1998 the EI ratio for the DFIs was as high as 180.4 percent. The lowest ratio was 87.8 percent in 2010. The ratio was somewhat less for the PCBs. The FCBs had the lowest EI ratio in the industry indicating best performance in respect of management soundness. The high ratios for all banks, specially the local ones reflect management inefficiency in the banking sector of Bangladesh. However, EI ratio for all banks demonstrates a declining trend since 2000. From 2005 in particular, the EI ratio is consistently declining. This indicates a gradual improvement in the management soundness in the banking industry.

Figure VII-17 depicts the trend in the EI ratio for all banks in Bangladesh.

Figure VII-17

Expenditure-Income Ratio for All Banks



Source: Table VII-18.

The Figure illustrates that, the EI ratio for the banking industry reached at the peak in 2000. The industry witnessed a sharp decline in the ratio in 2001. After that, minor fluctuations occurred in EI ratio for the industry. Though remaining high, the declining trend in the EI ratio in the recent years is clearly observable in the Figure.

7.5.4.4 Earnings and Profitability

Strong earnings and profitability profile of a bank determine its capacity to absorb losses by building an adequate capital base, finance its expansion and pay adequate dividends to its shareholders. There are various measures of earning and profitability.

But Return on Assets (ROA)[85] supplemented by Return on Equity (ROE)[86] and Net Interest Margin (NIM)[87] is considered as the best and is used widely.

ROA by types of banks have been presented in Table VII-19.

Table VII-19

Return on Assets (ROA) by Types of Banks

(In percent)

Year	Types of Banks				Total
	NCBs	DFIs	PCBs	FCBs	
1997	0.0	-2.1	1.1	4.8	**0.3**
1998	0.0	-2.8	1.2	4.7	**0.3**
1999	0.0	-1.6	0.8	3.5	**0.2**
2000	0.1	-3.7	0.8	2.7	**0.0**
2001	0.1	0.7	1.1	2.8	**0.7**
2002	0.1	0.3	0.8	2.4	**0.5**
2003	0.1	0.0	0.7	2.6	**0.5**
2004	-0.1	-0.2	1.2	3.2	**0.7**
2005	-0.1	-0.1	1.1	3.1	**0.6**
2006	0.0	-0.2	1.1	2.2	**0.8**
2007	0.0	-0.3	1.3	3.1	**0.9**
2008	0.7	-0.6	1.4	2.9	**1.2**
2009	1.0	0.4	1.6	3.2	**1.4**
2010	1.1	0.2	2.1	2.9	**1.8**
2011	0.6	-0.3	1.6	3.6	**1.3**

Source: Bangladesh Bank, *Annual Report*, various issues.

The Table shows that, ROA of the NCBs had been very low, even negative in some years. ROA of the DFIs had been worse being negative for most of the years. The PCBs had positive ROA by small margin. The FCBs had the highest ROA in the industry. ROA of the banking industry was found positive, but very low and inconsistent.

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[85] ROA=Net after-tax profit/ Bank assets.

[86] ROE=Net after-tax profit/ Bank's equity capital.

[87] NIM is defined as the difference between "interest expenses" and "interest income" per unit of "total bank assets".

ROE by types of banks has been presented in Table VII-20.

Table VII-20

Return on Equity (ROE) by Types of Banks

(In percent)

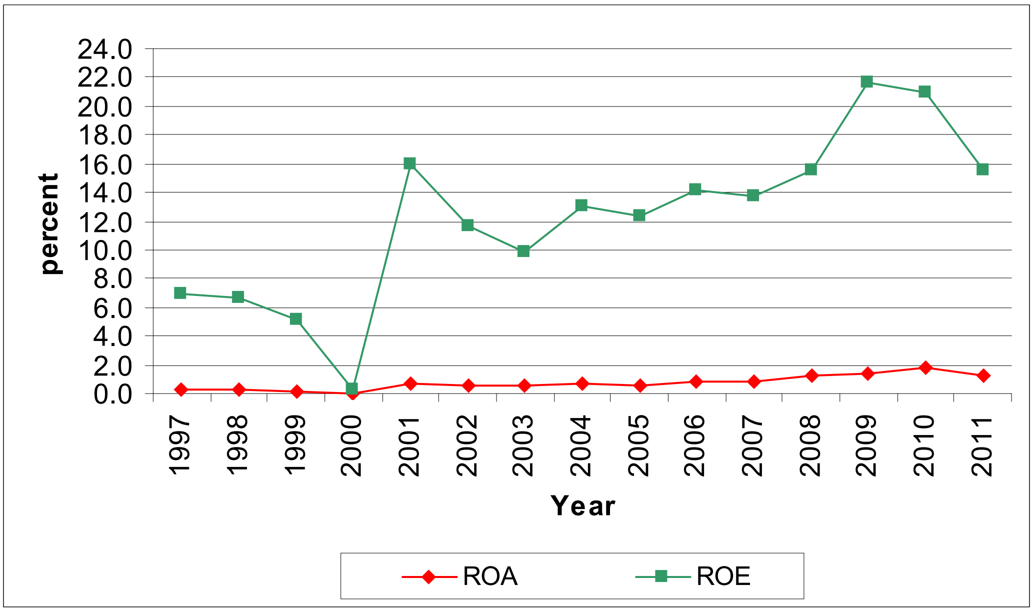
Year	Types of Banks				Total
	NCBs	DFIs	PCBs	FCBs	
1997	1.3	-29.1	24.4	38.2	**7.0**
1998	0.3	-36.3	26.8	40.7	**6.6**
1999	-1.1	-29.4	15.3	41.8	**5.2**
2000	1.7	-68.0	17.0	27.3	**0.3**
2001	2.4	12.3	20.9	32.4	**15.9**
2002	4.2	5.8	13.6	21.5	**11.6**
2003	3.0	-0.6	11.4	20.4	**9.8**
2004	-5.3	-2.1	19.5	22.5	**13.0**
2005	-6.9	-2.0	18.1	18.4	**12.4**
2006	0.0	-2.0	15.2	21.5	**14.1**
2007	0.0	-3.4	16.7	20.4	**13.8**
2008	22.5	-6.9	16.4	17.8	**15.6**
2009	26.2	-171.7	21.0	22.4	**21.7**
2010	18.4	-3.2	20.9	17.0	**21.0**
2011	10.0	-5.2	15.6	20.2	**15.5**

Source: Bangladesh Bank, *Annual Report,* various issues.

It is observed in the Table that, ROE of the NCBs had been very low till 2007. It had also been negative for some years. But since 2008, ROE of the NCBs have been impressive, though is on downward trend since 2009. ROE of the DFIs had been worse with negative values throughout the period under consideration except only two years. The PCBs had been in better position, but had a declining trend in ROE in the last three years. The FCBs as usual, had the highest ROE in the banking sector. The banking sector experienced low ROE in the whole period under consideration. Moreover, ROE of the industry is on downward trend since last three years. The sector witnessed a sharp decline and a sharp rise in its ROE in 2000 and 2001 respectively. This happened mainly due to huge loan loss provisioning by the DFIs in 2000 which is also evident in the -68.0 percent ROE of the DFIs in that year.

The aggregate position of ROA and ROE has been shown in Figure VII-18.

Figure VII-18
Aggregate Profitability by All Banks



Source: Table VII-19 and Table VII-20.

The low level of ROA and ROE of the banking industry along with the fluctuations in the ROE are evident in the above Figure. Presently ROE is on downward trend.

Net Interest Income (NII)[88] by types of banks have been presented in Table VII-21. It is observed in the Table that, NII of the NCBs became positive in 2005 after remaining negative for five successive years. The DFIs experienced an inconsistent trend, but positive NII since 1999. The PCBs had their interest income more than interest expenses resulting in positive NII and maintained an increasing trend in it except 2011. The FCBs also witnessed consistently increasing trend in NII since 1999 till 2010. The Table shows a consistently upward trend for the overall industry till 2010. The high rate of increase in NII of the PCBs and NCBs in the later half of the last decade made it happen. This indicates a general big interest rate spread in the banking industry.

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[88] It is accepted to use NII as a proxy for NIM and Bangladesh Bank employs NII to supplement ROA under the CAMELS framework.

Table VII-21

Net Interest Income by Types of Banks

(In billion Taka)

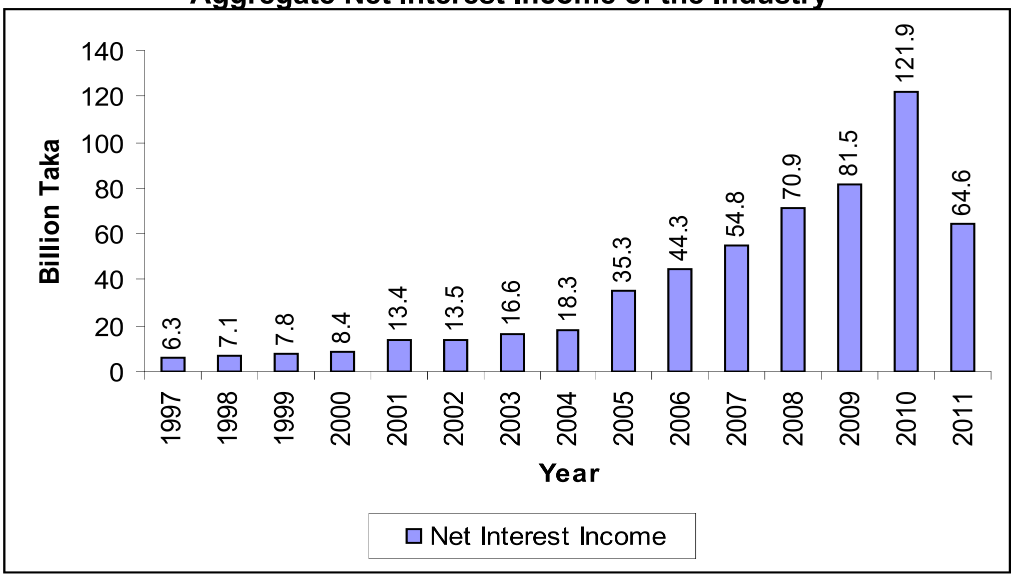
Year	Types of Banks				Total
	NCBs	DFIs	PCBs	FCBs	
1997	2.7	-0.1	1.7	2.0	**6.3**
1998	2.2	0.5	2.3	2.2	**7.1**
1999	3.1	-0.1	3.0	1.8	**7.8**
2000	-1.2	1.0	6.1	2.5	**8.4**
2001	-1.8	2.7	9.2	3.3	**13.4**
2002	-1.5	1.4	10.2	3.4	**13.5**
2003	-0.3	1.3	12.0	3.6	**16.6**
2004	-1.1	1.8	13.7	4.2	**18.3**
2005	7.7	1.0	21.0	5.6	**35.3**
2006	9.0	1.7	25.4	8.2	**44.3**
2007	7.4	1.4	36.1	9.9	**54.8**
2008	7.9	1.9	48.5	12.6	**70.9**
2009	12.1	1.9	56.7	10.7	**81.5**
2010	19.8	6.2	82.8	13.0	**121.9**
2011	10.0	4.0	42.2	8.4	**64.6**

Source: Bangladesh Bank, *Annual Report,* various issues.

Aggregate NII of the banking industry has been depicted in Figure VII-19. The Figure shows a consistently increasing trend in aggregate NII till 2010. The sharp increase in 2005 was caused mainly by the sudden reversal of the NCBs in that year of experiencing Taka 7.7 billion NII, following NII of -1.1 in the previous year, coupled with a sharp increase in NII of the PCBs.

Figure VII-19

Aggregate Net Interest Income of the Industry



Source: Table VII-21.

7.5.4.5 Liquidity

The commercial banks of Bangladesh are to maintain Statutory Liquidity Ratio (SLR) as certain percentage of their deposits. SLR includes Cash Reserve Ratio (CRR), which is to be kept with the Bangladesh Bank. The remainder of SLR may be kept in cash or in Government securities. Liquid assets held by the commercial banks in excess of the SLR, is considered as excess liquidity. Liquidity indicators, measured as percentage of demand and time liabilities (excluding inter-bank items) of the banking sector have been presented in Table VII-22. The Table shows that, all the banks had excess liquidity. As usual, FCBs had the highest excess liquidity. This situation of constant surplus of liquidity warrants lowering of costs for creation of effective demand for credit in the economy.

Table VII-22

Liquidity Ratio by Types of Banks

(in percent)

Year	Liquid Assets					Excess Liquidity				
	Types of Banks				Total	Types of Banks				Total
	NCBs	DFIs	PCBs	FCBs		NCBs	DFIs	PCBs	FCBs	
1997	22.7	16.9	24.2	31.2	**23.3**	2.7	9.7	6.0	11.2	**4.5**
1998	24.4	16.6	24.8	39.8	**25.2**	4.4	9.2	6.7	19.9	**6.4**
1999	25.2	15.7	25.9	51.3	**27.0**	5.2	8.7	8.0	31.4	**8.3**
2000	26.5	16.2	24.8	34.7	**26.1**	6.5	9.9	6.8	14.8	**7.5**
2001	25.7	15.3	24.2	34.1	**25.3**	5.7	8.9	6.2	14.3	**6.7**
2002	27.3	13.7	26.3	41.6	**27.2**	7.3	6.9	8.5	21.8	**8.7**
2003	24.4	12.0	24.4	37.8	**24.7**	8.4	5.8	9.8	21.9	**9.9**
2004	22.8	11.2	23.1	37.8	**23.4**	6.8	4.7	8.8	21.9	**8.7**
2005	20.0	11.2	21.0	41.5	**21.7**	2.0	6.2	5.1	23.6	**5.3**
2006	20.1	11.9	21.4	34.4	**21.5**	2.1	3.8	5.6	16.4	**5.1**
2007	24.9	14.2	22.2	29.2	**23.2**	6.9	5.6	6.4	11.2	**6.9**
2008	32.9	13.7	20.7	31.3	**24.8**	14.9	4.9	4.7	13.3	**8.4**
2009	25.1	9.6	18.2	31.8	**20.6**	17.6	7.1	5.3	21.8	**9.0**
2010	27.2	21.3	21.5	32.1	**23.0**	8.2	2.3	4.6	13.2	**6.0**

Source: Bangladesh Bank, *Annual Report,* various issues.

It transpires from the above analysis of the performance of the banking sector that, the new tools, instituted under the reform agenda could not generate desired outcome in the Bangladesh banking sector. The various indicators employed under the CAMELS framework indicate overall institutional inefficiency specially for the NCBs and the DFIs. Performance indicators of the banking industry depict a trend similar to that of the state-owned banks, which happens due to their predominant market share. It has been observed that, financial performance of the PCBs and FCBs was better than the industry average.

Interest rate deregulation and other Monetary Policy reforms could not ensure price competition in the banking sector; nor could bring efficiency in resource allocation. The huge volume of NPLs in the economy exposes the poor quality of loan portfolio and hence ineffectiveness of the new loan classification system. The banks failed to maintain loss provisioning by wide margins. Banks also failed to maintain the regulatory capital adequacy requirement. In almost all of the cases the state-owned banks were found responsible to pull down the performance of the whole banking sector. Thus, it becomes clear that, the reforms undertaken by Bangladesh Bank failed to generate the expected outcomes.

7.6 An Analysis of the Causes of the Failure

The above discussion reveals that, the reform objectives still remain largely unfulfilled. The main advocate of the reform, the World Bank also admitted the failure of the reform measures as, "the project was not successful".[89] The causes of the failure were various**.** There were some loop holes in the reform framework, the banking problems were not identified correctly, there were flaws in the sequencing of the reform agenda, regulatory forbearance on the part of the Bangladesh Bank was also responsible. Besides, exogenous elements like, imposition of the reform programme from outside and the influence of the vested interest groups also contributed to the mentioned failure of the reform initiative. The main causes of the failure may be identified and grouped as follows.

7.6.1 Design and Sequencing of the Reform Agenda

The design of the reform framework in terms of adequacy, justification and sequencing was inappropriate. It was observed that in the reform agenda, the "core aspects" of reform became subordinate to the "peripheral aspects". The core consists of ensuring dominance of market forces, competition among banks, financial discipline through broad based legal and regulatory base and operational efficiency; and the peripheral or secondary aspects are denationalization and privatization of commercial banks, to help achieve the core objectives.[90] In a deregulated financial system, implementation of strict prudential

[89] World Bank, "Financial Sector Adjustment Credit (Credit 2152-BD)", *Performance Audit Report*, p. 12.

[90] Choudhury and Moral, "Commercial Bank Restructuring, *op. cit.,* p. 101.

regulations and effective supervision are of utmost importance. For the matter of improving the operations of financial markets, it is imperative that as the financial network of a country increases implementing prudential and information regulations become much more important than economic regulations.[91] But in the banking sector reform agenda in Bangladesh, more emphasis was placed on economic deregulations rather than broadening of prudential regulations and supervision. It may be recalled that, the recommendations of NCMBC were basically focused on fundamental problems of the banking system rather than giving priority to economic deregulations.[92]

At the time of introduction of the reform measures, the banking sector of Bangladesh was caught by different sorts of structural weaknesses. In such a situation, interest rate deregulation was introduced with the mission of bringing price competition and efficient resource allocation in the banking sector without addressing the structural weaknesses, such as a stronger, autonomous central bank and a functioning legal loan recovery system[93]. Consequently this measure could not meet the objectives.

In the pre-reform period, the market mechanism was inefficient and the market structure was imperfect as well as underdeveloped. Considering the stage of development of the financial markets in Bangladesh and their imperfect nature, it was not justified to leave the determination of interest rates entirely to market forces. Moreover, the pre-reform concessional rates prescribed for target groups under the priority sector lending manifested some social concerns and considerations. The NCMBC observed that no progamme of rationalization relating to interest rate structure should ignore these social concerns and considerations. Therefore, the NCMBC suggested a fair degree of regulation of interest rates.[94]

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[91] Asian Development Bank, *Asian Development Outlook*, 1995 and 1996, cited in Choudhury and Moral," Commercial Bank Restructuring", *op. cit.,* p. 97.

[92] Choudhury and Raihan, *Structural Adjustment, op. cit.,* p. 91.

[93] World Bank, "Financial Sector Adjustment Credit (Credit 2152-BD)", *Performance Audit Report*, p. 13.

[94] Government of the People's Republic of Bangladesh, *Report on Money, Banking and Credit* (Dhaka: GoB, June 1986), p. 82, cited in Choudhury and Raihan, *Structural Adjustment, op. cit.,* p. 92.

The complete dismantling of controlled lending rates substantially hampered the allocation of resources to priority sectors; because the priority sectors like agriculture are considered as more risky sectors by the banks. To ensure adequate allocation of resources to priority sectors, the Commission instead of completely discarding the controlled interest rate structure, rather suggested to channelise the flow of credit from local private and foreign banks to agricultural and rural sectors at least to the extent of fifteen percent of their loaning operation.[95]

In the reform process some steps were taken in the supply side of the banking sector problems. But the demand side constraints of the banking sector, specially of access to credit were largely ignored. The demand side constraints include need to bribe, time consuming and complicated procedures, lack of collateral, inability to fulfill loan conditions, high incidental costs, etc. For these impediments, flow of credit to rural and small entrepreneurs remained inadequate. One study shows that, more than fifty percent stakeholders (borrowers) belonging to rural and Small and Medium Enterprise (SME) sector do not have any access to formal credit in Bangladesh. The study also reveals that, a substantial portion of the borrowers, who have access to credit, have access in "restricted" sense.[96] On the other hand, the supply side constraints (from the viewpoint of bankers) include high risks and transaction cost, outside interference, inadequate collateral, ineffective legal framework for debt recovery, institutional constraints, etc.[97] No effective measure was initiated under the reform programme towards removing the above problems. Though the reform measures were basically supply-led, yet the supply aspects also were not properly covered in the supply-led measures; especially concerns of the implementation stakeholders were largely bypassed. Moreover, the knowledge, experience and skill of the bank executives and employees, their attitude towards market based actions, their accountability and incentive structures, internal control mechanism of the banks, undue influence of CBA and employee union leaders in banking decision making etc, were also bypassed.[98] The supply side

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[95] Choudhury and Raihan. *Structural Adjustment, op. cit.,* p. 92.

[96] *Ibid.,* p. 95.

[97] *Financial Sector Reforms Task Force Report*, Mahmud, Chairman, *op. cit.,* p. 4.

[98] *Ibid.*, p. 6.

was incorrectly, partially and in some cases inadequately addressed. Overemphasis on economic deregulation, unsatisfactory enforcement status of the prudential requirements, ineffective legal system, lack of commitment on the part of the Government, etc are some of this genre. This mismatch between demand side constraints and supply response was one of the very important reasons for the non-fulfillment of the financial sector reform objectives.

A number of old PCBs are encountering almost the same level of classified loans as of the NCBs. The PCBs established during 1990s deserve more appreciation than the PCBs established during 1980s regarding the improvement in loan quality. A class of sponsor directors, who had grabbed a huge amount of unauthorized financial facilities from the PCBs under their control, is mainly guilty for the poor loan status of the old PCBs.[99] This reveals a flaw in the sequencing of the reform agenda which was rightly recognized by the BRC.[100] The Government started the process of licensing PCBs to start operation at the instance of the donor agencies before ensuring the enforcement of proper legal and regulatory system.

The reform programme was not comprehensive. The broad reform measures excluded the DFIs, though the NCMBC report dealt elaborately with the DFIs, specially their default problem. DFIs were missing in the later reform actions also. The narrowly focused reform programme, deliberately dropping a part (DFIs) of the financial system, though small, failed to create a sustainable, sound and robust banking sector in Bangladesh.

7.6.2 Supervisory and Regulatory Forbearance of Bangladesh Bank

Supervisory and regulatory forbearance on the part of Bangladesh Bank has been one of the main reasons for the accumulated and continuing banking problems as well as for the poor outcome of the reform measures in Bangladesh.[101] By any standard all of the NCBs and DFIs may be categorized as problem banks. But these banks were not considered as problem banks by the

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[99] *Ibid.*, p. 7.

[100] *Bank Shangoskar Committeer Protibedon,* Mahmud, Chairman, *op. cit.,* p. 7.

[101] *Ibid.*, p 23.

Bangladesh Bank.[102] Again, the sheer negligence of the problem banks and many other banks to fulfill the regulatory requirements are well known. But there had not been any exemplary evidence of awarding legal and sever punishment against concerned institutions for such non-compliance. Even, individuals managed to escape the legal measures even after their involvement in financial corruption and frauds were exposed.[103]

One major reason for the mentioned forbearance was the lack of autonomy of Bangladesh Bank. According to the present practice, the members of the Board of Directors of Bangladesh Bank hold office at the pleasure of the Government, while the Governor and Deputy Governors may be summarily removed by the Government.[104] As par the Banking Companies Act 1991, many important banking regulatory issues are at the disposal of the Government. The little regulatory authority Bangladesh Bank possesses is too actually applicable to the private sector banks only. As a result, the major segment of the banking sector, i.e. the NCBs virtually remains outside the purview of Bangladesh Bank.[105] The Government uses the Banking Division in imposing its own priorities on the NCBs and very often the Banking Division issues orders in sheer violation of the fundamental legislation (i.e. Presidential Order 26) and guideline (i.e. BPRD Circular Order 26) of the NCBs.[106] Bangladesh Bank, which is subordinate to Government, is assumed to be the regulatory authority of the banking sector. At the same time, Government owns the largest portion of the sector i.e. the NCBs. This dilemma of subordination of regulator (Bangladesh Bank) to owner (Government) made it very difficult on the part of the regulator to enforce regulations on the owners.

Another reason behind the flexible attitude of the Bangladesh Bank was the fear that, any stern action like closing down or liquidation would have adverse

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[102] Choudhury and Raihan, *Structural Adjustment, op. cit.,* p. 99.

[103] *Financial Sector Reforms Task Force Report*, Mahmud, Chairman, *op. cit.,* p. 8.

[104] Wasim Md. Mazbahul Haque, “Financial Development in Bangladesh”, Ph.D. Dissertation submitted in Institute of Bangladesh Studies”, Rajshahi University (Rajshahi: IBS, 2004), p. 244.

[105] *Bank Shangoskar Committeer Protibedon*, Mahmud, Chairman, *op. cit.,* p. 10.

[106] Haque, “Financial Development in Bangladesh”, *op. cit.,* p. 246.

impact on the depositors, which was capitalized by the owners and management of the problem banks.[107] Lack of co-ordination among the supervisory departments of Bangladesh Bank is a major limitation of the supervision activities of the Bangladesh Bank;[108] Besides, the efficiency level of the Bangladesh Bank staffs is also questionable, which hinders the proper implementation of the reform measures. The existing personnel policy of Bangladesh Bank is not favourable for the development of necessary human resources.[109] Another significant reason was the absence of solid legal infrastructure for which an efficient and strong financial supervision could not be sustained.

7.6.3 Government-led Distortions

The Government was found guilty of initiating some distortions in the financial market and thus for the poor outcome of the reforms. The Government in Bangladesh plays triangular role simultaneously in the banking sector. It is the owner, regulator and at the same time the client of the NCBs.[110] This triangular role along with the State Owned Enterprises (SOEs), public borrowing (non-bank) and occasional interest and/or loan waiver are the main sources of the above mentioned distortions.

One major shortcoming of the interest rate deregulation was the continuation of directed lending to the SOEs, particularly in energy and civil aviation.[111] The SOEs, many of which never made any profit, borrowed huge amount of money from the NCBs and the Speialised Banks (SBs), which in turn led to NPLs due to large-scale corruption, inefficient management and low technical skills of the SOEs. As of March 2006, outstanding loans to the public sector corporations and SOEs by NCBs were over BDT 130 billion; out of this amount, BDT 13.38 billion was classified loans.[112] This created a negative impact on the NCBs overall financial condition and their liquidity situation. Moreover, the

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[107] Choudhury and Raihan, *Structural Adjustment, op. cit.,* p. 99.

[108] *Bank Shangoskar Committeer Protibedon*, Mahmud, Chairman, *op. cit.,* p. 24.

[109] *Ibid*., p.17.

[110] *ibid.,* p. 7.

[111] Bangladesh Bank, *Financial Sector Review*, vol. 1, no. 1, *op. cit.,* p. 74.

[112] *Ibid.*, p. 93.

huge volume of NPL was one real causative factor for the high lending interest rate and high interest rate spread in Bangladesh.[113]

In the recent times, a fiscal policy element, namely public borrowing (non-bank) for the financing of budgetary deficits has generated occasional shocks to the credit market equilibrium. The principal device has been the NSD certificates. These instruments offer non-market rates of return to the depositors, which are considerably higher than the deposit rates in the banking sector. This contributes to the high deposit as well as lending rates and consequent high interest rate spread in the banking sector. Whenever the NSD rates are re-evaluated by the Ministry of Finance (MoF), the market experiences a jolt. Subsequent adjustments in the structure of interest rates reverberate throughout the financial system until a new equilibrium is reached. Thus, the NSD rates setting have dominated the Monetary Policy tools employed by Bangladesh Bank in influencing the financial market interest rates.[114]

The Government often extended concessions in the form of partial, even full waiver of interest and in some cases principal amount of loans to some overdue borrowers. This created serious moral hazard problem and incentives for other borrowers to be reluctant in the repayment performance in the expectation that, they too might be accorded similar concessions. Loan forgiveness and debt exemption schemes were implemented in the agricultural sector also (indeed in some particular situations like, disastrous natural calamities, such sorts of selective support to a reasonable extent to the distressed farmers were justified). Such waiver schemes undermined the integrity of the financial system and contributed to the default phenomenon.[115]

7.6.4 Lack of Commitment

Lack of commitment on the part of the Government to make the reform programme a success was also responsible for the poor picture of achievement. The World Bank identified this as a significant cause for the failure in 1997.[116]

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[113] *Ibid*., p. 80.

[114] Bangladesh Bank, *Financial Sector Review*, vol. 1, no. 1, *op. cit.,* pp. 74 & 75.

[115] Choudhury and Raihan, *Structural Adjustment, op. cit.,* p. 13.

[116] World Bank, "Financial Sector Adjustment Credit (Credit 2152-BD)", *Performance Audit Report*, p. 13.

Lack of commitment is equally an important cause even today. An instance is suffice to justify this inference. Much later of the World Bank assessment, in April 2001, the Parliament of Bangladesh had changed the definition of loan defaulter by amending the Bank Company Act, 1991. According to this amendment, an individual or institution will be considered a defaulter only if its loan becomes overdue by six months. Prior to this amendment, the time limit was three months for current or demand loan and six months for term loan.[117] After attaining international standard of loan classification norms, introduction of such flexibility in terms of defining a loan defaulter, does not demonstrate firm commitment on the part of the political parties in the Parliament for resolving loan default problem and making the reform initiative a success. The lack of commitment on the part of the Government was not only because of ownership conflict with the World Bank and donor agencies, but also because of the peculiar characteristics of the country's power structure.[118] The democratic culture is weak and fragile in Bangladesh and the Government is often hostage to different kinds of vested interest groups. Sometimes the Government was observed uncommitted to the reform measures, when the reform issues conflicted with the interest of the vested groups.[119]

7.6.5 Weak Legal Framework

Existing weak legal framework and its lengthy procedure was largely responsible to hinder the reform process and stood on the way of achievement. This manifested in the non-recovery of the default loan and deterioration in the quality of overall credit management in Bangladesh.[120] Though a number of steps had been taken regarding legal framework, yet a very small portion of total litigated amount of default loan was recovered to date. Another very significant point is that, most of the settled loan cases of MLC were small loan defaulters, indicating that, the large and influential defaulters are still outside the coverage of legal framework. Again, in many settled cases, the receivers had not yet been able to recover the decreed money, mainly due to unholy alliance between

[117] Choudhury and Adhikary, "Loan Classification", *op. cit.,* p. 173.

[118] Choudhury and Raihan, *Structural Adjustment*, *op. cit.,* p.107.

[119] *Ibid*.

[120] *Financial Sector Reforms Task Force Report,* Mahmud, Chairman, *op. cit.,* p. 5.

administration and influential defaulters reflecting overall lawlessness and sheer poor governance of the country.[121] Here the laws themselves were not responsible, but different studies identified the gaps between formulation and application of legal frameworks and/or between application and effectiveness of legal systems as responsible for the problems.

Another very important flaw in the legal framework was that, it had been designed for only recovery of default loan and hence the resolution measures can tackle the existing NPL problems. Proper attention was not paid to “prevention” measures of NPL.

7.6.6 Ownership of the Reform

It is clear from the background of the Financial Sector Adjustment Credit (FSAC) of the World Bank and the several conditions imposed by it before releasing particular tranche and the subsequent compliance of those conditions by the Government of Bangladesh that, the reform was not owned by the Government of Bangladesh. At the same time, the stakeholders of the reform process were not aware of the reform process and their anticipated outcome. For successful reform programme, the ownership by the implementing state and a majority public acceptance are extremely required.[122]

7.7 Conclusion

After liberation, the then Government nationalized and reorganized all the financial institutions in Bangladesh excepting the few foreign bank branches to achieve its economic objectives. The rigid Government and Central Bank regulations covered fixation of interest rates on deposits and credits, directed expansion of bank branches, direction of credit to public sector enterprises and priority sectors etc. Consequently, with little improvement in branch expansion, deposit mobilization and lending volume, the financial sector suffered from different distortions and experienced deterioration in operational efficiency defined in terms of profitability and productivity. The quality of loan portfolio of the banks declined and huge NPL accumulated in the banking sector.

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[121] *Ibid.*

[122] Choudhury and Raihan, *Structural Adjustment*, *op. cit.,* p. 93.

To resolve these distortions and at the same time, to fulfill the obligations originating from SAF, ESAF and FSAC loans of IMF and the World Bank, the Government embarked upon reform programme in the banking sector in 1983. Starting with denationalization of two nationalised banks and granting permission to private sector commercial banking, the Government initiated a wide range of reform. Bangladesh Bank almost completely deregulated the interest rate structure in phases to ensure price competition in the banking sector and efficient resource allocation, adopted new market based Monetary Policy tools, introduced a number of new management and operational tools for the commercial banks, enforced prudential regulations like loan classification and provisioning and capital adequacy and upgraded those norms to international standard. Some legal reforms had also been initiated with amending some existing Orders and enacting some new laws and establishing some courts accordingly. Banking sector reform is still an ongoing and continuous process in Bangladesh.

The failure of the reform programme does not suggest dismantling of reform measures. Rather the programme should continue with enhanced attention, wisdom and farsightedness being aware of and rectifying the past mistakes. The banking sector problems in Bangladesh are systemic in nature. So, a comprehensive and sequentially arranged reform programme is warranted incorporating both the demand and supply aspects. To facilitate this, an enabling environment should be ensured, which requires macroeconomic stability, political commitment and non-interference by the Government and vested interest groups.

The next chapter deals with Bangladesh Bank's role in development.

CHAPTER VIII

BANGLADESH BANK'S ROLE IN DEVELOPMENT

8.1 Introduction

A Central Bank of a developing economy has a twin role to perform, that of a regulator as well as that of a promoter.[1] These two roles are not contradictory. The regulatory and prudential functions of the Central Banks have a promotional angle insofar as these functions promote the banking habit and help financial intermediation by inspiring greater public confidence in financial institutions.[2] Central Banks of the neighboring developing countries like India, Pakistan, and South East Asian countries are pursuing active development role.[3] Central Banks not only of the developing countries, but also of the developed countries like USA, Italy, Japan, the Netherlands, Sweden, West Germany etc. have some promotional mandates to serve respective national economic goals.[4] Bangladesh Bank is mandated by its charter to promote and maintain high level of output, employment and real income, fostering growth and development of the country's productive resources. The Bangladesh Bank Order 1972 mentions this development role of Bangladesh Bank in the preamble as the underlying reason of establishing the Bank as follows:

> Whereas, it is necessary to establish a central bank in Bangladesh to manage the monetary and credit system of Bangladesh with a view to stabilising domestic monetary value and maintaining a competitive external par value of the Bangladesh Taka towards fostering growth and development of country's productive resources in the best national interest.[5]

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[1] C. R. Basu, *Central Banking in a Planned Economy: the Indian Experiment* (New Delhi: Tata McGraw-Hill Publishing Co. Ltd., 1976), p. 145.

[2] Anand G. Chandavarkar, "Promotional Role of Central Banks in Developing Countries", *IMF Working Paper,* No. WP/87/20 (IMF: March 27, 1987), p. 8.

[3] For detail, see, for India, C. R. Basu, *Central Banking in a Planned Economy,* for Pakistan, S. A. Meenai, *Money and Banking in Pakistan* (Karachi: The Allies Book Corporation, 1966), for ASEAN countries, Bimal Nath Rimall, " The Role of South East Asian Central Banks in Development Finance", *Staff Paper*, No. 5 (The SEACEN Research and Training Centre, 1985).

[4] Chandavarkar, "Promotional Role of Central Banks", *op.cit.,* Pp.2 & 3.

[5] Substituted by the Bangladesh Bank (Amendment) Act, 2003.

The rationales of the developmental role of Bangladesh Bank have been discussed in detail in Chapter II.

8.2 Mode of the Development Role Performed by Bangladesh Bank

The promotional role which the Central Bank of a developing economy has to play, involves undertaking a multiplicity of functions and the use of a variety of techniques.[6] The Central Banks of the developing countries around the globe employ an array of promotional techniques including guarantees and insurance mechanisms, preferential interest and rediscount rates and facilities, differential reserve requirements, credit-deposit ratio targets, participation in development finance institutions, open market operations, and allocation of Central Bank profits and credit.[7]

The Bangladesh Bank adopts a two pronged growth supportive approach to attain developmental objectives without compromising the monetary and financial stability objectives. Firstly, a Bangladesh Bank guided Corporate Social Responsibility (CSR) driven financial inclusion campaign is reaching out with financial services to the hitherto un-served or under-served productive economic sectors (like small holder agriculture and SMEs). This approach is supposed to stimulate employment, income and output. Secondly, the Bank maintains some degree of deliberate directional bias in its credit policies to encourage credit flows to the productive purposes; at the same time, to discourage credit expansion for unproductive uses.[8] The activities of Bangladesh Bank is to bring about, in relation to the credit requirements of the different sectors of the economy and the activities of the institutions designed to meet them, an extension in the scope of operations, expansion in the scale of financing, improvement in the efficiency of service, and flexibility in procedure and techniques.

Bangladesh Bank has been playing active development role in agriculture, industry, Small and Medium Enterprises (SME) and women entrepreneurship,

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[6] Basu, *Central Banking in a Planned Economy, op.cit.,* p. 189.

[7] Chandavarkar, "Promotional Role of Central Banks", *op.cit.,* p. iii.

[8] Bangladesh Bank, *Developmental Central Banking in Bangladesh: Recent Reforms and Achievements (2009-2012)* (Dhaka: Bangladesh Bank, n. d.), p.7.

export, customer interest protection, automation of the banking system, and green banking.

It has been observed that, Bangladesh Bank adopts mainly two courses of action to perform the development role. Firstly, it issues policy directives through different circulars to be followed by the banks and financial institutions. Secondly, it conducts refinance schemes to finance the desired sectors. In addition to these, the Bank employs moral suasion and declaring incentives for compliance of the directives and for successful operation by the banks and financial institutions as considering the compliance for CAMELS rating and /or opening new branches, etc.

Though the primary role of any Central Bank is that of a regulator, the developmental aspect of Bangladesh Bank has come to be considered very much significant especially in the recent times.

8.3 Development Role of Bangladesh Bank in Agriculture

Agriculture sector is specially significant in the economy of Bangladesh. Food security, employment generation and poverty alleviation are closely related with the development of this sector. More over, the majority of the population of this country lives in rural areas. So, any development endeavour must address agriculture and rural economy properly. Bangladesh Bank initiated a comprehensive set of programmes in this regard. At present in the financial sector there are two specialized banks viz., Bangladesh Krishi Bank (BKB) and Rajshahi Krishi Unnayan Bank (RAKUB) established specifically for agricultural development. Besides, the four state-owned commercial banks and Bangladesh Rural Development Board (BRDB) are taking active part in the development of agriculture and rural sector. Private and foreign commercial banks and some Micro Financial Institutions (MFIs) along with some NGOs are also coming forward with development agenda for this sector. Bangladesh Bank, as the Central Bank of the country works in close proximity with all of these institutions and guides and monitors the functions of these institutions on regular basis. The initiatives taken by Bangladesh Bank for the development of agriculture in Bangladesh are discussed below.

8.3.1 Support and Promotion of Agricultural Lending

In the development strategy for agriculture and rural sector, agricultural credit is an effective instrument. In order to employ this instrument effectively, Bangladesh Bank formulates 'Agricultural and Rural Credit Policy and Programme' each year. The Bank has a specialized department namely 'Agricultural Credit and Financial Inclusion Department' at its head office which formulates the 'Agricultural and Rural Credit Policy and Programme'. The banks and institutions extend agricultural credit under the above mentioned policy and programme. The credit program is being operated through the commercial and specialised banks. Since October 2008, participation in agricultural credit programme has been made mandatory for all scheduled banks operating in Bangladesh including the private and the foreign banks.[9] Bangladesh Bank made it mandatory for the banks to set the annual agricultural./rural credit disbursement target at 2.5% of their total loans and advances from FY 2011-2012.[10] Recently the role of private sector domestic and foreign banks in agricultural lending is increasing remarkably, as they contributed Taka 29.74 billion which is around 24.41 percent of the total agricultural loan disbursed in FY11.[11] Total disbursements of agricultural credit are on rising trend. The scenario of total agricultural credit disbursement has been depicted in the Table VIII-1. It can be seen in the Table VIII-1 that, both the target for and actual disbursement of agricultural credit are steadily on rising trend. Disbursement of agricultural credit against the target was not satisfactory till the fiscal year 1997-98. But, since the fiscal year 1998-99, actual disbursement was close to target. Even in 200-08, it crossed the target.

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[9] GoB, *Bangladesh Economic Review 2011 (*Dhaka: Ministry of Finance, 2011), p. 95.

[10] Bangladesh Bank, *Recent Reform Initiatives* (Dhaka: Bangladesh Bank, n.d.), p. 18.

[11] Bangladesh Bank, *Annual Report 2010 - 11* (Dhaka: Department of Public Relations and Publications, Bangladesh Bank), p. 87.

Table VIII-1

Agricultural Credit Disbursement

Period	Target (in crore Taka)	Disbursement (in crore Taka)	Disbursement as Percentage of Target (in percent)
1992-93	1474.41	841.85	57.10
1993-94	1643.08	1100.79	67.00
1994-95	2161.72	1605.44	74.27
1995-96	2434.27	1635.81	67.20
1996-97	2394.22	1672.43	69.85
1997-98	2525.83	1814.53	71.84
1998-99	3270.01	3245.36	99.25
1999-2000	3331.00	2851.29	85.60
2000-01	3265.92	3019.67	92.46
2001-02	3326.64	2954.91	88.83
2002-03	3560.53	3278.37	92.08
2003-04	4378.94	4048.41	92.45
2004-05	5537.91	4956.78	89.51
2005-06	5892.21	5496.21	93.28
2006-07	6351.30	5292.51	83.33
2007-08	8308.55	8580.66	103.28
2008-09	9379.23	9284.46	98.99
2009-10	11512.30	11116.88	96.57
2010-11	12617.40	12184.32	96.57

Source: GoB, *Bangladesh Economic Review (*Dhaka: Ministry of Finance), various issues.

To stimulate agricultural credit, Bangladesh Bank extends refinance facilities to the specialized banks and institutions operating in this sector. It provides refinance to Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank (RAKUB), Bangladesh Samabaya Bank Limited (BSBL) and Bangladesh Rural Development Board (BRDB). The amounts of Bangladesh Bank's refinance to the lending institutions, state of repayment and outstanding have been shown in Table VIII-2.

Table VIII-2
Bangladesh Bank's Refinance against Agricultural Loans

(in billion Taka)

Period	Refinance	Repayment	Outstanding
2001-02	7.70	3.70	46.20
2002-03	1.99	2.27	45.93
2003-04	4.71	2.56	48.08
2004-05	7.36	4.66	55.20
2005-06	1.43	2.92	56.38
2006-07	-	3.47	55.07
2007-08	6.72	3.54	60.02
2008-09	2.94	3.73	59.80
2009-10	1.58	4.28	57.45
2010-11	1.86	3.64	56.03

Source: Bangladesh Bank, *Annual Report,* Various issues.

8.3.2 Credit Program for Sharecroppers

Sharecropper farmers in Bangladesh had long been excluded from formal financial system because of lack of collateral. To make agricultural credit available to the sharecroppers, in Fiscal Year 2010 Bangladesh Bank launched a refinance scheme worth Taka 5.0 billion in partnership with Bangladesh Rural Advancement Committee (BRAC).[12,13] Under this refinance scheme, primarily credit has been extended for three years at a flat interest rate of ten percent to 3,00,000 sharecroppers in 172 upazillas in 37 districts for crop cultivation and purchasing of agricultural machineries.[14] This was the first ever initiative for this group of farmers in the country. Considering the far reaching positive impact of this programme in poverty reduction of the sharecroppers, the length of this refinance scheme has been extended by three years to June 2015. In the extended length, loan facility will be sanctioned to 5,00,000 sharecroppers in 250 upazillas in 48 districts for crop cultivation and purchasing of agricultural machineries.[15] Under this scheme, BRAC has provided loans of Taka around 512.11 crore to 4,31,841 sharecroppers in 181 upazillas in 39 districts till 30 June 2012.[16]

Apart from the refinance scheme, sate-owned banks are also extending loans to sharecroppers. In Fiscal Year 2012, agricultural credit totaling Taka 10.86 billion was disbursed by the state-owned banks to around 5,00,000 sharecroppers. Recently some private commercial banks are also coming forward to provide loans to the sharecroppers prompted by their Corporate Social Responsibility (CSR) obligations, campaigned by Bangladesh Bank.[17]

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[12] Bangladesh Bank, *Developmental Central Banking*, *op.cit.,* p. 08.

[13] BRAC, based in Bangladesh, is the largest non-governmental development organization in the world (as of November 2012), measured by the number of employees and the number of people it has helped. It was known formerly as the Bangladesh Rehabilitation Assistance Committee and then as the Bangladesh Rural Advancement Committee. Currently, BRAC does not represent an acronym.

[14] Bangladesh Bank, *Agricultural & Rural Credit Policy and Programme for the FY 2012-2013* (Dhaka: Agricultural Credit and Financial Inclusion Department, Bangladesh Bank, n. d.), 29.

[15] *Ibid.*

[16] *Ibid,.* p.11.

[17] Bangladesh Bank, *Developmental Central Banking*, *op.cit.,* p. 09.

8.3.3 Promoting Cultivation of Specific Crops

In spite of high demand for pulse, spices, lentils and oilseeds in the country, the production of these crops are not sufficient to meet the domestic demand which causes large volume of import at the cost of huge foreign exchange. To reduce import dependence and to encourage domestic production of these crops, agricultural credit at concessional four percent interest rate per annum is being extended by the banks to farmers for growing pulse, spices, lentils and oilseeds since 1st July 2011.[18] The banks get six percent interest subsidy from the Government through Bangladesh Bank. The procedure of getting the interest subsidy has been simplified. If even after getting the interest subsidy, the banks face interest loss, then this loss segment is treated as Corporate Social Responsibility (CSR) of that particular bank.[19]

Bangladesh Bank monitors this credit programme thoroughly. In fiscal year 2011-12 Taka 81.63 crore has been disbursed in this sector against a target of Taka 77.63 crore. In fiscal year 2010-11, Taka 70.60 crore was disbursed.

8.3.4 Support of Credit for Crop Diversification

For poverty reduction the Bangladesh Bank has adopted crop diversification in place of conventional mono crop production as a strategy. In recent times, Bangladesh Bank got involved in two projects aiming at poverty reduction through crop diversification.

8.3.4.1 Northwest Crop Diversification Project (NCDP)

To alleviate the poverty of the country's poverty ridden North-Western districts, the Government implemented Northwest Crop Diversification Project (NCDP). It was funded by ADB having a credit component of Taka 1.74 billion for financing production and marketing of high value crops (vegetables, fruits, flowers, spices, oilseeds, etc.) instead of conventional crops in sixteen north-western districts. The Project was launched in December 2001 and was completed by June 2009.[20] Under this project, diverse crops are being cultivated in 1,53,000 hectre

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[18] Bangladesh Bank, *Agricultural & Rural Credit Policy, op.cit.,* p. 24.

[19] *Ibid.*

[20] Bangladesh Bank, Annual Report 2010-11, *op.cit.,* p. 88.

land which was primarily targeted to be 40,000 hectre. A total of around 2,40,000 farmers have been brought under the credit coverage of this project.[21]

8.3.4.2 Second Crop Diversification Project (SCDP)

Motivated by the success of NCDP, the Government has launched another project namely Second Crop Diversification Project (SCDP) with the financial assistance of ADB. The credit component of the project is USD 26 million equivalent to around Taka 175 million. Bangladesh Bank is the implementing agency of the credit component of this project. The project aims at conducting credit programme in 48 upazillas under 25 districts of Rajshahi, Rangpur, Khulna, Barisal and Dhaka division. Like NCDP, under this project credit will be disbursed for cultivation of higher value crops. Higher value plantation will also be financed. Loan disbursement has already been started since fiscal year 2011-12 through BRAC under the wholesaling oversight of two private sector banks namely Eastern Bank Limited and BASIC Bank Limited. Till 30 June 2012, under this project Taka 8,66,ooo has been provided to 90 farmers.[22]

8.3.5 Agro based Industries

Bangladesh Bank launched a refinance scheme of Taka 1.0 billion in November 2001 out of its own fund to finance establishment of agro product-processing industries in the areas outside divisional head quarters and Narayanganj town. Under this scheme refinance facilities were provided to banks and financial institutions at the bank rate. An amount of Taka 1.3 billion has been disbursed under this scheme till end June 2011.[23] In fiscal year 2011-12, the total amount of disbursement to agro-based industries by the SCBs, PCBs, FCBs and SDBs was Taka 19.378.19 crore. It was 16.80 percent higher than the previous fiscal year 2010-11.Out of the total credit of Taka 19.378.19 crore, highest 68.62 percent was disbursed by the PCBs, whereas the disbursements by the SCBs, FCBs and SDBs were 6.52, 18.44 and 6.42 percent respectively.[24]

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[21] Bangladesh Bank, *Agricultural & Rural Credit Policy, op.cit.,* p. 29.

[22] *Ibid,.* pp. 11 & 29-30.

[23] Bangladesh Bank, *Annual Report 2010-11, op.cit.,* p. 88.

[24] Bangladesh Bank, SME and Special Programs Department.

8.3.6 Bank Accounts for Farmers and Other Underprivileged People

Bangladesh Bank is taking financial inclusion initiatives in increasing hassle-free availability of banking services to the farmers. As per regulations of the Bank, now any farmer can open a bank account by keeping only ten taka as initial deposit. For this purpose, the farmer is to show his/her National Identity Card/Birth Registration Certificate and Agriculture Inputs Assistance Card issued by the Agriculture Extension Department and the banks do not require filling the Know Your Customer (KYC) form. For such accounts, the condition of maintaining a minimum balance will not be applicable and also these accounts will remain free of any additional charge or fees.[25] The farmers responded to this initiative sharply. The banks have opened more than ten million new bank accounts in names of small farmers and other rural and urban people of small means at no charge with the deposit of ten Taka. These accounts are being used by the account holders as savings and payments medium; at the same time for receipt of agricultural input subsidies, social safety net payments, etc.[26] Loan disbursement, savings, foreign remittance and domestic remittance through these accounts In fiscal year 2011-12 were Taka 223.54 crore, 114.50 crore, 38.80 crore and 22.25 crore respectively.[27]

Due to the phenomenal increase in the bank account, financial inclusion as percentage of adult population increased from 65.33 percent in 2004 to 87.23 percent in 2010.[28]

8.4 Development Role of Bangladesh Bank in Industry

In the industry sector, Bangladesh Bank has been playing some development role in the form of implementing specialized projects. At present it is running two vital projects in industry sector namely Equity Entrepreneurship Fund (EEF) and Investment Promotion and Financing Facility (IPFF) Project, which have been discussed in the following sub-sections briefly.

[25] Toufic A. Choudhury, "Inclusive Financing: Access to Banking Services", at www.bb.org.bd/pub/research index, php.

[26] Bangladesh Bank, *Developmental Central Banking*, *op.cit.,* p. 10.

[27] Bangladesh Bank, *Agricultural & Rural Credit Policy, op.cit.,* p. 10.

[28] Md. Ezazul Islam and Md. Salim ali Mamun, 'Financial inclusion: The Role of Bangladesh Bank", Working Paper series: WP1101 (Dhaka: Bangladesh Bank, December 2011), p. 10.

8.4.1 Equity Entrepreneurship Fund (EEF)

Equity and Entrepreneurship Fund (EEF) was formed by the Government of Bangladesh in FY 2001 through budgetary allocation of Taka 1.0 billion to encourage investments in the risky but prospective agro-based/food processing and IT sector projects. Here food processing and agro-based industry excludes the conventional sub-sectors such as rice mills, flour mills, fishing trawlers, cold storage of potatoes, etc The Fund is maintained by the Bangladesh Bank. An agreement has been signed on 1 June 2009 between Bangladesh Bank and Investment Corporation of Bangladesh (ICB) regarding the transfer of operational activities of EEF.

Under this agreement ICB is now performing the operational activities of EEF while EEF Unit of Bangladesh Bank is carrying on the activities relating to policy making, fund management and performance monitoring. There is an ultimate approving authority namely Technical Advisory Committee (TAC) at Bangladesh Bank to approve the projects under EEF. TAC is a four member expert Committee chaired by the Governor.

So far Taka 12.3 billion has been released to the fund by the Government out of total budgetary allocation of Taka 21.0 billion in different fiscal years. Up to 30 June 2011 with the project cost of Taka 35.2 billion, a total of 820 projects (including 771 agro-based/food processing projects and 49 IT projects) got EEF sanction at different stages of disbursement. Cumulative equity disbursement stood at Taka 5.9 billion at the end of FY 2011 against total fund disbursement of Taka 12.3 billion from the Government. Till now 24 (twenty four) EEF supported companies availed share buy-back facilities partially or fully to the tune of Taka 0.7 billion. So far three EEF supported projects have paid dividend to the tune of Taka 0.05 million to EEF.[29]

8.4.2 Investment Promotion and Financing Facility (IPFF) Project

Bangladesh Bank has been implementing a project named "Investment Promotion & Financing Facility (IPFF) Project" on behalf of Finance Division, Ministry of Finance since January 2007. IPFF is a 5-year term (January 2007 –

[29] Bangladesh Bank, *Annual Report 2010-11*, *op.cit.,* p. 78.

December 2011) International Development Association (IDA) supported on-lending based Technical Assistance (TA) project. The main objectives of IPFF are:[30]

(i) to supplement the resource of the Bangladesh financial markets to provide term finance for infrastructure and other investment projects beyond the capacity of local financial institutions; and

(ii) to promote the role of private sector entrepreneurs in the development of capital projects, especially infrastructure.

Under IPFF, Government approved private infrastructure development projects, implemented on Public-Private Partnership (PPP) basis are being financed through selected participating financial institutions (PFIs). The eligible sectors for financing under IPFF are:[31]

- power generation, transmission, distribution and services,
- port development (sea, river and land),
- environmental, industrial and solid waste management,
- highways and expressways including flyovers,
- water supply and distribution,
- sewerage and drainage,
- industrial estates and park development etc.

IPFF consists of two components viz., (i) Infrastructure Development Lending Component and (ii) Technical Assistance (TA) component.

As per agreement, total cost of the project was USD 60.00 million with five years tenure starting from January 2007 to December, 2011. IPFF has been able to disburse 100 percent (Taka 4.22 billion equivalent to USD 57.50 million) of its on-lending component to seven small power plants having capacity of 178 MW within 4th year of the project tenure. Resultantly additional fund of USD 307.00 million (IDA USD 257.00 million and GoB USD 50.00 million) was sanctioned for extending the tenure of the project up to December 2014.[32]

[30] *Ibid.,* p. 77.

[31] *Ibid.*

[32] *Ibid.,* pp. 77-78.

8.5 Small & Medium Enterprises (SME) and Women Entrepreneurship

The role of Small and Medium Enterprises (SMEs) is indispensable for overall economic development of a developing country like Bangladesh. Since this sector is labor intensive with short gestation period requiring comparatively lower volume of capital than heavy industry, it has the potential to increase national income as well as rapid employment generation; achieving Millennium Development Goals (MDGs), especially eradication of extreme poverty and hunger, gender equality and women empowerment.[33] Considering SME development as one of the important development agenda of the country, Bangladesh Bank has launched a host of programs and policies for financing of SME sector.

8.5.1 Establishment of New Department and Formulation of New Policy

Recognizing the driving potential of SME for poverty reduction and employment generation, a new department namely 'SME and Special Programmes Department' has been established in Bangladesh Bank on 31 December 2009.[34] This department is solely responsible for policy formulation, facilitating fund, monitoring and development of entrepreneurship in the SME sector in Bangladesh. Besides, a separate inspection department has been established in the Bank to monitor effectively SME type credit.[35] In 2010 the Bank formulated the "SME Credit Policy and Programs, 2010".[36] This is a comprehensive initiative with the following special features:[37]

(i) Setting up an indicative target for SME loan disbursement;
(ii) Following the Area Approach Method with cluster development policy'
(iii) Prioritizing small entrepreneurs, women entrepreneurs with special emphasis for manufacturing and services sectors;
(iv) Following a separate business strategy in financing SME with speedy loan sanction and disbursement

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33 Bangladesh Bank, *Small and Medium Enterprise (SME): Credit Policies and Programmes* (Dhaka: Bangladesh Bank, n.d.), p. 5.

34 www.bangladesh-bank.org/recentupcomong/news/jan012013sme.pdf.

35 Bangladesh Bank, *Developmental Central Banking, op.cit.,* p. 11.

36 www.bangladesh-bank.org/recentupcomong/news/jan012013sme.pdf.

37 Bangladesh Bank, *Developmental Central Banking*, *op.cit.,* p. 10.

Accordingly, the banks and financial institutions are fixing an indicative yearly target of disbursing SME credit for every year since 2010. The banks and the financial institutions are directed to attain their indicative targets separately by dividing it as branch wise, region wise and sector wise following the "area approach method".

8.5.2 Refinance Schemes for SME Sector

The Bangladesh Bank has been pursuing refinance schemes regularly to provide medium and long term fund to the banks and financial institutions against their disbursed SME credit. At present the Bank with the help of Government and different development partners, is implementing five refinance schemes, namely:[38]

(i) Bangladesh Bank Fund;
(ii) IDA fund;
(iii) ADB-1 Fund;
(iv) ADB-2 Fund; and
(v) JICA Fund.

All of these funds are revolving in nature. Till 30 September 2012, Taka 25.72 billion has been refinanced against 32,018 enterprises. Against this disbursement, Taka 17.61 billion has been recovered and the outstanding amount of SME credit was Taka 17.69 billion. Besides, a two-stage loan scheme amounting to JPY 5.0 billion has been formed with the assistance of JICA to provide medium to long-term fund to the small and medium enterprises through refinance and pre-refinance facilities. Under this scheme, refinancing has been commenced since October 2012 and Taka 82.4 million has been refinanced so far to 22 enterprises having priority in productive manufacturing and service sector.[39] The Table VIII-3 presents data on SME refinance by Bangladesh Bank to banks and financial institutions upto March 2008 since the outset of the refinance scheme.

[38] Bangladesh Bank, *Developmental Central Banking, op.cit.,* p. 11.

[39] *Ibid.*

Table VIII-3
SME Refinance by Bangladesh Bank

(Taka in million)

Name of Banks/FIs	Amount Refinanced (million Tk)				No. of Beneficiary Enterprises	Average Amount Refinanced per Enterprise
Banks	Working Capital	Mid Term	Long Term	Total		
NCC Bank Ltd.	21.6	155.0	14.8	191.4	796	0.2
Jamuna Bank Ltd.	164.8	29.3	15.4	209.5	152	1.4
National Bank Ltd.	15.0	0.0	0.0	15.0	4	3.8
ONE Bank Ltd.	197.1	141.8	14.8	353.7	445	0.8
Premier Bank Ltd.	239.0	24.5	9.3	272.8	227	1.2
BRAC Bank Ltd.	48.6	637.8	0.0	686.4	1,736	0.4
Southeast Bank Ltd.	81.2	3.2	3.5	87.9	86	1.0
Dutch Bangla Bank Ltd.	100.8	1.3	0.0	102.1	56	1.8
Mercantile Bank Ltd.	0.8	34.2	0.0	35.0	344	0.1
Eastern Bank Ltd.	113.8	262.1	240.3	616.2	581	1.1
Dhaka Bank Ltd.	326.5	149.8	0.0	476.3	553	0.9
Trust Bank Ltd.	17.6	0.4	0.6	18.6	15	1.2
Prime Bank Ltd.	198.1	10.7	6.9	215.7	234	0.9
Bank Asia Ltd.	0.3	10.0	0.0	10.3	21	0.5
Sub Total	1525.2	1460.1	305.6	3290.6	5,250	0.6
Financial Institutions						
Uttara Finance &Investment Ltd.	8.7	123.1	360.5	492.3	279	1.8
Prime Finance & Investment Ltd.	22.5	19.0	14.3	55.8	31	1.8
MIDAS Financing Ltd.	0.7	325.7	168.0	494.4	776	0.6
IDLC of Bangladesh	7.7	317.9	82.9	408.5	348	1.2
Phoenix Leasing Co. Ltd.	11.6	54.1	71.7	137.4	129	1.1
United Leasing Co. Ltd.	60.1	124.9	140.4	325.4	209	1.6
Vanik Bangladesh Ltd.	0.3	0.5	0.0	0.8	2	0.4
Bay Leasing	2.5	5.1	4.7	12.3	8	1.5
Fidelity Assets & securities Co. Ltd.	0.0	9.0	234.5	243.5	143	1.7
Islamic Finance & Investment Ltd.	6.1	120.7	23.2	150.0	125	1.2
Peoples Leasing and Financial Services Ltd.	4.0	28.9	196.1	229.0	123	1.9
Bangladesh Finance and Investment Ltd.	0.0	12.6	59.3	71.9	25	2.9
IIDFC	17.0	29.3	58.9	105.2	67	1.6
GSP Financing	5.0	0.0	20.8	25.8	6	4.3
National Housing Ltd.	4.0	7.6	9.1	20.7	12	1.7
Oman Bangladesh	0.0	1.2	4.0	5.2	21	0.2
International Leasing	4.6	31.8	24.3	60.7	26	2.3
Union Capital	5.0	3.5	9.5	18.0	7	2.6
Fareast Finance and Investment Ltd.	0.0	1.3	0.0	1.3	2	0.7
Premier Leasing	0.0	11.4	6.7	18.1	9	2.0
Sub Total	159.8	1227.6	1488.9	2876.3	2,348	1.2
Grand Total	**1685.0**	**2687.7**	**1794.5**	**6167.2**	**7,598**	**0.8**

Note: Upto March 2008.

Source: Md. Didarul Zamal, "Financing of Small and Medium Scale Industries in Bangladesh: A Study on Light Engineering Enterprises", unpublished Ph.D. Dissertation submitted at Institute of Bangladesh Studies, Rajshahi University, RajshahI, 2011.

8.5.3 SME Cluster Development and Area Approach Method

With a view to mainstream SME credit, Bangladesh Bank has directed the banks and financial institutions to adopt cluster development policy. The objectives of this policy are strengthening of the existing clusters, development of new clusters in special sector, development and expansion of sustainable and competitive technology, skill development of entrepreneurs, development of marketing channels, reduce credit risk and enhance overall product development.[40] The strategies suggested for cluster development are as follows.[41]

(1) Identification of the cluster;
(2) Formation of committee for cluster development;
(3) Conduct baseline survey & diagnostic study;
(4) Fixation of action plan;
(5) Implementation of action plan;
(6) Review & monitoring.

Banks and financial institutions are instructed to follow 'area approach method' while developing clusters. According to this approach, the localities in Bangladesh with conducive environment for producing distinct manufacturing goods or localities which are famous for producing certain manufacturing goods, or areas which are important for geographical location should be taken into consideration while disbursing SME loan.[42]

Bangladesh Bank has undertaken various steps to identify different clusters around the country and has been encouraging all stakeholders for further development of such clusters. As per the directives of Bangladesh Bank, banks and financial institutions are coming forward for SME cluster development. A good number of small scale clusters have been identified by this time in some districts. A list of mentionable clusters in which banks and financial institutions are disbursing SME credit, has been presented in Table VIII-4.

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[40] Bangladesh Bank, *Developmental Central Banking, op.cit.,* p. 12.

[41] Bangladesh Bank, *Small and Medium Enterprise (SME)*, *op.cit.,* p. 8.

[42] *Ibid.,* p. 7.

Table VIII-4

List of Clusters

District	Type of Clusters
Bogra	Light Engineering Cluster
Sherpur, Bogra	Agricultural Machineries Cluster
Kamalgonj, Moulvibazar	Monipuri Tnat (handloom)
Baralekha, Moulvibazar	Agar Cluster
Chandina, Comilla	Khadi Cluster
Munshigonj	Bamboo-cane Cluster
Bhairab, kishoreganj	Leather and Footwear Cluster
Jamalpur	Handicrafts Cluster
Syedpur	Small Garments Manufacturing Cluster
Ulipur, Rangpur	Tnat Cluster
Laxsmipur	Soya Bean Cluster

Source: Bangladesh Bank, *Developmental Central Banking in Bangladesh: Recent Reforms and Achievements (2009-2012)* (Dhaka: Bangladesh Bank, n. d.), p.13.

8.5.4 Women Entrepreneurship Development

For mainstreaming women in economic activities, Bangladesh Bank has taken some initiatives to ensure that women have easy access to financial facilities. The Bank has attached significant priority to this access to facilitate it on simple terms and conditions and make it women-friendly. These initiatives are taken mainly by using the SME facilities which are discussed in the following paragraphs.

8.5.4.1 Policy Guidelines

Bangladesh Bank has put some directives to be followed by the banks and financial institutions specially for the women entrepreneurs. They are as follows:[43]

(i) For more participation of women entrepreneurs in industrial development of the country and for conducting business activities by women entrepreneurs in large number, priority shall have to be given to potential women entrepreneurs in respect of SME credit disbursement.

(ii) Banks and financial institutions shall put the highest priority in receiving loan application from small and medium women entrepreneurs and settle the loan disbursement process within very reasonable time from the date of acceptance of the application.

[43] *Ibid.,* pp. 5 & 6.

(iii) Each bank and financial institution shall establish a separate 'Women Entrepreneurs' Dedicated Desk' with necessary and suitable manpower, provide them training on SME financing and suiltably appoint a lady officer as chief of dedicated desk. Branch wise list of 'Women Entrepreneurs' Dedicated Desk 'should be sent to SME and Special Programmes Department of Bangladesh Bank within two months from the date of declaration of this policy and programme.

(iv) Banks and financial institutions may sanction up to Tk. 25,00,000 to women entrepreneurs against personal guarantee. In that case, group security/social security may be considered.

8.5.4.2 Refinance Facilities

To ensure loan facility for the women entrepreneurs, Bangladesh Bank allocated at least 15 percent of total Bangladesh Bank refinance fund for them at a reduced rate of ten percent. The banks and the financial institutions are allowed to sanction loan upto Taka 2.5 million to women entrepreneurs without collateral but against only personal guarantee under Bangladesh Bank refinance facilities. The Bank has initiated a policy of group based lending of upto Taka 50 thousand or above to facilitate the inclusion of a large number of micro women entrepreneurs in the SME credit facilities.[44]

The amount of SME loan facilities towards women entrepreneurs and the number of women entrepreneurs, who availed these loan facilities has been increasing over the years. It is evident in the Table VIII-5.

Table VIII-5

SME Loan Facilities towards Women Entrepreneurs

Year	**Number of Women Entrepreneurs**	**Growth Rate of Women Entrepreneurs** (in percent)	**Amount of SME Loan to Women Entrepreneurs** (in billion Taka)	**Growth Rate of SME Loan to Women Entrepreneurs** (in percent)
2010	13831		18.05	
2011	16696	20.71	20.48	13.46
2012*	12287		17.24	

* Upto September 2010.

Source: Bangladesh Bank, *Developmental Central Banking in Bangladesh: Recent Reforms and Achievements (2009-2012)* (Dhaka: Bangladesh Bank, n. d.), p. 12.

[44] Bangladesh Bank, *Developmental Central Banking, op.cit.,* pp. 11 & 12.

The Table shows that, in 2010 the number of women entrepreneurs and the amount of financing by banks and financial institutions were 13831 and Taka 18.05 billion respectively. In 2011, the number of women entrepreneurs grew to 16696 registering an annual growth rate of 20.71 percent and the amount of financing was increased to Taka 20.48 billion registering annual growth rate of 13.46 percent. In 2012 upto September, the number of women entrepreneurs was 12287 and the amount of financing was Taka 17.24 billion, both reflecting good rate of progress.

8.6 Role of Bangladesh Bank to Promote Export

Bangladesh Bank has been playing special role to promote export of the country. At present it is implementing one very important Fund namely Export Development Fund (EDF) to enhance export. A short description of the Fund has been given below.

8.6.1 Export Development Fund (EDF) and Its Objectives

Established in 1989, the Export Development Fund (EDF) is intended to facilitate access to financing in foreign exchange for input procurements by manufacturer-exporters. Authorized Dealer (AD) banks can borrow US Dollar funds from the EDF against their foreign currency loans to manufacturer-exporters for input procurements. At their option the ADs can also lend to some extent from their own foreign exchange funds for input procurements.[45]

The EDF is held and managed by the Foreign Exchange Reserve and Treasury Management Department (FRTMD) at the head office of Bangladesh Bank. Initial fund was USD 300 million. Later to facilitate export trade of the country, the fund was raised to USD 600 million.[46] The Operational Procedure of the Fund was prescribed in BCD Circular No. 29, dated December 07, 1988. Since then a number of circulars were issued amending the said operational procedure.

8.6.2 Interest Rate on Borrowings from EDF

On the loan disbursements in USD to AD banks up to 31st December 2009, interest was charged by EDF @ six-month USD London Interbank Offered Rate

[45] Bangladesh Bank, FE Circular No. 25, dated December 22, 2009.

[46] *The Financial Express,* 07 November, 2012.

(LIBOR),[47] with the ADs charging interest @ six-month LIBOR+1 percent from the manufacturer-exporter clients borrowing for input imports.

From the 1st January 2010 onwards, EDF loan disbursements to ADs in USD was charged interest @ six-month USD LIBOR+1 percent, with the ADs charging @ six-month LIBOR +2.5 percent on their USD loan disbursements to manufacturer-exporters.

To promote export trade, with effect from the 1st January 2010 Bangladesh Bank decided that EDF loans to a single manufacturer-exporter could be sanctioned up to USD 1.50 million and the charged interest would be @ six-month LIBOR +1 percent per annum. For EDF loans in excess of USD 1.50 million (from the same AD or from up to two other AD banks), the interest rate will be as before, i.e., six-month LIBOR +2.5 percent per annum.[48] The revised interest rates remained valid till June 30, 2011.

8.6.3 Tenor of EDF Loans

EDF loans from Bangladesh Bank are repayable by the ADs upon receipt of proceeds of the relative exports (except in case of loans for bulk import of cotton and other textile fibre by BTMA member mills against past export performance); in all cases within 180 days from dates of disbursement, extendable by Bangladesh Bank up to 270 days upon application to Bangladesh Bank explaining the necessity of longer period for repatriation of export proceeds.

8.6.4 Eligibility for EDF Loans

(i) Input imports by manufacturer-exporters against which an AD seeks EDF loan must be in full compliance with the value addition criterion and other requirements of the government's Import Policy Order (IPO) in force; and of foreign exchange regulations and instructions laid down in the GFET 2009 and subsequent circulars of Bangladesh Bank.

[47] LIBOR stands for London Interbank Offered Rate which is the average interest rate estimated by leading banks in London that they would be charged if borrowing from other banks. It is the primary benchmark for short term interest rates around the world. Libor rates are calculated for ten currencies and 15 borrowing periods ranging from overnight to one year and are published daily at 11:30 am (London time). Many financial institutions, mortgage lenders and credit card agencies set their own rates relative to it.

[48] Bangladesh Bank, FE Circular No. 19, dated September 29, 2010.

(ii) Input imports of a manufacturer-exporter defaulting in repatriation of export proceeds within the statutory period (within 120 days from date of shipment, or such extension as permitted by Bangladesh Bank) will not be eligible for financing from the EDF besides other usual regulatory penalties.

(iii) The loans to manufacturer-exporters to be eligible for EDF financing must be within the single borrower exposure limit prescribed by Bangladesh Bank.

(iv) EDF financing will be admissible for input procurements against back to back import LCs/ inland back to back LCs in foreign exchange; by manufacturers producing final output for direct export, and also by producers of local deliveries of intermediate outputs to manufacturers of the final export.

8.6.5 Amounts of EDF Loans

(a) For manufacturer exporters other than BTMA mills producing yarn:

An EDF loan to an AD shall not exceed-

(i) the limit of input imports permissible against an export LC/ firm export contract/ inland back to back LC in terms of the value addition requirements prescribed in the IPO in force, or

(ii) USD 10 million, whichever is lower.

(b) For BTMA mills making bulk import of raw cotton or other fibres against deemed exports (local deliveries of yarn to manufacturer-exporters against inland back to back LCs in foreign exchange):

An EDF loan to an AD shall not exceed-

(i) the amount in foreign exchange realized against inland back to back LCs over the past twelve months, or

(ii) USD 10 million, whichever is lower.

8.7 Customer Interest Protection

Bangladesh Bank has undertaken some initiatives to protect the interest of the customers of the banking sector. These initiatives are discussed below.

8.7.1 Deposit Insurance Scheme

To minimize or eliminate the risk of loss of depositors' fund with banks, Bangladesh Bank introduced Deposit Insurance Scheme in Bangladesh in August 1984 to act as a safety net.[49] Deposit insurance in Bangladesh is now being governed by the Bank Deposit Insurance Act 2000. The Bank created a Deposit Insurance Trust Fund (DITF) for providing limited protection (not exceeding Taka 0.10 million) to a small depositor in case of winding up of any bank. The Board of Directors of Bangladesh Bank is the Trustee Board for the DITF. Bangladesh Bank has become a member of International Association of Deposit Insurers (IADI). At the end of June 2011, the total assets of the DITF stood at Taka 17.9 billion of which Taka 17.7 billion were invested in Government securities. In January 2007 the Bank introduced revised risk based premium rate. As per the new schedule, the banks under problem bank category will have to pay 0.09 percent whereas other banks will pay 0.07 percent as premium on their deposits. To inform the public and for stabilizing the payment system in the banking sector, Bangladesh Bank discloses the information regarding deposit insurance scheme, its nature, operating procedures, level of coverage, premium rates etc. and last audited balance sheet in its official website.[50]

8.7.2 Complaint Cell

Bangladesh Bank advised the banks to set up a "Complaint Cell" in each bank to deal with all sort of complaints, either received directly by them or referred through different agencies or institutions including Bangladesh Bank. Bangladesh Bank outlined the operational activities, formation and monitoring method of the 'Complaint Cell' through formal circular.[51] The Bank has also set up a 'Complaint Cell' headed by a Deputy General Manager in its Department of Banking Inspection at the head office. The responsibility of this Cell is to check the performance, effectiveness and functioning of the Complaint Cells of the banks and monitor the status of the customer complains.[52]

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[49] Bangladesh Bank, *Annual Report 2010 - 11*, *op.cit.,* p. 49.

[50] *Ibid.*

[51] Bangladesh Bank, BRPD Circular No. 01, dated January 05, 2005.

[52] Bangladesh Bank, *Annual Report 2004 - 05* (Dhaka: Department of Public Relations and Publications, Bangladesh Bank), p. 38.

8.7.3 Customers' Interest Protection Centre (CIPC)

With a view to prompt resolution of the complaints against banking services at the customer level, to observe the level of satisfaction of the customers and to ensure improved customer services, Bangladesh Bank established 'Customers' Interest Protection Centre' (CIPC) at its head office and at the branch offices in March 2012.[53] In the CIPC along with other devices of electronic communication, a separate dedicated (hot line) number '16236' has been provided. Since the inception of the CIPC, huge number of complaints has been coming through telephone, mobile phone, e-mail and even by post. The number of total complaints received upto September 2012 was 3824, out of which 3018 has been resolved, making the rate of resolution 79 percent.[54]

Recently Bangladesh Bank has established a new department namely 'Financial Integrity and Customer Services Department' at its head office for dealing with complaints of the customers and clients of the banks and financial institutions more easily and quickly.[55]

8.7.4 Rationalization of Schedule of Charges

To ensure the interest of depositors/investors/customers Bangladesh Bank recently has rationalized the charges of some services. It advised all scheduled banks to display the complete schedule of charges in suitable visible places in their branches and head offices for the information of their customer and upload the same in their respective websites. Considering the interest of the small depositors, Bangladesh Bank decided that no charge can be imposed as account maintenance fee for average deposit balance up to Taka 5000. The Bank also decided that Taka 100 at maximum may be imposed as account maintenance fee for average deposit balance up to Taka 25000 on six monthly basis.[56]

8.8 Automation of the Banking System

To meet the diversified needs of the present day financial transaction, the banking system should be modern technology based, efficient and secure. In this

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[53] Bangladesh Bank, *Developmental Central Banking, op.cit.,* p. 13.

[54] *Ibid.*

[55] *Ibid.*

[56] Bangladesh Bank, *Annual Report 2010 -11, op.cit.,* p. 52.

regard the Bangladesh Bank has taken some important steps including automated payment systems, online banking system, online CIB service, mobile banking, e-commerce, etc. Installation of National Payment Switch software is underway. A brief sketch of these initiatives has been given below.

8.8.1 Modernization of Payment Systems

To make the payment system fast and secure, Bangladesh Bank introduced fully automated clearing settlement of interbank paper based and electronic fund transfer system in Bangladesh. In October 2010, the first ever electronic clearing house, Bangladesh Automated Clearing House (BACH) came into operation. BACH has two wings namely Bangladesh Automated Cheque Processing System (BACPS) and Bangladesh Funds Transfer Network (BEFTN).

8.8.1.1 Bangladesh Automated Cheque Processing System (BACPS)

Bangladesh Automated Cheque Processing System (BACPS) started its activities within Dhaka clearing area on 7 October, 2010 with the participation of 47 scheduled banks of the country. For the purpose of automated cheque processing system, all the clearing instruments have been standardized.[57] Each instrument has been encoded with Magnetic Ink Character Recognition (MICR) line. This MICR line includes information on the amount, transaction code, clients account, routing number and the cheque leaf's serial number. Currently approximately 1.5 million regular and 90,000 high value cheques and other instruments i.e., on average 95 percent of the clearing instruments are being cleared per month through BACPS.[58]

8.8.1.2 Bangladesh Electronic Funds Transfer Network (BEFTN)

Bangladesh Electronic Funds Transfer Network (BEFTN) started its 'live operation' on 28 February 2011. A wide array of credit transfer applications such as payroll, foreign and domestic remittances, company dividends, retirement, bill payments, corporate payments, tax payments, government license fees and person to person payments are settled under this network. Also the debit transfer

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[57] Cheques, drafts, pay orders, dividend and refund warrant are recognized as clearing instruments.

[58] Bangladesh Bank, *Developmental Central Banking, op.cit.,* p. 14.

applications such as mortgage payments, membership dues, loan payments, insurance premiums, utility bill payments, etc. are settled under this network. The electronic funds transfer network reduces the operational cost and risk and increases the efficiency of the payments process. Currently, approximately 200,000 EFT-credit and 2000 EFT-debit transactions are being processed per month with an increasing trend.[59]

8.8.2 On-line Baking

Access to online banking facility for the customers in Bangladesh is expanding rapidly along with increase in the number of branches with online coverage and accounts facilitated with internet banking.[60] At present, around 80 percent of the country's total banks are offering on-line banking services to their customers. Out of 47 scheduled banks in Bangladesh 37 are fully automated. Four banks partially launched on-line services in the sense that, they connected some selected branches only.[61] Looking at the branchwise data it has been found that, 3,226 out of total 8,199 bank branches covering all types of banks are equipped with online banking services. Data on the number of branches of all bank types with online banking facility have been presented in the Table VIII-6.

Table VIII-6

Bank Branches with Online Banking Facility

Type of Banks	Total Number of Branches	Number of Branches with Online Banking Facility	% of Branches with Online Banking Facility
SCBs	3469	168	4.84
PCBs	3224	2925	90.73
FCBs	73	73	100.00
SDBs	1433	60	4.19
Total	**8199**	**3226**	**39.35**

Source: Bangladesh Bank, *Green Banking in Bangladesh: Fostering Environmentally Sustainable Growth Process*, p. 18.

[59] *Ibid.*

[60] Bangladesh Bank, *Green Banking in Bangladesh: Fostering Environmentally Sustainable Growth Process* (Dhaka: Department of Communications and Publications, Bangladesh Bank, n. d.), p. 18.

[61] Bangladesh Bank, *Developmental Central Banking, op.cit.,* p. 13

It is shown in the Table that, all the branches of the FCBs have online banking facility; impressive 90.73% branches of the PCBs have the same. But the state-owned banks are lagging far behind.

8.8.3 On-line CIB Service

In order to ensure prompt collection of credit data from the sources as well as instantaneous delivery of Credit Information Bureau (CIB) report to the users applying latest computer technology, the Bangladesh Bank started diagnostic analysis of the customer and the Central Bank with effect from 13 July 2007 under DFID financial assistance programme aimed at implementing on-line services between the Bureau and the lending institutions. Bangladesh Bank opened up the CIB online service on 19 July 2011.[62] CIB online is a web-based online system through which banks and financial institutions can furnish credit information and can access credit reports within few seconds by searching online from their respective workstations at any time round the year. This service has been a great saver of time and cost for the banks and the financial institutions as physical presence is no longer needed for collection of CIB reports and submission of credit information to the CIB database.

8.8.4 Mobile Financial Service (MFS)

Mobile Financial Services (MFS) is an approach to offer bank-led mobile financial services that combines banking with mobile wireless networks which enables users to execute banking transactions like making deposits, withdraw, and sending or receiving funds from a mobile account.[63] Bangladesh Bank introduced mobile financial services in Bangladesh in order to bring the vast unbanked / under-banked population under the umbrella of formal financial service. A variety of services including disbursement of inward foreign remittance and domestic fund, payment of utility bills, salary, allowances, pension, buying and selling of goods and services, balance inquiry, tax payment, Government subsidy payment and payment of the benefits of social safety nets can easily and quickly be provided through mobile financial services. This service is available 24 hours a day and seven days a week.

[62] Bangladesh Bank, *Annual Report 2010 -11, op.cit.,* p.57.

[63] Bangladesh Bank, *Mobile Financial Services in Bangladesh: An Overview of Market Development* (Dhaka: Research Department, Bangladesh Bank, July 2012), p, 9.

Bangladesh Bank has taken various steps to make MFS more effective. It issued the 'Guidelines for Mobile Financial Services for the Banks' on 22 September 2011.[64] Till March 2012, excluding remittance-only deployments, number of banks licensed by Bangladesh Bank was 10 and the number of live MFS deployments was five. During this time 9093 agents have been appointed and 4,42,269 mobile accounts have been opened. Total value of transactions was Taka 207 crore.[65] At present, daily volume of transaction through MFS is Taka 350 million. The volume of transaction is increasing at a rate of 15 percent per month. Approximately Taka 35 billion has been disbursed through MFS. Around 12000 railway tickets are sold per month using MFS.[66]

Through MFS, opportunity has been created for fast and cost-effective transaction even to the remotest corner of the village. MFS has given access to modern banking service to the rural poor including the social safety net beneficiaries. This has opened the scope of a rejuvenated widening of the real base for participatory growth of the economy.

8.8.5 e-Commerce

Bangladesh Bank started e-Commerce in Bangladesh in November 2009 through issuing a circular. Through e-commerce operation specific services can be offered by the scheduled banks of Bangladesh like online bill payment from client's accounts to recipient's accounts, online money transfers from one account of a client to his/her another account in the same bank, collection of money from/to buyer's bank account to seller's bank account for purchase/sale of products under e-commerce system, transaction via internet using credit cards in local currency, etc. By this time, two banks have started e-commerce whereas the other banks are preparing to start e-commerce soon.[67]

8.8.6 National Payments Switch

In order to make the payment systems of Bangladesh more efficient and dynamic, National Payment Switch (NPS) has been decided to establish within

[64] Bangladesh Bank, DCMPS Circular No. 08, dated September 22, 2011.

[65] Bangladesh Bank, *Mobile Financial Services in Bangladesh.*

[66] Bangladesh Bank, *Developmental Central Banking in Bangladesh*, p. 16.

[67] *Ibid.*

the scope of national information and communication policy.[68] It is expected that, this switch will create a single, integrated and effective platform for settling interbank electronic payments deriving from different channels such as Automated Teller Machine (ATM), Point of Sale (POS), internet, mobile application, etc.[69] NPS will act as the mother switch in the country which will connect all the child switches already in place in private sector. Also the e-payment gateway of Public Accounts Department (PAD) of Bangladesh Bank will be connected through NPS. Necessary hardware for NPS has already been installed and installation of the switch software is in progress.[70]

8.8.7 Automation in Bangladesh Bank

With the view to render better service which definitely has important implications in its development initiatives, Bangladesh Bank attempts to equip itself with technological development. In this regard, it launched the Central Bank Strengthening Project (CBSP) in late 2003 with financial assistance of the International Development association (IDA) to achieve the goal of automating its business process along with infrastructural and capacity building.[71] The project is expected to be completed by December 2012. Under this project, more than 150 servers, around 4000 personal computers and sufficient number of printers and scanners have already been installed at Bangladesh Bank.[72] The other developments regarding automation have been listed below.

8.8.7.1 Networking

The departments at the head office and branch offices of Bangladesh Bank have been connected through LAN or WAN since 17 May 2010.[73] Security and availability of the information reserved in Bangladesh Bank have been ensured through establishing advanced data centre and disaster recovery site within the network. The networking has opened up opportunity to the employees of the Bank to connect with the information highway as well as develop skill and knowledge-based talent which in turn is supposed to promote efficient service.

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[68] Bangladesh Bank, DCMPS (PSD) Circular No. 02/2012 dated March 20, 2012.

[69] Bangladesh Bank, PSD Circular No. 04/2012 dated December 24, 2012.

[70] Bangladesh Bank, *Developmental Central Banking, op.cit.,* pp. 16 & 17.

[71] Bangladesh Bank, *Annual Report 2004-05*, *op.cit.,* p. 89.

[72] Bangladesh Bank, *Developmental Central Banking, op.cit.,* p. 17.

[73] *Ibid.*

8.8.7.2 Enterprise Resource Planning (ERP)

Bangladesh Bank has been preparing financial statements electronically following international standard by Systems, Applications and Products (SAP) of Enterprise Resource Planning (ERP). Electronic accounting, budgeting, accounts payable, accounts receivable, cash management, fixed assets management, human resource management, budget and cost centre accounting, material management etc. are being facilitated by ERP. Thus, it is playing a supporting role in improving the entire working skill of Bangladesh Bank.

8.8.7.3 Core Banking Applications

To automate Bangladesh Bank's entire banking activities, banking software has been installed at the Bank. Most of the financial transactions of the Government are being accomplished electronically through it. Transactions like debt management through treasury bills/bonds, treasury bill/bond sale, repurchase, secondary trading, foreign reserve management, prize bond, sanchayapatra, wage earners bond, various investment bond sale, profit disbursement and realization etc. are being done electronically.

8.8.7.4 Enterprise Data Warehouse

Realizing the importance of data, Bangladesh Bank has developed Enterprise Data Warehouse (EDW). EDW is an advanced technology based data warehouse, used as a central data centre for a variety of purposes like collection of information from the banks and financial institutions through online system, preservation, electronically run analysis etc. All sorts of macroeconomic data such as export, import, remittance, inflation, banking, monetary policy, banking supervision, credit and research based data are centrally preserved and processed by the EDW. Now the banks and the financial institutions can upload their various information from their offices by using web portal.

8.8.7.5 Website and Intranet Development

Bangladesh Bank launched its own website in 2001. Recently it redesigned the website with latest technology. The site contains up to date information regarding financial and economic state and Bangladesh Bank activities. It also contains the soft copies of Bangladesh Bank publications along with the earlier issues and some online publications. The website of the Bank is a rich source of research materials. Beside the website, intranet in Bangladesh Bank has been improved as a strong base of information management. At present, all internal office/administrative circulars or orders are uploaded directly in the intranet. This development helped discontinuation of hardcopy circulation of the said circulars and orders. At the same time it created the opportunity of faster response from the employees. It also helped avoid unnecessary printouts or cyclostyles saving huge amount of papers.

8.9 Green Banking[74]

Bangladesh's vulnerability to floods, cyclones and to the threat of inundation of large coastal areas due to global warming driven sea level rise makes a prime development concern. On the other hand, financing practices has the potential to crucially influence the speed of adoption of environmentally sustainable output practices in the real economy through facilitating transition to resource-efficient and low carbon industries in general. Recognizing this prospect, as the regulator of the financial sector, the Bangladesh Bank took some significant steps towards adoption and promotion of green banking practices throughout the financial sector in Bangladesh.

8.9.1 Policy Directives

Bangladesh Bank issued guidelines on Environmental Risk Management (ERM) in January 2011 to streamline solutions for managing the environmental risks in the financial sector.[75] Then, the Bank issued policy guidelines for green banking in February 2011.[76] According to the guidelines, all the banks and financial institutions need to take effective measures to conduct environment friendly banking activities in the country. A comprehensive guideline on Corporate Social Responsibility (CSR) has been issued where the banks have been asked to link CSR at their highest corporate level for engraining socially and environmentally responsible banking practices and engaging with borrowers in scrutiny of the

[74] The term "green banking" generally refers to the banking practices that foster environmentally responsible financing practices and environmentally sustainable internal processes minimizing Green House Gas (GHG) emissions.

[75] Bangladesh Bank, BRPD Circular No. 01 dated January 30, 2011.

[76] Bangladesh Bank, BRPD Circular No. 02 dated February 27, 2011.

environmental and social impacts.[77] Banks are now required to have a considerable amount of allocation for green banking in their annual budgets. This allocation is to be made in three broad areas viz., (a) Budget for green finance, (b) Budget for Climate Risk Fund and (c) Budget for marketing and capacity building for green banking.[78] 35 banks have allocated Taka 23,018.36 million for green banking in their annual budget for 2012, making an average allocation of Taka 657.67 million by the banks. Areawise allocation has been presented in the Table VIII-7.

Table VIII-7

Areawise Allocation by the Banks for Green Banking in FY 2012

Sl no.	Area	Amount (in million Taka)
1.	Green Finance	20,034.59
2.	Climate Risk Fund	2,141.74
3.	Marketing & Capacity Building for Green Banking	842.73

Source: Bangladesh Bank, *Green Banking in Bangladesh: Fostering Environmentally Sustainable Growth Process*, p. 17.

8.9.2 Bangladesh Bank Refinance Scheme

Under the green banking initiative, Bangladesh Bank has launched a revolving refinance scheme amounting Taka two billion to facilitate the financing to selected sectors namely solar energy, bio-gas, Effluent Treatment Plant (ETP) and Hybrid Hoffman Kiln (HHK) at a very convenient and concessional rate. As of October 2012, Taka 838.4 million from this refinance scheme has been allocated to the green projects mentioned in the following Table.

Table VIII-8

Categorywise Disbursement of Bangladesh Bank Refinance

Sl No.	Category	Amount (in million Taka)
1.	Solar irrigation pump	23.9
2.	Solar home system	87.8
3.	Bio-gas plant	262.7
4.	Effluent Treatment Plant (ETP)	90.4
5.	Hybrid Hoffman Kiln (HHK)	124.8
6.	Solar PV module assembling plant	248.8
	Total	**838.4**

Source: Bangladesh Bank, *Green Banking in Bangladesh: Fostering Environmentally Sustainable Growth Process,* p. 15.

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[77] Bangladesh Bank, *Green Banking in Bangladesh*, *op.cit.,* p. 30.

[78] Bangladesh Bank, BRPD Circular No. 02 dated February 27, 2011.

8.9.3 Incentives

To encourage the participating banks to engage more proactively in green banking activities, the Bangladesh Bank has announced to provide the following preferential treatments to the compliant banks:[79]

(i) awarding credit points for green banking initiatives in the assessment of management component of CAMELS rating for a bank;

(ii) publicizing names of the top ten performers in green banking in Bangladesh Bank website;

(iii) taking into account green banking performance while considering requests for new bank branch licenses.

Motivated by the policy directives and the incentives of the Bangladesh Bank and as part of CSR initiatives, the banks and financial institutions are coming forward with environmentally responsible financing.

8.10 Other Promotional Role

Apart from the above discussed functions, the Bangladesh Bank performs some other roles mainly in line with financial inclusion which have significant development potential for the economy and the society.

8.10.1 Bank Account for Hardcore Poor

A hardcore poor can open bank account by depositing Taka ten at any state owned commercial and specialized bank against national ID card and registration card issued by the Ministry of Food and Disaster Management. There will be no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts.[80]

8.10.2 Bank Account for Unemployed Youth

An unemployed youth can open a bank account by depositing Taka 50 at any scheduled bank under National Services Program.[81]

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[79] *Ibid.*

[80] Bangladesh Bank, *Recent Reform Initiatives* (Dhaka: Bangladesh Bank, n.d.), p. 18.

[81] *Ibid.*

8.10.3 Bank Accounts for Freedom Fighters

A freedom fighter can open bank account by depositing Taka ten at any state owned commercial and specialized bank against national ID card and Payment Receipt Book for freedom fighter's allowance. There are no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts. Total number of freedom fighters' accounts was 92,693 as of 29 March 2012.[82]

8.10.4 Banking Service for Physically Handicapped People

Bangladesh Bank advised the banks to designate an official as 'Focal Point' at each branch of their bank with a view to making the banking services beneficial and easily accessible to the physically handicapped people.[83]

8.10.5 Bank Accounts for Beneficiaries under Social Security Program

Beneficiaries under Social Security Program can open bank account by depositing Taka ten at any state owned commercial and specialized bank against national ID card and Payment Receipt Book containing Pension Payment Order (PPO) for the beneficiaries. There are no bindings for maintaining minimum balance on the said accounts and banks shall not impose any charges/fees on these accounts. As of 29 March 2012, total number of accounts for Beneficiaries under Social Security Program was 25,80,668.[84]

8.10.6 Bank Account for Distressed People

Beneficiaries under Hindu Religious Welfare Trust can open bank account by depositing Taka ten at any state owned commercial and specialized bank against national ID card and certificate issued by Hindu Religious Welfare Trust.[85]

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[82] *Ibid.*

[83] *Ibid.*

[84] *Ibid.*

[85] *Ibid.*

8.10.7 Bank Account for Small Life Insurance Policy Holder

Small life insurance policy holders (up to Taka 0.15 million) can open bank account by depositing Taka 100 at any state owned commercial and specialized bank against national ID card/birth certificate and premium deposit book/document for life insurance. Total number of such accounts for small life insurance policy holder was 5,702 as of March 29, 2012.[86]

8.10.8 Bank Account for Aila Affected People

Aila affected people are also being provided with the facility of opening bank account at Kaira and Dakup Upazilla branches of Sonali, Agrani, Rupali and BKB by depositing Taka ten.[87].

8.11 Conclusion

The policy and measures undertaken under the development initiatives of Bangladesh Bank so far are of course significant and have already started creating positive impacts. The inclusive approach followed by the Bank is a very timely one which is also internationally recognized and practiced. But the measures so far taken are yet to be fully able to address the demand side problems of the financially excluded sections of the population. Studies have shown that, financial exclusion is not only a supply-side problem.[88] To make the development initiatives more effective, the banking industry as a whole should be more service oriented. A study reveals that, for availing SME credit the entrepreneurs had to visit the bank on average 15 times for one loan, whereas frequency of visit for getting loan from informal money lender was three, from association 2.5 and from relatives and friends 2.25.[89] Another study found 'lengthy procedure' in sanctioning SME credit as the most acute constraint to

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[86] *Ibid.,* p. 19.

[87] *Ibid.*

[88] Toufic A. Choudhury, "Inclusive Financing", *op.cit*.

[89] Nasima Nazneen Rikta, "Institutional Lending and Financing Policy for SMEs in Bangladesh", Policy Note Series: PN 0804 (Dhaka: Bangladesh Bank, December 2007), pp. 3 & 4.

SME finance encountered by the respondents.[90] It is seemed that two very important sectors of the economy, industry and the external should occupy broader-based place in the development initiatives of Bangladesh Bank. The Bank should follow a comprehensive and well-coordinated development agenda to be more effective. But still the development role of Bangladesh Bank is impressive considering the limitations and constraints of the whole economy and the socio-economic realities of the country. Here reference can be made to Dr. Yaga Venugopal Reddy, who recently came to Bangladesh to give a lecture on 'Ethics in Banking' termed Bangladesh Bank as "a Central Bank with a human face".[91]

The next chapter deals with summary, recommendations and conclusion.

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[90] Md. Didarul Zamal, "Financing of Small and Medium Scale Industries in Bangladesh: A Study on Light Engineering Enterprises", unpublished Ph.D. Thesis (Rajshahi: Institute of Bangladesh Studies, Rajshahi University, 2011), p.207.

[91] *The Financial Express,* 25 December 2012.

CHAPTER IX

SUMMARY, RECOMMENDATIONS AND CONCLUSIONS

9.1 Preamble

There had been no clearly defined concept of Central Banking prior to eighteenth century in the world. In course of long evolution Central Bank came into being. Though considering the time of establishment, the Riksbank of Sweden is regarded as the oldest Central Bank, it is the Bank of England, established in 1694, which was the first bank of issue to assume the position of Central Bank and to develop the fundamentals of the art of central banking. At present, every country of the world has a Central Bank of its own which is the apex institution in the financial system of that economy. By the conduct of its multifarious operations, the Bank influences the behavior of financial institutions so as to support the economic policy of the Government. In most of the developed economies Central Banks are vested only with the conduct of Monetary Policy, with a single objective of maintaining price stability. But, in most of the developing economies Central Banks besides Monetary Policy also shoulder many other responsibilities.

Bangladesh Bank being the Central Bank of Bangladesh has been entrusted with functions and responsibilities with a view to stabilizing domestic and external monetary value and promoting and maintaining a high level of production, employment and real income in the country. To achieve these objectives, Bangladesh Bank anchored on multi-dimensional functions. It incorporated a wide range of reform measures and adopted a host of development activities also.

Bangladesh is a developing country, which is undergoing positive structural changes with a trend of increasing share of industry and decreasing share of agriculture in its Gross Domestic Product (GDP). The other macro economic variables like inflation and GDP growth rate manifest a moderate progress of the economy. In this backdrop, though the Bangladesh Bank claims itself to be considerably successful, many economists and analysts differ. In this perspective, it is necessary to analyze the various dimensions of the functions of Bangladesh Bank to see what role the Bank actually plays as a Central Bank of a developing country.

The study aims at critically evaluating the role of Bangladesh Bank as a Central Bank in a developing economy like Bangladesh. The specific objectives of this research are to trace the structure and growth trend of Bangladesh Bank, to examine the Monetary Policy pursued by Bangladesh Bank, to investigate into the policies and actions undertaken by Bangladesh Bank as a banker of the scheduled banks, to examine the role of Bangladesh Bank as a banker to the Government, to make a critical analysis of the reforms undertaken by Bangladesh Bank and to explore the developmental role played by Bangladesh Bank as the Central Bank of the country.

This is a basically a case study on Bangladesh Bank in its present life context. But past history and future prospects of the Bank have also been discussed here. The study also evaluates past and present performance of the Bank. Multiple methods including content analysis, historical analysis, story telling, etc. have been used in conducting the present research. The researcher has exploited data of the last 40 years (1972-2011) of the relevant sections of Bangladesh Bank and the banking sector of Bangladesh. Data have been analyzed both quantitatively and qualitatively. In this research, growth rates like Simple Growth Rate (SGR) and different ratios have frequently been used as measuring indicators. Except these rates and ratios, percentage share of some variables in relation to some measure of National Income (GNP or GDP) or in respect to some other variables have commonly been used throughout the research. Some formulas have also been used in this study. The study employed time series analysis. Besides, tabular presentation, charts, graphs etc. have been used extensively.

9.2 Summary of Key Findings

Each of the foregoing chapters has a short summary with findings at the end. However, more elaborative chapter wise findings have been presented in this section as a summary of the whole research.

9.2.1 Role of Central Bank in a Developing Economy

There are significant differences between the role of a Central Bank in a developed country and that in a developing country. Central Bank of a developing economy is supposed to perform some special roles which are indeed of development orientation. Of course it is to conduct the traditional Central Bank functions which include issuing of notes, acting as banker of the commercial banks, pursuing Monetary Policy and acting as banker to the Government. But there are lots of rationales for the Central Bank of a developing country to undertake promotional functions for the respective economy. Firstly, it is its apex position in the financial system which enables the Bank to exercise huge authority in the needed developmental direction and to facilitate the promotion of development activities in the economy. Secondly, the generally existing dualism of traditional and modern sector in the developing economy implies that, in the course of the country's growth, not just the capital requirement of the modern sector appears on the money and capital market, but the monetization of the traditional sector means a money requirement. Thirdly, undue concentration of banking business risks is very likely to occur in the developing countries coupled with difficulty for the commercial banks in attracting and holding sufficient capital and managerial ability. This may cause slow development of commercial banking in the developing economies leading to a gap threatening the adequate provision for the country's economic potentialities. Fourthly, the long-term capital market is practically very narrow and in many cases absent in the developing countries. So, the Central Bank in a developing economy is to occasionally step into the long-term market. Fifthly, in developing countries commercial bank financing is very low in sectors like agriculture and small and medium enterprises in spite of their vital role in those economies. Moreover, the banks find the majority rural people as not credit-worthy. In this backdrop, it is argued that, Central Bank in a developing economy can not confine itself solely to the traditional functions like its counterpart in the developed countries. Rather undertaking promotional functions is imperative for the Central Bank of a developing country.

There is a big array of the promotional functions for the Central Banks. The Chapter organized these functions in seven areas. Firstly, the Bank should foster the growth of the banking system and institution building. The Central Bank should foster the process of widening and deepening of the geographical penetration of the banking system as quickly as possible through creation of a nation-wide network of bank branches. It may also take initiatives in organizing subsidiaries for the purpose of facilitating the supply of capital of different terms for different sectors with varying needs. Secondly, the Central Bank can act as a bank for the general public. The slow pace of development of sound commercial banking system in the developing countries forms the main justification of this role. Thirdly, the Central Bank should ensure supply of long-term capital to different sectors in the economy. It can adopt either of two methods for this purpose. The Bank can start separate department or it can co-operate and participate in setting up separate institutions for the supply of long-term finance. While the former sparks debates regarding the Central Bank's direct involvement in long-term financing, the latter goes with tradition having some advantages also. Fourthly, the Central Bank is needed to ensure financing of the under served sectors like agriculture. The Chapter discussed various methods followed in some developed and developing countries with their applicability in a developing economy. It is found that, the method followed by the Commonwealth Bank in Australia of setting up separate Department like Rural Credits Department fits best in the developing economy set up. But the limits to such operations are suggested to be carefully maintained. Fifthly, the Central Bank may pursue selective credit policy to channel credit to a particular real market. Four methods have been identified in this chapter to pursue selective credit policy for the targeted sector(s). Sixthly, the Bank should play the role of catalyst and innovator with development objectives. It can perform this role in many areas in versatile ways. The Bank can widen the functional scope of the commercial banking system, devise attractive financial instruments, expand the coverage of existing schemes and policies, generate confidence in the financial sector and thus stimulate financial saving. The Central Bank can play catalytic and innovative role in the reorientation of goals and objectives of financial institutions towards socially responsible lending practices. Other promotional functions-identified in this chapter form the seventh area,. Providing guidelines for the planners, publishing financial sector information, promoting research, providing training for the bank officials, etc. are the functions included in this category.

Some challenges have been identified in this chapter, which the Central Bank of a developing country is likely to confront. In the developing countries the role of the Central Banks has to be changed from an agency of regulation to one of development. At the same time, the Banks should be aware of the potential problem of harmonization between the regulatory and developmental objectives as the two objectives may conflict with each other.

9.2.2 Origin, Structure, Functions and Growth Trend of Bangladesh Bank

The establishment of Bangladesh Bank inherits a long history of banking development in the South Asian region. After the independence of Bangladesh, the officers, branches and assets of the State Bank of Pakistan in the Eastern wing were declared to be deemed as those of Bangladesh Bank under the Bangladesh Banks (Temporary) Order, 1971 (Acting President's Order. 2 of 1971), promulgated by the Government. Bangladesh Bank came into existence on the 31st October 1972 under the Bangladesh Bank Order 1972 (President's Order No. 127 of 1972), which took effect on the 16th December 1971.

A nine member Board of Directors, which is the highest policy making body, directs the affairs and business of Bangladesh Bank. The Board consists of the Governor as Chairman, a Deputy Governor, three senior government officials and four persons having experience and proven capacity in the fields of banking, trade, commerce, industry or agriculture. All of the members are nominated by the government. Bangladesh Bank is reportable to a Co-ordination Council, which is chaired by the Minister for Finance. There is an Executive Committee for the Bank consisting of the Governor and three Directors of the Board of Directors to deal with and decide any matter within the competence of the Board when the Board is not in session. The Head Office of Bangladesh Bank is situated at Motijheel of Dhaka. It has ten branches all over the country. The Bank is organized into several Departments at the Head Office. At present the number of Departments is forty three. The total manpower of Bangladesh Bank is 4951. The legal framework of Bangladesh Bank is supported by the Bangladesh Bank Order 1972. Besides this Order, a set of laws, regulations and guidelines have been enacted and promulgated time to time since the establishment of Bangladesh Bank, which empowered the Bank to perform its role as a Central Bank.

According to the Bangladesh Bank Order 1972 the functions of Bangladesh Bank are (a) to regulate the issue of the currency and the keeping of reserves; (b) to manage the monetary and credit system of Bangladesh with a view to stabilizing domestic monetary value; (c) to preserve the par value of the Bangladesh Taka; (d) to promote and maintain a high level of production, employment and real income in Bangladesh; (e) to foster growth and development of the country's productive resources for the national interest. The functions were little changed by the Bangladesh Bank (Amendment) Act 2003. The most significant change in the functions was the incorporation of Monetary Policy explicitly for the first time in the functions of Bangladesh Bank. The Bank mentions its functions in its publications, mission statement and in the official website slight differently. Moreover, in the same official website the functions were found mentioned little different at different times. However, in the vision statement the Bank states its vision as to develop continually as a forward-looking central bank with competent and committed professionals of high ethical standards, conducting monetary management and financial sector supervision to maintain price stability and financial system robustness, supporting rapid broad based inclusive economic growth, employment generation and poverty eradication in Bangladesh.

Bangladesh Bank follows a “Fixed Reserve System” regarding note issue. Bangladesh has been a member of the IMF since 1972. Bangladesh Bank acts as both the fiscal agent and the depository agent for the IMF.

In 1972, the Bangladesh Bank started with four branches allover the country. The number of branches increased gradually and on 16 January 2012 the number stood at ten. The Bank started operation with a number of employees of 2,562. In FY 2010-11 the number was 4,878 almost double of the initial number.

Following the Bank of England, Bangladesh Bank maintains two balance sheets, one for the banking department and the other for issue department. The balance sheet analysis of the Banking Department reflects the matrix of financial transaction of Bangladesh Bank, while the balance sheet analysis of the Issue Department gives the picture of the trend of Note Issue by Bangladesh Bank.

The Banking Department has two sides on its balance sheet viz., assets side and liabilities side. The components of assets side are arranged in three categories in the present study, viz., (1) ‘notes & coin, bills purchased & discounted and balance abroad’, (2) ‘loan & advances, government debtor balance and investment’, and (3) ‘other assets’. The first two categories are known as traditional assets, whereas the third one as non-traditional asset. The annual average growth rates of these categories from 1975 to 2011 were 25.73, 22.78 and 34.89 percent respectively. It was found that, the growth rate of non-traditional assets was faster than that of traditional assets in the period under consideration. The components of liabilities of Banking Department are also arranged in three categories in the study, viz., (1) 'paid up capital and other funds', (2) 'deposits and bills payable' and (3) 'other liabilities'. The first two categories are known as traditional liabilities, whereas the third one as non-traditional liability. The annual average growth rates of these categories from 1975 to 2011 were 17.69, 16.41 and 18.46 percent respectively. It was found that, the growth rate of non-traditional liabilities was faster than that of traditional liabilities. The growth rate of over all assets/ liabilities in the same period was 16.41 percent.

The Issue Department also has two sides on its balance sheet viz., assets side and liabilities side. Assets of issue Department are brought under three categories in the study, viz., (1) 'foreign assets', (2) 'taka coin', and (3) 'securities of Bangladesh Government, internal bills of exchange and other commercial papers'. The annual average growth rates of these categories from 1975 to 2011 were 29.51, 27.34 and 12.87 percent respectively. The components of liabilities of Issue Department are included in two categories: (1) 'Notes in the Banking Department' and (2) 'Notes in Circulation'. The annual average growth rates of these categories from 1975 to 2011 were 104.67 and 15.72 percent respectively.

The income statement of Bangladesh Bank comprises of 'total income', 'total expenditure' and 'net profit'. The annual average growth rates of 'total income', 'total expenditure' and 'net profit' from 1975 to 2011 were 28.19, 27.98 and 35.04 percent respectively.

9.2.3 Monetary Policy of Bangladesh Bank

Though formulation and implementation of Monetary Policy is one of key functions of Bangladesh Bank, it was not formally mentioned in the original Bangladesh Bank Order 1972. Monetary Policy appeared for the first time as the main function of the Bank in 2003 through the Bangladesh Bank (Amendment) Act 2003. Monetary Policy in Bangladesh is formulated around price stability and economic growth rates as the basic policy targets. In terms of the conduct of Monetary Policy, Bangladesh Bank pursues the Policy within a framework of monetary targeting. In this approach, levels and growth paths of the relevant monetary aggregates such as reserve money and broad money are projected and monitored as operating target and intermediate target respectively. Monetary authorities then set policy instruments at levels commensurate with achieving the stated targets.

Consumer Price Index (CPI) inflation, expressed as the rate of change of CPI is used in Bangladesh for assessing price stability in conducting Monetary Policy. The target level of CPI inflation is chosen taking into account the country's past long run inflation performance, and the domestic and external factors driving the current trend of domestic inflation. The Bank eyes economic growth in terms of sustained and stable output growth.

Based on the quantity theory assumption that inflation rises and falls with increase and decrease in the rate of growth of money stock, the annual monetary program targets a growth path for the intermediate target i.e., broad money (M_2) consistent with inflation and real GDP growth targets of Monetary Policy, allowing for the likely changes in income velocity of money. Bangladesh Bank calculates M_2 as the sum of ‘currency outside banks’, ‘demand deposits’ and ‘time deposits’. It has been found that, ‘time deposit’ had been the largest component of money supply (M2) in Bangladesh. The operating target Reserve Money (RM) is called inter alias high power money and base money in the economy. On the demand side, reserve money is the sum of currency outside banks, currency in tills of DMBs and deposits of the banks and financial institutions with Bangladesh Bank. Assuming that money multiplier is fairly stable, Bangladesh Bank tries to fulfill the demand for RM with its targeted supply equation, where in the supply side RM is the sum of net domestic assets and net foreign assets. As NFA remains practically beyond the control of Bangladesh Bank, it tries to equilibrate the demand and supply of reserve money through the variation of net domestic assets.

Bangladesh Bank employs a judicious mix of instruments in the Monetary Policy. These include Bank Rate, Repurchase Agreement *(Repo)* and *reverse repo* interest rates of Bangladesh Bank, Cash Reserve Requirement (CRR), Statutory Liquidity Ratio (SLR), credit control and credit rationing. *Repo* (repurchase agreement) and *reverse repo* interest rates of Bangladesh Bank and treasury bill/bond auction yields are the key policy rates in the present indirect monetary management. Bangladesh Bank has introduced *repo*, *reverse repo* and *interbank repo* operations in July 2002, April 2003 and July 2003 respectively.

Through *Repo* operation, Bangladesh Bank lends fund to a bank or financial institution by purchasing security, which the bank or financial institution repurchases upon maturity. The *Reverse Repo* facility enables participating institutions to purchase government securities from Bangladesh Bank upon commitment of resale after the agreed upon term. Both *Repo* and *Reverse Repo* arrangements are for overnight to seven day terms. In addition to the *Repo* and *Reverse Repo* arrangements, the Bangladesh Bank also allows the banks and other financial institutions to make secondary transaction of treasury bills and other government securities in their possession, which is called "*Interbank Repo*".

From the analysis of money supply, the growth of broad money in Bangladesh has been found erratic. In FY2011, broad money growth rate stood at 21.34 percent which was lower than the 22.44 percent growth rate recorded in Fiscal Year 2010, but higher than the growth rate of 19.17 percent in Fiscal Year 2009. It has been found that, without a few exceptions most of the time the actual growth rate of broad money was higher than the projected growth rate. Analysis of the supply side composition of reserve money shows that, 'Net Foreign Assets (NFA)' always held a big share in the reserve money of Bangladesh. In FY 2010-11, NDA was Taka 28,345.7 crore, while NFA was Taka 61,388.7 crore, more than double of NDA. As NFA remains outside the control of Bangladesh Bank, the large share of NFA in the reserve money composition implies substantially limited control of Bangladesh Bank over broad money. The second largest source of reserve money is 'Net Credit to Government'. This source derives mainly from Government budget deficits and thus manifests fiscal dominance.

It was found that, bank rate as a Monetary Policy instrument had been used infrequently. SLR and CRR were observed to be revised upward in a tightening Monetary Policy stance since FY 2004-05. The *repo* and *reverse repo* rates have been adjusted upward in recent times.

Analysis of the Monetary Policy stance shows that, after liberation during the period of 1970s Bangladesh Bank pursued an easy Monetary Policy. That phase of Monetary Policy was characterized by heavy deficit financing by the Government to support the nationalized corporations, to reconstruct and rehabilitate the war-torn infrastructure and also to revive the economic activities. The standby arrangement of Bangladesh with IMF In 1975, necessitated an explicit target of safe limit of monetary expansion on annual basis. Thus the country's Monetary Policy got a changed shape. Bangladesh Bank started setting short-term objectives of Monetary Policy. Prior to 1990, the Policy was based on a method of direct control over interest rates and exchange rates as also on the volume and direction of credit flows. With the implementation of FSRP in 1990, the emphasis has been shifted to indirect instruments of monetary management and market determined interest rates. Until the earlier months of FY2005, Bangladesh Bank continued with the growth supportive accommodative monetary stance. The reason of this stance of that time was the additional expenditures incurred by the government to pay for the high priced oil imports as well as to rebuild the economy following the losses caused by two consecutive floods occurring within very short span of time. Another reason for the accommodating Monetary Policy was to provide support to the garments sector following the expiry of MFA by end-December 2005. In the backdrop of accommodative Monetary Policy stance, supply shocks in the world market and depreciation of Taka against major currencies inflationary pressure began mounting up in the economy and an adverse trend in the current account balance was also in place. As a result, the Bangladesh Bank switched from an accommodative to a tightened Monetary Policy stance from the third quarter of FY05.

In the external front Bangladesh remained under the fixed exchange rate system until 1979. Thereafter it switched to a pegged exchange rate system experimenting with a variety of currency baskets. In 1983, the intervention currency was changed from Pound Sterling to US Dollar making Taka pegged to a trade-weighted basket of currencies, with US Dollar as the intervention currency. In 1985, Bangladesh Bank introduced Real Effective Exchange Rate (REER) index. Until the initiation of convertibility of Taka in 1994, Bangladesh Bank used to declare the mid-rate along with specified buying and selling rates for US Dollar for transactions with the ADs. In line of liberalization, under the 'Structural Adjustment Program (SAP)' and the 'Financial Sector Reform Program (FSRP)' Taka has been made convertible on current account in April 1994 by removing some exchange controls. Bangladesh entered into a floating exchange rate regime effective from May 31, 2003. Now Bangladesh Bank no longer uses any preannounced rate for transactions with the banks; rather it influences the market exchange rate of Taka indirectly. In addition to the occasional interventions, Bangladesh Bank employs tightening or loosening policy in the money market through the auctions of T-bills, repo and reverse repos to influence the exchange rate indirectly. The transition to floating exchange rate regime proved exceptionally smooth in Bangladesh.

Some factors, which are by nature inherent characteristics of the developing economy, have been identified as posing limitations to the efficacy of Monetary Policy of Bangladesh Bank. These include unorganized money market, narrow security market, external factor, lack of central bank independence, etc. It has been observed that, the Central Bank solely on its own cannot ensure price stability. A well coordinated effort of Monetary Policy and Fiscal Policy is imperative to attain the policy goals.

9.2.4 Role of Bangladesh Bank as a Banker of the Scheduled Banks

Like any other Central Bank of the world, Bangladesh Bank performs the role of banker's bank in the country's financial system. According to the Bangladesh Bank Order 1972, the Bank is mandated to regulate and supervise the banking companies and financial institutions of the country. As per the mandate, the Bank provides financial support to the banks and financial institutions, formulates different policies, regulations and guidelines and supervises the business of these institutions. All these functions have been included into nine groups in the present study.

As the lender of last resort, Bangladesh Bank provides credit to the financial institutions. This role bears special significance in the absence of a well organized money market in the country. Until 2002, Bank Rate was employed as a prime instrument in the credit policy. Under the purview of FSRP, Bangladesh Bank has introduced *Repo (Repurchase Agreement)* in July 2002 and placed greater importance on it than the Bank Rate for lending to the financial institutions. Bangladesh Bank was found not only the lender of last resort, but also the largest source of borrowing for the banking companies. In FY 1974-75 borrowing from Bangladesh Bank constituted 52.69 percent share in the total borrowing of DMBs. Share of borrowing from Bangladesh Bank in total DMB borrowing was the highest 87.23 per cent in FY 1990-91. In the period under consideration, average share of borrowing from Bangladesh Bank in total DMB borrowing was 69.85 per cent and the Simple Growth Rate (SGR) of DMB borrowing from Bangladesh Bank was 21.16 per cent.

Bangladesh Bank acts as the bank of clearance, settlement and transfer in the financial system. Recently the Bank established Bangladesh Automated Clearing House (BACH), replacing the traditional paper based clearing and settlement system. BACH has two components – the Bangladesh Automated Cheque Processing System (BACPS) and the Electronic Funds Transfer (EFT). BACPS started 'Live Operation' on 7 October 2010. At present, 85,000 (approximately) regular and 3000 high value cheques and other instruments are cleared through BACPS. BEFTN started its 'Live Operation' on 28 February 2011 with 47 banks of the country. The network started with credit transactions and will gradually progress to debit transactions. The amount transferred using BEFTN is approximately Taka 120 million per day. In order to make the payment systems of Bangladesh more efficient and dynamic, National Payment Switch (NPS) has been decided to establish within the scope of national information and communication policy. Bangladesh Bank introduced mobile financial services in Bangladesh in order to bring the vast unbanked / under-banked population under the umbrella of formal financial service. At present, daily volume of transaction through MFS is Taka 350 million.

Bangladesh Bank issues license to the banking companies in Bangladesh. It also holds the authority to cancel a license granted to a banking company on account of some valid reasons.

Bangladesh Bank as the regulator of the banks in Bangladesh formulates the policy on capital adequacy, fixes the norms of adequacy and from time to time makes revisions to upgrade the norms of adequacy to international standard. In a process of gradual development the Bank fully implemented Basel II regime in Bangladesh from January 01, 2010.

To ensure quality of loan portfolio of the banking industry, Bangladesh Bank formulated a good number of policies and regulations and adopted some significant initiatives. These include (i) policy on loan classification and provisioning, (ii) payment of dividend by bank companies, (iii) rescheduling of loans, (iv) loan write-off; single borrower exposure, (v) large loan restructuring scheme (LLRS), (vi) restriction on lending to directors of private banks and (vii) establishment of Credit Information Bureau (CIB).

For efficient management and supervision of the financial system, Bangladesh Bank formulated some guidelines and undertook some measures. It has been found that, the guidelines, policies or initiatives of the Bangladesh Bank are not mutually exclusive in terms of objectives or outcomes. Same policy or initiative can facilitate efficient management simultaneously can help achieve quality of loan portfolio. However, the guidelines and initiatives considered in this group include (i) guidelines on managing core risks in banking, (ii) prudential guidelines for consumer financing and small enterprise financing, (iii) CAMELS ratings, (iv) Early Warning System (EWS), (v) supervision of banks, (vi) deregulation of interest rates on deposit and lending and (vii) rationalizing bank charges.

The Bangladesh Bank was found keen to ensure good governance in bank management in the financial sector of Bangladesh. To establish good governance and to develop transparency and accountability in bank management Bangladesh Bank formulated various rules, regulations and directives and brought amendments therein occasionally. These rules, regulations and directives cover (i) constitution of the board of directors and fit and proper test for appointment of bank directors, (ii) appointment of chief executive and advisor in banks, (iii) corporate governance in bank management, and (iv) constitution of the audit committee of board of directors.

As a guardian of the financial sector, the Bangladesh Bank attempts to protect the interest of the customers of this sector. In this regard the Bank was found to take some measures, which include establishment of Deposit Insurance Scheme (DIS), facilitating setting up of 'Complaint Cell' at the banks, introduction of better disclosure and transparency standards, regulatory oversight of the banks, etc.

As a banker of the banks, Bangladesh Bank was found to address all the major aspects of the financial system of the economy. It formulated many regulations, policies, guidelines and adopted different measures. These were also revised occasionally to upgrade to international standard and to meet the changing need of time.

9.2.5 Role of Bangladesh Bank as a Banker to the Government

In the evolution process of central banking, one bank's role as Government's banker and agent was a determining factor for that bank to bloom into a Central Bank. So, to act as the banker to the Government is the fundamental role of any

Central Bank. Bangladesh Bank acts as the banker and debt manager of the Government of Bangladesh in terms of Article 20 of the Bangladesh Bank Order 1972 and an agreement made between the Government of the People's Republic of Bangladesh and Bangladesh Bank on 10 September 1985.

As a banker to the Government, Bangladesh Bank was found to perform a good deal of functions. Among those functions the most important is public debt management. Due to mismatch between revenue and expenditure, the Government of Bangladesh faces huge budget deficit. For financing of this budget deficit and for other needs, the Government embarks upon debt where Bangladesh Bank serves as a dominant internal source. It provides ways and means loan to the Government. The limit of this loan was found to be revised occasionally. At present the limit is Taka 2000 crore. The domestic debt management strategy is determined by the Cash and Debt Management Committee (CDMC), which is composed of high officials of the Ministry of Finance and Bangladesh Bank. The Bank implements the strategy adopted by CDMC. The Bank issues and services public debt on behalf of the Government through a network of Primary Dealers. It collects Government revenue i.e., taxes from different sources. The Bank performs the treasury functions on behalf of the Government. Bangladesh Bank renders advice to the Government on financial matters, whenever called upon to do so.

9.2.6 A Critical Analysis of the Reforms Undertaken by Bangladesh Bank

The reforms undertaken in the banking sector of Bangladesh have multi-dimensional background weaved by economic, historic and conditionality factors. The nationalization and reorganization of the financial institutions by the Government immediately after the liberation of Bangladesh and the subsequent rigid Government interventions in the financial market resulted in operational inefficiency and deterioration of customer services of the banks operating in Bangladesh, though they had little positive impact on increase in the number of bank branches, reduction in population per branch, urban-rural proportion of branches in favour of rural areas and growth of deposit and credit. Consequently, the financial sector suffered from different distortions; the quality of loan portfolio of the banks declined and huge NPL accumulated in the banking sector.

In this perspective and at the same time to fulfill the conditions of SAF, ESAF and FSAC loans of IMF and the World Bank, the Government initiated reform programme in the banking sector in 1983. It denationalized two nationalized banks, The Government appointed NCMBC in 1984 to diagnose the malaise in the banking sector of Bangladesh and to identify remedial measures. The NCMBC formulated a set of recommendations. Subsequently, a World Bank team conducted an in-depth study on the financial sector of Bangladesh and suggested reforms in many areas. In 1992, FSRP was instituted at Bangladesh Bank to assist the implementation of the reform measures. In 1996, the Government appointed BRC to evaluate the overall situation of the NCBs and place recommendations. Based on all these recommendations and suggestions, the Government implemented in phases a wide range of reforms in the banking sector of Bangladesh. Broadly the reform measures include interest rate deregulation, implementation of new system of loan classification and provisioning, new capital adequacy requirement, new supervision, operational and management tools, and lastly, reforms in the legal framework.

Under interest rate deregulation effort, Bangladesh Bank almost completely deregulated the interest rate structure in phases to ensure price competition in the banking sector and efficient resource allocation. It removed the lending rate bands from all sectors excepting the export sector only and abolished the ceiling and floor rates from savings and fixed deposits. Along with interest rate deregulation, Bangladesh Bank adopted market oriented approach for Monetary Policy and switched from direct quantitative monetary control to indirect methods of monetary management. It introduced *repo, reverse repo and interbank repo* operations in July 2002, April 2003 and July 2003 respectively to reinforce indirect monetary operation and manage day-to-day liquidity position in the market.

In 1989, Bangladesh Bank enforced new system of loan classification and provisioning in the banking sector mainly to ensure the quality of loan portfolio in the banking sector by strengthening the banking institutions and harnessing the prevailing huge NPLs. Subsequently, the norms of loan classification and provisioning were upgraded to international standard. According to the new system of loan classification and provisioning, the banks are to classify all loans under four categories viz., continuous loan, demand loan, fixed term loan and short term agricultural loans / micro credit. Each category is to be further classified as “classified’ or “unclassified”. ‘Classified” loans again are to be classified as “sub-standard”, “doubtful” and “bad / loss” depending on the length of overdue criteria. At present, for all categories of loans excepting the short term agricultural loans / micro credit, the banks are to maintain provision of one percent against unclassified loans, 20 percent against sub-standard, 50 percent against doubtful and 100 percent for bad loan / loss. For short term agricultural loans / micro credit, the rate of required provision is five percent against unclassified, sub-standard and doubtful category each. 100 percent provision should be kept for bad / loss loans.

In January 1996, Bangladesh Bank formally introduced risk-based capital requirement in line with Basel Accord I and over time made this requirement more stringent. At the end of one year parallel run period with Basel I, Basel II regime has been started from January 01, 2010 in full swing. At present, the banks are to maintain capital to RWA ratio of 10% at the minimum with at least 50% of required capital as Tier 1 capital.

Bangladesh Bank introduced many new supervision, operational and management tools under its reform package. It added off-site surveillance with on-site supervision. In 1994 the Bank enacted CAMEL rating covering five risk components in banking business. On the basis of the ratings under CAMEL, a “Problem Bank Cell” has been instituted in Bangladesh Bank and Early Warning Signals (EWS) are being issued to applicable banks. One Credit Information Bureau (CIB) and a Large Loan Review Cell (LLRC) have been installed at Bangladesh Bank. At the same time, the Bank introduced some new management and operational tools for the commercial banks, such as Lending Risk Analysis (LRA), New Loan Ledger (NLL), Performance Planning system (PPS) etc. In July 2006, a sixth risk component namely “sensitivity to market risk” was incorporated in the CAMEL framework and the framework was renamed as CAMELS.

The Bank initiated reforms in the legal framework also. Amendments in and enactment of some Orders and laws have been made in this course. The Bangladesh Bank Order 1972, Bangladesh Banks (Nationalisation) Order 1972, Negotiable Instruments Act 1881, Banking Companies Act 1991, lender’s recourse related laws like Artha Rin Adalat (Money Loan Court) Act 1990 and Bankruptcy Act 1997 are mention-worthy in this regard. It needs to be mentioned that, banking sector reform is still an ongoing and continuous process in Bangladesh.

It was found that, the new tools, instituted under the reform agenda failed to generate desired outcome in the Bangladesh banking sector. The indicators employed under the CAMELS framework indicate overall institutional inefficiency specially for the NCBs and the DFIs. Performance indicators of the banking industry depict a trend similar to that of the state-owned banks, which happens due to their predominant market share. It has been observed that, financial performance of the PCBs and FCBs was better than the industry average.

The study revealed several reasons of the failure of the reform programme. Flaws in the reform design and sequencing, ineffective and weak legal framework, supervisory and regulatory forbearance of Bangladesh Bank, ownership conflict of the reform programme, lack of commitment on the part of the Government, even in some cases Government-led distortions were found to be the main causes for the poor outcome. However, it was a success of the reforms that, now the weaknesses of the banking sector are completely exposed, which may compel adoption of appropriate remedial measures. It is suggested that, the reform programme should continue with enhanced attention, wisdom and farsightedness accompanied with political commitment and non-interference by the Government and vested interest groups.

9.2.7 Bangladesh Bank's Role in Development

Bangladesh Bank adopts a two pronged approach to attain developmental objectives. Firstly, a Bangladesh Bank guided Corporate Social Responsibility (CSR) driven financial inclusion campaign is reaching out with financial services to the hitherto un-served or under-served productive economic sectors (like small holder agriculture and SMEs). Secondly, the Bank maintains some degree of deliberate directional bias in its credit policies to encourage credit flows to the productive purposes; at the same time, to discourage credit expansion for unproductive uses. Bangladesh Bank has been found to adopt mainly two courses of action to perform the development role. Firstly, it issues policy directives through different circulars to be followed by the banks and financial institutions. Secondly, it conducts refinance schemes to finance the desired sectors. In addition to these, the Bank employs moral suasion and declaring incentives for compliance of the directives and for successful operation by the banks and financial institutions as considering the compliance for CAMELS rating and /or opening new branches, etc. It has been found playing development role in agriculture, industry, Small and Medium Enterprises (SME) and women entrepreneurship, export, customer interest protection, automation of the banking system, and green banking.

The Bank has a specialized department namely ‘Agricultural Credit and Financial Inclusion Department’ at its head office which formulates the ‘Agricultural and Rural Credit Policy and Programme’ each year. Since October 2008, participation in agricultural credit programme has been made mandatory for all scheduled banks operating in Bangladesh. Bangladesh Bank made it mandatory for the banks to set the annual agricultural/ rural credit disbursement target at 2.5% of their total loans and advances from FY 2011-2012. Disbursement of agricultural credit against the target was not satisfactory till the fiscal year 1997-98. But, since the fiscal year 1998-99, actual disbursement was close to target. To stimulate agricultural credit, Bangladesh Bank extends refinance facilities to the specialized banks and institutions operating in this sector. In FY 2010-11, disbursement of refinance facility was Tk, 1.86 billion and the outstanding amount of refinance in the same year was TK. 56.03 billion. To make agricultural credit available to the sharecroppers, in Fiscal Year 2010 Bangladesh Bank launched a refinance scheme worth Taka 5.0 billion in partnership with BRAC. Under this refinance scheme, primarily credit has been extended for three years at a flat interest rate of ten percent to 3,00,000 sharecroppers in 172 upazillas of 37 districts for crop cultivation and purchasing of agricultural machineries. The length of this refinance scheme has been extended by three years to June 2015 which is supposed to cover 5,00,000 sharecroppers in 250 upazillas of 48 districts. In Fiscal Year 2012, agricultural credit totaling Taka 10.86 billion was disbursed by the state-owned banks to around 5,00,000 sharecroppers. To reduce import dependence and to encourage domestic production of pulse, spices, lentils and oilseeds, agricultural credit at concessional four percent interest rate per annum is being extended by the banks to farmers since 1st July 2011. In fiscal year 2011-12, Taka 81.63 crore has been disbursed in this sector against a target of Taka 77.63 crore. For poverty reduction, Bangladesh Bank has adopted crop diversification in place of conventional mono crop production as a strategy. In recent times, Bangladesh Bank got involved in two projects namely Northwest Crop Diversification Project

(NCDP) and Second Crop Diversification Project (SCDP) aiming at poverty reduction through crop diversification. Bangladesh Bank launched a refinance scheme of Taka 1.0 billion in November 2001 out of its own fund to finance establishment of agro product-processing industries in the areas outside divisional head quarters and Narayanganj town. To increase hassle-free availability of banking services to the farmers, the Bank introduced opening of a bank account by a farmer by keeping only ten Taka as initial deposit. As a result, financial inclusion as percentage of adult population increased from 65.33 percent in 2004 to 87.23 percent in 2010.

In the industry sector, Bangladesh Bank has been playing some development role in the form of implementing specialized projects. At present Bangladesh Bank is running two vital projects in industry sector namely Equity Entrepreneurship Fund (EEF) and Investment Promotion and Financing Facility (IPFF) Project. Equity and Entrepreneurship Fund (EEF) was formed by the Government of Bangladesh in FY2001 through budgetary allocation of Taka 1.0 billion to encourage investments in the risky but prospective agro-based/food processing and IT sector projects. The Fund is maintained by the Bangladesh Bank. An agreement has been signed on 1 June 2009 between Bangladesh Bank and Investment Corporation of Bangladesh (ICB) regarding the transfer of operational activities of EEF. Up to 30 June 2011 with the project cost of Taka 35.2 billion, a total of 820 projects (including 771 agro-based/food processing projects and 49 IT projects) got EEF sanction at different stages of disbursement. Bangladesh Bank has been implementing "Investment Promotion and Financing Facility (IPFF) Project" on behalf of Finance Division, Ministry of Finance since January 2007. IPFF is a 5-year term (January 2007 – December 2011) International IDA supported on-lending based Technical Assistance (TA) project designed to supplement the resource of the Bangladesh financial markets to provide term finance for infrastructure and other investment projects beyond the capacity of local financial institutions; and to promote the role of private sector entrepreneurs in the development of capital projects, especially infrastructure. As per agreement, total cost of the project was USD 60.00 million with five years tenure starting from January 2007 to December, 2011. IPFF has been able to disburse 100 percent (Taka 4.22 billion equivalent to USD 57.50 million) of its on-lending component to seven small power plants having capacity of 178 MW within 4th year of the project tenure.

Bangladesh Bank has placed greater emphasis on Small and Medium Enterprises (SME) and Women Entrepreneurship. A new department namely ‘SME and Special Programmes Department’ has been established in Bangladesh Bank in December 2009. In 2010 the Bank formulated the “SME Credit Policy and Programs, 2010”. At present the Bank with the help of Government and different development partners, is implementing five refinance schemes. Till 30 September 2012, Taka 25.72 billion has been refinanced against 32,018 enterprises. With a view to mainstream SME credit, Bangladesh Bank has directed the banks and financial institutions to adopt cluster development policy. Banks and financial institutions are instructed to follow ‘area approach method’ while developing clusters.

At present Bangladesh Bank is implementing one very important Fund namely Export Development Fund (EDF) to enhance export. Established in 1989, the Export Development Fund (EDF) is intended to facilitate access to financing in foreign exchange for input procurements by manufacturer-exporters. The EDF is held and managed by the Foreign Exchange Reserve and Treasury Management Department (FRTMD) at the head office of Bangladesh Bank. Initial fund was USD 300 million. Later to facilitate export trade of the country, the fund was raised to USD 400 million.

Bangladesh Bank has undertaken some initiatives to protect the interest of the customers of the banking sector. To minimize or eliminate the risk of loss of depositors' fund with banks, Bangladesh Bank introduced Deposit Insurance Scheme in Bangladesh in August 1984 to act as a safety net. The Bank created a Deposit Insurance Trust Fund (DITF) for providing limited protection (not exceeding Taka 0.10 million) to a small depositor in case of winding up of any bank. At the end of June 2011, the total assets of the DITF stood at Taka 17.9 billion of which Taka 17.7 billion were invested in Government securities. Bangladesh Bank advised the banks to set up a "Complaint Cell" in each bank to deal with all sort of complaints, either received directly by them or referred through different agencies or institutions including Bangladesh Bank. The Bank has also set up a ‘Complaint Cell’ headed by a Deputy General Manager in its Department of Banking Inspection at the head office. The responsibility of this Cell is to check the performance, effectiveness and functioning of the Complaint Cells of the banks and monitor the status of the customer complains. With a view to prompt resolution of the complaints against banking services at the customer level, to observe the level of satisfaction of the customers and to ensure improved customer services Bangladesh Bank established 'Customers' Interest Protection Centre' (CIPC) at its head office and at the branch offices in March 2012. The number of total complaints received upto September 2012 was 3824, out of which 3018 has been resolved, making the rate of resolution 79 percent. Recently Bangladesh Bank has established a new department namely 'Financial Integrity and Customer Services Department' at its head office for dealing with complaints of the customers and clients of the banks and financial institutions more easily and quickly. Considering the interest of the small depositors, Bangladesh Bank decided that no charge can be imposed as account maintenance fee for average deposit balance up to Taka 5000. The Bank also decided that Taka 100 at maximum may be imposed as account maintenance fee for average deposit balance up to Taka 25000 on six monthly basis.

To make the banking system modern technology based, efficient and secure, the Bangladesh Bank has taken some important steps including Bangladesh Automated Clearing House (BACH), online banking system, online CIB service, mobile banking, e-commerce, etc. Installation of National Payment Switch software is underway. CIB online is a web-based online system through which banks and financial institutions can furnish credit information and can access credit reports within few seconds by searching online from their respective workstations at any time round the year. Bangladesh Bank introduced mobile financial services in Bangladesh in order to bring the vast unbanked / under-banked population under the umbrella of formal financial service. A variety of services including disbursement of inward foreign remittance and domestic fund, payment of utility bills, salary, allowances, pension, buying and selling of goods and services, balance inquiry, tax payment, Government subsidy payment and payment of the benefits of social safety nets can easily and quickly be provided through mobile financial services. At present, daily volume of transaction through MFS is Taka 350 million. The volume of transaction is increasing at a rate of 15 percent per month. With the view to render better service, Bangladesh Bank made attempts to equip itself with technological development like networking, Enterprise Resource Planning (ERP), Enterprise Data Warehouse (EDW), Website and Intranet Development.

9.3 Policy Recommendations

The present research is descriptive in nature. It is intended to reveal the functions and role of Bangladesh Bank, which it performs in the developing economy perspective of Bangladesh. Doing so, some suggestions have already been made in the preceding Chapters. A descriptive research does not need to place policy suggestions; still some policy suggestions have been put forward below.

(1) It seemed that, Bangladesh Bank is over loaded with numerous objectives and functions to carry on satisfactorily with the existing capability. The functions and objectives may be curtailed to reasonable level.

(2) Bangladesh Bank should try to address the demand side problems of the financially excluded sections of the population.

(3) It should follow a comprehensive and well-coordinated development agenda to be more effective.

(4) The Bank should urgently explore the causes of Non-performing Loans (NPLs) and the remedies thereof in Bangladesh.

(5) Bangladesh Bank should identify the impacts of its developmental activities on the economy and on the livelihood of the people of Bangladesh.

(6) The Bank should review the impacts of its reform measures on the banking sector and the economy of Bangladesh categorically.

(7) The Policy Analysis Unit (PAU) should be revived soon and should be obligated with undertaking central banking related research regularly.

(8) Bangladesh Bank should be sanctioned more independence. This independence should be ensured systematically, not just through uncertain practice. It is to be made immediately free from interference and dominance of Ministry of Finance.

(9) A central authority for collecting and publishing banking sector related data should be raised. Access to those data by researchers and the people with interest should be made free and easy.

9.4 Conclusions

Central Bank of a developing country has a dual role to perform: that of a regulator, as well as that of a promoter. Bangladesh Bank undertakes all the traditional functions as the Central Bank of the country. In the monetary sector well articulated co-ordination between Monetary Policy and Fiscal Policy is warranted. Instead of addressing numerous objectives, the Bank may focus on selected specific manageable issues. It initiated a host of reforms in the financial sector starting from the later part of 1980s. But the reforms failed to bring about desired outcomes; especially the prevalence of non-performing loan could not be controlled. Flaws in the reform design and sequencing, ineffective and weak legal framework, supervisory and regulatory forbearance of Bangladesh Bank, ownership conflict of the reform programme, lack of commitment on the part of the Government, even Government-led distortions were found to be the main causes for the poor outcome. These factors influence not only the reform agenda, but almost the whole gamut of the functions of Bangladesh Bank to varying degrees. The Bank undertakes a good deal of development initiatives mainly in financial inclusion approach. These functions have already begun to exhibit good prospect. Considerable independence is a pre-condition for Bangladesh Bank to perform its expected role effectively.

9.5 Suggestions for Further Research

Central banking is an enormously big business. The present research is the first attempt to cover all the major aspects of the business of Bangladesh Bank in a single study. Moreover, the research has been conducted on a forty year long time span. It is not possible to explore and analyze all the issues of this vast area with due weight in a single thesis. It is expected that, the present study will inspire further research on specific issues of the broad area of central banking in Bangladesh. In the light of the experience of the present research, some suggestions for further research are placed below:

(1) Economic growth is one of the two policy targets of Monetary Policy in Bangladesh. There are varying opinions regarding the prospect of Monetary Policy in playing effective role in boosting economic growth. An in-depth research can be undertaken to examine the role of Monetary Policy in economic growth in Bangladesh.

(2) A study may be pursued to suggest the appropriate measure of inflation from Consumer Price Index (CPI) and core inflation in Bangladesh.

(3) It is high time to undertake an investigation to assess the effectiveness of *repo, reverse repo and interbank repo* operations of Monetary Policy in Bangladesh.

(4) A study may be done to determine the mode and details of the co-ordination between Monetary Policy and Fiscal Policy, suitable for Bangladesh.

(5) An in-depth research need to be initiated on the estimation of a stable money demand function in Bangladesh.

(6) An investigation is needed on how much Central Bank Independence (CBI) practically Bangladesh Bank enjoys and how much CBI is actually required in Bangladesh perspective.

(7) A comparative study can be done on traditional commercial banking and Islamic banking in Bangladesh.

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APPENDIX

Appendix: Table 1

List of Story Tellers

Sl No.	Name	Designation
01.	Dr. Salehuddin Ahmed	Ex-Governor, Bangladesh Bank
02.	Md. Abul Quasem	Deputy Governor, Bangladesh Bank
03.	Dr. Md. Akhtaruzzaman	Economic Advisor, Bangladesh Bank
04..	Dr. Md. Ezazul Islam	Deputy General Manager, Bangladesh Bank
05.	Md. Golam Moula	Deputy General Manager, Bangladesh Bank
06.	Mesbah Ul Haque	Deputy General Manager, Bangladesh Bank
07.	Md. Sakhawat Hossain	Joint Director, Bangladesh Bank

Appendix: Table-2

Statement of Affairs on Assets of Bangladesh Bank Banking Department (Taka in millions)

End of Period	Notes & Coins	Bills Purchased & Discounted	Balance Abroad	Notes & Coins, Bills Purchased & Discounted, Balance Abroad	Loans & Advances			Govt. Debtor Balance	Investment	Loan & Advance, Government Debtor Balance, Investment	Other Assets	Total Assets
					Government	Others	Total					
1	**2**	**3**	**4**	**5=2+3+4**	**6**	**7**	**8=6+7**	**9**	**10**	**11= 8+9+10**	**12**	**13= 5+11+12**
1975	9.9	404.7	1296.2	1710.8	200.0	1896.5	2096.5	99.9	1659.6	3856.0	121.7	5688.5
1976	13.7	618.0	3317.0	3948.7	200.0	835.0	1035.0	91.0	1721.8	2847.8	120.7	6917.2
1977	13.2	788.6	1384.7	2186.5	200.0	2394.5	2594.5	90.6	1593.7	4278.8	213.1	6678.4
1978	0.9	1097.4	2688.9	3787.2	142.5	3298.0	3440.5	0.0	336.5	3777.0	417.8	7982.0
1979	11.3	2667.0	3485.8	6164.1	200.0	3182.5	3382.5	90.6	1237.6	4710.7	2002.5	12877.3
1980	18.4	2728.1	3902.8	6649.3	200.0	4850.6	5050.6	0.0	3632.1	8682.7	1006.0	16338.0
1981	4.7	4370.9	2217.3	6592.9	153.9	6931.3	7085.2	0.0	4972.1	12057.3	1216.3	19866.5
1982	8.0	3173.0	3849.5	7030.5	200.0	12083.4	12283.4	0.0	3073.7	15357.1	3061.7	25449.3
1983	8.5	801.0	11701.4	12510.9	183.7	7957.2	8140.9	0.0	1512.2	9653.1	5239.1	27403.1
1984	8.2	3197.9	8008.0	11214.1	200.0	11826.1	12026.1	0.0	1667.9	13694.0	4675.3	29583.4
1985	7.1	2043.8	7622.9	9673.8	0.0	15210.6	15210.6	0.0	5377.9	20588.5	6075.2	36337.5
1986	5.0	910.5	6995.9	7911.4	0.0	12758.9	12758.9	0.0	3640.5	16399.4	8289.3	32600.1
1987	9.3	4000.2	23009.6	27019.1	200.0	12396.9	12596.9	0.0	5417.0	18013.9	9932.4	54965.4
1988	8.5	2586.9	30846.0	33441.4	200.0	8449.5	8649.5	0.0	6243.9	14893.4	12412.4	60747.2
1989	4.9	3959.9	12804.5	16769.3	200.0	13606.2	13806.2	0.0	13636.2	27442.4	13023.1	57234.8
1990	6.2	3958.2	20192.6	24157.0	0.0	15294.7	15294.7	0.0	10170.9	25465.6	14727.3	64349.9
1991	3.7	4244.9	45889.8	50138.4	200.0	9384.4	9584.4	0.0	7089.7	16674.1	16367.4	83179.9
1992	3.7	247.6	61070.9	61322.2	200.0	6292.5	6492.5	0.0	6862.9	13355.4	18469.2	93146.8

(Continued to next page)

Appendix: Table-2 (Concluded)

End of Period	Notes & Coins	Bills Purchased & Discounted	Balance Abroad	Notes & Coins, Bills Purchased & Discounted, Balance Abroad	Loans & Advances			Govt. Debtor Balance	Investm-ent	Loan & Advance, Government Debtor Balance, Investment	Other Assets	Total Assets
					Govt.	Others	Total					
1993	0.3	204.0	74086.4	74290.7	0.0	9342.4	9342.4	0.0	4466.4	13808.8	22356.1	110455.6
1994	7.3	0.0	91625.6	91632.9	0.0	11821.3	11821.3	0.0	5209.7	17031.0	16688.7	125352.6
1995	7.8	0.0	54193.0	54200.8	200.0	9274.7	9474.7	0.0	23299.5	32774.2	16463.8	103438.8
1996	6.5	0.0	37291.0	37297.5	640.0	14763.6	15403.6	0.0	34636.6	50040.2	18308.5	105646.2
1997	0.8	329.5	29944.1	30274.4	640.0	11507.2	12147.2	0.0	28251.4	40398.6	21151.7	91824.7
1998	3.0	90.6	52403.3	52496.9	640.0	16349.0	16989.0	0.0	34744.4	51733.4	26247.6	130477.9
1999	9.2	0.0	42647.9	42657.1	640.0	17725.8	18365.8	0.0	43695.1	62060.9	27245.9	131963.9
2000	8.9	149.0	40018.9	40176.8	0.0	20038.1	20038.1	0.0	29321.0	49359.1	26203.5	115739.4
2001	9.2	0.0	42027.3	42036.5	0.0	21578.2	21578.2	0.0	56738.0	78316.2	30223.8	150576.5
2002	5.0	2502.0	56602.0	59109.0	640.0	23774.0	24414.0	0.0	13711.0	38125.0	49912.0	147146.0
2003	8.0	35.0	91522.0	91565.0	0.0	23583.2	23583.2	0.0	-5736.0	17847.2	61082.3	170494.5
2004	9.3	0.0	109484.5	109493.8	0.0	25451.9	25451.9	0.0	31501.7	56953.6	73513.5	239960.9
2005	7.4	0.0	95091.7	95099.1	640.0	29552.3	30192.3	0.0	85725.0	115917.3	83330.6	294347.0
2006	9.3	0.0	175538.7	175548.0	10000.0	29724.9	39724.9	0.0	60374.6	100099.5	106653.3	382300.8
2007	8.4	0.0	247305.3	247313.7	10000.0	30959.7	40959.7	0.0	34695.0	75654.7	126215.2	449183.6
2008	3.8	0.0	229151.8	229155.6	10000.0	66254.2	76254.2	0.0	31598.3	107852.5	119321.4	456329.5
2009	3.1	0.0	454919.3	454922.4	0.0	40225.7	40225.7	0.0	91619.1	131844.8	121441.1	708208.3
2010	7.2	0.0	315021.4	315028.6	0.0	89648.6	89648.6	0.0	136027.9	225676.5	150824.9	691530.0
2011	1.0	0.0	221999.9	222000.9	20000.0	94045.6	114045.6	0.0	174336.5	288382.1	331857.0	842240.0

Source: Bangladesh Bank, *Bangladesh Bank Bulletin,* various issues.

Appendix: Table-3

Statement of Affairs on Liabilities of Bangladesh Bank Banking Department (Taka in millions)

End of Period	Paid up Capital	Other Funds	Deposits				Bills Payable	Other Liabilities	Liabilities
			Govt.	Banks	Other	Total			
1975	60.0	122.5	0.0	719.9	2226.1	2946.0	1.6	2558.4	5688.5
1976	60.0	162.5	0.0	933.1	3618.7	4551.8	0.8	2192.9	6968.0
1977	60.0	202.5	0.0	1106.7	3414.6	4521.3	0.7	1893.9	6678.4
1978	60.0	242.5	5.0	1285.1	3810.4	5100.5	1.0	2578.0	7982.0
1979	60.0	325.0	0.0	2003.2	6575.5	8578.7	0.5	3918.5	12882.7
1980	60.0	575.0	10.0	2375.2	8682.5	11067.7	0.9	4634.3	16337.9
1981	60.0	885.0	5.1	2437.8	11630.6	14073.5	0.7	4847.3	19866.5
1982	60.0	1195.0	12.6	3090.2	15305.7	18408.5	0.9	5784.9	25449.3
1983	60.0	1510.0	5.0	3773.7	17193.9	20972.6	1.8	4858.7	27403.1
1984	60.0	1890.0	6.5	5382.3	15892.4	21281.2	0.9	6351.3	29583.4
1985	60.0	2270.0	10.2	5938.0	18713.3	24661.5	2.2	9343.8	36337.5
1986	60.0	2650.0	9.9	7309.2	17128.0	24447.1	0.8	8112.2	35270.1
1987	60.0	3030.0	12.0	16482.7	22282.2	38776.9	1.9	13096.5	54965.3
1988	60.0	3410.0	11.6	18494.2	25393.7	43899.5	1.1	13376.6	60747.2
1989	60.0	3672.3	9.0	21275.3	20137.1	41421.4	1.6	12079.5	57234.8
1990	60.0	4057.8	12.4	23087.3	25198.5	48298.2	1.7	11932.2	64349.9
1991	60.0	4446.9	10.9	19410.4	42995.6	62416.9	902.9	15353.2	83179.9
1992	60.0	5905.9	7.9	25040.8	51013.4	76062.1	902.2	10216.6	93146.8
1993	60.0	5368.5	6054.7	35086.8	49025.1	90166.6	1453.1	13407.4	110455.6
1994	60.0	5748.4	895.4	42473.7	50746.2	94115.3	4004.9	21424.0	125352.6
1995	60.0	5687.8	12.6	24747.9	47183.7	71944.2	2760.2	22986.6	103438.8
1996	60.0	6367.9	8.8	28630.1	40233.2	68872.1	7379.4	22966.8	105646.2
1997	60.0	7047.9	12.8	28608.5	32364.2	60985.5	4.0	23727.3	91824.7
1998	60.0	7727.9	13.8	40701.2	43674.0	84389.0	8.3	38292.7	130477.9
1999	60.0	8407.9	9.4	35074.8	47714.5	82798.7	6.5	40690.8	131963.9
2000	60.0	9087.8	11.0	34198.7	27103.3	61313.0	5.1	45273.5	115739.4
2001	60.0	9637.9	9.9	57956.7	23340.1	81306.7	56.8	59515.1	150576.5
2002	60.0	10188.0	10.0	56040.0	19845.0	75895.0	36.0	60967.0	147146.0
2003	60.0	10672.6	11.8	63201.0	20797.0	84009.8	9.1	75743.0	170494.5
2004	60.0	10737.8	8.1	63525.5	25445.3	88978.9	70.7	140113.5	239960.9
2005	60.0	10737.9	12.0	87560.8	33165.7	120738.5	12.7	162797.9	294347.0
2006	60.0	10737.9	5.1	97679.9	49786.6	147471.6	27.6	224002.8	382299.9
2007	60.0	10287.8	14.4	112669.4	58941.5	171625.3	29.3	267181.2	449183.6
2008	4280.5	19636.3	5.0	139670.8	75718.0	215393.8	12.8	217006.1	456329.5
2009	4280.5	26805.8	108012.9	200628.6	63061.1	371702.6	35.4	305384.0	708208.3
2010	4280.5	24358.4	15215.8	239403.9	65004.4	319624.1	58.1	343208.9	691530.0
2011	4280.5	31497.6	5.0	283956.4	60024.9	343986.3	54.0	462420.7	842239.1

Source: Bangladesh Bank, *Bangladesh Bank Bulletin,* various issues.

Appendix: Table-4

Statement of Affairs on Assets of Bangladesh Bank Issue Department (Taka in million)

End of Period	Foreign Assets	Domestic Assets					Total Assets
		Taka coin	Securities of Bangladesh Govt.	Internal Bills of Exchange & Other Commercial Paper	Silver Bullion	Total	
1975	700.0	87.9	2955.8	0.0	0.0	3043.7	3743.7
1976	1000.0	105.6	2815.9	0.0	0.0	2921.5	3921.5
1977	2000.0	101.2	3156.4	0.0	0.0	3257.6	5257.6
1978	2000.0	47.2	4686.5	0.0	0.0	4733.7	6733.7
1979	2846.1	35.0	2005.4	2575.0	0.0	4615.4	7461.5
1980	1349.6	21.2	4924.5	2592.4	0.0	7538.1	8887.7
1981	835.0	27.9	6429.1	2592.4	0.0	9049.4	9884.4
1982	803.0	56.5	6151.1	3592.4	0.0	9800.0	10603.0
1983	936.5	24.7	6767.6	6882.4	0.0	13674.7	14611.2
1984	2411.3	34.1	5442.8	11292.4	0.0	16769.3	19180.6
1985	2400.2	21.2	5143.9	12322.4	0.0	17487.5	19887.7
1986	2515.9	27.9	2698.2	16072.4	0.0	18798.5	21314.4
1987	2712.2	61.2	5499.4	16972.4	0.0	22533.0	25245.2
1988	2774.5	26.7	2747.1	22672.4	0.0	25446.2	28220.7
1989	2692.5	84.8	3660.7	24130.8	0.0	27876.3	30568.8
1990	2742.8	177.3	5260.4	25420.8	0.0	30858.5	33601.3
1991	2831.1	130.5	2552.0	29990.8	0.0	32673.3	35504.4
1992	10886.2	86.6	3406.9	27300.8	0.0	30794.3	41680.5
1993	23033.3	246.1	2489.9	23160.8	0.0	25896.8	48930.1
1994	35092.9	576.8	2050.3	23990.8	0.0	26617.9	61710.8
1995	41096.2	320.5	2046.9	26690.8	0.0	29058.2	70154.4
1996	41188.9	103.4	7754.2	24950.8	0.0	32808.4	73997.3
1997	41147.8	492.8	10535.4	30360.8	0.0	41389.0	82536.8
1998	41081.2	375.1	16442.0	30040.8	0.0	46857.9	87939.1
1999	41001.6	195.8	26681.5	35790.8	0.0	62668.1	103669.7
2000	41599.8	194.5	50153.3	35700.8	0.0	86048.6	127648.4
2001	31730.7	453.8	74902.4	31130.8	0.0	106487.0	138217.7
2002	42250.0	329.0	72273.0	29301.0	0.0	101903.0	144153.0
2003	62721.0	501.0	66044.0	25370.0	0.0	91915.0	154636.0
2004	83032.6	375.3	68300.5	31120.8	0.0	99796.6	182829.2
2005	83846.0	587.3	99277.1	36080.8	0.0	135945.2	219791.2
2006	84930.8	337.6	191298.8	37630.3	164.0	229430.7	314361.5
2007	106486.2	346.6	212549.6	30410.2	187.9	243494.3	349980.5
2008	158599.2	244.6	213897.4	30800.3	137.1	245079.4	403678.6
2009	224528.8	442.6	188134.5	31270.3	220.4	220067.8	444596.6
2010	405923.7	285.0	131688.7	34890.2	401.3	167265.2	573188.9
2011	507622.4	204.0	91931.3	31640.3	413.8	124189.4	631811.8

Source: Bangladesh Bank, *Bangladesh Bank Bulletin,* various issues.

Appendix: Table-5

Statement of Affairs on Liabilities of Bangladesh Bank Issue Department

(Taka in million)

End of Period	Notes in the Banking Department	Notes in Circulation	Total Notes Issued/Liabilities
1975	9.5	3734.2	3743.7
1976	13.5	3908.0	3921.5
1977	1.6	5245.0	5246.6
1978	0.9	6732.8	6733.7
1979	11.3	7540.2	7551.5
1980	18.4	8869.3	8887.7
1981	4.7	9879.7	9884.4
1982	8.0	10595.0	10603.0
1983	8.6	14602.6	14611.2
1984	8.2	19172.4	19180.6
1985	7.1	20150.6	20157.7
1986	5.0	21309.4	21314.4
1987	9.3	25235.9	25245.2
1988	8.5	28212.2	28220.7
1989	4.8	30564.0	30568.8
1990	6.2	33589.1	33595.3
1991	3.7	35500.7	35504.4
1992	3.7	41676.8	41680.5
1993	0.3	48929.8	48930.1
1994	7.3	61703.5	61710.8
1995	7.8	70146.6	70154.4
1996	6.5	73990.8	73997.3
1997	0.8	82536.0	82536.8
1998	3.0	87936.1	87939.1
1999	9.2	103660.5	103669.7
2000	8.9	127639.5	127648.4
2001	9.2	138208.5	138217.7
2002	5.0	144148.0	144153.0
2003	8.0	154628.0	154636.0
2004	9.3	182819.9	182829.2
2005	7.4	219783.8	219791.2
2006	5.0	314356.5	314361.5
2007	8.4	349972.1	349980.5
2008	3.8	403674.8	403678.6
2009	3.1	444593.5	444596.6
2010	7.1	573181.8	573188.9
2011	0.1	631811.7	631811.8

Source: Bangladesh Bank, *Bangladesh Bank Bulletin,* various issues.

Appendix: Table-6

Money Supply in Bangladesh (Taka in crores)											
Period	Bangladesh Bank Notes & Coins	Govt. Notes & Coins	Currency in Tills of DMBs	Currency Outside Banks	Demand Deposits	Time Deposits	Deposits with Bangladesh Bank other than DMB	Narrow Money	Broad Money	Post Office Deposits	Monetary Assets
1	2	3	4	5=2+3-4	6	7	8	9=5+6+8	10=7+9	11	12
1973-74	324.6	27.6	21.1	331.1	414.0	499.2	-	745.3	1244.5	34.2	1278.7
1974-75	282.9	33.9	26.6	290.2	508.9	460.4	-	799.2	1259.6	32.0	1291.6
1975-76	333.2	30.9	34.3	329.9	552.2	514.7	-	882.2	1396.9	34.8	1431.7
1976-77	390.9	30.9	65.4	356.3	616.4	767.0	-	972.9	1739.9	36.5	1776.4
1977-78	533.7	37.0	66.4	504.3	719.5	916.9	-	1224.1	2141.0	38.6	2179.6
1978-79	651.0	42.3	80.0	613.3	911.4	1235.2	-	1524.8	2760.0	41.1	2801.1
1979-80	747.9	48.7	103.2	693.4	1038.2	1513.2	-	1731.8	3245.0	45.0	3289.9
1980-81	984.2	56.8	126.2	914.8	1071.3	2149.7	-	1986.3	4136.0	50.1	4186.1
1981-82	954.3	58.5	135.6	877.5	1134.5	2536.6	-	2012.1	4548.7	50.8	4599.5
1982-83	1221.3	63.8	146.5	1138.6	1495.0	3264.0	-	2634.3	5898.3	56.3	5954.6
1983-84	1721.9	69.9	235.5	1556.3	1993.4	4835.9	-	3549.9	8385.8	68.4	8454.2
1984-85	1919.3	79.3	275.7	1722.9	2508.7	6302.4	-	4231.8	10534.2	81.6	10615.8
1985-86	2205.6	85.9	338.4	1953.1	2974.3	7410.2	-	4927.9	12338.1	95.0	12427.1
1986-87	2346.3	90.6	362.0	2074.9	3186.3	9090.3	-	5262.8	14353.1	107.0	14460.1
1987-88	2724.1	93.2	402.3	2415.0	2632.7	11360.3	-	5047.7	16408.0	140.9	16548.9
1988-89	2930.9	117.8	432.5	2615.6	2845.1	13617.4	-	5460.7	19078.1	192.2	19270.3
1989-90	3566.3	128.0	506.0	3188.3	3180.4	15928.9	-	6368.7	22297.6	255.1	22552.7
1990-91	4102.4	133.3	623.9	3611.8	3591.9	17800.7	-	7203.7	25004.4	269.2	25273.6
1991-92	4534.4	136.9	598.7	4072.6	4184.6	20268.7	-	8257.2	28525.9	268.9	28794.8
1992-93	4885.2	133.8	538.9	4480.1	4582.5	22473.0	-	9062.6	31535.6	395.4	31931.0
1993-94	5966.2	141.3	691.5	5416.0	5751.1	25235.9	-	11167.1	36403.0	722.2	37125.2
1994-95	7030.5	158.0	623.4	6565.1	6614.3	29032.9	-	13179.4	42212.3	1184.5	43396.8
1995-96	7718.0	181.3	776.0	7123.3	7336.1	31231.1	-	14459.4	45690.5	1561.6	47252.0

(Continued to next page)

Appendix: Table-6 (contd.)

1996-97	8249.2	205.5	880.1	7574.6	7592.4	35460.3	-	15167.0	50627.5	1515.7	52143.0
1997-98	8852.2	224.4	923.3	8153.3	7735.2	39980.5	-	15888.5	55869.0	1264.3	57133.3
1998-99	9478.6	234.9	1026.9	8686.6	8562.8	45777.3	-	17249.4	63026.7	1057.1	64083.8
1999-2000	11034.6	229.8	1088.4	10176.0	9705.3	54881.1	-	19881.3	74762.4	967.0	75729.4
2000-01	12547.0	285.8	1354.5	11478.3	10869.1	64826.8	-	22347.4	87174.1	1039.2	88213.3
2001-02	13581.6	298.6	1348.8	12531.4	11620.4	74454.9	9.3	24161.1	98616.0	1385.4	100001.4
2002-03	15024.4	317.7	1440.5	13901.8	12827.9	87251.1	13.7	26743.4	113994.5	2208.0	116202.3
2003-04	16942.2	345.2	1476.4	15811.0	14612.6	99273.7	24.4	30448.0	129721.7	3399.5	133121.2
2004-05	19965.9	362.0	1809.8	18518.1	16849.9	116042.3	36.1	35404.1	151446.4	4660.2	156106.6
2005-06	24496.3	397.8	2032.0	22862.1	19739.6	138021.9	50.6	42652.3	180674.2	5027.7	185701.9
2006-07	28363.0	424.4	2143.6	26643.8	23462.5	161336.2	61.7	50168.0	211504.2	5619.3	217123.5
2007-08	35188.3	460.2	2958.6	32689.9	26517.6	189480.5	106.9	59314.4	248794.9	5031.3	253826.3
2008-09	38970.0	478.7	3399.5	36049.2	30236.5	230073.0	141.2	66426.9	296499.9	6084.7	302584.6
2009-10	49947.3	518.1	4308.3	46157.1	41621.8	275042.8	209.4	87988.3	363031.1	6935.3	369966.4
2010-11	59915.5	611.4	5731.8	54795.1	48106.2	337418.9	199.8	103101.1	440520.0	4976.0	445496.0

Source: Bangladesh Bank, *Economic Trends,* various issues (Dhaka: Statistics Department, BB).

Appendix: Table-7

Interest Rate Spread in Banking Sector of Bangladesh

End of Period	Weighted Average Interest Rate on Advaces	Weighted Average Interest Rate on Deposits	Required Reserve Ratio (SLR)	1/(1-k)	Desiarble Lending Rate	Desirable Spread	Actual Spread	Difference between Actual and Desirable Spread
(1)	(2)	(3)	(4)	(5)	(6)=(5)*(3)	(7)=(6)-(3)	(8)=(2)-(3)	(9)=(8)-(7)
1974-75	11.28	3.51	25.00	1.33	4.68	1.17	7.77	6.60
1975-76	11.62	4.23	25.00	1.33	5.64	1.41	7.39	5.98
1976-77	11.03	4.32	25.00	1.33	5.76	1.44	6.71	5.27
1977-78	10.66	4.22	25.00	1.33	5.63	1.41	6.44	5.03
1978-79	11.12	4.27	25.00	1.33	5.69	1.42	6.85	5.43
1979-80	11.04	4.31	25.00	1.33	5.75	1.44	6.73	5.29
1980-81	13.07	6.98	25.00	1.33	9.31	2.33	6.09	3.76
1981-82	13.53	7.29	25.00	1.33	9.72	2.43	6.24	3.81
1982-83	13.55	7.36	25.00	1.33	9.81	2.45	6.19	3.74
1983-84	13.75	8.11	25.00	1.33	10.81	2.70	5.64	2.94
1984-85	14.50	8.13	24.00	1.32	10.70	2.57	6.37	3.80
1985-86	14.66	8.54	24.00	1.32	11.24	2.70	6.12	3.42
1986-87	14.70	8.59	20.00	1.25	10.74	2.15	6.11	3.96
1987-88	14.66	8.69	25.00	1.33	11.59	2.90	5.97	3.07
1988-89	14.68	8.88	25.00	1.33	11.84	2.96	5.80	2.84
1989-90	14.83	9.06	25.00	1.33	12.08	3.02	5.77	2.75
1990-91	14.99	9.11	23.00	1.30	11.83	2.72	5.88	3.16
1991-92	15.12	8.11	20.00	1.25	10.14	2.03	7.01	4.98
1992-93	14.39	6.51	20.00	1.25	8.14	1.63	7.88	6.25
1993-94	12.78	5.34	20.00	1.25	6.68	1.34	7.44	6.11
1994-95	12.22	4.86	20.00	1.25	6.08	1.22	7.36	6.15
1995-96	13.41	6.11	20.00	1.25	7.64	1.53	7.30	5.77
1996-97	13.69	6.67	20.00	1.25	8.34	1.67	7.02	5.35
1997-98	14.02	7.07	20.00	1.25	8.84	1.77	6.95	5.18
1998-99	14.16	7.28	20.00	1.25	9.10	1.82	6.88	5.06
1999-2000	13.86	7.21	20.00	1.25	9.01	1.80	6.65	4.85
2000-01	13.75	7.03	20.00	1.25	8.79	1.76	6.72	4.96
2001-02	13.16	6.74	20.00	1.25	8.43	1.69	6.42	4.74
2002-03	12.78	6.29	20.00	1.25	7.86	1.57	6.49	4.92
2003-04	11.01	5.65	16.00	1.19	6.73	1.08	5.36	4.28
2004-05	10.93	5.62	16.00	1.19	6.69	1.07	5.31	4.24
2005-06	12.06	6.68	18.00	1.22	8.15	1.47	5.38	3.91
2006-07	12.78	6.85	18.00	1.22	8.35	1.50	5.93	4.43
2007-08	12.29	6.95	18.00	1.22	8.48	1.53	5.34	3.81
2008-09	11.87	7.01	18.00	1.22	8.55	1.54	4.86	3.32
2009-10	11.31	6.01	18.50	1.23	7.37	1.36	5.30	3.94
2010-11	12.42	7.27	19.00	1.23	8.98	1.71	5.15	3.44

Note : k= SLR/100

Source: Interest Rate: Bangladesh Bank, *Economic Trends,* various issues.

SLR : Bangladesh Bank, *Annual Report,* various issues.

Appendix: Table-8

Advances and Deposits of Deposit Money Banks

(In crore Taka)

End of Period	Deamnd Deposit (DD)	Time Deposit (TD)	Total Deposits =DD+TD	Growth Rate of Total Deposits	Total Advances by DMBs (Excluding inter-bank)	Growth Rate of Total Advances	Advance/ Deposit
1973-74	414.0	499.2	913.2		737.1		0.807
1974-75	508.9	460.4	969.3	6.1	806.8	9.5	0.832
1975-76	552.2	514.7	1066.9	10.1	948.4	17.6	0.889
1976-77	616.4	767.0	1383.4	29.7	1188.7	25.3	0.859
1977-78	719.5	916.9	1636.4	18.3	1447.4	21.8	0.885
1978-79	911.4	1235.2	2146.6	31.2	1864.1	28.8	0.868
1979-80	1038.2	1513.2	2551.4	18.9	2540.7	36.3	0.996
1980-81	1071.3	2149.7	3221.0	26.2	3091.1	21.7	0.960
1981-82	1134.5	2536.6	3671.1	14.0	4114.6	33.1	1.121
1982-83	1495.0	3264.0	4759.0	29.6	4706.7	14.4	0.989
1983-84	1993.4	4835.9	6829.3	43.5	6436.3	36.7	0.942
1984-85	2508.7	6302.4	8811.1	29.0	8570.7	33.2	0.973
1985-86	2974.3	7410.2	10384.5	17.9	10456.4	22.0	1.007
1986-87	3186.3	9090.3	12276.6	18.2	11289.1	8.0	0.920
1987-88	2632.7	11360.3	13993.0	14.0	13341.5	18.2	0.953
1988-89	2845.1	13617.4	16462.5	17.6	15886.7	19.1	0.965
1989-90	3180.4	15928.9	19109.3	16.1	19032.5	19.8	0.996
1990-91	3591.9	17800.7	21392.6	11.9	21245.7	11.6	0.993
1991-92	4184.6	20268.7	24453.3	14.3	21586.0	1.6	0.883
1992-93	4582.5	22473.0	27055.5	10.6	23192.5	7.4	0.857
1993-94	5751.1	25235.9	30987.0	14.5	24043.3	3.7	0.776
1994-95	6614.3	29032.9	35647.2	15.0	32433.8	34.9	0.910
1995-96	7336.1	31231.1	38567.2	8.2	36864.8	13.7	0.956
1996-97	7592.4	35460.3	43052.9	11.6	40967.5	11.1	0.952
1997-98	7735.2	39980.5	47715.7	10.8	46402.1	13.3	0.972
1998-99	8562.8	45777.3	54340.1	13.9	52577.8	13.3	0.968
1999-2000	9705.3	54881.1	64586.4	18.9	57916.6	10.2	0.897
2000-01	10869.1	64826.8	75695.9	17.2	67090.9	15.8	0.886
2001-02	11620.4	74454.9	86075.3	13.7	75954.0	13.2	0.882
2002-03	12827.9	87251.1	100079.0	16.3	84571.5	11.3	0.845
2003-04	14612.6	99273.7	113886.3	13.8	95004.0	12.3	0.834
2004-05	16849.9	116042.3	132892.3	16.7	111471.0	17.3	0.839
2005-06	19739.6	138021.9	157761.5	18.7	129648.1	16.3	0.822
2006-07	23462.5	161336.2	184798.7	17.1	148429.8	14.5	0.803
2007-08	26517.6	189480.5	215998.1	16.9	183114.4	23.4	0.848
2008-09	30236.5	230073.0	260309.5	20.5	214218.6	17.0	0.823
2009-10	41621.8	275042.8	316664.6	21.6	264182.2	23.3	0.834
2010-11	48106.2	337418.9	385525.1	21.7	326634.2	23.6	0.847

Source: Bangladesh Bank, *Economic Trends,* various issues and Researcher's own calculation.

Appendix: Table-9

Sectoal Distribution of Bank Advances by Scheduled Banks											
End of Period	Advances to Agriculture (crore Taka)	Growth of Advances to Agriculture (%)	Share of Agriculture in Total Bank Advance (%)	Advance to Industry (crore Taka)	Growth of Advances to Industry (percent)	Share of Industry in Total Bank Advance (%)	Advance to Service (crore Taka)	Growth of Advances to Services (percent)	Share of Service in Total Bank Advance (%)	Advance to Miscellaneous (crore Taka)	Total Bank Advances (crore Taka)
1984-85	2732.71	—	30.59	2425.80	—	27.15	3258.36	—	36.47	516.32	8933.19
1985-86	3128.83	14.50	28.70	2977.73	22.75	27.32	4257.43	30.66	39.06	536.51	10900.50
1986-87	2912.52	-6.91	24.66	3523.18	18.32	29.83	4710.94	10.65	39.88	665.81	11812.45
1987-88	3442.58	18.20	24.68	4368.19	23.98	31.32	5461.41	15.93	39.16	673.97	13946.15
1988-89	4201.08	22.03	25.18	4754.02	8.83	28.49	6870.83	25.81	41.18	860.79	16686.72
1989-90	4631.84	10.25	23.26	8245.86	73.45	41.42	6157.98	-10.38	30.93	873.75	19909.43
1990-91	4505.23	-2.73	21.07	8570.62	3.94	40.07	7446.71	20.93	34.82	864.63	21387.19
1991-92	4420.85	-1.87	18.76	9728.77	13.51	41.28	8212.34	10.28	34.84	1207.59	23569.55
1992-93	4774.20	7.99	17.79	11207.06	15.20	41.77	9307.86	13.34	34.69	1542.05	26831.17
1993-94	5288.12	10.76	18.67	12841.50	14.58	45.33	8479.62	-8.90	29.93	1717.99	28327.23
1994-95	5894.91	11.47	17.81	13980.16	8.87	42.24	10975.80	29.44	33.16	2245.53	33096.40
1995-96	6433.78	9.14	17.31	15776.76	12.85	42.45	12076.47	10.03	32.49	2879.03	37166.04
1996-97	6740.00	4.76	16.14	18560.00	17.64	44.44	13270.00	9.88	31.77	3195.00	41765.00
1997-98	6990.00	3.71	14.57	21868.00	17.82	45.57	15000.00	13.04	31.26	4132.00	47990.00
1998-99	8038.00	14.99	14.89	24351.00	11.35	45.11	16303.00	8.69	30.20	5292.00	53984.00
1999-2000	8675.00	7.92	14.61	25520.00	4.80	42.99	18950.00	16.24	31.92	6217.00	59362.00
2000-01	9315.00	7.38	13.54	28377.00	11.20	41.26	22338.00	17.88	32.48	8748.00	68778.00
2001-02	9646.00	3.55	12.56	32390.00	14.14	42.19	25862.00	15.78	33.69	8874.00	76772.00
2002-03	9340.00	-3.17	11.02	37512.00	15.81	44.27	30011.00	16.04	35.42	7871.00	84734.00
2003-04	9844.00	5.40	10.35	42303.00	12.77	44.47	34034.00	13.41	35.78	8941.00	95122.00
2004-05	10675.00	8.44	9.55	49483.00	16.97	44.26	41656.00	22.40	37.26	9998.00	111812.00
2005-06	11353.00	6.35	8.79	58946.00	19.12	45.64	46639.00	11.96	36.11	12227.00	129165.00
2006-07	10903.00	-3.96	7.44	69146.00	17.30	47.18	52166.00	11.85	35.59	14358.00	146573.00
2007-08	12223.00	12.11	6.73	81376.00	17.69	44.82	68521.00	31.35	37.74	19429.00	181549.00
2008-09	13754.00	12.53	6.58	95211.00	17.00	45.55	78250.00	14.20	37.43	21833.00	209048.00
2009-10	15569.00	13.20	6.05	111035.00	16.62	43.13	101332.00	29.50	39.36	29507.00	257443.00
2010-11	19655.00	26.24	6.12	141420.00	27.37	44.02	127315.00	25.64	39.63	32895.00	321285.00

Source: From 1984-85 to 1988-89: *Statistical Year Book of Bangladesh, 1991,* p.453, from1989-90 to 1995-96: *Statistical Year Book of Bangladesh, 1997*, p.431, from 1996-97 to 2005-06: *Bangladesh Economic Review 2006,* p.244*.* from 2003-04 to 2010-11: *Bangladesh Economic Review 2012*, p. 265.

Appendix: Table-10

Credit Allocation Index for Broad Sectors

(in percent)

End of Period	Agricultue			Industry			Service		
	Share of Agriculture in Total Bank Advance (A_{it})	Share of Agriculture to GDP (Q_{it})	CA Index (Ait / Q_{it})	Share of Industry in Total Bank Advance (A_{it})	Share of Industry to GDP (Q_{it})	CA Index (Ait / Q_{it})	Share of Service in Total Bank Advance (A_{it})	Share of Service to GDP (Q_{it})	CA Index (Ait / Q_{it})
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1985-86	28.70	40.41	0.710	27.32	15.52	1.761	39.06	44.08	0.886
1986-87	24.66	40.76	0.605	29.83	14.84	2.010	39.88	44.40	0.898
1987-88	24.68	38.79	0.636	31.32	15.01	2.086	39.16	46.20	0.848
1988-89	25.18	37.20	0.677	28.49	15.40	1.850	41.18	47.39	0.869
1989-90	23.26	36.85	0.631	41.42	15.80	2.621	30.93	47.35	0.653
1990-91	21.07	30.37	0.694	40.07	21.74	1.843	34.82	47.90	0.727
1991-92	18.76	29.39	0.638	41.28	22.48	1.836	34.84	48.14	0.724
1992-93	17.79	26.25	0.678	41.77	23.82	1.754	34.69	49.92	0.695
1993-94	18.67	25.63	0.728	45.33	24.33	1.863	29.94	50.05	0.598
1994-95	17.88	26.38	0.678	42.04	24.55	1.712	33.28	49.06	0.678
1995-96	17.31	25.68	0.674	42.45	24.87	1.707	32.49	47.45	0.685
1996-97	16.14	25.78	0.626	44.44	25.14	1.768	31.77	49.06	0.648
1997-98	14.57	25.45	0.572	45.57	25.82	1.765	31.26	48.73	0.641
1998-99	14.89	26.18	0.569	45.11	25.16	1.793	30.20	48.66	0.621
1999-2000	14.61	24.62	0.594	42.99	24.39	1.763	31.92	47.48	0.672
2000-01	13.54	23.29	0.582	41.26	25.07	1.646	32.48	48.28	0.673
2001-02	12.56	21.93	0.573	42.19	25.47	1.656	33.69	50.06	0.673
2002-03	11.02	20.97	0.526	44.27	25.33	1.748	35.42	50.15	0.706
2003-04	10.35	20.18	0.513	44.47	25.52	1.742	35.78	50.25	0.712
2004-05	9.55	19.32	0.494	44.26	26.11	1.695	37.26	50.49	0.738
2005-06	8.79	18.89	0.465	45.64	26.87	1.698	36.11	50.55	0.714
2006-07	7.44	18.61	0.400	47.18	27.44	1.719	35.59	50.64	0.703
2007-08	6.73	18.32	0.368	44.82	27.47	1.632	37.74	50.57	0.746
2008-09	6.58	18.10	0.364	45.55	27.67	1.646	37.43	50.84	0.736
2009-10	6.05	17.98	0.336	43.13	27.53	1.567	39.36	51.20	0.769
2010-11	6.12	17.65	0.347	44.02	27.21	1.618	39.63	51.63	0.768

Source:

For Sectoal Distribution of Bank Advances:

From 1984-85 to 1988-89: BBS, *Statistical Year Book of Bangladesh, 1991*, p.453;

From1989-90 to 1995-96: BBS, *Statistical Year Book of Bangladesh, 1997,* p.431;

From 1996-97 to 2005-06: GoB, *Bangladesh Economic Review 2006*, p.244;

From 2003-04 to 2010-11: GoB, *Bangladesh Economic Review 2012*, p. 265.

For Percentage Share of Broad Sectors to Total GDP:

From 1985-86 to 1989-90: Bangladesh Bank, *Economic Trends*, vol. XXI, no. 12 (December, 1995), p. 32 & 33;

From 1990-91 to 1998-99: BBS, *National Accounts Statistics of Bangladesh (Revised Estimates, 1989-90 to 1998-99),* (Dhaka: BBS, December, 2000), p. 50;

From 1999-2000 to 2010-11: Bangladesh Bank, *Economic Trends*, various issues.

Appendix: Table-11

List of Governors of Bangladesh Bank

No.	Name of the Governors	Term
01.	A.N.M. Hamidullah	18.01.1972 – 18.11.1974
02.	A.K.N. Ahmed	19.11.1974 – 13.07.1976
03.	M. Nurul Islam	13.07.1976 – 12.04.1987
04.	Shegufta Bakth Chaudhuri	12.04.1987 – 19.12.1992
05.	Khorshed Alam	20.12.1992 – 21.11.1996
06.	Lutfar Rahman Sarkar	21.11.1996 – 21.11.1998
07.	Dr. Mohammad Farashuddin	24.11.1998 – 22.11.2001
08.	Dr. Fakhruddin Ahmed	29.11.2001 – 30.04.2005
09.	Dr. Salehuddin Ahmed	01.05.2005 – 30.04.2009
10.	Dr. Atiur Rahman	01.05.2009 – to date