POLICY BRIEFS SERIES

Exchange Rate Management in Bangladesh

Malcolm F. McPherson
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HARVARD Kennedy School
RAJAWALI FOUNDATION INSTITUTE FOR ASIA

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About the Author

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About the Rajawali Foundation Institute for Asia

The Rajawali Foundation Institute for Asia is housed at the Ash Center for Democratic Governance and Innovation, one of twelve research centers at Harvard Kennedy School. In 2008, under the leadership of Anthony Saich, the Asia Programs at HKS (now the Rajawali Foundation Institute for Asia) joined the Ash Institute for Democratic Governance and Innovation. Two years later, the permanently endowed Rajawali Foundation Institute for Asia was established as part of the Ash Center to bring together academics and practitioners from around the world to enhance research, teaching, and training on public policy and governance issues of critical importance in Asia.

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The Bangladesh Public Administration Project is a multiyear initiative housed at Harvard Kennedy School's Rajawali Foundation Institute for Asia. The purpose of the project is to strengthen the institutional capacity of the Bangladesh civil service and the individual capacity of its civil servants. The project mainly focuses on three interrelated activities: curriculum review at the nation's civil service training institutes, training on interactive pedagogy and core competencies essential for the civil service, and policy research on Bangladesh's most pressing issues.

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The Roy and Lila Ash Center for Democratic Governance and Innovation advances excellence and innovation in governance and public policy through research, education, and public discussion. By training the very best leaders, developing powerful new ideas, and disseminating innovative solutions and institutional reforms, the Center's goal is to meet the profound challenges facing the world's citizens. The Ford Foundation is a founding donor of the Center. Additional information about the Ash Center is available at ash.harvard.edu.

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Key Points

Bangladesh authorities have mismanaged the nation's exchange rate over the last two decades, with major adverse effects on the economy and its future prospects.

The sharp increase in worker remittances from the mid-2000s induced the authorities to manipulate the exchange rate in ways that undermined the economy's international competitiveness.

The country has been affected by Dutch Disease undermining export diversification, depressing the growth of exports, worsening income inequality, and distorting the allocation of resources within the economy.

The pattern of manipulation has recently eased but continues as Bangladesh Bank, against all comparative evidence, presumes it can effectively manage a crawling peg.

Remedies will involve the full float of the exchange rate supported by monetary, fiscal, and debt management policies that eliminate the budget deficit, improve the efficiency of public sector spending, and reform the financial system.

Generating these conditions will require a major upgrading of the competences of the relevant public sector officials and a fundamental reorientation of their policies to reflect the broader growth and development priorities of Bangladesh and its citizens.

Introduction

This policy note discusses the macroeconomic difficulties in Bangladesh created by the counterproductive manipulation of the exchange rate from the mid-2000s and suggests potential remedies.

Following the end of military rule in 1991, exchange rate management in Bangladesh has been through two phases. From 1992 to 2006, the taka floated with its exchange rate broadly determined by market conditions. From 2006 to the present, the taka has been subject to several protocols: managed float, fixed, "inflation anchor," modified fix/crawl, and most recently a return to a managed float.

These various interventions since 2006 have adversely affected the economy and seriously compromised its prospects for future growth and development. The difficulties were well illustrated by the dramatic depletion of the country's foreign exchange reserves that began in late 2021 and, together with other macroeconomic difficulties, led the previous government to seek emergency assistance from the International Monetary Fund (IMF).[1] The IMF responded with a $4.7 billion 42-month program in February 2023 "aimed at restoring macroeconomic stability, relaxing financing constraints to prevent disruptive adjustment, and rebuilding FX reserves."[2] Before the former government was displaced, Bangladesh was implementing the program's conditions and benchmarks though not without some significant slippage. Improving exchange rate management should have been addressed more urgently.

Much remains to be done if the economy is to stabilize. A fundamental challenge is to ensure that the exchange rate policy rapidly restores Bangladesh's international competitiveness. Without that, few of the plans that the interim government is currently formulating for reforming and restructuring the economy are likely to materialize.

Background

Those who study Bangladesh's macroeconomic performance over recent decades quickly discover a major anomaly regarding exchange rate management. Official descriptions of how the exchange rate should be managed to support the economy's growth and development in the nation's Five-Year Plans (FYPs) and some (limited) commentary by Bangladesh Bank (BB), have diverged from how the exchange rate, in practice, has been managed especially since 2006. A further anomaly is the absence of any official rationale why this happened, particularly as the adverse effects of the overvalued real exchange rate became increasingly apparent.

As shown in Annex 1, officers at the Planning Commission responsible for formulating the FYPs, especially the 5th to 8th FYPs, and the local economists who advised them, understood the benefits for Bangladesh of an internationally competitive exchange rate.[3] Furthermore, their baseline projections of the principal macroeconomic data include adjustments to keep the real exchange rate stable.[4] To gain perspective on the broader pattern of exchange rate management, it is useful to understand how the economy was performing.

Bangladesh ended military rule in March 1991 in poor shape. In that year, per capita gross national income (GNI) was $310 per capita, and GDP per capita was $283.[5] GDP was growing at 3.5%, while exports were 6.7% of GDP and imports were 12.2% of GDP. Net aid inflows were equivalent to 5.1% of GDP, and remittance inflows from abroad were 2.5% of GDP. Furthermore, gross capital formation (i.e., investment) was 16.9% of GDP, and gross savings was 22.6%. Net foreign direct investment was ~0%, and broad money growth was 5.7%. In agriculture, the labor force share was 64.2%, while its share of GDP was 32%. Agricultural growth was 2.1%, which was marginally above the population growth rate of 1.9%. Cereal production totaled 27.7 million metric tons,[6] with average cereal yields of 2,491 kilos per hectare.[7] Consumer Price Index (CPI) inflation was 6.4%. The under-5 mortality rate was 140 per 1,000 live births, and the rates of stunting of the under-5 population was 74%, and inequality measured as the share of income in the top to bottom 10% of the population was 5.7.[8]

Despite the obvious difficulties—low income, limited national food supply, the high share of agricultural employment, elevated rates of under-5 mortality and stunting, unbalanced trade accounts, among several others—there were some positive elements. Both the food production and livestock production index had begun to rise robustly,[9] and GDP inflation was 2.7%. More important, the exchange rate (taka per dollar) was

market determined. In 1991 it was 36.6, up from 34.6 in 1990—a depreciation of ~6%. This market-driven adjustment was consistent with local CPI and GDP inflation and the corresponding inflation rates of Bangladesh's few trading partners.

Harsh realities imposed this outcome. Even if it had been so inclined, the incoming civilian government had no capacity to fix the exchange rate or effectively manage a float. The country's trade account was chronically unbalanced[10] and foreign reserves provided import coverage of 1.3 months in 1991. Foreign debt was 41% of GNI (or 45.5% of GDP) with debt service on public guaranteed debt equivalent to 19.1% of 1991 exports of goods, services, and primary income. Viewed in terms of "debt sustainability" criteria, Bangladesh was seriously "debt distressed."

Economic performance improved markedly from 1992 to 2006.[11] Average annual GDP growth was 5%, and exports as a share of GDP increased from 7.6% in 1992 to 16.4% in 2006. Remittance inflows also increased from 2.9% of GDP in 1992 to 3.7% in 2000 and 7.6% in 2006. The share of both savings and investment rose sharply from 22% and 17.3% of GDP, respectively, in 1992 to 35.3% and 26.1% in 2006. During this interval, the exchange rate continued to float, moving up from 39 in 1992 to 68.9 in 2006, a devaluation of 77%. The corresponding cumulative price increases were 107.9% (CPI) and 103.8% (GDP). When related to the respective inflation rates in the United States of 44.7% and 34.2%, the taka marginally depreciated in real terms against the dollar. That trend ended abruptly from 2006 to 2010, with the taka/dollar exchange rate depreciating by only 1%. In the meantime, Bangladesh inflation was 35.5% (CPI) and 31.2% (GDP). With corresponding US prices rising by only 8.2% and 6.6%, the taka sharply appreciated in real terms.[12]

The shift in policy adversely affected the economy. The export share peaked at 20.2% of GDP in 2012 and declined to 10.7% in 2021, the year the "fix" that had begun in 2012 ended.[13] Bangladesh's export sector lost its dynamism. From 2006 to 2012, exports grew by an average of 12.6% per annum (p.a.), but from 2012 to 2021, the growth rate was 2.5%.[14] Other factors contributed as well—high production costs due to poor infrastructure, the continued operational dysfunction of state-owned banks,[15] financial regression from 2015 onward,[16] the persistent annual cycle of budget compression that undermined public sector efficiency, and the confidence-sapping high rate of chronic inflation.[17] Together, these factors compounded the damage generated by the adverse movements in the exchange rate.[18] For context, the real appreciation from 2006 to 2010, described above, set the stage. From 2010 to 2012, there was some minimal relief as the nominal exchange rose from 69.6 t/$ to 81.9, a depreciation of roughly 18%. From 2012 to 2017, the exchange rate fluctuated but overall fell from 81.9 t/$ to 80.4. In 2018, it increased to 83.5 and was 85.1 in 2021. For the whole period, from 2006 to 2021, the exchange rate depreciated by 30%. Corresponding local inflation was 193% (GDP) and 172% (CPI).

The pressures confronting Bangladesh's export sector are evident from the underlying real exchange rate appreciation that these price movements generated. Based on cross

rates to the dollar and the inflation differentials in each country, the taka's real appreciation rate between 2006 and 2021 against the US dollar was 34%, 22% against the yuan, 24% against the Indian rupee, 12% against the Singapore dollar, 37% against the South Korean won, 49% against the Japanese yen, 58% against the UK pound, 25% against the European euro (based on German prices), and 40% against the Indonesian rupiah.[19]

An interesting feature of these data is that while India and Indonesia had roughly the same cumulative inflation as Bangladesh, both the rupee and the rupiah devalued significantly against the dollar so that, overall, they devalued against the taka.[20]

This is not the first time that a country—developed or developing—has systematically undermined its international competitiveness due to real exchange rate overvaluation and experienced a dramatic decline in its export growth and export share.[21] The pattern has been repeated multiple times, especially when those who control the major instruments of macroeconomic policy lose sight of the broader challenges of maintaining the macroeconomic balances that help their economies remain resilient and dynamic.

In Bangladesh's case, a key factor that enabled (or induced) policymakers to ignore these "broader challenges" was the rapid increase in remittances from Bangladeshi citizens working abroad. The earliest reported inflow was 0.2% of GDP in 1976. It increased to 2.9% of GDP in 1992, 3.7% in 2000, and 7.6% by 2006. The inflows peaked at 10.6% of GDP in 2012, declining to 5.3% by 2021.[22] Starting in 2006, these inflows dramatically boosted foreign exchange reserves, reaching $46.4 billion in 2020–21, providing import coverage of around seven months.[23] Unlike the situation facing the Bangladesh government in 1991, the abundant reserves provided an opportunity to manipulate the exchange rate. No formal justification for this policy shift is available. As already noted, it was the opposite of what the national plans had indicated would, and should, be followed.[24] Based on comparable situations abroad, it is easy to speculate why the policy shift occurred—to maintain "market stability," to "anchor" inflation,[25] as a response to pressure from urban interests (especially public sector employees) to keep imports "cheap," and to funnel support to sectional interests. They all have one common feature: none of them has any direct relation to the goal of raising national welfare and citizen well-being.

The outcome was Dutch Disease. This phenomenon reflects the real exchange rate appreciation produced by a rapid inflow of foreign exchange—from international aid, resource discoveries, booming export markets, worker remittances, or other sources—that has no relation to the local economy's underlying productive capacity. The puzzle is why Bangladesh's authorities, in a period when there was voluminous international experience regarding Dutch Disease,[26] should have expected that these inflows represented anything other than a "windfall." The puzzle deepens when viewed against the regular reminders in the national plans of the benefit of an internationally competitive exchange rate, and the ample evidence that a "market-determined" exchange rate was driving the ready-made garment sector boom. Furthermore, in view of the mounting evidence,

especially from 2012 onward, observers will wonder why no official (or group of officials) within the government could induce the relevant policymakers to recognize that with the massive distortions generated by BB's manipulation, none of the government's emerging ambitious development goals could be achieved.[27]

Consequences

The pattern and persistence of exchange rate intervention beginning in 2006 had several adverse economic consequences.[28] Three will be discussed here: Dutch Disease, which systematically undermined Bangladesh's international competitiveness; the disconnect between planning and policy implementation; and the mismanagement of the economy in pursuit of sectional interests.

Loss of international competitiveness: The most direct official recognition of the damage associated with the persistent real overvaluation of the exchange rate emerged in 2022, when the Bangladesh authorities requested assistance from the IMF.[29] With that assistance now being provided, the challenge for the interim government is to ensure that it serves the purposes stated earlier of restoring macroeconomic stability, preventing disruptive adjustment, and rebuilding foreign exchange reserves. Without that, economic recovery will be problematic. Evidence from countries that have experienced prolonged periods of Dutch Disease indicates that efforts to overcome the adverse effects of the deep-seated distortions it created will take decades, not years.[30]

By systematically reducing the prices and costs of nontradables relative to those of tradables, real exchange rate overvaluation generates effects that are transmitted to every corner of the economy.[31] Firms and citizens responding to the incentives and disincentives associated with the distorted prices and costs behave in ways that "lock in" these effects.[32] The most obvious are the regional and sectoral distributions of productive activity; the levels and allocation of consumption and savings; the growth, diversity, and direction of imports and exports; the productivity of public and private investment; the rate of innovation and spread of entrepreneurship; and the distribution of income across regions and economic groups.

It is because of these interconnected impacts that remedial measures—macroeconomic stabilization, exchange rate reform, structural transformation, the restoration of confidence and trust in the authorities' capacities to efficiently and inclusively manage the country—take so long. There is no shortcut to realigning (or resetting) the incentives that will progressively modify the opportunity costs[33] of the nation's productive domestic resources—labor, capital, land, organizations, institutions, and information—in ways that restore its international competitiveness. A further point is that delayed action never helps.[34]

Disconnect between planning and policy implementation: In the heyday of national planning, specialists distinguished between the plan as a product and as a process.[35] With respect to the former, the plan (typically for five years) was viewed in multiple ways—as Soviet-style prescriptions for what must be done, how it would be financed, and who was responsible for its implementation; as patriotic assertions of the nation's goals for advancement (however that was defined); as a blueprint for engaging investors and mobilizing local and foreign finance to achieve the stated objectives; or as a prospective guide for future action, reflecting the perspectives and aspirations of the officials and consultants engaged in the plans' formulation.[36] Bangladesh's various plans—currently the 8th FYP and its second 20-year Perspective Plan—while not rigidly prescriptive serve the other purposes to varying degrees.

The emphasis on the plan as process seeks to build upon the inter-ministerial and inter-agency collaboration that was involved in identifying the proposed activities to take advantage—through the plan preparation and during its implementation—of the joint learning, data assembly, and perspective-sharing in ways that strengthen the organizational and human capabilities for managing the nation's development. For many specialists, the planning process became more important than the finished product because it established a means whereby the government could institutionalize a formal longer-term approach to policy formulation, implementation, and monitoring and evaluation.[37]

Bangladesh's plans are well-researched, professionally prepared, and thematically inspired narratives that have been formally reviewed and approved by the government. For example, the extensive consultations involved in their formulation provide an official assessment of the country's progress and its current circumstances. The core economic and social matters that must be addressed are identified and described.[38] There are also statements about what should be done and summaries of the resources—mainly local and foreign finance—that will be required to undertake the proposed activities. Bangladesh's widely acknowledged economic performance beginning in the mid-1990s provided some confirmation that the guidance offered, and the policy suggestions made in the plans, were important (if not instrumental) in the country's success.

This view, however, is contradicted by the discussion in this note (and its companion pieces)[39] and the recently completed analysis of the "Bangladesh paradox."[40] The analysis sought to understand why Bangladesh had grown and developed since the mid-1990s at rates that placed it among the best economic and social "performers" on the planet despite wide-spread evidence that its institutions (the rules of the game and the entities that apply those rules) ranked among the world's worst. While the paradox study focused on banking, finance, land administration, taxation, and budgeting, it provided insights regarding exchange rate management and the many adjustments by the government—tax relief, incentives, special access to credit, and regulatory indulgence—designed to compensate for the adverse effects of what one author described as the "managed overvalued exchange rate regime."[41]

Recent events have resolved the matter, affirming that the "paradox" was temporary. Bangladesh enjoyed roughly two-and-a-half decades of world-class development performance—fueled by an initial period of "enabling" policies (when, as noted earlier, the authorities lacked the capacity to manipulate key variables), growing remittances, buoyant exports, and solid agricultural growth. That performance was progressively scuttled by the dead weight of the distortions created by the widespread institutional dysfunction that, collectively and cumulatively, blocked the country's economic transformation.

The planners clearly recognized the dangers of an uncompetitive exchange rate, yet the policymakers, in the face of ample evidence of its adverse consequences allowed the exchange rate to become grossly overvalued. The question arises: Why plan if the policymakers ignore constructive guidance or cherry pick policies according to their whim? Recent statements by its Chief Advisor[42] suggest that the interim government will be moving on from what the previous government had in place. It is not clear whether planning will be abandoned. If not, it should be made more effective in serving the nation's purposes.[43]

Public management capacities: The damage created by the extended period of exchange rate manipulation raise questions regarding the institutional capabilities of Bangladesh's core ministries and agencies and the competences and skills of their respective staffs. Observers and officials regularly assert that Bangladesh does large amounts of planning but has trouble with implementation. This observation is confirmed by the FYPs themselves, especially the 5th through 8th, which review in detail the areas of the previous plan that was not implemented. The implementation problems persist. For instance, the current IMF program includes numerous commitments made by the authorities, many of which have been delayed or only partially fulfilled.

This does not tell the whole story. Not every element of each plan or program benchmark needs to be met. Indeed, many should be reconsidered and/or adjusted. A further issue arises when the government or one (or more) of its agencies acts, for example by manipulating the exchange rate, in ways that are demonstrably contrary to the national interest. In such cases, who within the system will (or should) be constructively critical? This question is pertinent with respect to BB's manipulation of the exchange rate, especially given the guardrails established by the Bank of Bangladesh Order of 1972 that were in place and should have been effective.

The Bank of Bangladesh Order of 1972 was created "to establish a central bank in Bangladesh to manage the monetary and credit system of Bangladesh with a view to stabilizing domestic monetary value and maintaining a competitive external par value of the Bangladesh Taka towards fostering growth and development of [the] country's productive resources in the best national interest."[44] Structured to achieve this goal, the order introduced a framework overseen by the Coordination Council, responsible "for the co-ordination of fiscal, monetary and exchange rate policies." This Council consisted of

the Minister of Finance, the Minister of Commerce, the BB governor, the Finance Secretary, the Secretary Industrial Resources Division (Ministry of Finance), and a (programming) member from the Planning Commission.[45] The order specified that the council would "ensure consistency among macro-economic targets of growth, inflation and fiscal, monetary and external accounts." With this high-level oversight and guidance, one of BB's key functions was "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."[46]

Since none of the subsequent amendments to the order changed any of these provisions, they have remained a part of BB's core operating principles since it was established. This raises the question of what led BB and the nation's key economic policymakers (finance, commerce, BB, and planning) astray? There may be multiple answers, but one factor stands out: from 2006 to 2021, it appears that no one on the Coordination Council or on BB's staff had the technical skills and administrative competences to appropriately advise the government on procedures for "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." The evidence clearly shows that BB did not maintain a competitive external par value for the taka, nor were the actions it did take "in the best national interest." For Bangladesh to recover and move forward, this gap in oversight needs to be addressed.[47]

Remedies

As noted above, dealing with the consequences of the extended pattern of exchange rate mismanagement will take time. More importantly, delay will not help. Due to capacity limitations, actions should be phased. Immediate responses should include the following:

- Fully float the taka by removing all means for BB to intervene in determining its value.
- Establish a technical working group with the authority to ensure that monetary, fiscal, exchange, rate, and debt policies are consistent with "stabilizing the macro economy."
- Accelerate actions on reforms that will raise the tax-to-GDP ratio, eliminate the budget deficit by adopting a cash budget for the public sector, arrest the regression of the financial sector, and rationalize the jumble of tariffs, subsidies, and other indulgences that continue to distort the allocation of tradables and nontradables.

Over the medium term, actions should include the following:

- Create structured programs for all staff of BB, Ministry of Finance, and other entities with economic management responsibilities to upgrade their technical skills and managerial competencies.
- Reform the processes and procedures that underpin the preparation of the annual budget and various plans (FYPs and Perspective Plans) in ways that make them "credible" and functional.
- Create a joint public-private partnership with civil society entities, think tanks, and academic agencies to regularly monitor and report on public sector implementation.

Concluding Comments

The official manipulation of the exchange rate in Bangladesh from 2006 to 2021 damaged the economy and undermined its potential for growth and development. Unraveling the distortions that this policy created for production, consumption, trade, sectoral transformation, income distribution, and core organizations and institutions will take a concerted whole-of-economy effort and considerable time. A major difficulty will be restoring trust among investors (local and foreign) and citizens more generally that neither BB nor the government will repeat this pattern of intervention. The interim government and the responsible economic agencies—BB, Ministry of Finance, Ministry of Commerce, Ministry of Industries, and the Chief Advisor's Office—face a formidable task. Yet, without the needed time and effort, Bangladesh cannot achieve the economic recovery that will support longer-term growth and development.

For immediate progress, the interim government should end BB's ability to continue manipulating the exchange rate. This would involve abandoning what the current IMF program anticipates, namely that BB will conduct a "managed crawl" that "over time . . . gradually [widens the bands of the crawl] . . . to allow for greater exchange rate flexibility." Indeed, Bangladesh should cut its losses and float the currency. Among other things, this action would align the country with current practice in all major trading countries, none of which directly controls its exchange rate. With its limited technical and administrative capacities, Bangladesh would be unwise to continue assuming that it can do otherwise.

Floating the currency will only be a start since under such a regime all macroeconomic shocks will be reflected in exchange rate movements. To stabilize a market-determined exchange rate, the interim government will need to address other macroeconomic difficulties that are holding back the economy's recovery effort, such as chronically weak revenue mobilization and the annual cycle of budget compression. Together, these two difficulties sustain the country's elevated rate of inflation.

With higher revenue mobilization and no budget compression, the interim government could roughly balance the budget over the business cycle. This would lower local

inflation to rates consistent with international norms, which would in turn ease the pressure on the exchange rate.

Annex 1: Exchange Rate Policy—What the FYPs Reveal

This annex reviews exchange rate trends in Bangladesh's 4th through 8th FYPs to highlight the differences between what was intended and what actually occurred. The analysis reveals that the officials who devised the plans, and the local economists who helped them, recognized the importance of maintaining a competitive exchange rate to help promote equitable and inclusive economic growth, export expansion and diversification, debt sustainability, and to complement monetary and fiscal policy. There is no ambiguity in the advantages they describe. Looking back, the willingness of policymakers to diverge from what the planners intended seriously compromised the country's prospects. During the period when Bangladesh maintained an internationally competitive exchange rate, it experienced a period of relatively robust growth and inclusive development.[48]

The 5th FYP (FY97–FY02) summarized the approach to exchange rate management in the 4th FYP (FY90–FY95): "Bangladesh has been pursuing a flexible exchange rate policy to ensure its competitiveness in international trade." This was achieved by BB, ensuring that "each day," the "buying and selling rates of US dollar in terms of taka are changed with due regard to the nominal as well as real effective exchange rate (REER) index and levels of trade with its important trading partners."[49]

The 5th FYP described what would be done over the next five years: "Bangladesh will follow an exchange rate policy which is sufficiently flexible to deal with the macroeconomic environment and to maintain sustainable external balance. This will require adjustment of the exchange rate in line with the movement of the real effective exchange rate (REER) of Taka."[50] This was described as a "managed flexible exchange rate system . . . [in which]. . . . (T)he nominal exchange rate is maintained at a level which is consistent with keeping the real effective exchange rate (REER) stable or slightly depreciating over time on the basis of estimated REER indices using trade weights of a 15-country currency basket. . . . The real effective exchange rate will be maintained at a stable level to influence choices not only between tradables of Bangladesh vis-a-vis its trading partners but also between tradables and non-tradables within Bangladesh."[51]

Few textbooks are this precise about what should be done and would continue to be done to ensure that the exchange rate remained internationally competitive and, more important, served its appropriate functions of rationing and efficiently allocating local and imported resources.

The 6th FYP (FY10–FY15) confirmed what had occurred: "By and large, Bangladesh has well managed its exchange rate policy." It suggested caution by adding "although the appreciation of the real exchange rate since 2006 needs careful monitoring."[52] The cautionary note carried over in the plan's description of what had been unfolding:

> Bangladesh Bank has been following a flexible market-based exchange rate policy since the adoption of the floating exchange rate regime in 2003. This policy has generally served the economy very well by allowing the rate to be

> determined in the interbank foreign exchange market with some interventions from Bangladesh Bank to minimize the exchange market volatility. This policy has enabled Bangladesh Bank to ensure stability in the exchange rate, primarily against the US dollar while at the same time enabling it to build up foreign exchange reserves to a very comfortable level (above $10 billion).[53]

For the whole 2001 to 2010 period, the t/$ exchange rate depreciated from 52.1 to 69.6, with most of that change occurring before 2006. From 2006 to 2010, the depreciation was 1%, during which time local prices increased by 31.2%. Contrary to what the plan stated would be done, BB *did not follow* a "flexible market-based exchange rate policy."

Ignoring this fact and the admonition about "careful monitoring," the planners offered the following "policy commitment"[54]: "The policy of exchange rate flexibility with limited interventions to ensure market stability will be continued during the plan period. While maintaining the exchange market stability, the rate will be allowed to be determined by economic fundamentals and taking into account the objective of maintaining comfortable reserve levels throughout the Plan period."

The four criteria—"exchange rate flexibility," "maintaining exchange market stability," "limited interventions," and allowing the rate to be "determined by economic fundamentals"—are mutually incompatible. In the event, the commitment to exchange rate flexibility determined by market fundamentals was shunted aside in favor of unlimited interventions and exchange market stability.

Subsequent events reveal this. After rising to 81.9 t/$ in 2012, the nominal exchange rate appreciated by 4.9% to 77.9 in 2015. Over that period, local prices increased by 20%, accentuating the real appreciation of the exchange rate. A major reason for the policy switch was the continued increase in foreign remittance inflows from workers abroad. Before 2002, remittance inflows had been relatively steady at ~3 percent of GDP, after which they increased rapidly, reaching 9.4% of GDP in 2010, helping provide what was described above as the "very comfortable level" of reserves. The "comfort" provided was misinterpreted. BB's "success" in holding the exchange rate led to the real appreciation that resulted in Dutch Disease (discussed in the main text), which subsequently undermined the dynamism of exports.

This policy shift from a commitment to "exchange rate flexibility" reflecting "economic fundamentals" to "[nominal] exchange rate stability" accounts for the widely noted lack of export diversification in Bangladesh.[55]

The 6th FYP's exchange rate outcomes described in the 7th FYP (FY15–FY20) confirmed the policy shift: "The performance of the Sixth Plan in the external sector is solid in terms of maintaining external stability. The current account has been in surplus, the reserve level has accumulated at a very fast pace and external debt to GDP ratio has been falling. Remittance inflows have also been very strong, although the end-year inflow is lower than planned. The stability aspects of the balance of payments' outcome

exceed the respective targets in the Sixth Plan." It continued, "This strong performance in the balance of payments has allowed the maintenance of a stable exchange rate and provided great flexibility in managing foreign borrowing."[56]

Other (positive) outcomes of exchange rate "management"—such as the buoyant remittance income and declining exports to the EU (due to euro depreciation)[57]—were mentioned as well. The plan, however, specifically noted that "prudent management of exchange rate and ensuring exchange rate stability are critical for BOP sustainability and macroeconomic stability. Accordingly, BB in its recent Monetary Policy Statements aimed to use exchange rate and monetary policies for the purpose of preserving external sector stability, maintaining satisfactory building up reserves and avoiding excessive volatility of the exchange rate."[58]

This and several other assertions underscore the degree to which BB's exchange rate policy objectives had shifted from a flexible to a stable (which in practice meant fixed) exchange rate. The 7th FYP highlighted the downside of that shift:

> While Bangladesh Bank has been successful in keeping the exchange rate of the Taka very stable against the dollar and did not allow the Taka to appreciate against the dollar in nominal terms, the Real Effective Exchange Rate (REER) of Taka still appreciated significantly, eroding the competitiveness of Bangladeshi exporters. A sharp appreciation of the US dollar against the Euro and other major currencies, and the relatively high domestic rate of inflation compared with the inflation rates of Bangladesh's trading partners, have contributed to the appreciation of the REER of Bangladesh Taka and erosion of export competitiveness. Bangladesh Bank's own calculation indicates that the REER index of Taka appreciated from below 89 in FY11 to more than 106 in FY 14, entailing more than 19% erosion of export competitiveness.[59]

Given what BB had been doing, none of this was (or should have been) a surprise. The surprise was that no one in authority was capable of, or willing to, persuade BB to modify its approach, which in effect was scuttling "international competitiveness" to promote "external sector stability."[60]

For its part, the 8th FYP (FY21–FY26) did not challenge or criticize the country's exchange rate policy. It did, however, carefully restate the key considerations for appropriately managing the exchange rate. In the section on "exchange rate policy," it noted the following:[61]

> Another policy consensus that has received wide acceptance in the postwar era is the advantage of flexible over fixed exchange rates. By and large, all economies have essentially abandoned the policy of fixed exchange rates and moved to flexible or floating exchange rates with different degree of flexibility. Evidence is clear that overvalued exchange rates must be discarded by governments

> at all costs because it destroys the incentive to export, generates a balance of payment crisis over time, and is typically anti-poor because the rich have a much higher propensity to import. Currency overvaluation can dampen domestic production and employment, and can induce consumption and asset bubbles that may be difficult to placate. While the orthodox approach is to manage competitive exchange rates, the more popular policy stance undertaken by governments is to keep exchange rates significantly undervalued in order to make their exports more competitive in the global market. This was the policy stance that supported export-led growth in many East Asian economies and continues to be the policy stance in China. Exports boost productivity, which exposes domestic producers to competition in the foreign markets. Export growth generates trade surpluses and enables accumulation of foreign currency reserves which can reduce balance of payments vulnerability.

This is (perhaps) as succinct as any official statement available in Bangladesh of the virtues of an exchange rate policy that maintains the country's international competitiveness. It is completely at odds with the exchange rate policy that Bangladesh's authorities had been pursuing and, at the time the 8th FYP was formulated (in 2020), still had in place. The planners, however, were correct to emphasize the need for greater flexibility: "The 8FYP is committed to improving the exchange rare management to bring in greater flexibility to correct for the past appreciation of the real exchange rate and then make concerted efforts to avoid real exchange appreciation over the coming years. This flexible management of the exchange rate is essential to support the diversification of exports. Care will be taken that this flexibility is consistent with the inflation targets."[62]

While the authorities did not act on this commitment—the exchange depreciated by 0.2% from 2020 to 2021 before jumping by ~8% in 2022—the need for "greater exchange rate flexibility" (a long-standing slogan of the IMF, described below) became an immediate need. Indeed, this requirement has been central to the IMF program that began in January 2023.[63] Even then, the response was tepid. It was not until May 2024 that BB "followed through on its earlier announced intention (in January 2024) and implemented a crawling peg with a band regime together with an upfront devaluation of 6.4 percent (from 110 to 117 BDT/USD)."[64]

This response was an improvement. However, as noted in the text, a crawling peg (or "managed float") for Bangladesh is misguided for (at least) three reasons.[65] First, BB's performance over the last two decades shows that it lacks the technical and administrative capabilities for that task. There has been nothing in that performance to induce Bangladesh's citizens to believe that the BB will manage the exchange rate in their interest. Second, anyone with the inclination and resources (the rich) can readily "game the system." Given Bangladesh's current economic difficulties (especially its high inflation rate relative to all its trading partners), the only option for the taka is continued

depreciation. Third, as noted in the text, since none of the major market economies have the capacities or resources to directly manage their exchange rate, it is fundamentally naive to expect that Bangladesh does.

Annex 2: The IMF's Views on Bangladesh's Exchange Rate Management

From its founding at Bretton Woods, the IMF's mission has been to oversee the international system of trade and exchange, with a special focus on exchange rate arrangements. According to American records, the IMF was originally "charged with the maintenance of a system of fixed exchange rates centered on the U.S. dollar and gold."[66] These responsibilities have been modified over time with attention shifting from an "appropriate exchange rate regime—floating, managed or fixed"[67] to "choosing a suitable exchange rate arrangement"[68] within the context of the IMF's long-standing role in reporting on exchange rate "restrictions."[69]

Annex 1 described the pattern of exchange rate manipulation in Bangladesh from the mid-2000s. This annex traces the IMF's commentary and advice on exchange rate matters. We begin in 2012 when Bangladesh requested assistance from the Fund under an Extended Credit Facility (ECF) arrangement.

Bangladesh's ECF request was approved in April 2012, provided against a background of intense balance of payments pressures that emerged during 2011. The three-year ECF would support reforms to "restore macroeconomic stability, strengthen the external position, and engender higher, more inclusive growth." The intention was for the government to commit to "actions to create more fiscal space, reinvigorate the financial sector, and catalyze additional resources to boost social- and development-related spending, tackle power shortages and the infrastructure deficit, and stimulate export-oriented investment and job growth."[70] No exchange rate actions were required as performance criteria, prior actions, or structural benchmarks,[71] though the authorities were urged to "allow greater exchange rate flexibility and improve market operations." There was, however, one commitment: "To boost turnover in the foreign exchange markets to alleviate pressures on reserves, BB will allow interbank transactions at market-determined rates and limit its intervention to smoothing short-term volatility, consistent with meeting NIR [Net International Reserves] targets."[72] At the time, the IMF and Bangladesh officials were far more concerned with other matters. Indeed, the only related advice offered by the IMF was that "sound monetary management and exchange rate flexibility remain essential to reducing inflation pressures and building a reserve buffer."[73]

The Article IV consultations in 2013 included the third review of the ECF arrangement, and the IMF's "taking stock" was upbeat. The anticipated balance of payments crisis did not materialize, while Bangladesh's implementation of the structural reforms was judged to have "been strong." IMF staff noted that "international reserves have doubled, underlying inflation has steadily eased, and public debt has declined."[74] The "external sector assessment" was similarly upbeat, reporting that "the real effective exchange rate (REER) is broadly in line with fundamentals." This assessment was reached despite the IMF staff

noting that "more than undoing the depreciation in previous years, the REER appreciated significantly in late 2012 and the first half of 2013 supported by a strong CA [current account], large capital inflows, and faster price increases than in competing countries."[75]

An "external sector assessment" in the 2015 Article IV report[76] stated that "after remaining broadly constant for about two decades, the real effective exchange rate (REER) has appreciated steadily for the past three years. . . . Nominal effective appreciation and relatively higher domestic inflation contributed about equally to this appreciation." It added, "Despite the strong recent REER appreciation, there is no clear evidence of misalignment or lack of competitiveness."[77]

The 2018 Article IV report asserted that "the overall external position in FY17 is assessed to be broadly in line with fundamentals and desired policies," adding that "after a long period of appreciation, the Taka real exchange rate started to depreciate vis a vis trading partners." Later, the report noted that "the de jure exchange rate arrangement is floating, and the central bank intervenes in the foreign exchange market to keep the exchange rate relatively stable against the US dollar. Enhanced flexibility would help buffer the economy against external shocks, preserve the level of reserves, and increase monetary policy autonomy."[78]

The 2019 Article IV consultation provided a positive assessment of the external sector and exchange rate conditions. Noting that "the external position in CY18 [Calendar Year] was broadly in line with fundamentals and desired policies," the Fund stated that "the real effective exchange rate (REER) appreciated by around 5 percent in April 2019 (average 12-month y-o-y rate). . . . Reserve coverage is adequate with gross official reserves covering 5.8 months of prospective imports in FY18, but is expected to gradually decline as imports continue to grow without further accumulation of reserves." It suggested that "the authorities should continue to gradually expand exchange rate flexibility. This will help buffer the economy against external shocks and preserve the level of reserves."[79]

Despite evidence of a rising real exchange rate overvaluation in Table 1 and Figure 6 (p. 32), the March 2022 Article IV report gave no indication of the external pressures that would, within six months, require the government of Bangladesh to seek the massive level of assistance ($4.7 billion) provided under its current program. The report refers to many of the same structural impediments identified in earlier country reports but concluded that "the external position is broadly in line with the level implied by fundamentals and desirable policies in FY21."[80] Repeating its advice from earlier consultations, the IMF stated, "Greater exchange rate flexibility would help buffer external shocks and manage domestic liquidity conditions," explicitly adding that "greater flexibility will also strengthen monetary transmission and help BB adopt an interest based monetary system." It is also noteworthy that this country report said that "safeguarding FX reserve buffers remains crucial," explaining that "the use of FX reserves to finance crucial infrastructure projects through the newly created Bangladesh Infrastructure Development Fund (BIDF) raises governance and external sustainability concerns."[81] This diversion of reserves is why the

current IMF program had required BB to use the BPM6 standard, referred to in note 1 in the main text.

An IMF report titled "Bangladesh in Transition" examined how the country could respond to its prospective graduation from least developed country status in 2026. Among the issues raised were the poor performance of exports and their lack of diversification. After examining the complex cascading layers of subsidies, tariff relief, and protection that Bangladesh provides to its trade sector, the authors referred to the commitments made in the 8th FYP. One of these was that the government "also proposes to remove the trade policy bias against exports by reducing trade protection and by promoting a more flexible and competitive exchange rate."[82] In its response to the Fund, BB officials asserted that "to meet rising import needs, the authorities will continue to provide FX and allow the Taka to depreciate gradually against the US dollar."[83] It is noteworthy that neither Bangladesh officials nor IMF staff recognized the adverse underlying dynamics or anticipated that, within six months, the country would experience a collapse of business and citizen confidence, leading to the depletion of foreign reserves and forcing a major depreciation of the currency.

The 2023 IMF program was designed to remove the multiple exchange rate restrictions that Bangladesh had introduced over the years, to wit: "The authorities are committed to unifying the multiple exchange rates that resulted from disorderly FX market conditions and will continue to allow interbank transactions at market-determined rates. BB will also use the market-determined exchange rate for all official FX transactions on behalf of the government."[84]

In its first review of performance under the program, the IMF noted Bangladesh had "made good progress," among other things, of "transitioning to a single exchange rate for all market participants." It met the "structural benchmark" of using a market-determined exchange rate for official FX transactions on behalf of the government.[85] Overall, the IMF's assessment was positive but noted that "further reforms to the exchange rate framework would help restore external resilience." It also warned that "FX pressures persist" and suggested that "a move to a more flexible exchange rate regime would help accelerate repatriation of export proceeds and channel remittances through official channels." In response, BB committed to moving "toward a crawling peg with a band corridor."[86]

By June 2024, the IMF's attention had shifted to the new exchange rate mechanism, that is, a managed float. It noted that "exchange rate policy should focus on ensuring the smooth functioning of the new exchange rate regime" and added that "restoring the proper functioning of the interbank FX market is critical to ensure the success of the new exchange rate arrangement. In the near term, BB should also steadfastly adhere to the mechanism of readjusting (shifting) the band to avoid excessive depletion of FX reserves." Furthermore, it highlighted that "over time, the parameters of the new regime should be periodically reviewed to ensure that the rate of crawl is consistent

with the monetary policy settings and the band is gradually widened to allow for greater exchange rate flexibility."[87]

The last sentence captures the fundamental error with the proposed change. The IMF has falsely presumed that BB has the technical capacities to manage the crawl, accounting for "monetary policy settings." This presumption provides BB management with the discretion to review "over time" the "rate of crawl" of the exchange rate. Finally, IMF staff have systematically ignored the significance of its perennial calls for "greater exchange rate flexibility" and the damage caused by BB's regular rejection of this advice. If citizen trust and investor confidence are to be restored as rapidly as possible so that the economy can recover, the exchange rate needs to float. Enabling BB to continue its manipulation will not help.

Reviewing the above collections of IMF assessments that cover more than a decade of exchange rate actions advice and commentary prompts three observations. First, the IMF persistently urged Bangladesh authorities to allow "greater exchange rate flexibility" and was just as persistently rebuffed. Second, its own calculations regularly revealed the serious degree to which the taka exchange rate was overvalued in real terms. Indeed, even with the recent adjustments to the nominal exchange rate, the June 2024 IMF country report shows that the exchange rate remains significantly overvalued.[88]

Third, during the whole period, IMF staff consistently have made, and regularly repeated, the fundamental mistake of presuming that the "overall external position" was "broadly in line with fundamentals and desired policies." They, just like BB officials, were mistaken to believe that Bangladesh's external position (current account, reserve levels, and import coverage, which *include* remittance flows) reflected the intrinsic productivity of the Bangladesh economy and especially the productivity and capacities of the domestic labor force. By raising national income, remittances allow domestic absorption to exceed domestic output. This situation has advantages for a low-income, developing country. Productively utilized the additional income can raise investment, enhance education, and improve health. However, these advantages do not emerge concurrently with the inflows, which have a direct immediate impact on the exchange rate without a corresponding increase in the nation's current productive capacity or its "fundamentals" (as the IMF staff referred to them).

By ignoring this detail, both the IMF staff and Bangladesh's authorities have subjected the economy to a sustained period of Dutch Disease, eroded the country's international competitiveness, and undercut the dynamism of the export sector. The result is that the economy has deep-seated structural distortions that will take years (even decades) to unravel.

Notes

1. Bangladesh's foreign reserves were reported to be $42.3 billion in 2020, $45.3 billion in 2021, $32.9 billion in 2022, and $20.9 billion by 2023. The totals were significant overstatements. Data published by Bangladesh Bank show that gross reserves were too high, with recent estimates suggesting by around 20%. The new reporting requirement follows the definition in the IMF's Balance of Payments and International Investment Position Manual (BPM6). It adjusts for foreign reserves that the former government and BB had diverted for, among other things, projects implemented through the Bangladesh Infrastructure Development Fund (BIDF).
2. IMF (2023a, p. 1). With respect to exchange rate management, the current program includes one quantitative performance criterion ("floor on net international reserves") and two structural benchmarks. BB "reports official reserves as per BPM6 definition" and "uses market determined exchange rate for official FX transactions on behalf of the government" (IMF 2023a*,* Table 8, p. 41 and Table 11, p. 44).
3. Annex 2 surveys the IMF's advice on exchange rate management.
4. Examples are Annex Tables 3.1 and 3.5 of the 7th FYP (General Economics Division 2015, ch. 3), which provide projections for the period FY16–FY20 of the exchange rate together with the trading partners' inflation rates and expected inflation in Bangladesh. Similar data for FY21–FY25 appear in the 8th FYP (General Economics Division 2020c, ch.3, Table 3.6, p. 68).
5. Data are taken from World Bank World Development Indicators (WDI) online (accessed August 2024).
6. This is gross production. Approximately 12% of rice and wheat produced is seed, feed, and wastage (Talukder 2005, n. 4, p. 38).
7. These totals were inadequate to feed the population of 111.3 million in 1991. A survey of rural nutrition in 1993 (Ahmed 1993, Tables 2 and 3, Fig. 4) by the International Food Policy Research Institute concluded that "about half of the country's 112 million people cannot afford an adequate diet. Due to their inadequate purchasing power, they lack access to enough food and thus remain seriously underfed" (p. 3). Table 3 of that study showed that an estimated 61.5% of the rural population was "calorie deficient."
8. As shown below, this is lower (i.e., more equal to) than recent estimates.
9. Bangladesh—like China and Vietnam a decade or so earlier—transformed its agricultural policies in ways that helped support the economy's recovery and subsequent growth. The major "breakthrough" for agriculture in Bangladesh occurred in 1995/96. From 1974 to 1995, agriculture growth was 2% p.a., while population growth was 2.3%. p.a. Corresponding data for the period 1996 to 2022 were 3.9% and 1.4%. These changes are reflected in the indexes of livestock and food production. In the 21 years before 1995, livestock output increased by 43% (1.7% p.a.), while food production increased by 53% (2.1% p.a.). For the 26 years after 1995, the respective data were 294% (5.4% p.a.) and 167% (3.9% p.a.).
10. For the period 1974 to 2022, the imports of goods and services exceeded exports by an average of 6.7% of GDP. From 1974 to 1992, the gap was 8.1%, while it was 5.1% from 1992 to 2006.
11. Mahmud (2004) provided an excellent review of the economy's performance from 1900–91 to 2002–03. See especially his Table 2 (pp. 4029–30).
12. I focus on the t/$ exchange rate due to the increased importance over time of the US market for Bangladesh trade and the almost universal use of the dollar to finance the country's trade. For example, India, which is Bangladesh's second largest trading partner, has only recently

allowed rupee payments in its official trade transactions (Mahmud 2023). The amount allowed, however, covers only the value of Bangladesh's exports to India. India requires the remaining transactions, which in 2022 were above $11 billion, to be settled in US dollars. Data are from a report on Bangladesh trade by the Observatory of Economic Complexity (https://oec.world/en/profile/bilateral-country/ind/partner/bgd, accessed September 2024).

13. The break came between 2021 and 2022 when the rate moved from 85.1 t/$ to 91.7, a 7.4% depreciation. By 2023, the rate was 106.3, a cumulative two-year devaluation of 25%.
14. By any measure, this is a major reduction from the export growth in earlier periods of 19.4% (1992–2006) and, as noted above, 12.6% (2006–12).
15. Evident from their large nonperforming loans, a problem—still unresolved—that was the subject of an IMF program in April 2012 (IMF 2012, pp. 11, 15 and Table 6, p. 33; IMF (2013, par. 4, pp. 8–9 and Box, p. 12).
16. For example, after rising to 64.5% in 2015, the ratio of broad money to GDP declined to 51.2% in 2023 (World Bank WDI, accessed September 2024). Recent IMF data (IMF 2024a, Table 4, p. 33) estimate it to be 50.5% in FY24.
17. Bangladesh's inflationary bias and budget compression are discussed in companion policy notes.
18. The real appreciation may have also affected inflows of foreign direct investment. From 2006 to 2015, they averaged 1.2% p.a., while from 2016 to 2021, the average was 0.6% p.a. (World Bank WDI, accessed September 2024).
19. Author's calculations based on World Bank WDI GDP inflation data and official exchange rates of individual currencies relative to the dollar.
20. Except for the UK pound, the other currencies revalued against the US dollar.
21. Also relevant is the international experience, beginning with Britain's return to the gold standard in April 1925, and tracing through the post-WWII devaluations and debt problems faced by many countries under the Bretton Woods protocols, to the structural adjustment and debt relief programs for developing countries in the 1970s and 1980s. Some of this history can be found in Johnson (1967), Obstfeld and Rogoff (1996, ch. 4, 8), Hinkle and Montiel (1999), McPherson (2002), Yeyati and Sturzenegger (2010), World Bank (2023a,b), and Romeu (2024). Debt crises spurred by exchange rate troubles continue. Recent IMF data show that "around 15 percent of low-income countries are in debt distress and another 40 percent are at risk of distress" (Pazarbasioglu 2024).
22. World Bank WDI, accessed August 2024.
23. As noted earlier, the reserves were overstated because some of them have been diverted for non-reserve purposes.
24. The 7th FYP (General Economics Division 2015, Sec. 3.4, p. 71) offered some insights when it noted that "Bangladesh Bank in its recent Monetary Policy Statements aimed to use exchange rate and monetary policies for the purpose of preserving external sector stability, maintaining satisfactory building up reserves and avoiding excessive volatility of the exchange rate." More recent monetary policy statements, for example, for FY2022–23, July–December 2023, and July–December 2024, obfuscate rather than clarify. For instance, the FY23 statement asserted that "Bangladesh Bank (BB) . . . has been carrying out its principal task of formulating and implementing monetary policy to manage the monetary and credit system of the country with a view to stabilizing domestic monetary value and maintaining a competitive external par value of Taka towards fostering growth and development of [the] country's productive resources in the best national interest" (Bangladesh Bank 2023a,

par. 1). The July–December 2023 statement is especially noteworthy for its incoherence. It multiple measures for addressing the economy's macroeconomic problems were internally inconsistent (Bangladesh Bank 2023b). The most recent Statement (July–December 2024) is especially discouraging. It reports that "as the Forex market is showing reasonable stability and transactions are taking place within predefined bands, BB decides to keep the crawling peg mid-rate unchanged at Tk.117.00 per USD" (Bangladesh Bank 2024, p. 2). Observers will wonder what there is to "decide" about "keeping" the peg at one rate or another if, as noted earlier, BB is committed under the IMF program to a "market-determined" exchange rate.

25. Varghese and Hul (2023).
26. There has been some significant local contributions to this literature (Chowdhury and Rabbi 2014; Raihan 2023, ch. 4, p. 134; de Melo 2023).
27. At the time, that is 2012, the main objectives were the Millenium Development Goals for 2015 and graduation from low-income status, which, according to Bangladesh's first 20-year Perspective Plan, would be around 2021. It is especially noteworthy that there was minimal official concern about the pattern of exchange rate management that was undermining the export sector so tangibly when the major development goals—SDGs (2020), middle-income status (2031), high-income status (2041), and environmental sustainability (2041) (General Economics Division 2018, 2020a, b, c)—were being crafted. None of them could be achieved as planned without a dynamic export sector, the very driver of growth that kept Bangladesh's economy aligned with world economic growth.
28. While there is evidence that the recent shifts in the exchange rate (in September 2024 to 118 t/$) have removed a significant degree of the real overvaluation, more immediate adjustment followed by market-determined movements will be needed. Bilateral exchange rate calculations show that at the end of 2023, the taka was still overvalued by 13% relative to the US dollar, neutral relative to the euro, and undervalued relative to China and India (both around 12%). It was still grossly overvalued relative to the Japanese yen (41%) and the British pound (62%). This incomplete pattern of adjustment is why the IMF's recommendation that Bangladesh conduct a "managed float" is counterproductive (Varghese and Hul 2023; IMF 2024a, p. 14, par. 21). The reality is that BB lacks the capacity to effectively manage the necessary exchange rate realignment. A further drawback for the proposed managed float is that Bangladesh's citizens have no reason to trust that BB officials will manage the float to serve the national interest. These points are discussed further below.
29. I focus on the IMF assistance here but also recognize that other international entities (primarily the Asian Development Bank and the World Bank) and several bilateral agencies have pledged additional support.
30. The persistent distortions in the basic costs and prices of tradables and nontradables leaves little room for the adjustments that can feasibly (or politically) be made, let alone those that must be made if the economy is to recover its dynamism. Multiple countries across the globe are evidence of these points: South Africa, Russia, Zimbabwe, Egypt, Angola, Turkey, Peru, and most of the Gulf States. Some countries in the last group have been "rich enough" to endure long periods with minimal internal economic transformation. Others, like Nigeria, Venezuela, and Myanmar, fail to develop in any meaningful sense. More important, some countries such as Zambia and Ghana have never moved beyond the structural rigidities generated by extended periods of real exchange rate overvaluation.
31. This point can be readily demonstrated with interindustry tables. Early examples include Cordon (1966) and Bruno (1972), who among others, used input-output analysis to trace the

system-wide impacts of tariffs and other impediments to, or incentives for, trade. McPherson (1980) applied a similar approach to identify the barriers to Zambia's development.

32. In technical terms, real overvaluation systematically shifts the domestic resource costs (labor, capital, land, information) of producing and consuming tradables relative to the resource costs of nontradables (Banerji and Donges 1974). Based on Bangladesh's experience, the effects are never trivial.
33. A measure of the best alternative use of each resource.
34. This would be demonstrated by an exercise that weighed the costs (political, economic, and social) of making the necessary adjustments to reform the exchange rate system against the similar costs of not adjusting. Hill and McPherson (2004) edited a volume on Zambia that highlighted this issue. The basic conclusion was that the more than a dozen attempts at structural reform (most of them abandoned) left Zambia and its citizens significantly worse off. Fast forward to the present, Zambia yet again is in deep debt distress and is being bailed out by its international creditors (G20 2023, p. 9; Pazarbasioglu 2024, Chart; UN Conference on Trade and Development 2024). A similar point was made under the heading the "cost of inaction" by Meier (1976, pp. 847–49) in reference to employment reforms proposed in Kenya in 1972. The lessons of the study generally apply: "Once a structure of demand and production has been created which is incompatible with fuller employment, it becomes progressively more difficult and expensive to reverse it later. . . . An ossified structure may create a situation where any interference will only aggravate unemployment in the short run (and possibly beyond the limits of what is tolerable) while the structure itself prevents the implementation of the policies required for full and widespread employment."
35. See Kindleberger (1958) and Herrick and Kindleberger (1977).
36. A further function of plans was (and continues to be) a means for justifying the creation of additional ministries and agencies to support new initiatives. Recent examples from Bangladesh involve digitization, artificial intelligence, the Fourth Industrial Revolution, and the institutional machinery that was being formed to support "Smart Bangladesh" (United News of Bangladesh 2022; ICT Division 2023; BBF Digital 2023; Kamal 2023, Ali 2024).
37. Countries following this path have been South Korea and Singapore (Ministry of Trade and Industry 2022; Ministry of Economy and Finance 2024).
38. Often in considerable detail, as the 726 pages of the 7th FYP and 849 pages of the 8th FYP indicate (General Economics Division 2015, 2020c).
39. As noted earlier, they address Bangladesh's enduringly low tax-to-GDP ratio, annual cycle of budget compression, and persistent high rate of inflation.
40. Raihan, Bourguignon, and Salam (2023).
41. Raihan (2023, Box 4.1, pp. 111–13 and ch. 4, p. 134).
42. Md. Yunus interview with *New York Times*, September 27, 2024 (https://m.youtube.com/watch?v=P4G4rvAeOUA).
43. A useful exercise for Bangladesh before it does any additional planning would be to run a counterfactual exercise projecting the country's growth and development trajectory from the mid-2000s without the subsequent distortions to the exchange rate. Since, as noted earlier, the projections in the 6th, 7th, and 8th FYPs already include adjustments designed to keep the exchange rate internationally competitive, the exercise would not take long. An extension of this counterfactual could be to include the various recommendations for addressing the low tax-to-GDP ratio. One outcome of the exercise is that it would show that without exchange rate manipulation and with improved tax mobilization, Bangladesh would not have the intense

budget compression that it has imposed perennially to control the budget deficit. A lower deficit would have reduced the rate of money creation, thereby lowering the country's chronic rate of inflation. That, in turn, would have obviated the need for BB to use a fixed exchange rate as a "nominal anchor."

44. Chowdhury (2019).
45. Ministry of Law and Parliamentary Affairs (1972, Sec. 9A, c). Chowdhury (2019) reported the same structure.
46. Ministry of Law and Parliamentary Affairs (1972, Sec. 7A, c).
47. I purposely avoid any suggestion that a solution would be for BB to be "independent," whatever that can mean for any public agency that can, at best, be "independent within but not of" the government of Bangladesh (Nawaz and Chowdhury 2014). That phrase borrows from the testimony of Robert Roosa, then undersecretary of the US Treasury, to Congress on the independence of the Federal Reserve. (I owe this anecdote to my mentor the late James Duesenberry, William James Maier Professor of Money and Banking at Harvard University.)
48. Basu (2021, p. 29) reviewed Bangladesh's performance and concluded that "all the good news is no guarantee of sustained development." The authorities missed this possibility.
49. Government of Bangladesh (1997, Sec. 1.2.25, p. 9).
50. Government of Bangladesh (1997, Sec. 4.16.4, p. 88).
51. Government of Bangladesh (1997, Sec. 5.20.1, p. 108).
52. 6th FYP (General Economics Division 2011, ch. 2, p. 54). The extent of the real appreciation is evident in Figure 3.6 which shows that the nominal exchange rate depreciated by 1% despite local inflation of 31.2% (Government of Bangladesh 1997, Sec. 1.2.25, p. 9).
53. Figure 3.6 of the 6th FYP showed that foreign reserves increased from less than $2 billion in F00 to ~$10 billion in FY10 (General Economics Division 2011, p. 88).
54. General Economics Division (2011, p. 88).
55. See Ali and Mufti (2023) and Razzaque, Dey, and Rabi (2024). It also partially explains Bangladesh's failure to promote trade reform (World Bank 2023c) and the massive distortions that emerged over time as officials attempted through (tariff relief, subsidies, and other indulgences such as favored access to credit) to offset the increasingly severe exchange rate distortions. The point was confirmed in the 6th FYP (General Economics Division 2011, p. 54): "While trade protection has come down sharply from its very high levels in the early 1990s, Bangladesh remains amongst the most heavily protected countries in the world. Trade reform has also stagnated over the past few years."
56. General Economics Division (2015, Sec. 1.5.3, p. 17).
57. General Economics Division (2015, Sec. 3.3, p. 67).
58. General Economics Division (2015, Sec. 3.4, p. 71).
59. Figure 3.5 of the plan shows the increase in the appreciation of the Taka against the dollar for the period FY03 to FY14 (General Economics Division 2015, p. 64). Additional evidence of the real appreciation is provided in the 8th FYP, Figures 3.6 and 3.7, which show the divergence of the taka against the US dollar and euro beginning in FY03 and continuing through FY19 (General Economics Division 2020c, pp. 65–6).
60. Since "external sector stability" is such an amorphous goal and was meaningless in the context of the "erosion of export competitiveness," the benefit to BB must have been (primarily) administrative. This recalls Sir John Hicks's statement that "the best of all monopoly profits is a quiet life" (Hicks 1935, p. 8). Observers might speculate that Bangladesh's central bankers were especially satisfied with the "external sector stability" that their policies had produced relative to

the obvious “instability” next door. Over the period 2012 to 2015, when Bangladesh’s fortunes seemed so bright, the t/$ exchange rate appreciated by 5%, while the rupee/$ rate depreciated by 20%. This apparent advantage was a mirage: While Bangladesh’s exports were being undercut by its eroding international competitiveness, India maintained its export share (World Bank WDI data online for Bangladesh and India, accessed September 2024).

61. General Economics Division (2020c , pp. 48–9).
62. General Economics Division (2020c, p. 66).
63. IMF (2023a, pp. 14–5, par. 21).
64. IMF (2024a, par. 6, p. 8).
65. The IMF recommended that Bangladesh adopt a “new exchange rate arrangement,” that is, a crawling peg with a “gradual shift from a single reference currency peg to a basket of currencies with a narrow band corridor” (Varghese and Hul 2023, p. 17, par. 14; IMF 2024a, p. 21, par. 14).
66. US Department of State (2009).
67. IMF Staff (2000, p. 1).
68. Casiraghi, Habermeier, and Harjes (2022).
69. This responsibility relates to Sections 2 and 3 of the Article XIV of the IMF’s Articles of Agreement (IMF 2023c, p. 1), which contains a detailed description of Bangladesh’s exchange rate regime (pp. 512–51).
70. IMF (2012, p. 2).
71. IMF (2012, attachment 1, Tables 1, 2, pp. 54–5).
72. IMF (2012, p. 10, par. 15 and p. 50, par. 20). The NIR target was a floor in foreign reserves.
73. IMF (2012, par. 34, p. 15).
74. IMF Staff (2013, p.5, par. 1).
75. IMF (2013, Box 2, p. 8).
76. IMF (2016, Box 1, pp. 9–11).
77. This was the time during which export diversification stalled and export growth sharply slowed.
78. IMF (2018, pp. 8–9, pars 18, 19). REER data are reported in Table 1, p. 26.
79. IMF (2019, p. 17, par. 13). It is remarkable that in Annex 1, p. 34, which reviews Bangladesh’s “response to past Fund policy advice, the suggestion “gradually increase exchange rate flexibility” elicited the comment: “BB has intervened occasionally in the foreign exchange market to avoid excessive rate fluctuations. The currency has been relatively stable against USD, while REER appreciated.” BB and the IMF were talking past each other.
80. IMF (2022, p. 8, par. 12).
81. IMF (2022, p. 14, par. 27).
82. Hussain and Basu (2022, p. 59, par 4). This is an area of reform identified by both the Asian Development Bank (2021, 2024) and World Bank (World Bank 2023c).
83. IMF (2022, p. 15, par. 28).
84. IMF (2023a, p. 15, par. 23).
85. IMF (2023b, p. 8, par. 11, and Table p. 9). This was a fudge. The rates used were “market-based” only in principle. At the time, the exchange rate was not freely floating.
86. IMF (2023b, p. 15, par. 24).
87. IMF (2024a, p. 14, par. 21).
88. IMF (2024a, Fig. 3, p. 26).

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