

CHAPTER 8: CREATING A MORE EFFICIENT FINANCIAL SYSTEM

1. Introduction

8.1 Creation of a deeper and more efficient financial system can be considered a sine qua non for sustaining high growth and attaining the middle-income country status that is desirable for Bangladesh. It is reasonably clear that this will require a substantial change in the role of government – from an operator and arbiter in the financial system to a facilitator role. This implies not only divestment from the nationalized commercial banks (NCBs), a laudable reform process that is underway, but also de-politicization of the licensing process and a market-based framework for resolving bank failure. Most importantly, the government would need to move away from the implicit guarantee provided to depositors and owners to applying the existing limited explicit deposit insurance for depositors, while simultaneously relying more on market participants to monitor and discipline banks instead of micro-managing financial institutions. This redefinition of government’s role also applies to other segments of the financial system, such as capital markets and the micro-finance sector, and should be seen as an essential element in the governance reform agenda and in the movement from a relationship-based economy to a market- and arms-length economy.

II. The Structure and Recent Performance of the Banking Sector in Bangladesh

8.2 *Financial intermediation in Bangladesh, as in majority of the developing world, is heavily dominated by commercial banks.* As of end-2005, the banking sector comprised four groups of “scheduled banks” (see **Table 8.1**): four NCBs, five government-owned development financial institutions (DFIs) (specialized banks that deal in “development financing”), thirty private commercial banks (PCBs), and nine foreign commercial banks (FCBs). While there are a number of investment banks, merchant banks, leasing and finance companies, insurance companies, and stockbrokers, these are small in comparison. As of December 2001, the banking sector accounted for 89 percent of the country’s financial assets.¹⁵⁸ The story of the banking sector, therefore, is largely also the story of the financial sector in Bangladesh.

Table 8.1: Structure of the Banking System (end-2005)

Bank Types	Number of Banks	Number of Branches	% of Industry Assets	% of Industry Deposits
NCBs	4	3386	37	41
DFIs	5	1342	10	6
PCBs	30	1643	46	46
FCBs	9	41	7	7
Total	48	6412	100	100

Source: Bangladesh Bank Financial Sector Review, May 2006

8.3 *Immediately after independence, the Government decided to nationalize the banking sector. The legacy of that move carried on for several decades.* Although two of the six NCBs were privatized in the 1980s and private banking was permitted, Bangladesh started out the 21st century with a banking system dominated by government-owned banks and several weak privately-owned banks.

8.4 *The structure of the banking sector has evolved quite remarkably since 2001, benefiting from some bold reforms* that have sought to deemphasize the role of the NCBs, strengthen competitive pressures, loosen government control, and tighten prudential regulations and regulatory quality (See **Annex 8.1** for a chronology of major banking sector reforms). The structural shift is most visible in the

¹⁵⁸ *Financial Performance and Soundness Indicators of South Asia*, World Bank, 2004.

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declining share of the NCBs in the industry's total assets, from 54 percent in 1998 to 37 percent in 2005, mirrored by the increase in the share of the PCBs, from 27 percent in 1998 to 46 percent in 2005. In 2004, for the first time, the combined share of the NCBs and DFIs in total banking sector assets was lower than the combined share of the PCBs and FCBs. Similar trends can be seen for bank deposits and loans; with the PCBs and FCBs increasing their market share at the expense of the NCBs and DFIs.

8.5 A number of key performance measures in the banking sector have responded positively to the recent reforms (**Table 8.2**). The Capital Adequacy Ratio (CAR) of banks increased from 6.7 percent in 2001 to 8.3 percent in 2006, mainly due to sharp increases in the CARs of FCBs and DFIs; the CAR of the NCBs fell over the period. The non-performing loans (NPLs) to total loans ratio improved considerably for all categories of banks, responding to restructuring measures, improved lending practices, and strengthened loan recovery drives. The gross NPL ratio of the NCBs fell from 46 percent in 1999 to 23 percent in 2005. Underlying the history of the high NPLs in the NCBs and DFIs are the problems of weak management, constant political interference, and problems of corruption and directed lending; issues which are beginning to be addressed under the ongoing reforms. The PCBs managed to cut their gross NPL ratio to 5 percent by 2006, down from an astounding 33 percent in 1998. There is substantial variation in performance among the PCBs though, with several older ones having been under intensive Bangladesh Bank care for over a decade due while others have maintained healthy balance sheets positions.¹⁵⁹

Table 8.2: Performance Measure in the Banking Sector

Bank Type	Capital to risk weighted assets ratio							Ratio of gross NPL to total loans						
	2000	2001	2002	2003	2004	2005	2006	2000	2001	2002	2003	2004	2005	2006
NCBs	4.4	4.2	4.1	4.3	4.1	-0.4*	1.1	38.6	37.0	33.7	29.0	25.3	21.3	22.9
DFIs	3.2	3.9	6.9	7.7	9.1	9.2	9.5	62.6	61.8	56.2	47.4	42.9	34.9	33.7
PCBs	10.9	9.9	9.7	10.5	10.3	9.2	9.8	22.0	17.0	16.4	12.4	8.5	5.6	5.4
FCBs	18.4	16.8	21.4	22.9	24.2	25.1	22.7	3.4	3.3	2.6	2.7	1.5	1.3	0.8
Total	6.7	6.7	7.5	8.4	8.7	7.3	8.3	34.9	31.5	28.0	22.1	17.6	13.5	13.1

Note: NPL numbers are without adjustment for actual provision and interest suspense.

* Negative CAR for NCBs in 2005 because of negative capital of Agrani bank

Source: Bangladesh Bank Quarterly, various issues.

8.6 ***Despite the recent improvements, the banking sector, having been plagued by systemic distress over the last 20 years, is only beginning to emerge from a crisis situation and has a long road ahead to full recovery.*** Applying one of the criterion for a systemic banking crisis, gross NPL ratio of more than 10 percent of aggregate loan portfolio, Bangladesh has been in one since 1983 – with gross NPLs standing at 13.1 percent in 2006 and NPLs net of loan provisions at 7.1 percent of total loans.¹⁶⁰ In addition, provisioning by the NCBs and the problem PCBs has typically fallen well short of requirement. The required to actual provisioning ratio for the banking sector as a whole fell from 60 percent in 2001 to 41 percent in 2004, before recovering a bit to 48 percent in 2005. With a provision maintenance ratio of about 25 percent and a provisioning shortfall equaling Tk. 40 billion, the (in)solvency situation was the worst in NCBs. The FCBs were the only category that met its provisioning requirement in 2005.

¹⁵⁹ There were several waves of PCBs licensed at different points in time, referred to as generations. The first generation of PCBs was licensed during 1972 and 1989, the second during 1991 and 1996 and the third between 1999 and 2001.

¹⁶⁰ Other criteria commonly used to identify a systemic banking crisis include: (i) emergency measures were taken to assist the banking system (such as bank holidays, deposit freezes, blanket guarantees to depositors or other bank creditors), (ii) large-scale nationalizations took place, or (iii) the fiscal cost of the rescue operations was at least 2 percent of GDP. Compare Demirguc-Kunt and Detragiache (2005).

III. Bangladesh's Financial System in International Comparison

8.7 *The level of development of Bangladesh's banking system is comparable with other South Asian countries and higher than the average for low-income countries, although on some important indicators of banking efficiency and solvency Bangladesh lags many comparators.* Other segments of the financial system, such as the insurance sector and the stock market are substantially less developed in Bangladesh than in the comparator countries. Both the banking system and stock markets are less developed and less efficient in Bangladesh than in East Asia.

8.8 As seen in **Table 8.3**, in 2004, on all three financial intermediation development indicators used – Private Credit to GDP ratio, Liquid Liabilities to GDP ratio, and Bank Deposits to GDP ratio – Bangladesh performed worse than India, but better than Indonesia, Pakistan, the average for South Asian countries, and the averages for low-income countries. Not surprisingly, it fared worse than the average for East Asian countries whose financial systems have by now recovered from the 1997 crisis. On a positive note, Bangladesh's loan-deposit ratio stood at an exceptionally high 80 percent, i.e. four-fifths of banks' deposits were intermediated into private sector loans. This is even higher than the East-Asian average. One of the reasons for this is that the Government directly competes with banks through the National Savings Schemes (NSS), which go straight into its budget, leaving limited need for direct bank loans to the Government.¹⁶¹

Table 8.3. Banking and Non-Banking Indicators for Bangladesh in International Comparison (2004)

Panel A – Banking Sector Indicators						
	Loan-Deposit Ratio	Liquid Liabilities/GDP	Private Credit/GDP	Bank Deposits/GDP	Overhead Costs	Net Interest Margin
Bangladesh	0.801	0.389	0.274	0.342	0.026	0.026
Indonesia	0.540	0.433	0.210	0.389	0.031	0.048
India	0.641	0.616	0.328	0.511	0.022	0.032
Nepal		0.367	0.021	0.033
Pakistan	0.748	0.469	0.257	0.344	0.021	0.028
Low Income	0.656	0.294	0.147	0.220	0.058	0.077
South Asia	0.677	0.486	0.269	0.402	0.024	0.031
East Asia & Pacific	0.712	0.544	0.402	0.456	0.026	0.041
Panel B – Non-Banking Sector Indicators						
	Stock Market Value Traded/GDP	Stock Market Turnover Ratio	Life Insurance Premium Volume/GDP	Non-Life Insurance Premium Volume/GDP		
Bangladesh	0.016	0.365	0.004	0.002		
Indonesia	0.107	0.430	0.006	0.007		
India	0.548	1.137	0.024	0.006		
Nepal	0.004		
Pakistan	0.769	3.268	0.002	0.004		
Low Income	0.096	0.720	0.009	0.007		
South Asia	0.273	1.239	0.009	0.005		
East Asia & Pacific	0.223	0.311	0.017	0.011		

Source: Financial Structure Database, Beck, Demirguc-Kunt and Levine (2000). Data are revised up to 2004.

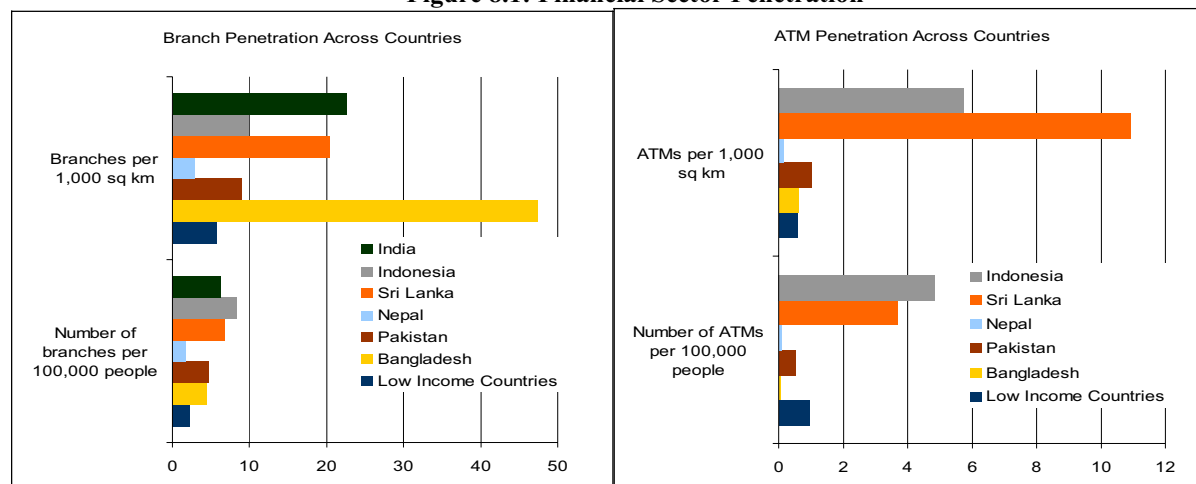
¹⁶¹ These NSS are mostly for 3-5 years of maturity and their sale is restricted to individuals. Their rate of return is significantly above that of bank deposits, especially since there seems a very low penalty for early liquidation. At the end of 2004, there were Tk 349 billion outstanding NSS, but only Tk 182 billion outstanding government papers.

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8.9 *Comparisons of operational efficiency paint a mixed picture.* The NPL ratios in Bangladesh are significantly higher than in the comparator countries. In 2002, the gross NPL ratio of the banking sector stood at 28 percent, compared with 9 percent in India, 16 percent in Pakistan, and 14 percent in Sri Lanka. Despite the reductions since, Bangladesh has not yet caught up with these comparator countries. On the other hand, overhead costs and net interest margins – measures of inefficiency in the banking system – are at comparable levels with other South Asian and East Asian countries and significantly lower than the average for low-income countries (Table 8.3).¹⁶²

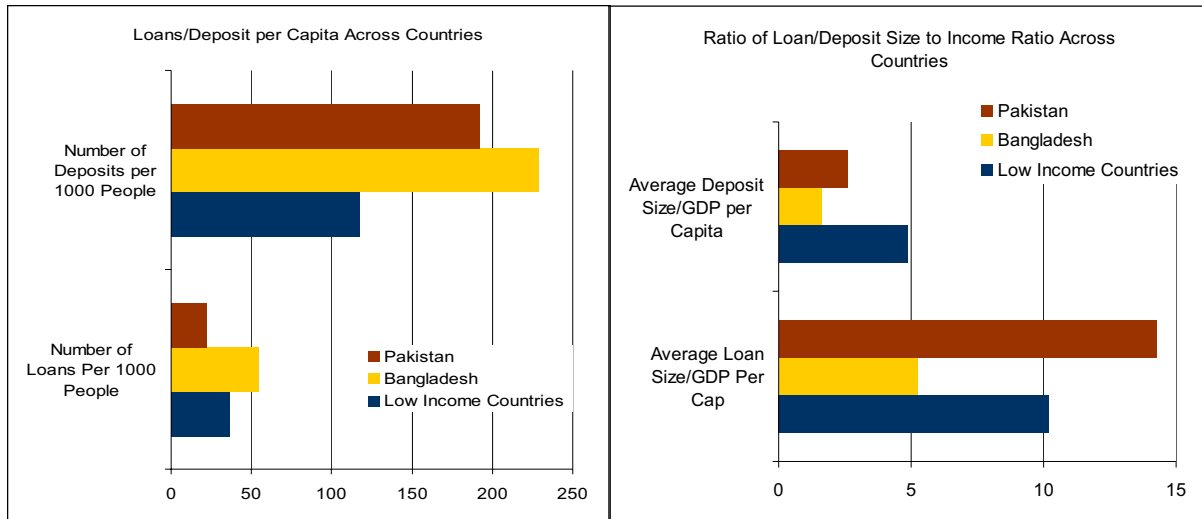
8.10 *Comparisons with other countries in the region and low-income countries suggests that banking penetration in Bangladesh is adequate for the level of financial and economic development.* Here, we use a new database on access to and use of banking services, compiled from regulatory entities and public information for the years 2003/2004 and discussed in Beck, Demirguc-Kunt and Martinez Peria (2005). Bangladesh has 47 bank branches per 1,000 square kilometer which is significantly higher than in comparator countries (Figure 8.1). Bangladesh's demographic branch penetration, four branches per 100,000 people, is at similar or higher levels than in Pakistan, Nepal and the average low-income country, but significantly below the level observed for India, Indonesia and Sri Lanka. ATM penetration of less than one ATM per 1,000 square kilometer and per one million people is significantly lower than the comparator countries with the exception of Nepal. The number of loan and deposit accounts per capita is higher than in Pakistan and the average low-income country, while the average loan size and deposit account size relative to GDP per capita – negative indicators of outreach – are below the levels in Pakistan and the average low-income country. While these indicators are only for the formal banking sector, the limited data available for the microfinance sector suggest that access to and use of formal financial services is higher than in many comparable countries. Bangladesh has the highest microfinance penetration in the world (borrowing clients constitute 13 percent of total population), twice that of Indonesia, which has the second highest penetration rate.¹⁶³

Figure 8.1: Financial Sector Penetration



¹⁶² Overhead costs are banks' total operating costs relative to total assets while net interest margins are net interest revenue (i.e. interest revenue from loans minus interest costs from deposits) relative to total earning assets.

¹⁶³ Honohan (2004).



Source: Beck, Demirguc-Kunt and Martinez Peria (2005)

8.11 ***Other segments of the financial system in Bangladesh are significantly less developed than the banking system, and this disparity stands out relative to comparator countries.*** There is a small but growing non-bank financial sector comprising leasing and finance companies. The stock market is a small, inactive and stagnant market. Stock market capitalization relative to GDP stands at about 5 percent, and the turnover ratio – trading relative to capitalization – is lower than most comparator countries. The shares of financial institutions – mandated by law to list – dominate the Dhaka stock exchange;¹⁶⁴ in December 2006, they constituted 55 percent of market capitalization. There were only two Initial Public Offerings (IPOs) of non-financial companies in 2005 and none in 2004. There are few incentives for a firm to go public, and stocks of a typical company are rarely traded freely.¹⁶⁵

8.12 ***Long-term contractual savings institutions are virtually absent and even their miniscule presence does not serve the societal purpose of promoting long-term saving.*** The insurance sector is small and inefficient – in 2004, life and non-life insurance penetration (premiums relative to GDP) stood at just 0.4 percent and 0.2 percent, respectively, below the average for both low-income and the South Asian country averages (Table 8.3). Not only that, life insurance companies undertake reverse maturity transformation, i.e. transform long-term liabilities into short-term assets, such as bank deposits, which can be partly explained by the reluctance to issue long-term savings instruments that would have to compete with the NSS. There are few private pension funds and mutual funds whose development is most likely also prevented by the existence of the NSS that offer rates above deposit interest rates in the banking sector. Both the pension and mutual fund industry are dominated by public pension schemes and by the Investment Company of Bangladesh (ICB) that also holds a large part of the shares on the Dhaka Stock Exchange.¹⁶⁶ Unlike private funds, ICB is not subject to Securities and Exchange Commission (SEC) supervision and has fewer restrictions on its activities, so that private institutions do not face a level playing field.¹⁶⁷ This lack of privately owned institutional investors has negative repercussions for corporate governance and stock market liquidity.

8.13 ***The picture painted by the aggregate indicators is confirmed by firm-level indicators of financing patterns.*** Firms in Bangladesh finance a lower share of their working capital and new

¹⁶⁴ There is a second smaller stock exchange in Chittagong.

¹⁶⁵ Sobhan and Werner, 2003.

¹⁶⁶ It is estimated that ICB holds 20% of shares through their mutual funds and own accounts as brokerage firm (Asian Development Bank, 2004)

¹⁶⁷ Sobhan and Werner (2003).

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investment with retained earnings than firms in Pakistan and the average firm in low-income country, but more than in other comparator countries (**Figures 8.2.a** and **Annex Figure 8.2**). Differentiating by sources of external finance, Bangladeshi firms finance a larger share of working capital and new investment with banking credit, while private equity and the sales of stocks play a miniscule role. At the same time though, Bangladeshi firms view access to external finance and cost of external finance as bigger obstacles than firms in Pakistan, Sri Lanka, Indonesia and the average firm in the average South Asian or East Asian country or, for that matter, in the average low-income country (**Figure 8.2.b**).¹⁶⁸

Figure 8.2a: Sources of Firm Financing: Share of Working Capital

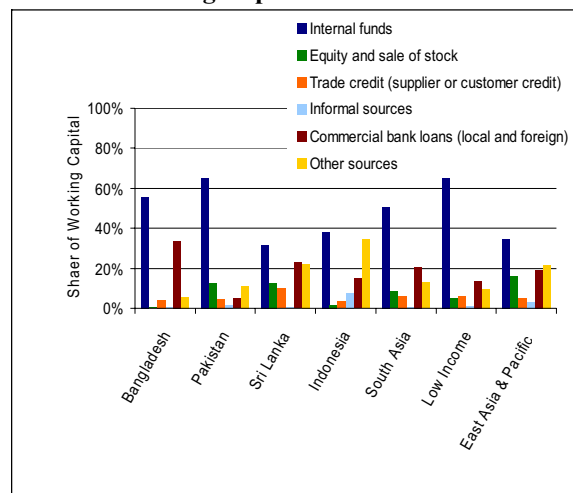
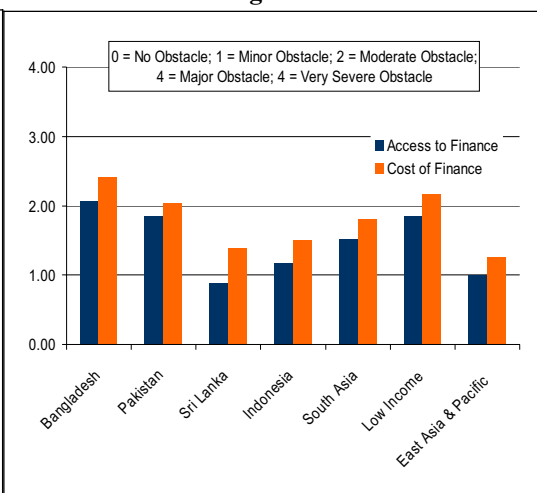


Figure 8.2b: Financing Obstacles: Access to and Cost of Financing



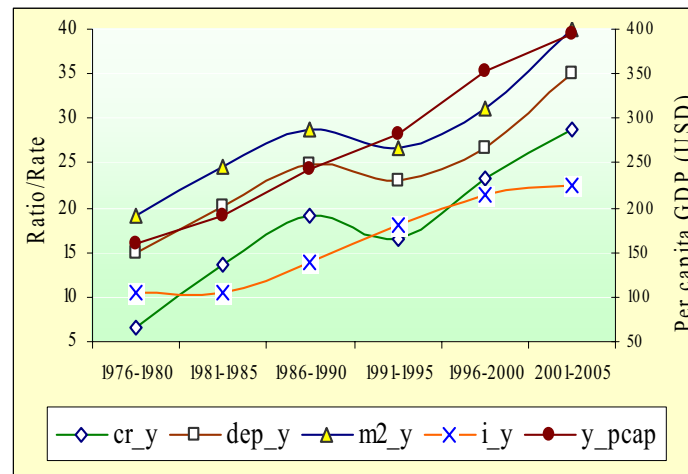
Source: Investment Climate Assessments

IV. Finance Development and Growth in Bangladesh: Is there a Link?

8.14 *Financial development indicators, such as Private Credit to GDP, Total Deposits to GDP and M2 to GDP display rising long-term trends in Bangladesh, suggesting financial sector deepening (Figure 8.3 and Annex Table 8.2).* As seen in **Figure 8.3**, the year 1991 marked a turn-around in financial sector performance, resulting from the Financial Sector Reform Program (FRSP) that was initiated in that year and aimed at moving the financial system to a more market-based one. Reductions in interest rate controls and credit quotas were among the major changes under the FRSP. It is important to note, however, that the FSRP led to a more *quantitative* improvement in the financial development indicators: i.e., although, for example, the volume of credit increased in the first phase, the quality of lending did not necessarily improve. As noted in **Section II**, the *qualitative* shift occurred as a result of the reforms started in 2001.

¹⁶⁸ Although these are subjective assessments, that Beck, Demirguc-Kunt and Levine (2006) find that in countries where firms report higher financing obstacles, industries that depend more on external finance grow relatively more slowly and investment resources are reallocated more slowly as demand changes across industries. Also, Beck, Demirguc-Kunt and Maksimovic (2005) find a significant negative impact of financing obstacles on firm growth.

Figure 8.3: Financial Development, Investment and Income in Bangladesh over Time



cr_y is Private Credit to GDP, dep_y is total deposits to GDP, m2_y is M2 to GDP, i_y the investment-GDP ratio and y_pcap income per capita in current USD.

Source: Bangladesh Bank and authors' calculations.

8.15 **Financial development has been positively correlated with and very likely has contributed to the rising income levels.** Figure 8.3 shows the positive correlation between the financial development indicators and the investment to GDP ratio as well as GDP per capita. Use of econometric time-series techniques – that are elaborated in Annex 8.2 – shows that not only is financial development positively correlated with investment and income in Bangladesh, it also seems to have positively impacted the two: i.e., higher levels of financial development have *caused* higher levels of investment rate and per-capita GDP. Results show that a one percent increase in the ratio of private credit to GDP led to a 0.15 percentage point increase in the investment rate and a 0.22 percent increase in per capita income. The finding of a positive impact of financial development on per capita income is after controlling for the indirect impact through investment activity, suggesting that financial development likely enhanced both the level and efficiency of investment.¹⁶⁹

8.16 **The positive relationship between financial development, investment, and per capita income is driven by the post-FSRP period of 1991 to 2005.** The econometric results reported in the previous paragraph hold only for the 1991-2005 period and not for the pre-FSRP period of 1976 to 1991. This is consistent with the cross-country evidence discussed below and carries some important policy conclusions. Specifically, a financial system that relies heavily on nationalized banks, interest rate controls and directed credit, as was the case in pre-FSRP period, cannot be expected to fulfill its important role in channeling society's savings into investments and fostering economic growth.

V. Finance as Key to Faster Economic Development: Cross-Country Evidence

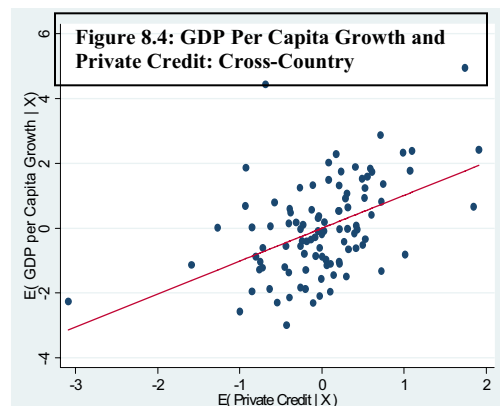
8.17 **The positive impact of financial development on income levels in Bangladesh is consistent with economic theory as well as cross-country evidence.** Financial markets and institutions arise to alleviate market frictions that prevent the direct pooling of society's savings and channeling to investment projects. Well developed financial systems ease the exchange of goods and services by providing payment services, help mobilize and pool savings from a large number of investors, acquire and process information about enterprises and possible investment projects, thus allocating society's savings to its

¹⁶⁹ The results also show a positive and significant relationship between investment and per capita income. In the long-run a 1 percentage point increase in the investment-GDP ratio is shown to increase per capita income by 0.2%.

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most productive use, monitor investments and exert corporate governance and help diversify and reduce liquidity and intertemporal risk.¹⁷⁰

8.18 *A well-established body of evidence corroborates that countries with better developed financial systems experience faster economic growth.*¹⁷¹ Annex Table 8.1 and Figure 8.4 summarize this evidence; countries with higher levels of credit to the private sector relative to GDP experienced higher per capita growth rates over the period 1980 to 2003.^{172,173} [Note that the positive relationship between private credit and growth shown in Figure 8.4 is after controlling for the standard growth regressors such as education, government consumption, trade, black market premium, inflation, and population growth.] This relationship is not only statistically, but also economically significant. Results in Annex Table 8.1 suggest that a



doubling of private sector lending to GDP ratio in Bangladesh over the period 1980-2003, from 22 to 44 percent, would have resulted in 0.7 percentage higher GDP growth per year.^{174,175} Other measures of financial development, such as M2 to GDP or the turnover ratio in stock markets yield similar results.¹⁷⁶

8.19 *Financial development is not only pro-growth, but also pro-poor.* Annex Figure 8.1 shows the negative relationship between Private Credit and the average annual change in Headcount – the share of population living on less than one dollar a day – over the period 1980-2000.¹⁷⁷ Note that the relationship represented in Annex Figure 8.1 is after controlling for the effect of average economic growth suggesting that financial intermediaries help the poor also by improving the inequality situation.¹⁷⁸

8.20 *Bigger is not always better in financial development, however! For financial development to positively impact growth, an enabling policy environment is essential.* Private credit is not a policy variable itself. A rapid increase in private sector lending not supported by macroeconomic stability and the contractual and informational framework discussed below can result in fragility and banking crises, as experienced by many countries over the past 30 plus years, with associated costs in the form of lost growth and worsened poverty situation.¹⁷⁹

¹⁷⁰ Levine, 1997 and 2005.

¹⁷¹ To be sure, there is also a feedback of faster economic growth on the development of the financial system.

¹⁷² Private Credit to GDP is a standard measure of financial intermediary development and is the ratio of claims by deposit money banks and other financial institutions on the private, domestic non-financial sector relative to GDP. Private credit to GDP was 173% in the U.S. in 2003, but only 2% in Mozambique.

¹⁷³ The set of explanatory variables follows a standard regression set-up from the finance and growth literature, for example, as used in Beck, Levine and Loayza (2000).

¹⁷⁴ Such counterfactuals have to be interpreted with caution as the coefficients indicate marginal effects from which we are extrapolating to discrete changes. Further, this counterexample serves an illustrative purpose; it does not actually tell us how to achieve higher growth rates.

¹⁷⁵ The relationship between financial intermediary development and economic growth is not only robust to controlling for other factors that are associated with economic growth, but to controlling for the reverse causation from faster economic growth to financial development and to the relationship being driven by a third factor.

¹⁷⁶ Levine, Loayza and Beck (2000); Beck and Levine (2004).

¹⁷⁷ As shown by Beck et al. (2004), this relationship is robust to controlling for characteristics such as government consumption, inflation, openness and population growth, as well as for reverse causation and simultaneity bias.

¹⁷⁸ Changes in poverty can be decomposed into economic growth and changes in income inequality (Bourguignon, 2004). Kraay (2006) shows that the larger part of poverty changes can be explained by economic growth.

¹⁷⁹ Demircuc-Kunt and Detragiache (1999); and Caprio and Klingebiel (1997).

VI. Three Pillars of an Effective and Stable Financial System¹⁸⁰

8.21 This section discusses the three building blocks – macroeconomic stability, contractual framework, and informational framework – for a sound and effective financial system and benchmarks Bangladesh in those areas. Bangladesh has made impressive progress in securing macroeconomic stability, but still has a long way to go in building the contractual and informational framework.

Macroeconomic stability

8.22 *Macroeconomic stability is a prerequisite for financial development and a first building block for an effective financial system.* A low and stable rate of inflation provides incentives for financial rather than non-financial forms of savings. It is also conducive to long-term contracting and thus long-term savings and investment. Economic theory predicts and cross-country studies have shown that countries with lower and more stable inflation rates have more rapid banking sector and stock market development.¹⁸¹ This is illustrated in **Annex Figure 8.3**, which plots Private Credit to GDP over the period 1980 to 2003 against the average annual inflation rate for the same period for a cross-section of countries. Similarly, a lower fiscal deficit can enhance financial sector deepening by avoiding crowding-out of private sector lending and investment. As discussed in **Volume I** of this report, macroeconomic stability has been an area of strength for Bangladesh, with inflation rates having stayed in single digits for almost two decades now and the fiscal deficit and debt situation well under control.

Contractual framework

8.23 *Financial contracts depend on the certainty of legal rights of borrowers, creditors and outside investors and the predictability and speed of their fair and impartial enforcement.* Private property rights and enforcement of contracts – both vis-à-vis other private parties and vis-à-vis the government – are thus a second crucial pillar of an effective financial system. Savers will relinquish control over their savings only if they can be sure to receive principal and contracted interest in return. Similarly, outside financiers – be they equity or debt holders – will only be willing to invest in companies and projects if their legal claims and rights are upheld. Critical in the relationship between minority shareholders and controlling shareholders and management are often problems of looting and tunneling, i.e. the possibility for the controlling shareholder to remove assets outside the firms, and the remedial actions that the legal system offers minority shareholders against them.¹⁸² This points to both creditor rights and minority shareholder rights as being critical for external financing, as well as the role of corporate governance in both financial institutions and non-financial corporations.

8.24 *An effective legal system is an important feature of the contractual framework as it provides timely, efficient and impartial resolution of insolvent borrowers through the efficient liquidation of unviable enterprises and the rehabilitation of viable businesses.* International comparisons have provided ample evidence for the critical role of legal system efficiency and its different elements for financial sector development.¹⁸³ The effect of legal system efficiency on financial intermediation is illustrated in **Annex Figures 8.4 to 8.6**, which show the positive relationship between creditor rights and private credit to GDP, the negative relationship between the time it takes to enforce contracts and private credit to GDP and the positive relationship between better protection of minority shareholder rights and the market capitalization in stock markets.

¹⁸⁰ This and the following section draw heavily on Beck (2006).

¹⁸¹ Boyd, Levine and Smith (2001).

¹⁸² Johnson et al. (2000).

¹⁸³ La Porta et al. (1997); see overview in Beck and Levine (2005).

8.25 *While Bangladesh has made some progress in the contractual framework over the past years, there is still significant room for improvement.* Corruption is widely regarded a major problem in the country (Chapter 7). Although creditor and minority shareholder rights are relatively strong on the book, their enforcement is weak. Lenders and borrowers have to deal with an ineffective collateral system for movable and immovable assets. Land titling is hampered by poor and unreliable records, high fees, and fraud. The movable collateral regime is effectively available only for limited liability companies, as these are the only ones that can register charges with the Registry of Joint Stock Companies.¹⁸⁴ This effectively excludes most of the small and micro enterprises from using such assets as collateral. These problems have increased reliance of lenders on personal guarantees from company directors. The bankruptcy legislation is rarely used in practice as a tool to resolve corporate distress, with less than half of the cases in the two bankruptcy courts actually being declared bankrupt at the end of the process.¹⁸⁵ This is partly due to the stigma attached to bankruptcy and possible criminal prosecution of bankrupt debtors.¹⁸⁶ While some progress has been made with the recent introduction of the money loan courts and alternate dispute resolution mechanisms that allow a faster and less bureaucratic enforcement of claims, it is still too early to say whether these reforms have significantly impacted the availability and cost of loans. Further, appeals to the high court still pose a major bottleneck to the quick resolution of claim resolution because of the delays involved.¹⁸⁷

8.26 *The deficiencies in the contractual framework are reflected in cross-country benchmarking.* The 2006 *Doing Business Indicators* rank Bangladesh 147th out of 153 in terms of days needed to register a property, 76th out of 155 on days needed to enforce a contract, and 101st out of out of 144 on days needed to close a business.

Informational framework

8.27 *Financial markets and institutions arise due to information asymmetries that prevent direct interaction between multiple savers and investors. Accordingly, effective financial intermediation depends on tools to reduce these information asymmetries.* The informational framework is thus a third crucial pillar for effective financial intermediation. International experience has shown that credit information sharing is important to reduce adverse selection problems and foster competition in the financial system. Credit registries have an important role to play as they can dramatically reduce the time and costs of obtaining such information from individual sources. They are especially important for SMEs as their creditworthiness is harder to evaluate and they have less visibility and transparency relative to large enterprises. International comparisons show that countries with better developed systems of credit information sharing enjoy higher levels of financial development and their firms report lower financing obstacles.¹⁸⁸ **Annex Figure 8.7** illustrates the positive relationship between the efficiency of credit information sharing and Private Credit to GDP.

8.28 *Bangladesh has a well functioning public Credit Information Bureau (CIB),* established in 1992 and housed in the Bangladesh Bank. It collects data on a monthly basis from all banks and financial institutions that are regulated and supervised by Bangladesh Bank on all borrowers. While there is no unique borrower identifier, the wealth of information of individual borrowers seems to allow a relative good match. All financial institutions are required by law to obtain information about a borrower from the CIB before granting or renewing a loan. This provision was introduced in the effort to reduce NPLs in the banking system.

¹⁸⁴ Meagher (1998).

¹⁸⁵ Asian Development Bank, 2004.

¹⁸⁶ Sobhan and Werner (2003).

¹⁸⁷ *ibid.*

¹⁸⁸ Japelli and Pagano (2002); Love and Mylenko (2003); Djankov et al. (2005), and Miller (2003) for an overview.

8.29 *While the CIB has a long and positive track record, several shortcomings of the existing financial informational system should be noted.* First, the system is still limited by the lack of computerization. Second, banks effectively obtain current information only about existing borrowers, but not about past payment performance. This is an important omission in the CIB's function as it prevents borrowers from building "reputation collateral", which would allow them to use their track record as reference in future loan applications. Third, only financial institutions participate in the information sharing agreement, other non-financial institutions such as utility companies, which are a source of valuable credit information about customers in other countries are excluded. Further, the minimum threshold of Tk 50,000 (US\$700) excludes small and opaque enterprises. While technical problems are certainly recognized, a move towards including all borrowers irrespective of the size of their loans should be envisioned in the medium-term. Another important step would be to link the existing CIB to the credit registry to be created for micro-finance institutions (MFIs). Finally, private institutions should be allowed to provide credit information services, for which the necessary legal provisions would need to be changed. While it seems unlikely that such an industry would immediately flourish, it can become an important element in the move from a relationship-based economy to an arms-length economy, which relies on numerous information brokers, including credit rating institutions and credit registries.

8.30 *Similarly, more accurate and transparent financial statements can help reduce information asymmetries between borrowers and lenders.* Financial statements that give an accurate picture of a firm's financial situation reduce screening and monitoring costs for financial institutions and increase the efficiency of resource allocation. Cross-country comparisons have shown a positive association of more transparent and comprehensive accounting standards with higher levels of financial development.¹⁸⁹ Similarly, transparent and more informative financial statements lower information costs for investors and can foster stock market development and liquidity.¹⁹⁰

8.31 *The quality of financial statements in Bangladesh, however, is undermined by weak accounting and auditing practices, due to institutional weaknesses in regulation, compliance, and enforcement of standards and rules.*¹⁹¹ While all incorporated companies must file annual audited financial statements with the Registrar of Joint Stock Companies, there is no effective enforcement of the timely and accurate filing. A review of published financial statements revealed numerous compliance gaps. There is limited accounting and auditing capacity and numerous violations of professional ethical standards. While listed companies are subject to additional oversight by the SEC, there are legal and judicial constraints to effective enforcement of this oversight. Further, there seems little confidence in the financial reports issued by companies with no or perverse price effects of such announcements.^{192, 193} More importantly, the costs of going public seem to surmount their benefits, as public firms are subject to more scrutiny by tax authorities.

VII. The Evolving Role of the Government in Bangladesh's Financial System

8.32 *What is the appropriate role for the government in the development of the financial system, in addition to providing its three essential pillars described above?* Should it leave it all to the markets, take it upon itself to provide financial services, or seek to enable markets by addressing market failures and reducing market frictions? As described in **Box 8.1**, it is evident from global experiences that the

¹⁸⁹ Levine, Loayza and Beck (2000) and La Porta et al. (1997).

¹⁹⁰ Levine (2003).

¹⁹¹ Investment Climate Assessment, World Bank, 2003

¹⁹² Asian Development Bank, 2004.

¹⁹³ Sobhan and Werner (2003) even quote the example where a bank's stock price increased after irregularities in its lending practices became public, most likely due to manipulating transactions in the market.

(relatively new) market enabling approach is generally the most attractive option for government intervention. What has been the approach adopted in Bangladesh?

Box 8.1: Three Different Approaches to the Role of Government in Financial Service Provision

The role of the government in financial service provision has been controversial. While most economists agree by now on the role of government in providing a stable monetary environment and the contractual and informational frameworks, the government's roles as provider, regulator, and supervisor of financial service remains moot. Three different approaches to the government's role have been applied:

The laissez-faire approach: This approach sees no role for government involvement in the financial system. Market discipline rules the relationship between banks and depositors and between banks and borrowers. A modified laissez-faire approach stresses the importance of macroeconomic stability and the contractual and informational framework and sees a role for government in providing these necessary elements. The laissez-faire approach has been criticized for ignoring market imperfections and failures that lead to a breakdown of bank-depositor and bank-borrower relationships as envisioned in theory.

From market to government failures: Government solutions to overcome market failures rely on two crucial assumptions. First, governments know better than markets; second, governments act in the best interest of society. Both assumptions find little empirical support. Bureaucrats as bankers have failed almost everywhere, but especially in developing countries; economies with a higher share of government-owned banks typically have lower levels of financial development, more concentrated lending and lower economic growth and are more likely to suffer systemic banking sector fragility (La Porta et al, 2001; Barth, Caprio and Levine, 2004). High NPLs in these systems often result in banking crises (Barth, Caprio and Levine, 2004; Caprio and Martinez Peria, 2003), at large costs to the budget. Further, the negative impact of government-owned banks spreads often beyond these institutions and adversely affect governance and efficiency of private banks as well.

Enabling markets – a new approach: According to this approach, rather than replacing market failures with government failures, policies need to address market failures directly by reducing market frictions. Cross-country comparisons show that countries with lower entry barriers into the financial system, fewer restrictions on banking and a higher share of foreign-owned banks, each resulting from lowering of market frictions by governments, have more competitive banking systems (Claessens and Laeven, 2004; Beck, Demirguc-Kunt and Maksimovic (2004), Demirguc-Kunt, Laeven and Levine (2004); Beck, Demirguc-Kunt and Levine (2006b). This is not a laissez-faire approach; rather, it relies on the government to enable and develop markets. The approach relies on private institutions to provide financial services efficiently but takes into account their incentive structure. It sees a critical role of the government in ensuring a competitive and contestable financial system. The approach envisions monitoring and disciplining of banks by private actors, together with a role for effective government intervention in troubled institutions. It also argues for strengthening the independence and accountability of regulators to protect them against political and regulatory capture and, a careful, incentive compatible designing of deposit insurance where it already exists. It sees an important role for the government in avoiding segmentation in the financial sector through expanding access to the payment system or the credit information sharing system beyond the commercial banks to bank-like institutions such as cooperatives or regulated microfinance institutions can help the financial system cater to marginal customers in all financial

8.33 *The role of the government after independence was a highly interventionist one, following the examples of many other developed and emerging economies.*¹⁹⁴ Through nationalization of banks it hoped to enhance mobilization of savings, direct credit to “priority sectors”, and make financial services affordable for larger parts of the population. Through interest rate controls it hoped to reduce lending costs, while credit quotas were supposed to guarantee flow of financial resources to priority and underserved sectors, such as agriculture. Through specialized institutions, such as agricultural banks and industrial development finance companies, the government hoped to provide more financial resources to these sectors. As in many other countries, deposit insurance was introduced to prevent bank runs and

¹⁹⁴ See Fry (1988) for a discussion of these policies and numerous examples in other countries.

protect small savers. Essentially, in doing all these, the government completely rejected the *laissez-faire* approach and sought to replace it with a model based on government discipline.

8.34 ***Things didn't quite turn out as intended – market failures were soon replaced by government failures.*** This is also similar to the experience of other countries that attempted the public control approach: *bureaucrats as bankers have failed almost universally, but especially in developing countries (Box 8.1)*. By 1990s, it was clear that the highly interventionist approach had left a profound mark in the form of an inefficient state-dominated banking sector which fostered a culture of non-payment, provided excessive rents to private banks and distorted resource allocation at all levels; controlled interest rates that had nothing to do with risks and returns, resulting in gross misallocation of resources and large losses for the banking sector, and; political interference in most aspects of banking operations and supervision. By the late 1990s, the situation had come to such a pass that a 1998 World Bank report noted that “The three institutional pillars of banking – a strong regulatory system, well managed banks, and an effective court system – have crumbled to such a point that the banking institutions cannot be relied upon ensure the safety of deposits and efficiently allocate credit, their two most important functions. In a more difficult environment, the banking system could become Bangladesh’s Achilles Heel.”

8.35 ***Starting in 2001, the government began pulling back the banking sector from this brink by moving it toward a more market enabling approach.*** As described in **Box 8.1**, this approach recognizes the existence of frictions in financial markets which prevent their full functioning and calls for government intervention to create the conditions for a competitive and contestable system. Initial actions on reducing controls on the interest rates and credit quotas were undertaken under the FSRP in 1991,¹⁹⁵ but it wasn't until 2001 when a more substantial reform program was begun leading to qualitative improvements in the banking sector performance, as reported in **Section II**.

8.36 ***Authorities have embarked on a wide-ranging restructuring and divestiture program for the NCBs.*** Loan growth restrictions have been imposed on the four NCBs. Divestment of Rupali Bank, an NCB, to a strategic buyer is now close to being finalized. The three other NCBs are in the process of being corporatized and two of these would be partially privatized in the coming years; in the fourth NCB, the Sonali Bank, the government intends to sell only a minority share. The restructuring and divestiture process, however, has been much slower than envisaged because of political interference, resistance from labor unions, and judicial roadblocks. Nonetheless, the expected successful divestment of Rupali Bank, in itself an important milestone for banking sector reforms, should provide impetus for and set a useful precedence in following through with the rest of the NCBs.

8.37 ***Further, since 2001, Bangladesh Bank has followed international “best-practice” recommendations to strengthen bank regulations and supervision.*** Key measures include (see **Annex 8.1** for a more complete set of banking reforms):

- The capital adequacy ratio was raised from 8% to 9% of risk-weighted assets and the minimum capital requirements from Tk 400 million (US\$6 million) to Tk 1 billion (US\$15 million).
- Loan classification, rescheduling, and provisioning rules were tightened and single exposure and large loan limits introduced.
- Risk management guidelines were issued.

¹⁹⁵ Starting with the FSRP in the early 1990s, the government abolished most interest rate controls, with the exception of loans supporting export activities. Banks were asked to report reference lending interest rates for different sectors. Individual lending rates could only move within a band of 1.5 percentage points above and below this reference rate. Further, credit directives for privately owned banks were withdrawn, although government-owned banks were still expected to lend to priority sectors.

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- Measures to improve corporate governance were introduced. The number of board members in a financial institution was restricted to a maximum of 13; the term of a director was restricted to six years; shareholding by a single shareholder was limited to 10 percent of capital and only one member from a shareholding family could sit on the board; banks had to establish audit committees; limitations on dividend payout were imposed as well as on expenditures for automobiles and travel expenses for executives.

Responding robustly to the ensuing conducive environment, private banks have dramatically increased their market share and turned around their operational and financial performance, as noted in **Section II**.

8.38 ***Certain amount of political capture of Bangladesh Bank, however, continues to vitiate market discipline and works against its move toward the market enabling approach.*** Bangladesh Bank has not been immune from political interference in the bank licensing process, often having to follow “recommendations” of the political class to allow new banks into the system. Fortunately, the practice has ceased in recent years. Nonetheless, the past practice has resulted in a number of weak PCBs, plagued by insider lending and other owner abuses. Political capture of the regulatory entity also prevents proper resolution of failing banks.

8.39 ***Although there is an explicit deposit insurance scheme, it has not been used. Rather, Bangladesh Bank has extended an implicit guarantee to all banks.*** Over the past years, no domestic bank has been allowed to fail;¹⁹⁶ weak banks are referred to the Problem Bank Monitoring Department within Bangladesh Bank where they are subject to special supervisory oversight and certain regulatory restrictions and enjoy regulatory forbearance.¹⁹⁷

8.40 ***On its part, the Bangladesh Bank has sought to compensate for the lack of market discipline (induced by the implicit guarantee) by taking a somewhat interventionist approach to supervision.*** For example, in order to expand outreach, it requires banks to open three banks in rural areas for every branch opened in an urban area. It has also issued job and task descriptions for board members and CEOs and made the appointment of a CEO subject to its approval. However, the resulting heavy-handed regulation has its own costs. For example, banks can get around the branching requirement by opening new branches just outside the urban areas – given that the urban areas in Bangladesh are still growing, soon these branches will be inside the urban area. This particular regulation, therefore, only causes sub-optimal allocation of bank branches. Regulations such as for branch opening or prescribing bonuses and benefits for board members and executives cause additional transaction costs and cause inefficiencies in banks’ operations. Vetting the appointments of new CEOs by Bangladesh Banks seems rather in the old tradition of operating a financial system than regulating it. Similar governance measures can, in fact, benefit the NCBs and were even expanded to cover them, but there is no enforcement for the NCBs.

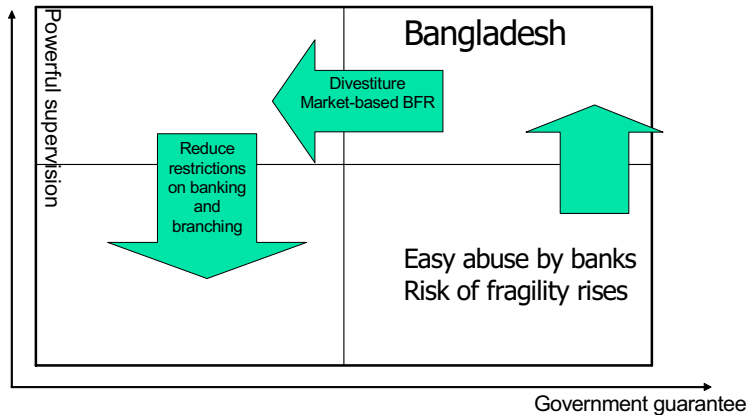
8.41 ***Figure 8.5 illustrates the interaction of the government guarantee and supervisory approaches.*** On the horizontal axis is the degree of government guarantee and on the vertical axis the degree of supervisory intervention. In the past, absence of both market and supervisory discipline resulted in easy abuse by banks and high risk of fragility, placing Bangladesh in the South East corner. Since 2001, with the reform measures noted above, Bangladesh Bank has thus opted for the supervisory intervention approach (North East corner). Given the continuing explicit and implicit guarantee, politicization of licensing and the absence of exit of weak banks, this approach can avoid any “open” failures, but comes at huge efficiency cost – such as large interest rate spreads and sub-optimal allocation of resources – and involves high and increasing contingent losses for the government. Further, bank owners face incentives

¹⁹⁶ The only bank to be closed was BCCI. The bank was restructured and reopened as Eastern Bank.

¹⁹⁷ Pubali Bank spent 10 and National Bank 3 years under the intensified supervision of the Problem Bank Monitoring Department.

to take aggressive credit risks, with little incentive for depositors or other creditors to exercise any market discipline in the presence of the implicit guarantee. This can explain the fragility in the banking system even beyond government-owned banks in the 1990s.

Figure 8.5: The Interaction of Government Guarantees and Supervisory Approach



8.42 *Nonetheless, Bangladesh Bank has laid the first fundamentals for market-based supervision.* It requires banks to go public at the stock exchange and aim to list 50 percent of their shares. Also, disclosure requirements are higher for financial institutions than for non-financial corporations: banks and non-bank financial institutions have to publish their annual financial statements in newspapers and display them for public view in their branches. Similarly, auditing requirements for banks are more stringent than for non-financial corporations; Bangladesh Bank maintains a separate list of approved auditors for banks. It is just that given its implicit guarantee for owners, creditors and depositors, these important actions cannot serve their function in enhancing market discipline.

VIII. A Financial Sector Reform Agenda For Bangladesh

8.43 While some of the reform measures of the past few years are consistent with the market-enabling approach, others are not. On the whole, a general paradigm shift is needed.

8.44 *The ongoing move to a privately-owned financial system is an important one.* But as discussed in **Box 8.2**, international experience advises caution (but not necessarily delay): a failed privatization process can be worse than government ownership. Privatization is also not a panacea, as privatizing into a non-competitive environment where other elements of the framework discussed earlier are not in place would not bring the intended benefits. Key points to note to ensure success of the privatization process:

- First, such a process should be ideally undertaken by an entity that is independent from the political sphere and will undertake the choice of strategic investors purely on terms of merit not on socio-political terms. The entity that comes closest to this is the Bangladesh Bank.
- Second, the privatization process should be used to minimize the share of government ownership and if possible reduce it to zero. The future private owners might not object to or may even welcome minority government ownership. However, this would send the wrong signal, that the government would like to continue influencing decisions in the banks, and – even worse – stands ready to bail out the private buyers of the NCBs. While the first concern can be addressed by excluding government representatives from NCB Boards, the second one is less easily to address.
- Third, the bank privatization process should be coupled with a resolution of the bad debts of the state-owned enterprises (SOEs).

- Finally, the government should ensure a level playing field between the privatized NCBs and other providers of financial services.¹⁹⁸

Box 8.2: Bank Privatization Process: Lessons from International Experience

A failed privatization process can be worse than government ownership. Poorly designed and executed privatization processes can lead to fragility and banking crises. Studies of privatization processes have shown the benefits and pitfalls of privatizing banks (compare Clarke, Cull and Shirley 2005 and other papers on the same issue). Global experience shows that it is important to open the books of the entity being privatized early in the process. This would make the cost of government ownership known to the taxpaying public and generate political pressure for privatization. While privatization should not be delayed to minimize fiscal and efficiency losses, fire sales might lead to divestment to investors that are not fit-and-proper or have not adequately assessed the situation of the bank. There are advantages to divesting to a strategic investor who can bring the necessary management and financial know-how, especially in a weak institutional environment and to open the privatization process to both qualified domestic and foreign bidders. By selling to reputable foreign banks, financial systems can benefit from expertise and from additional resources. Finally, country studies have shown the advantages of full rather than partial privatization to reduce possible future government influence. By giving up any ownership stake, a government signals that it does not plan to intervene after privatization and that it will not bail out the new private investors should things go wrong.

8.45 *Moving forward, de-politicization of entry into the banking sector and especially reform of the exit process would be key.* The licensing process of the financial system has to be put on objective, non-political basis. While technical issues might impede proper bank failure resolution, such as the lack of a merger and acquisition provision in the Companies Act, it is especially the political willingness to resolve failing banks with market-based solutions that counts. Resolving a weak bank through liquidation or a purchase and assumption operation with the use of the explicit deposit insurance scheme would send an important signal to the market that Bangladesh Bank is moving away from an implicit guarantee for all financial institutions to a system where it cares about financial intermediation not about individual institutions. This does not imply embracing the idea of deposit insurance; rather it encourages the use of an existing but unused mechanism to move to a market-based bank failure resolution.

8.46 *These different reform steps would help enhance market discipline and allow Bangladesh Bank to rely on a more market-based supervision.* This can be illustrated in **Figure 8.5** where divestiture of NCBs, de-politicization of licensing and a market-based bank failure resolution system would move the system away from the complete explicit and implicit guarantee to a system with a limited explicit depositor guarantee (North West corner). In the medium- to long-term, this would then allow Bangladesh to move towards the South West corner of the graph, a financial system with limited explicit guarantee and market-based supervision. Note that this would not mean a weaker Bangladesh Bank, but rather a regulator with the necessary powers and the necessary independence to foster market discipline and enhance a market-based financial system.

8.47 *While the reform agenda laid out above implies a rather radical change in the approach to the relationship between supervisors and those supervised and between the government and the private sector, it also implies concrete initial steps that should accompany the currently ongoing divestiture process of the NCBs.* *First*, given the large number of banks in the market a temporary and limited moratorium on new bank licenses should be imposed. *Second*, during this moratorium, all banks should be subjected to special audits to assess their long-term viability. *Third*, banks that are found non-viable should be resolved, preferably through market-based solutions such as merger and acquisition or purchase and assumption operations. *Fourth*, the legal and regulatory framework for bank failure resolution should

¹⁹⁸ This refers for example to Sonali Bank that has the function of a government agent in many localities, which effectively gives it a dominant market position in these areas.

be reviewed and possibly reformed. *Finally*, a medium- to long-term financial sector strategy should be developed that lays out further reforms in a clear and transparent manner.

8.48 ***While the analysis and policy discussion and recommendations of this chapter have focused on the banking system, they carry over to other parts of the financial system.*** As in the banking sector, regulation and supervision in the other parts should also rely on market participants. Prudential regulation should be limited to deposit-taking institutions and be clearly separated from non-prudential regulation. Finally, a level playing field should be generated, which implies that financial institutions should be regulated and supervised according to the products they offer, not according to the legal form they take.

8.49 ***Case in point is the stock market, which faces supervisory problems similar to those of the banking sector.***¹⁹⁹ While the SEC tries to enhance governance by forcing companies to hold shareholder meetings and publish audited financial statements within certain timeframe, it also interferes directly in their decisions, by prescribing dividend levels, for example, under the assumption that low dividends even if justified by poor performance must be because of fraudulent management actions. The authority to override the Companies Act or Articles of Association of any corporation is, in fact, provided under the law.²⁰⁰ SEC can also interfere in the appointment of board members and CEOs, just as Bangladesh Bank can for banks. While the justification for this is the underdeveloped shareholder culture, cross-country comparisons show little evidence of a positive effect of public enforcement on stock market development, but a positive effect of private monitoring and disciplining: that is, laws that mandate disclosure and facilitate private enforcement through liability rules foster stock market development.²⁰¹

8.50 ***Another cause for concern is the lack of a “limited liability culture”.*** While Bangladeshi law recognizes limited liability companies, directors and owners who hold more than a certain share of equity are personally liable for losses beyond paid-in capital. The reliance of banks on personal guarantees of company directors due to the deficiencies in the collateral regime is a factor that undermines the limited liability culture. It is a huge disincentive then to serve as independent director on a company’s board and a barrier to entrepreneurship. While this has to be understood in the context of a deficient contractual and informational framework with weak accounting standards and little protection for minority shareholders and creditors, it is clearly second-best and provides disincentives for innovation and entrepreneurship.

IX. Conclusions

8.51 The financial sector is critical for sustained economic development and poverty reduction. This chapter has argued that beyond macroeconomic stability and an effective and reliable contractual and informational framework, the role of government has to be redefined to make Bangladesh’s financial system more efficient and growth enhancing. Specifically, the government needs to move from the role of an operator and arbiter in the financial system to the role of an enabler and facilitator of markets. This would also facilitate the economy’s move from being relationship-based to an arms-length one.

8.52 Financial sector reforms, in fact, deserve a center stage place in the overall governance reforms agenda in Bangladesh, as elsewhere. “That is where the money is,” as Willie Sutton, the famous bank robber, is purported to have said when asked why he robbed banks, and that is also where the temptation for corruption lies. A proper and transparent divestiture process of the NCBs and de-politicization of financial sector regulation and supervision can serve as a model in the divestiture of other public sector entities. An autonomous and accountable Bangladesh Bank can similarly be a paragon for broader institutional reform.

¹⁹⁹ Asian Development Bank, 2004; Sobhan and Werner (2003).

²⁰⁰ Sobhan and Werner, 2003.

²⁰¹ La Porta, Lopez-de-Silanes and Shleifer, 2006.