A "Bank Rent" Approach to Understanding the Development of the Banking System in Bangladesh.

Yasushi SUZUKI
College of International Management
Ritsumeikan Asia Pacific University

Bishnu Kumar ADHIKARY
College of International Management
Ritsumeikan Asia Pacific University

RCAPS Working Paper No. 09-1
April 2009

Ritsumeikan Center for Asia Pacific Studies (RCAPS), Ritsumeikan Asia Pacific University,
URL: http://www.apu.ac.jp/rcaps/

A "Bank Rent" Approach to Understanding the Development of the Banking System in Bangladesh.

Yasushi SUZUKI[a] and Bishnu Kumar ADHIKARY[b]

Abstract

This paper applies the "bank rent" approach to understanding the development of the banking system in Bangladesh since its independence. The paper uses the financial restraint model as an analytical framework and argues that there still remains room for creating bank rents in order to change the current dreary performance of the banking system. The paper unearths a varied level of high nominal lending rates, high nominal spreads and too low or negative real spreads as per different clusters of banks both in the pre-liberalized and liberalized regime, and concludes that this persistent varied performance is largely the outcome of a high amount of non-performing loans, inefficiencies in managing credit risks, and fragmentation and distorted competition in the banking system. This varied level of performance of the banking clusters also results from the government's intervention in the activities of nationalized commercial banks and specialized banks for mediating credits to priority sectors at a subsidized rate. The paper suggests that a more coordinated use of monetary and fiscal policies is required with a view to creating appropriate rents for banks for redressing their current dismal performance.

Keywords: Bank rent, Bangladesh, Banking system, Banking development, Non-performing loans.

JEL Classification: E52, G21

---

[a] Yasushi SUZUKI is currently a Professor in the College of International Management, Ritsumeikan Asia Pacific University. The author can be contacted at: **szkya@apu.ac.jp**.

[b] Bishnu Kumar ADHIKARY is currently an Assistant Professor in the College of International Management, Ritsumeikan Asia Pacific University. The author can be contacted at: **adhikary@apu.ac.jp**

Introduction

The analysis of *bank rents*[1] has provided a new tool as an institutional approach to investigating the important role of banks as financial intermediaries and monitors in developing countries. It has been argued that rents create incentives for banks to exercise prudent strategies against imprudent ones (gambling and looting) which ensure an expected stream of future cash inflows, and create a 'franchise value' in their operation (Stiglitz and Weiss 1981). This franchise value then supports bank managers acting as long-run agents, prevents their imprudent behavior by way of making investment in firm specific knowledge, and provides incentives for increasing investment in monitoring activities. In consequence, bank managers' monitoring capabilities are increased and they can discharge their agency duties perfectly at a lower monitoring cost through efficient monitoring of their credit portfolios (Stiglitz and Weiss 1981; Hellmann *et al.* 1997). A rent also creates incentives for banks to prevent usury and collusive behaviors, and thus increases returns to financial intermediation (Wijnbergen 1985; Wade 1990; pp.7-14). When returns to financial intermediation increase, banks feel more comfort in expanding their branches, attracting deposits, and screening and monitoring credits, and ultimately, these lead the banking system to be robust, prudent and long-run oriented (Hellmann *et al.* 1997). Creation of rents is thus important for increasing financial deepening and preventing market failures, and is particularly important in developing countries which are characterized by high information asymmetry with a weak institutional and legal infrastructure. Keeping these in mind, this paper provides an empirical study for changes in bank commitments to monitoring efforts in changes in the bank rents under the financial restraint model in the case of Bangladesh.

[1] According to the definition by Khan (2000), *rents* refer to "excess incomes" which, in simplistic models, should not exist in efficient markets. "More precisely, a person gets a rent if he or she earns an income higher than the minimum that person would have accepted, the minimum being usually defined as the income in his or her next-best opportunity" (Khan 2000; p.21).

The rest of the paper is organized as follows. Section one explains the theoretical framework of our analyses, referring to the complex interrelationship between the role of bank rents, which is to create incentives for individual banks to operate as long-run agents that monitor borrowers effectively, and the optimal level of their monitoring efforts for society under the financial restraint model. Section two describes the development of the banking system of Bangladesh while section three unearths changes of bank rents in tune with the financial restraint policies of the government of Bangladesh both in the pre-liberalized and liberalized regime. Section four examines non-performing loans (NPLs) and their impact on bank rents in Bangladesh. Finally, section five offers some concluding remarks.

I. Theoretical Framework: A Lacuna in the Financial Restraint Model

The Stiglitz & Weiss (1981) model is of importance to show that credits are intrinsically rationed in developing economies due to problems of asymmetric information. Since lenders cannot perfectly and without costs select the right borrowers *ex ante* and monitor the behaviour of borrowers *ex post*, the price mechanism does not clear the excess demand for funds. For instance, even when a borrower deemed by a bank to be uncreditworthy offers to pay higher interest rates, the bank may decline the loan application, because this offer is interpreted as a signal of higher default risk. Figure 1 shows this interrelationship among the expected return to the bank, *r*, the nominal interest rate, *i*, charged to borrowers and the standard demand and supply for loanable funds, L_D and L_S, with respect to the interest rate. The lower diagram in Figure 1, shows that after an optimal level of interest rate of *i**, the expected return starts declining because of the "adverse selection" effect (for instance, too many bad risks are attracted at higher rates of interest) or the "moral hazard" effect as even good borrowers may be forced to act in riskier ways than the bank would like at high rates of

interest and find, as a result, that they go bankrupt. While there is an optimal level of interest rate *i** which maximizes returns for an individual bank, the problem is that this needs not be the market-clearing rate, in other words, this would not necessarily be optimal for society.

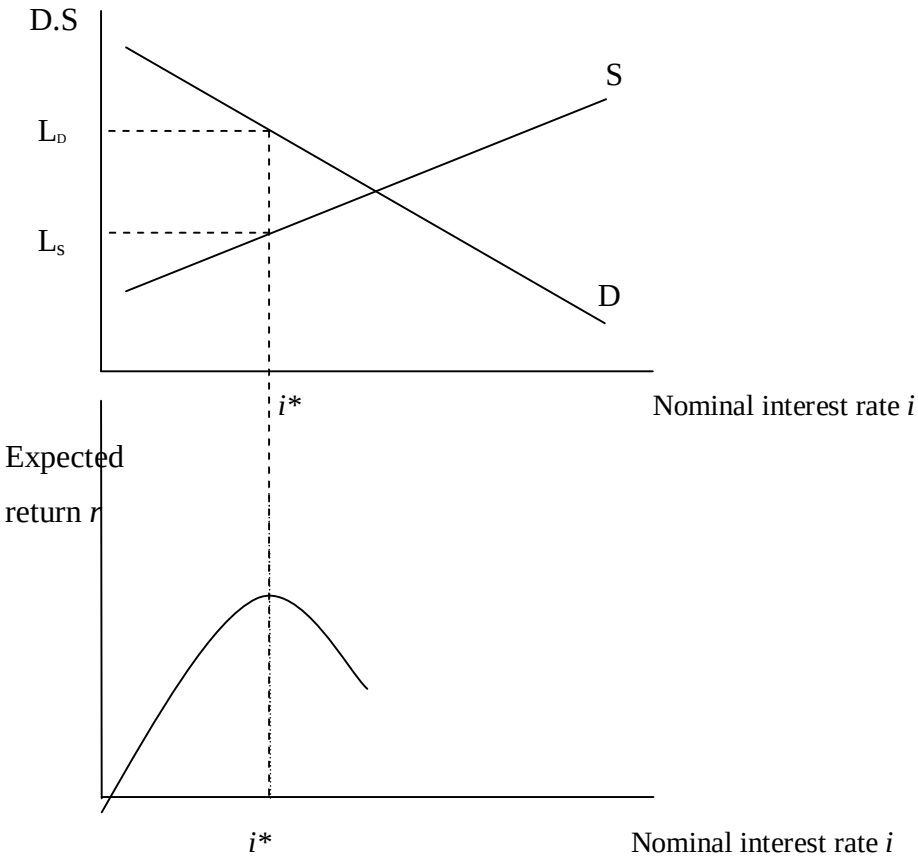


Figure 1: Market disequilibrium with efficient monitoring（Stiglitz and Weiss model）

The upper diagram shows that at the interest rate *i**, banks are only willing to lend L_S while the demand is for L_D of loans. The excess demand is dealt with by each bank's prudent monitoring, trying to maximize returns. This model shows that efficient financial markets will not necessarily be in equilibrium in the standard fashion (Khan 2000; pp.56-58).

Hellmann *et al.* (1997) expand this theory by arguing that government can enhance the incentives for banks to actively monitor their loan portfolios by enhancing bank-based rents. If government imposes ceilings on the deposit rate paid to savers that are below the market-clearing rate, rent opportunities may emerge in the form of a significant gap between

deposit and lending rates that will give banks strong incentives to monitor their portfolio more carefully.

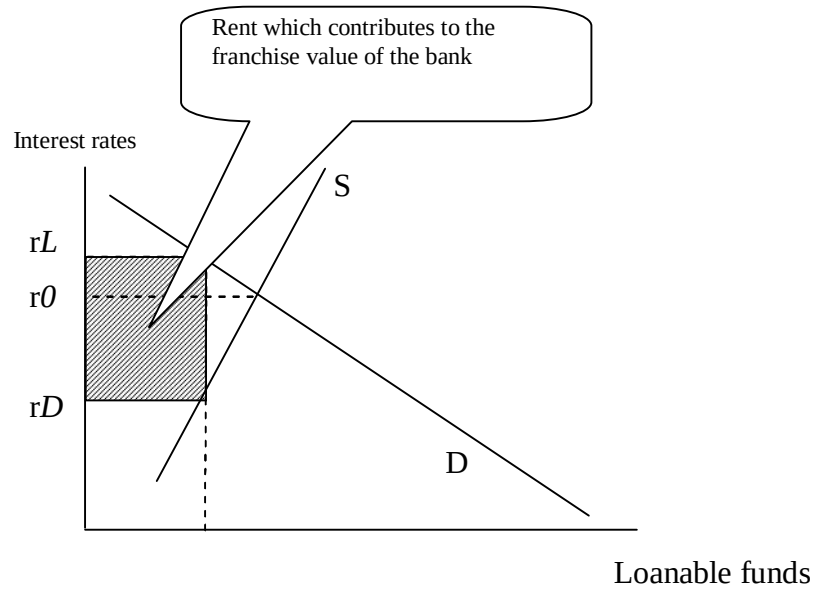


Figure 2: Financial sector rents as incentives for portfolio monitoring

According to the Hellmann *et al.* financial restraint framework, the household sector supplies funds, the corporate sector is a user of funds, and banks act as financial intermediaries. Figure 2 shows the market equilibrium at interest rate r*0* as the intersection of a supply curve of household funds and a corporate demand curve for funds. If the government intervenes in the financial sector by regulating the deposit rate of interest, financial intermediaries can capture rents. The new lending rate will be r*L* and the gap between the regulated deposit rate, r*D*, and the market lending rate, r*L*, is the source of the rent. The rent will continue to be available for banks, more precisely owners of banks, only if the banks' portfolio of assets and liabilities is managed sufficiently well to keep the portfolio solvent (Khan 2000a; p.58). It is possible to argue that the financial restraint framework can give the banks an incentive to improve their skill and expertise in monitoring and in financial intermediation, then, this can in turn contribute to an efficient social allocation of financial resources, at least, in a developing phase.

The model also argues that while savings may respond favourably to higher interest rates, this elasticity is likely to be very low (Hellmann *et al*. 1997; p.168). On the other hand, the model assumes that the amount of savings depends on the available infrastructure for deposit collection, in particular on the extent of the bank's branching network and the efficiency of services provided to the local communities. The model thereby claims that by increasing the returns to intermediation, banks have strong incentives to increase their own deposit bases.

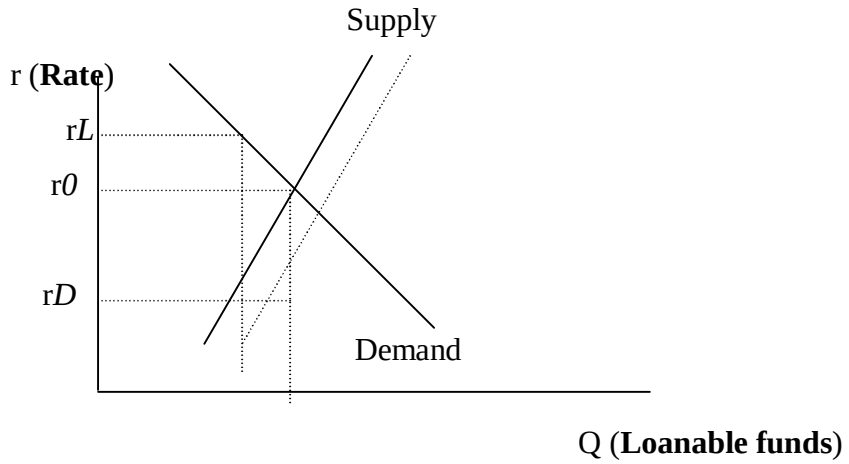


Figure 3: Financial sector rents as incentives for portfolio monitoring

The model further considers the possibility that the "rent effect" on savings is large, that is, the increased savings due to greater deposit security and/or increased investments in improving the deposit infrastructure and facilitating access to the formal financial sector will shift the supply curve rightward in Figure 3. If the rent effect is large relative to the interest-elasticity of savings, then it is possible that the total volume of funds intermediated through the formal financial sector will be larger with financial restraint than would be the case with free markets (Hellmann *et al*. 1997).

Then we have to ask the following questions; how does the increase in the total volume of funds intermediated under the financial restraint policy maintain the prudence of monitoring in individual banks? Is the lending rate reached under the financial restraint (*r0* in

Figure 3) the same as an interest rate in Figure 1 which would maximize returns for individual banks? However, the Hellmann *et al.* model does not argue the aspect of how net benefits for society are consistent with those for individuals. On the one hand, the prospective benefits from monitoring *efforts* in the rent-based mode include the rent that a bank earns if it can preserve its "franchise value" (Hellmann et al., 1997; pp. 171–174) and its "reputation" (Stiglitz 1994; p. 223). On the other hand, banks will incur costs of monitoring including the costs of acquiring information and of internalizing the skills and knowledge required for monitoring within a banking structure. In theory, the positive net benefit is the excess benefit that the bank *expects to potentially capture* at feasible levels of monitoring effort, and this gives the bank the incentive to undertake the necessary monitoring. The individual net benefit which gives a bank the incentive to monitor does not necessarily represent the optimal level of monitoring for society. If banks were to *free-ride* on this system of bank rents, monitoring would become inefficient and result in inferior outcomes from a regulatory perspective.

We should then look for empirical studies on the complex interrelationship between the role of *bank rents*, which is to create incentives for individual banks to operate as long-run agents that monitor borrowers effectively, and the optimal level of their monitoring efforts for society under the financial restraint policy. The Hellmann *et al.* financial restraint model provides a theoretical framework that provides the core elements of an explanation for the efficiency and effectiveness of, for instance, the Japanese "rent-based" main bank system in its effective period. However, the trend of banking internationalization and disintermediation and the technological change in Japan's position relative to the technology frontier will all have an effect on the cost of monitoring, since each of these would make it more difficult to assess or monitor borrowers. Suzuki (2005) points out that the diminishing net benefit of monitoring efforts may have an effect on attenuating lenders' incentives for doing so, and this resulted in Japan's financial bubble in the late 1980s. For another example, Chin and Jomo

(2000) take a look at the financial sector rents in Malaysia, and argue that the state's use of the banks to allocate redistributive rents prevented the rents in the financial sector from having the expected efficiency effects on the quality of industrial lending over the 1984-1995 period. Suzuki, Miah and Yuan (2008) also apply the financial restraint model to explain the massive accumulation of non-performing loans in China, and argue that failure to create sufficient economic rents is the chief reason underlying the current dismal performance of banks. Obviously, we need to conduct more empirical studies to accumulate knowledge in the literature of bank rents. This paper investigates the bank rents effects on the development of the banking system of Bangladesh as a continuation of the same process.

II. Tracing the Development of the Banking System in Bangladesh

The growth and development of the banking system[2] in Bangladesh since its independence can be categorized into three major phases. The period from 1972 to 1982 can be termed as the 1st phase, in which the government of Bangladesh aimed at *'nationalization, reconstruction and expansion of banks'*. The period from 1983 to 1989 can be considered as the 2nd phase that focused on *'denationalization and privatization'* while the period from 1990 till date can be viewed as the 3rd phase that aimed at *'financial liberalization and consolidation'*. In the first phase, the government exercised full control over the financial resources through the Nationalized Commercial Banks (NCBs)[3] and proceeded to revitalize the economy by way of expansion of bank branches and proffering of credits to the agriculture and 'public sectors'[4]. Table 1 shows this unprecedented growth of total bank

[2] At present the banking system of Bangladesh encompasses 30 domestic private commercial banks, 4 nationalized commercial banks, 5 specialized banks and 9 foreign commercial banks (Annual report, Bangladesh Bank, 2006-2007).

[3] Bangladesh nationalized six commercial banks in 1972 which were owned by the then Pakistani owners through Bangladesh Bank (Nationalization) Order 1972. These big sixes dominated the first phase of the banking system.

[4] Public sectors are enterprises owned and controlled by the government of Bangladesh. They are popularly known as state owned enterprises.

branches, total credits and total deposits during this 1st phase in comparison to the other phases of development. For instance, the number of bank branches increased to 4470 at the end of 1982 from merely 1196 in 1972. The total disbursement of credits also increased to Tk.49.952 billion in 1982 (1071% as compared to the year1972) from Tk. 4.2661 billion in 1972. Similarly, total deposits also increased from Tk. 5.2361 billion in 1972 to Tk.36.712 billion in 1982 (Table 1). With respect to the year- to-year growth rate, the 1st phase maintained a double-digit yearly growth rate on an average, above 20% for deposits and credits and approximately 15% for bank branches (Table 1).

Table 1: Phase-wise Total Credits, Deposits and Bank Branches (1973-2007)

	Total Credit		**Total Deposit**		**Number of Branches**	
Year	Tk. in billion	Average yearly growth (%)	Tk. in billion	Average yearly growth (%)	Total	Average yearly growth (%)
1972	4.2661	-	5.2361		1196	-
1982	49.952	28.26	36.712	21.85	4470	14.38
1989	187.414	21.11	164.625	24.26	5451	2.88
2007	1893.91	14.60	1847.98	15.26	6596	1.13

Source: Schedule Bank Statistics, December issues from 1972 to 2006, Bangladesh Bank; Economic Trends, June 2008, Bangladesh Bank.

.

The 2nd phase of the banking development started when government denationalized two nationalized banks, Uttara and Pubali Bank, in 1983 and 1984 respectively and allowed the private sector[5] to undertake financial intermediations. During this phase, the government pursued policies for catalyzing private industrial growth by way of disbursing easy credits both from the nationalized and private commercial banks. The government also continued its priority sector lending policies and instructed the four big NCBs to finance state owned enterprises. In fact, these big four NCBs dominated the banking system of Bangladesh during the 2nd phase of development both in terms of deposit accumulation and disbursements of credits, although a total number of nine private commercial banks was established during this

[5] Private sector banking was allowed at the second half of 1982.

2nd phase. Table 2 shows the deposit accumulation and credit disbursement performance as per cluster of Banks- NCBs (nationalized commercial banks), PCBs (private commercial banks, domestic), FCBs (foreign commercial banks) and SBs (specialized banks) in Bangladesh during the three phases of development. Table 2 reveals that NCBs accounted for 86.64% of total deposits (including SBs 92.42%) and 76.96% of total credits (including SBs 95.89%) at the end of the 1st phase (1982) and continued to dominate in the 2nd phase also where NCBs accounted for 64.04% of the total deposits (including SBs 68.48%) and 53.88% of the total credits (including SBs 74.69%) at the end of the year 1989.

Table 2: Phase-wise Performance of Deposits and Credit Disbursements by Cluster of Banks.

Year	1972		1982		1989		2007	
Type of Bank	Deposit (%)	Credit (%)	Deposit (%)	Credit (%)	Deposit (%)	Credit (%)	Deposit (%)	Credit (%)
NCBs	89.60	69.04	86.84	76.96	64.04	53.88	35.4	28.8
PCBs	0.00	0.00	0.33	0.19	24.41	19.39	52.2	54.6
FCBs	2.45	4.73	7.25	3.92	7.15	5.92	6.7	7.8
SBs	7.95	26.23	5.58	18.93	4.40	20.81	5.7	8.8

Source: Schedule Bank Statistics, December issues from 1972 to 2006, Bangladesh Bank.

It is important to note that although the dominance of NCBs was less in the 2nd phase compared to the 1st phase, because of increasing competition in the banking system, the average credit and deposit growth rate remained very high (approximately 22% for credit and 25% for deposit) during this 2nd phase (Table 1). On the whole, the government's policy during the 2nd phase of the banking development was also tailored to the easy disbursement of credits and accumulation of deposits, not on the control of credits.

The 3rd phase of banking development began in the 1990s when the government initiated a broad based financial liberalization measure under the name of the 'Financial Sector Reform Program (FSRP). The FSRP brought about a number of developments in the banking system of Bangladesh. Table 3, shown below, summarizes this development into four broad groups such as: (i) screening, (ii) monitoring, (iii) transparency, and (iv) lender's

recourse regulations. For instance, in case of screening, a 'lending risk analysis manual' was put into operation, directed lending and subsidy to the priority sectors were reduced, interest rates were liberalized, insiders' loan was controlled and banks were asked to follow the credit information bureau (CIB) report formulated by Bangladesh Bank. In the case of monitoring, the performance-planning system, large loan rescheduling system and the supervisory role of the central bank was given emphasis while, to ensure stability and transparency in financial intermediations, minimum capital requirement (Tk. 100 crore), capital adequacy ratio (8% of the risk weighted assets), CAMEL rating and the International Accounting Standard for the preparation of bank accounts were introduced. Banks were also asked to classify their loans, make provision thereof as well as instructed to disregard accrued interest on classified loans as their income so as to protect them from vulnerability. Alongside these measures the Money Loan Court Act and Bankruptcy Act were enacted to improve loan recovery performance.

Table 3: New Loan Laws and Regulations

Screening	Monitoring	Transparency	Lenders recourse
i) LRA ii) CIB iii) Loans to Insiders and Connected Parties iv) Interest Rate Deregulation	i) NLLC ii) LLRS iii) PPS iv) Off-site Supervision v) Repo and Reverse Repo Operations	i) Loan classification and Provisioning ii) Risk based Capital Adequacy iii) CAMELS rating iv) Adoption of IAS 30	i) Money Loan Court Act, 1990 ii) Bank Companies Act 1991 iii) Financial Institution Act 1993 iv) Bankruptcy Act, 1997

Source: Choudhury and Moral 1997; Adhikary, 2006.

Another noticeable development during this period was the setting up of a large number of private commercial banks[6] and their degree of involvement in bagging both credits and deposits. For example, while in 1989, NCBs accounted for 64.04% of total deposits and 53.88% of total credits; the same was reduced to 35.4% (deposits) and 28.8 % (credits)

[6] During the 1990s and early 2000s, a total number of 20 PCBs started commercial banking along with the 10 PCBs that were set up during the second phase (1983-1989).

respectively in 2007 (Table 2). Therefore, the development in the 3rd phase can be attributed to the reduction of government control, adoption of market-based mechanisms and the enforcement of prudential regulations to ensure healthy and effective financial intermediation.

III. Unleashing Financial Policies and Bank Rents

The financial policies that the government of Bangladesh adopted since its independence can be segregated into two major regimes- the pre-liberalized and the liberalized regime. The pre-liberalized regime consists of the development of the banking system during its 1st and 2nd phase while the 3rd phase of the development is attributed to the liberalized regime. In section two we have discussed the three phases of the development of the banking system. Now, it deserves attention to discuss the financial control policies of the government during these two regimes that created bank rents and augmented development of the banking system in Bangladesh.

Financial Policies in the Pre-liberalization Regime

During the pre-liberalized regime, the government relied on the 'financial restraint'[7] model to foster an environment of rent creation so that the banking system could take a long-term perspective in its activities. As a major vehicle of the financial restraint model, Bangladesh Bank adopted the administered interest rate policy since 1972 and continued it to the end of the 1980s. Bangladesh Bank[8] also imposed a number of credit control regulations like Cash Reserve Requirement (CRR) and Statutory Liquidity Reserve (SLR) requirements on the commercial banks, which were equal to 5% and 25% of their total demand and time liabilities respectively till the year 1987, in order to prevent low priority uses of bank funds in

[7] At the time of financial restraint the real interest rate remains positive and predictable and the government tries to maintain a low inflation environment. Most importantly, the government does not extract rent from but creates rent within the private sector (Hellman et al. 1997).

[8] Bangladesh bank is the central bank of Bangladesh and it controls the monetary and credit system of the country.

speculative activities[9]. Further, in order to gain the confidence of the depositors and to improve the liquidity position of the banks, all commercial banks were nationalized in 1972 and no domestic private commercial bank was allowed to undertake financial transactions till the year 1982.

A 'Scheme of Emergency Credit Facilities' was introduced under which standby credit was provided to the banks for the purpose of meeting unforeseen heavy withdrawals by their depositors as well as for financing additional credit requirements of trade and industry in the priority sector. *The government also directed commercial banks to disburse credit to the priority sectors at a subsidized interest rate.* Bangladesh Bank also fixed bank rate at 8% till the end of the year 1980 to control the expansion of credits in low priority areas and risky areas. An analysis of the lending rate and deposit rate during the pre-liberalized regime (annexure 1) shows that the government deliberately kept nominal deposit rate low till the end of 1980 so that a lower lending rate could be offered to the priority sectors in general and a reasonable bank rent could be created in particular for facilitating smooth intermediation of funds through the expansion of bank branches. The government also repressed interest rates heavily till the year 1980 with a view to receiving funds at a lower cost for financing both trade and fiscal deficits. Another notable point is that during this pre-liberalized regime, Bangladesh Bank imposed control on foreign exchange reserves and repressed exchange rates by using the pegging mechanism with a view to preventing capital flights.

In fact, these comprehensive financial control policies helped increasing both credits and deposits substantially, above 20% on an average during the pre-liberalized regime (Table 1). The banking system also booked a higher average bank rents (interest spread), 6.87% and 5.996% respectively during the 1st (1974-1982) and 2nd phase (1983-1990) of the pre-liberalized regime (Table 4).

[9] Bangladesh Bank reduced CRR and SLR frequently after 1987 to influence the lending rate and deposit rate in the desired direction and at present it is 5% (CRR) and 18% (SLR) respectively.

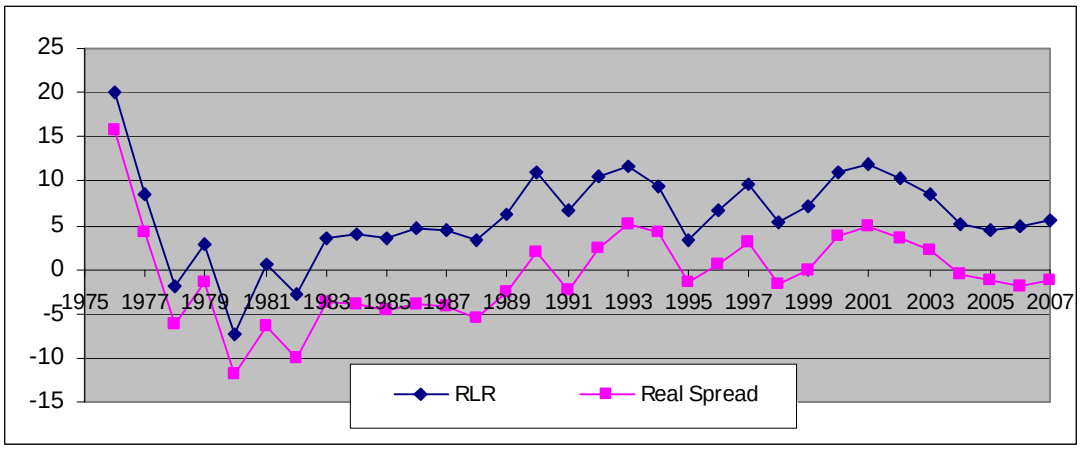
Table 4: Negative and Positive Bank Rents Regime with Major Financial Control Policies.

	1974-1982	**1983-1990**	**1991-2007**
Nominal Average Interest Spread (%)	6.876	5.996	6.587
Real Average Interest Spread (%)	-2.251	-3.318	1.131
Financial Control Policies	Administering interest rates and exchange rates, fixing reserve requirements and undertaking selective credit programs.	Administering interest rates and exchange rates, fixing reserve requirements and permitting private banks.	Financial Sector Reform Project (FSRP), deregulation of interest rate and exchange rate, enactment of prudential laws.

Source: Constructed by author.

Unfortunately, during the 1st phase of the pre-liberalization regime, the nominal interest rate on deposits reached below the rate of inflation in most years and this created a negative real return for the depositors, -3.798% on an average (Annexure 1). In order to correct this situation, the government then increased deposit rates from the beginning of the 1980s to give incentives to depositors to saving. As a result, the real average deposit rate reduced to -0.895% during the 2nd phase (Annexure 1). On the other hand, as the government increased deposit rates, the lending rate of the bank also increased so as to maintain a 6% nominal spread on an average during the 2nd phase of the pre-liberalized regime (Table 4; Annexure 1). However, the real interest spread or bank rent is found negative in this 2nd phase as well, as the changing rates of deposits were not fully in tune with the changes in inflation rates (Figure 4; Annexure 1). There was also the malign influence of the directive and subsidized credit policies of the government on the credit portfolios of the banks. As a result, the financial control policies of the government heralded high levels of financial repression during the pre-liberalized regime.

Figure 4: Real Lending Rate and Real Spread of the Banking System (1976-2007).



Source: Constructed by author using data from various issues of Scheduled Bank Statistics, Bangladesh Bank

Financial Policies in the Liberalization Regime

It was stated earlier that Bangladesh initiated FSRP at the end of 1989 in order to obtain better return on deposits, reduce financial distortions and ensure efficient credit allocations. As a result, a market oriented interest rate policy was introduced in January 1990 to remove shortcomings of the administered interest rate policy. But the government did not liberalize interest rates and other financial control policies at the same time. Rather the government followed a gradual approach to liberalize the financial policies through the following phases:

- In 1990, the government determined 11 exhaustive lending categories and set an interest rate band for them. The government paid subsidies to the scheduled banks, mainly nationalized commercial banks (NCBs), for lending below a shadow market rate determined by Bangladesh Bank, and made these subsidies transparent. Besides, the government allowed scheduled banks' to set freely both lending and deposit rates as long as they remained within the interest rate bands. However, a floor and ceiling for savings and fixed deposit was established. At that time, the directed credit program was redesigned and Bangladesh Bank initiated a rediscount facility essentially for lending to the scheduled banks at a uniform rate in order to remove the entire menu of refinance rates;

- In 1992, the prescribed bands for lending rate were removed from all but three sectors, namely agriculture, export and small-industry sectors. Floors on savings and fixed deposits were maintained but ceilings were removed;

- In 1997, the floor rates of deposits were also taken out. Finally, in August 1999, the interest band on agriculture and small and medium enterprises (SMEs) loans were eliminated;

- In 2005, the government brought down the level of CRR to 4.5% from 10% in 1991. Similarly, the SLR also reduced to 16% in 2005 from 20% in 1991.

In fact, these interest rate liberalization polices along with the reduction of the requirements of CRR and SLR encouraged the setting up of new commercial banks, enhanced competition in the banking business, and increased the volume of financial transactions in the economy. As a result, the total credit in the banking system increased to Tk.1893.91 billion in 2007 from Tk. 187.41 billion in 1989 (Table 1). By the same token, total deposits increased to Tk. 1847.98 billion from Tk.164.62 billion in 1989 (Table 1). During this liberalized regime, the private commercial banks also started dominating the banking system by way of bagging higher percentage of deposits and credits; 52.2% of the total deposits and 54.6% of the total credits in 2007 as opposed to 35.4% and 28.8% respectively by the nationalized commercial banks during the same period (Table 2). Importantly, the nominal average spread of the banking system increased to 6.587% in the liberalized regime as against 5.996% of the pre-liberalized regime (Table 4). The real average interest rate and deposit rate also reached to the positive level, 1.131% and 1.198% respectively in the liberalized regime as against -3.318% and -0.895% respectively in the pre-liberalized period 1983-1990 (Table 4; Annexure 1).

However, in comparison to the deposit rates, the lending rates and spreads of the clusters of banks in the banking system was fragmented and distorted even in the liberalized regime. For instance, in almost all cases the lending rates, the nominal spreads and the real spreads of NCBs are found to be lower in the liberalized regime while comparing the same with the PCBs and FCBs (Table 5). In fact, the average real spread of NCBs was much lower,

0.36% only in 2007, in comparison to the PCBs (1.87%) and FCBs (2.57%)[10]. However, with respect to the nominal deposit rates among the cluster of banks, NCBs are found to be higher in comparison to that of PCBs and FCBs during the period 1995-2001 whereas in other periods (1990-94 and 2002 –2007), a reverse situation (lower deposit rates) can be seen, except in some cases (Table 5)[11]. Importantly, the nominal deposit and lending rates for every cluster of banks are found in a declining trend, except in some cases, indicating increased competition within the banking system during this period (Table 5). But with respect to the real spreads, a varied level of performance is found among NCBs, PCBs and FCBs. While real spreads of FCBs are found positive in most of the cases, the real spread of NCBs and FCBs are found to be varied with negative and positive outcomes. Importantly, the real spread of NCBs and PCBs became negative from the year 2004 onwards as compared to PCBs during the same period that ultimately reflects that the banking system remained uncompetitive, distorted and inefficient even in this liberalized regime.

[10] The reason is that the government continued directed lending at an administered rate in certain sectors (especially state owned enterprises in energy and civil aviation) through nationalized commercial banks as well as government owned specialized banks (SBs). Also, the government continues borrowing from the public by selling National Savings Directorate Certificate (NSDC) at a non-market rate (presently 11.5%) which also affects banks to set their lending rates and spreads as well.

[11] This indicates the reflection of an important political change in Bangladesh that took place in the year 1990 by way of taking power of a democratic government which encouraged politicians to set-up private commercial banks. There is also effect of stock market crash in Bangladesh (1996-1997) that derailed the trust and confidence of the investors to invest in shares and to deposit in banks. In consequence, the government took initiative to restore the confidence of the depositors by offering higher rates by the nationalized commercial banks.

Table 5: Interest Rate Spread of Major Cluster of Banks During Liberalized Regime

Nationalized Commercial Banks					
Year	Deposit Rate	Lending Rate	Inflation	Nominal Spread	Real Spread
1990	9.29	14.06	9.30	4.77	-4.53
1991	9.12	14.03	8.31	4.91	-3.4
1992	6.98	14.36	4.56	7.38	2.82
1993	6.08	13.14	2.73	7.06	4.33
1994	5.14	11.63	3.3	6.49	3.19
1995	5.43	11.85	8.9	6.42	-2.48
1996	6.89	13.16	6.7	6.27	-0.43
1997	7.30	13.81	3.96	6.51	2.55
1998	7.43	13.98	8.66	6.55	-2.11
1999	7.69	13.69	7.06	6	-1.06
2000	7.36	13.36	2.79	6	3.21
2001	6.90	12.93	1.94	6.03	4.09
2002	6.27	12.42	2.79	6.15	3.36
2003	5.82	11.59	4.38	5.77	1.39
2004	4.88	9.75	5.83	4.87	-0.96
2005	4.59	10.00	6.49	5.41	-1.08
2006	5.21	10.84	7.16	5.63	-1.53
2007	4.96	11.00	7.20	6.04	-1.16
Average	**6.90**	**13.27**	**6.00**	**6.37**	**0.36**
Private Commercial Banks					
Year	Deposit Rate	Lending Rate	Inflation	Nominal Spread	Real Spread
1990	9.13	16.44	9.30	7.31	-1.99
1991	9.12	16.50	8.31	7.38	-0.93
1992	8.33	16.73	4.56	8.4	3.84
1993	6.49	14.97	2.73	8.48	5.75
1994	5.33	14.09	3.3	8.76	5.46
1995	4.88	14.05	8.9	9.17	0.27
1996	5.60	14.41	6.7	8.81	2.11
1997	6.21	14.66	3.96	8.45	4.49
1998	6.30	14.88	8.66	8.58	-0.08
1999	6.49	14.91	7.06	8.42	1.36
2000	6.75	14.71	2.79	7.96	5.17
2001	6.84	14.39	1.94	7.55	5.61
2002	7.07	14.12	2.79	7.05	4.26
2003	6.99	13.54	4.38	6.55	2.17
2004	6.46	12.00	5.83	5.54	-0.29
2005	7.40	12.47	6.49	5.07	-1.42
2006	8.62	14.06	7.16	5.44	-1.72
2007	8.44	13.43	7.20	4.99	-2.21
Average	**7.44**	**15.32**	**6.00**	**7.88**	**1.87**

Table 5: Continued

Foreign Commercial Banks					
Year	Deposit Rate	Lending Rate	Inflation	Nominal Spread	Real Spread
1990	6.58	15.54	9.30	8.96	-0.34
1991	5.55	14.50	8.31	8.95	0.64
1992	4.70	14.12	4.56	9.42	4.86
1993	3.46	12.86	2.73	9.4	6.67
1994	2.69	11.86	3.3	9.17	5.87
1995	3.52	11.13	8.9	7.61	-1.29
1996	4.71	12.15	6.7	7.44	0.74
Year	Deposit Rate	Lending Rate	Inflation	Nominal Spread	Real Spread
1997	5.53	12.80	3.96	7.27	3.31
1998	6.27	13.49	8.66	7.22	-1.44
1999	5.58	13.15	7.06	7.57	0.51
2000	5.04	12.68	2.79	7.64	4.85
2001	4.04	12.27	1.94	8.23	6.29
2002	4.57	11.97	2.79	7.4	4.61
2003	4.78	12.1	4.38	7.32	2.94
2004	4.00	11.45	5.83	7.45	1.62
2005	3.96	11.83	6.49	7.87	1.38
2006	4.77	12.89	7.16	8.12	0.96
2007	4.81	13.57	7.20	8.76	1.56
Average	**4.97**	**13.55**	**6.00**	**8.58**	**2.57**

Source: Scheduled Banks Statistics, 1990-2007, Bangladesh Bank

IV: Explaining High Nominal Spreads of the Banking System in Bangladesh

So far, the reason that has attracted most attention in banking literature for the dismal performance of banks is the nonperforming loans (NPLs) or classified loans which in fact indicate institutional inefficiencies to identify and manage credit risks successfully. NPL is the most crucial factor that forces banks' to fix high lending rates and high nominal spreads in order to recover past loan losses. As persistent high nominal spreads and very low or negative real spreads are observed in the banking system of Bangladesh even in the liberalized regime, this places our attention to examine the status of non-performing loans in the banking system of Bangladesh. From the analysis of NPL data[12] in table 6, it is observed that the NPL ratio of the banking system reduced to 13.23% in 2007, although it had reached to the highest level (41.11%) in the year 1999. The bad/loss loan as a percentage of total

[12] NPL data is not available before 1990s.

classified loans was also found above 75% during the last 10 years. Most importantly, the classified loans in the NCBs and SBs are found alarming from the very beginning which reduced to 29.87% and 28.58% respectively in 2007 as compared to 5.01% and 1.43% for PCBs and FCBs during the same time (Table 7). From this vantage point, we can conclude that apparently the real spreads of the banking system, which are found positive in many cases in the liberalized regime (3rd phase of the banking development) as compared to the pre-liberalized one (1st and 2nd phase), result from the continual reduction of NPLs but, in terms of the absolute level of NPLs, remain very high and depress the banking system. On the other hand, the persistent high NPLs in the NCBs are the cause of negative real spreads for them. Side by side with this, it is the directed credit of the government that has been given for political motives or as subsidized credit to the state owned enterprises that has created negative real spreads for the NCBs. If this is the case can we attribute the same effect to PCBs when they also show negative real spreads during the last couple of years?

The answer is not simple, as the NPLs for PCBs are significantly lower than NCBs and SBs (Table 7). Rather the negative real spreads of PCBs are attributed to higher deposit rates and lower nominal spreads (Table 5). On the other hand, the positive real spreads of the foreign commercial banks result from their efficiency in managing NPLs to the lowest level among the banking clusters (Table 7). But we must caution that although continual reduction of NPLs indicates overall improvement in the prudence of the banking operation, high nominal lending rates followed by high absolute level of NPLs signify that there remains room for creating bank rents to monitor the borrowers effectively. Besides, we can conclude that, as the NPLs of the PCBs are found declining to a great extent, the rents created by the financial restraint policies discussed above have been transferred to the industrial sector. However, this paper does not deal with the extent to which this transfer of rents has

contributed to industrial development in Bangladesh and this could be a limitation of this study.

Table 6: Status of classified loans: sub-standard, doubtful and bad/loss loans of all Banks (1990-2007)

(Taka in billion)

Year	Total loans	Total classified loans	Classified loans as % of total loans	Sub-standard loan as % of TCL	Doubtful loans as % of TCL	Bad/loss loans as % of TCL
1990	177.12	46.21	26.09	N.A	N.A	N.A
1991	185.60	46.54	25.00	N.A	N.A	N.A
1992	214.36	65.74	30.67	N.A	N.A	N.A
1993	244.28	85.16	34.86	N.A	N.A	N.A
1994	262.88	91.56	34.85	19.22	17.60	63.19
1995	310.29	99.42	32.04	13.08	12.36	74.56
1996	351.00	110.54	31.49	13.42	12.27	74.31
1997	462.27	173.32	37.49	7.88	11.70	80.42
1998	527.32	214.37	40.65	4.26	7.21	88.53
1999	580.83	238.79	41.11	5.26	8.27	86.47
2000	654.42	228.51	34.91	4.82	6.33	88.57
2001	749.49	235.99	31.49	7.93	5.48	86.60
2002	851.73	238.57	28.01	8.56	5.09	86.35
2003	914.90	203.2	22.1	10.24	8.75	80.97
2004	1079.71	190.03	17.6	7.2	6.6	86.19
2005	1292.51	175.14	13.56	8.66	6.96	84.37
2006	1528.58	200.98	13.15	13.13	7.15	79.72
2007	1710.44	226.24	13.23	14.16	9.24	76.62

Source: Banking Regulation & Policy Department, Bangladesh Bank, 2005; various annual reports of Bangladesh Bank.

Note 1: a. DFIs have been included in the classification system from 1997.

b. In 1997, DFIs comprise BKB, BSB and RAKUB.
c. In 1998, BSRS was included in the above list.
d. In 1999, BASIC was included in the above list.
e. Data corresponding to calendar years 1990 – 1996 include all banks except DFIs

Table 7: Trend of non-performing loans as a percentage of total loans for different clusters of banks (1990-2007)

Year	NCBs	PCBs	FCBs	SBs	All Banks
1990	27.59	23.73	20.65	NA	26.09
1991	26.30	34.20	11.87	NA	25.00
1992	31.86	31.10	12.64	NA	30.67
1993	32.23	44.42	10.46	NA	34.86
1994	32.12	44.53	8.89	NA	34.85
1995	31.00	39.43	5.40	NA	32.04
1996	32.55	34.77	4.72	NA	31.49
1997	36.57	31.42	3.58	65.72	37.49
1998	40.38	32.72	4.14	66.70	40.65
1999	45.62	27.09	3.80	65.02	41.11
2000	38.56	22.01	3.38	62.56	34.91
2001	37.02	16.98	3.32	61.80	31.49
2002	33.73	16.38	2.61	56.19	28.01
2003	29.0	12.4	2.7	47.4	22.1
2004	25.3	8.5	1.3	42.8	17.6
2005	21.35	5.62	1.26	34.87	13.56
2006	22.94	5.45	0.81	33.68	13.15
2007	29.87	5.01	1.43	28.58	13.23

Source: Banking Regulation & Policy Department, Bangladesh Bank, 1995-2005

Apart from the effect of NPLs, it is worthwhile to mention that the deposit rate in the banking industry in Bangladesh is exogenous to the market due to government borrowing requirements through NSD certificates and similar type of instruments by offering non-market rates (Islam & Begum 2004). Also, Bangladesh Bank still controls and sets bank rate, SLR and CRR requirements that influence the deposit and lending rates of the banking system. Moreover, the government intervenes in the activities of the SBs and NCBs in a number of ways to mediate funds to state owned enterprises as well as priority sectors, and this also influences interest rate structures in the banking system. Keeping these backdrops in mind, interpretation of the persistently high nominal spreads and a very low or negative real spreads is discussed below**:**

- If the banking industry of Bangladesh is assumed to be competitive and prudent in the liberalized regime, the high nominal spreads, then, would be an indication of the high costs of financial intermediation. Here, the high absolute amount of NPLs may figure as an explanation. Clearly, high NPLs faced by NCBs and SBs (Table 6 and 7) signify their monitoring inefficiencies. The high NPLs also simplifies that NCBs and SBs are

unable to make full use of their assets in earning the required return unless the lending rates are set relatively high in relation to deposit rates (Islam & Begum 2004). Moreover, the NCBs and SBs would end up with a negative net worth if 100% provisions are made against the NPLs and this may further influence a liquidity crisis. Importantly, the government still directs NCBs and PCBs to mediate funds to state owned enterprises at a subsidized rate and controls their spreads, and thus perpetuating market imperfections. Finally, substantial differences among banking clusters in terms of NPLs point out the overall inefficiency in financial intermediations, which is ultimately reflected in high nominal spreads;

- The second argument that may be put forward in explaining the high spreads is that the government borrows a substantial amount of money from the public by selling NSD certificate offering a non-market rate - 11.5% to be precise. This rate forces the deposit rate of the banking system to be higher in general. Now, given the 'high' deposit rates in the banking industry, the addition of even a 'normal' intermediation costs would cause the final break-even lending rate to be high, though this by itself does not explain high spread. But the point is that good lenders always try to earn enough return to satisfy the risk free opportunity cost of the depositors. Therefore, when deposit rates are set high, lenders need to undertake riskier transactions than usual (projects) with a view to generating higher average yields /returns from their investments. Unfortunately, higher average returns fuel average risks of default which prudent lenders need to take into account (risk premium) in setting the 'break-even' lending rate. In this mechanism, a high deposit rate creates a 'ratchet effect' on the high lending rate, which in turn results in high spread (Islam & Begum 2004). In this situation, if the monetary policies of the government fail to control inflation, the real spreads/rents of the banking system are likely to reach negative levels;

- Another important argument is that the financial market is non-competitive; hence the high spread is mainly indicative of 'monopoly' profit (Islam & Begum 2004). This view primarily rests on the market segmentation hypothesis, namely that each segment of the market (i.e., NCBs, PCBs, and FCBs) has distinct demand features which are catered to only by the respective segment. The four NCBs and five SBs still dominate the market by way of accounting for 47.1% of total industry assets and 45.8% of total deposits (Annual Report 2005-06, Bangladesh Bank) and they are also not free from government intervention. On the other hand, competition between the PCBs and FCBs is uneven as FCBs display a much higher spread than the rest of the segments and the differential seems strong, actually having risen substantially over the past few years (Table 5). This implies that the financial market of Bangladesh still remains highly distorted, fragmented and uncompetitive. Theoretically, high real interest rates following a period of interest rate deregulation may be expected in a market with oligopolistic structures and other imperfections like inadequate prudential regulations and supervisory framework as well as institutional bottlenecks.

- The remaining hypothesis is that the government has made an unplanned transition to financial liberalization. The reason is that at the initial phase of liberalization, the government allowed a significant number of private banks to begin operations without proper assessment of their skills in managing diverse form of credits as well as risky transactions, which are synonymous with financial liberalization. This becomes clear by observing the alarming NPL ratio of private commercial banks from 1990-1999, the first 10 years of the liberalization period (Table 7). An analysis of sector wise

distribution of credits by the commercial banks also fortifies this argument in that during the liberalization period the banking sector distributed more credits to the trade sector, 34.11% in 2006 as against 18.22% in 1982 (scheduled bank statistics, December 2006, Bangladesh Bank). It can also be said that the weak enforcement status of prudential laws and regulations (that the banking system adopted in the liberalization regime to ensure discipline and robustness of the financial system) is the result of unplanned transition to financial liberalization in 1990 (Choudhury & Moral 1999). Another important point is that the government adopted a floating exchange rate system in 2003 in the midst of large trade deficits that caused severe devaluation of the domestic currency from Tk. 57.90 in 2003 to Tk. 69.03 in 2007 as against the US Dollar (economic trends, June 2008, Bangladesh Bank) and influenced prices of imports as well as general price levels (inflation) to escalate. This floating rate exchange system along with inflation has pushed the real spread of the banking system to be negative for the last couple of years and thus leaving no options for the banking system but to have increasing spreads.

V: Concluding Remarks

We have attempted in this paper to investigate the development of banking practices in Bangladesh in terms of interest rate policies as well as spreads (bank rents) using a financial restraint model. In doing so, we report that the banking system of Bangladesh shows persistent high lending rates and high nominal spreads but too low or negative real spreads both in the pre-liberalized and liberalized regime. We report that high nominal spreads and too low or negative real spreads are largely the outcome of institutional inefficiencies, high amount of NPLs and uneven competition in the banking system. Also, we point out that the interest rate structure of the banking system is exogenous to the market as government borrows from the market by offering higher non-market yields through its saving certificates.

In addition, the government's intervention to the activities of the NCBs and SBs is perpetuating the malign performance of these two clusters and this does not assist the overall performance of the banking system. We suggest that the reduction of NPLs, government interventions and directive credits may reverse this situation. Alternatively, although the present lower real spreads may demand the reduction of deposit rates as a counterproductive measure, we note that any effort to reduce the deposit rate may adversely affect the saving

performance of the banks, especially when the government offers higher non market yields through its NSD instruments. It is also to be kept in mind that in an environment of rising inflation which is now seen in Bangladesh, any attempt to repress deposit rates may influence investment in the non-productive non-financial assets by households and this may create instability in financial intermediation. On the other hand, it is not logical to increase the nominal lending rates as this would increase adverse selection and the moral hazard problem in the banking market. It is to be noted that within the market determined interest rate policy regime the banks are free to set both lending and deposit rates in line with market conditions ,and the central bank can only pursue moral suasion to set an appropriate interest structure. In this context, the challenge of the commercial banks is to improve their performance by way of adopting effective risk management techniques and undertaking efficient monitoring of its credit portfolios. Side by side, a more coordinated use of monetary and fiscal policies is required to create appropriate incetentives for banks to discharge their agency duties perfectly and to limit unlimited competition, fragmentation and distortion which are currently prevalent in the banking system of Bangladesh.

Annexure-1: Trend of Interest Rate Structure In Bangladesh From 1974-2007.

Year	Nominal Interest Rate (weighted average)		Inflation (%)	Real Interest Rate (weighted average)		Actual Spread	Real Spread
	LR (%)	DR (%)		LR (%)	DR (%)		
1974	11.07	3.4	n.a.	n.a.	n.a.	7.67	n.a.
1975	11.28	3.51	n.a.	n.a.	n.a.	7.77	n.a.
1976	11.62	4.23	-8.36	19.98	12.59	7.39	15.75
1977	11.03	4.32	2.42	8.61	1.9	6.71	4.29
1978	10.66	4.22	12.62	-1.96	-8.4	6.44	-6.18
1979	11.12	4.27	8.24	2.88	-3.97	6.85	-1.39
1980	11.04	4.31	18.46	-7.42	-14.15	6.73	-11.73
1981	13.07	6.98	12.54	0.53	-5.56	6.09	-6.45
1982	13.53	7.29	16.29	-2.76	-9	6.24	-10.05
Average (1974-1982)	**11.602**	**4.725**	**8.887**	**2.837**	**-3.798**	**6.876**	**-2.251**
1983	13.55	7.36	9.93	3.62	-2.57	6.19	-3.74
1984	13.75	8.11	9.67	4.08	-1.56	5.64	-4.03
1985	14.5	8.13	10.94	3.56	-2.81	6.37	-4.57
1986	14.66	8.54	9.95	4.71	-1.41	6.12	-3.83
1987	14.7	8.59	10.35	4.35	-1.76	6.11	-4.24
1988	14.66	8.69	11.42	3.24	-2.73	5.97	-5.45
1989	14.68	8.88	8.4	6.28	0.48	5.8	-2.6
1990	14.83	9.06	3.86	10.97	5.2	5.77	1.91
Average (1983-1990)	**14.42**	**8.42**	**9.315**	**5.101**	**-0.895**	**5.996**	**-3.318**
1991	14.99	9.11	8.31	6.68	0.8	5.88	-2.43
1992	15.12	8.11	4.56	10.56	3.55	7.01	2.45
1993	14.39	6.51	2.73	11.66	3.78	7.88	5.15
1994	12.78	5.34	3.3	9.48	2.04	7.44	4.14
1995	12.22	4.86	8.9	3.32	-4.04	7.36	-1.54
1996	13.41	6.11	6.7	6.71	-0.59	7.3	0.6
1997	13.69	6.67	3.96	9.73	2.71	7.02	3.06
1998	14.02	7.07	8.66	5.36	-1.59	6.95	-1.71
1999	14.16	7.28	7.06	7.1	0.22	6.88	-0.18
2000	13.86	7.21	2.79	11.07	4.42	6.65	3.86
2001	13.75	7.03	1.94	11.81	5.09	6.72	4.78
2002	13.16	6.74	2.79	10.37	3.95	6.42	3.63
2003	12.78	6.29	4.38	8.4	1.91	6.49	2.11
2004	11.01	5.65	5.83	5.18	-0.18	5.36	-0.47
2005	10.93	5.62	6.49	4.44	-0.87	5.31	-1.18
2006	12.06	6.68	7.16	4.9	-0.48	5.38	-1.78
2007	12.78	6.85	7.20	5.58	-0.35	5.93	-
Average (1991-2007)	**13.24**	**6.65**	**5.46**	**7.79**	**1.20**	**6.59**	**1.13**

Note: LR = lending rate, DR = deposit rate, Actual Spread = Nominal lending rate – nominal deposit rate, Real Spread = real lending rate- nominal deposit rate.

Source: Bangladesh Economic review, 2005, p 249; Economic Trends, June issues (1979-2007), page 10.

References:

Adhikary, B. K. (2006) Non-performing Loan in The Banking Sector of Bangladesh: Realties and Challenges, *Ritsumeikan Journal of Asia Pacific Studies*, 21, 75-91.

Ahmed, S. and Islam E. (2006) Interest Rate Spread in Bangladesh: An Analytical review, Policy Note Series No. 0701, *Policy Analysis Unit*, Bangladesh Bank.

Bangladesh Bank. (2008) *Economic Trends* .1975-2007, Dhaka.

Bangladesh Bank. (2008) *Scheduled Bank Statistics*.1975-2007, Dhaka.

Bangladesh Bank. (2008) *Annual Report*. 1990-91-2006-07, Dhaka.

Buffie, E. F. (1984) Financial Repression, the New Structuralists, and Stabilization Policy in Semi-Industrialized Economies, *Journal of Development Economics*, 14(3), 305-322.

Chin, K. F. and Jomo, K. S. (2000) Financial Sector Rents in Malaysia, in M.Khan and Jomo, K.S. *Rents, Rent-Seeking and Economic Development: Theory and Evidence in Asia*, Cambridge: CUP.

Choudhury, T. Ahmed and Moral, L.H. (1999) Commercial Bank Restructuring in Bangladesh: From FSRP to BRC/CBRP. *Bank Parikrama*, March, Dhaka: BIBM.

Díaz-Alejandro, C. (1985) Good-bye Financial Repression, Hello Financial Crash, *Journal of Development Economics*, 19(1&2), 1-24.

Easterly, W. (1993) How Much do Distortions Affect Growth? *Journal of Monetary Economics*, 32(4), 187-212.

Fry, M. J. (1995) *Money, Interest, and Banking in Economic Development*, 2nd Ed. Baltimore: Johns Hopkins University Press.

Fry, M. J. (1982). Models of Financially Repressed Developing Economies, *World Development*, 10(9), 731-750.

Fry, M. J. (1980) Savings, Investment, Growth and the Cost of Financial Repression, *World Development*, 8(4), 317-327.

Hellmann, T., Murdock, K., and Stiglitz, J. (1997) Financial Restraint: Toward a New Paradigm, in Aoki, M., Kim, H-K., Okuno-Fujiwara, M., eds. *The Role of Government in East Asian Economic Development: Comparative Institutional Analysis*. Oxford: Clarendon Press.

Islam, I., and Begum, N. (2004) High Lending Rates in Bangladesh: An Analytical Review, *Bank Parikrama*, Vol. XXVIII & XXIX, Dhaka: BIBM.

Khan, M. (2000) Rents, Efficiency and Growth, in Khan, M & Jomo, K., *Rents, Rent-Seeking and Economic Development*. Cambridge: CUP.

McKinnon, R. I. (1973) *Money and Capital in Economic Development*, Washington DC: Brookings Institute.

Rangarajan, C., and Jadhav, N. (1992) Issues in Financial Sector Reform, In B Jalan (ed). *Indian Economy Problems and Prospects*, New Delhi: Viking Publishers.

Stiglitz, J. (1994a) The Role of the State in Financial Markets, *Proceedings of the Annual World Bank Conference on Development Economics*. Washington, D.C: The World Bank.

Stiglitz, J. (1994b) *Whither Socialism?* Boston: The MIT Press.

Stiglitz, J. and Weiss, A. (1981) Credit Rationing in Markets with Imperfect Information, *American Economic Review,* 71, June 1981.

Suzuki, Y. (2005) *Financial Market, Institutions and Credit Monitoring*, Tokyo: Yuigaku Shobo.

Suzuki, Y., Md. Dulal Miah., and Yuan, J. (2008) China's Non- Performing Bank Loan Crisis: the role of economic rents, *Asian-Pacific Economic Literature*, 22(1), 57-70.

Van Wijnbergen, S. (1985) Macroeconomic Effects of Changes in Bank Rates: Simulation Results for South Korea, *Journal of Development Economics,* 18(2&3), 541-554.

Van Wijnbergen, S. (1983) Interest Rate Management in LDCs, *Journal of Monetary Economics,* 12(3), 433-452.

Wade, R. (1990) *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, Princeton, N. J: Princeton University Press.